



2 February 2018

Our Ref: LEH: TEC003/4031

Mr David Jones
General Manager
Adjudication, Merger and Authorisation Review Division
Australian Competition & Consumer Commission
Level 20, 175 Pitt Street
SYDNEY NSW 2000

By email: adjudication@acc.gov.au

Dear Mr Jones

**Form G Notification of exclusive dealing conduct - Technicolor Pty Limited
Section 93(1) *Competition and Consumer Act 2010 (Cth)***

We act for Technicolor Pty Limited (**Technicolor**).

We **attach** for your consideration:

1. Form G - Notification of Exclusive Dealing lodged on behalf of Technicolor in respect of possible exclusive dealing other than third line forcing conduct, together with a public version of its Annexure A; and
2. a cheque for \$2,500.00 in payment of the lodgement fee.

If you have any questions in relation to the consideration of this notification, please do not hesitate to contact us.

Yours faithfully

Laura Hartley
Partner

Direct Line: +61 2 8915 1066
Direct Fax: +61 2 8916 2066
Email: laura.hartley@addisonslawyers.com.au

Encl.

Form G

Commonwealth of Australia
Competition and Consumer Act 2010 — subsection 93 (1)
NOTIFICATION OF EXCLUSIVE DEALING

To the Australian Competition and Consumer Commission:

Notice is hereby given, in accordance with subsection 93 (1) of the *Competition and Consumer Act 2010*, of particulars of conduct or of proposed conduct of a kind referred to subsections 47 (2), (3), (4), (5), (6), (7), (8) or (9) of that Act in which the person giving notice engages or proposes to engage.

PLEASE FOLLOW DIRECTIONS ON BACK OF THIS FORM

1. Applicant

- (a) Name of person giving notice:
(Refer to direction 2)

N100063

Technicolor Pty Limited ACN 000 978 343 (**Technicolor**).

- (b) Short description of business carried on by that person:
(Refer to direction 3)

Technicolor is a subsidiary within the Technicolor Group which operates in the content delivery market in Australia and in the segment of this market that provides content in physical form. Technicolor's main physical media operations are in the area of replicating (or manufacturing), assembling and packing compact discs (**CDs**), digital video disc (**DVDs**), Blu-ray discs (including UHD Blu-ray discs) (**BDs**) as well as finished goods distribution and transportation/freight optimisation solutions.

See Annexure A for more information.

- (c) Address in Australia for service of documents on that person:

Addisons Lawyers
GPO Box 1433
Sydney NSW 2001

2. Notified arrangement

- (a) Description of the goods or services in relation to the supply or acquisition of which this notice relates:

The manufacture, assembly and packing of DVDs, BDs and CDs.

- (b) Description of the conduct or proposed conduct:

Technicolor entered into a replication agreement with Sony DADC Australia Pty Limited ACN 000 033 581 (**DADC**) on 22 December 2017 (**Replication Agreement**). Under the Replication Agreement, Technicolor has the exclusive right to provide manufacturing, assembly and packaging services to DADC for CDs, DVDs and BDs in Australia and New Zealand and DADC agrees to ensure neither it nor entities within the Sony Group will manufacture, assemble or pack CDs, DVDs or BDs for delivery to

third parties in Australia and New Zealand for 5 years from 12 February 2018 (**Relevant Condition**).

The Relevant Condition may fall within the definition of exclusive dealing under section 47(2) of the *Competition and Consumer Act 2010* (Cth) as a supply on condition.

(Refer to direction 4)

3. Persons, or classes of persons, affected or likely to be affected by the notified conduct

- (a) Class or classes of persons to which the conduct relates:

(Refer to direction 5)

DADC, as the counterparty to the Replication Agreement.

- (b) Number of those persons:

- (i) At present time:

One.

- (ii) Estimated within the next year:

(Refer to direction 6)

Not applicable.

- (c) Where number of persons stated in item 3 (b) (i) is less than 50, their names and addresses:

Not applicable.

4. Public benefit claims

- (a) Arguments in support of notification:

(Refer to direction 7)

See Annexure A.

The public benefits significantly outweigh any anti-competitive detriment arising from the Relevant Condition.

- (b) Facts and evidence relied upon in support of these claims:

See the details referred to in paragraph 4(a) above.

5. Market definition

Provide a description of the market(s) in which the goods or services described at 2 (a) are supplied or acquired and other affected markets including: significant suppliers and acquirers; substitutes available for the relevant goods or services; any restriction on the supply or acquisition of the relevant goods or services (for example geographic or legal restrictions):
(Refer to direction 8)

See Annexure A.

6. Public detriments

- (a) Detriments to the public resulting or likely to result from the notification, in particular the likely effect of the notified conduct on the prices of the goods or services described at 2 (a) above and the prices of goods or services in other affected markets:
(Refer to direction 9)

See Annexure A.

The public benefits significantly outweigh any anti-competitive detriment arising from the Relevant Condition.

- (b) Facts and evidence relevant to these detriments:

See the details referred to in paragraph 6(a) above.

7. Further information

- (a) Name, postal address and contact telephone details of the person authorised to provide additional information in relation to this notification:

Laura Hartley
Partner
Addisons Lawyers
GPO Box 1433
Sydney NSW 2001

Direct telephone – (02) 8915 1066

Email – laura.hartley@addisonslawyers.com.au

Dated: *2 February 2018*

Signed by/on behalf of the applicant


(Signature)

Laura Elizabeth Hartley
(Full Name)

Addisons
(Organisation)

Partner
(Position in Organisation)

DIRECTIONS

1. In lodging this form, applicants must include all information, including supporting evidence that they wish the Commission to take into account in assessing their notification.

Where there is insufficient space on this form to furnish the required information, the information is to be shown on separate sheets, numbered consecutively and signed by or on behalf of the applicant.

2. If the notice is given by or on behalf of a corporation, the name of the corporation is to be inserted in item 1 (a), not the name of the person signing the notice, and the notice is to be signed by a person authorised by the corporation to do so.
3. Describe that part of the business of the person giving the notice in the course of the which the conduct is engaged in.
4. If particulars of a condition or of a reason of the type referred to in section 47 of the *Competition and Consumer Act 2010* have been reduced in whole or in part to writing, a copy of the writing is to be provided with the notice.
5. Describe the business or consumers likely to be affected by the conduct.
6. State an estimate of the highest number of persons with whom the entity giving the notice is likely to deal in the course of engaging in the conduct at any time during the next year.
7. Provide details of those public benefits claimed to result or to be likely to result from the proposed conduct including quantification of those benefits where possible.
8. Provide details of the market(s) likely to be affected by the notified conduct, in particular having regard to goods or services that may be substitutes for the good or service that is the subject matter of the notification.
9. Provide details of the detriments to the public which may result from the proposed conduct including quantification of those detriments where possible.

Restriction of Publication of Part Claimed

Annexure A

1. Background information on Applicant

1.1 Technicolor

- (a) Technicolor is an Australian subsidiary within the Technicolor Group, a worldwide technology leader in the media and entertainment sector with operations in North America, Southern EU, South America, Australia, UK, Northern EU and Eastern EU. The Technicolor Group maintains a number of global customer relationships, which it services using its production facilities around the world.
- (b) Technicolor's main physical media operations are in the area of replicating (or manufacturing), assembling and packing DVDs, BDs and CDs as well as finished goods distribution and transportation/freight optimisation solutions. Technicolor caters to major movie studios, independent content owners and game and software publishers.
- (c) Technicolor operates in the content delivery market in Australia (**Content Delivery Market**). In particular, Technicolor operates in the segment of that market that provides content in physical form. Customers in this market are typically content owners of films, music and games (**Customers**). Technicolor provides replication services in relation to the content provided to it by its Customers and also provides assembling and packing services and Australia-wide distribution services as required by those Customers, so that those Customers can sell to either wholesalers, retailers, e-tailers or other intermediaries in Australia for on-sale to consumers. Technicolor provides replication, packing and distribution services to its Customers primarily in relation to DVDs and BDs and to a much smaller degree provides replication, packing and distribution services in relation to CDs to those same Customers.
- (d) [Restriction of Publication of Part Claimed]
- (e) [Restriction of Publication of Part Claimed]
- (f) More information in relation to Technicolor can be found at: www.technicolor.com.

2. Notified arrangement

2.1 General background to notified arrangement

- (a) Sales of CDs have been falling on a volume and value basis globally and in Australia for a many years and the sales of DVDs and BDs have been falling on a volume and value basis globally and in Australia since at least 2008. These sales have been replaced by sales of digital content, which consumers can either stream or download. Sony Corporation wrote down its motion pictures business significantly in January 2017 citing the declining home entertainment market as the reason for that write down.¹
- (b) [Restriction of Publication of Part Claimed]
- (c) [Restriction of Publication of Part Claimed]
- (d) [Restriction of Publication of Part Claimed]
- (e) On 22 December 2017, Technicolor and DADC entered into a replication agreement (**Replication Agreement**). Pursuant to clause 2.1(a) of the Replication

¹ <https://www.sec.gov/Archives/edgar/data/313838/000115752317000222/a51501269.htm>

Restriction of Publication of Part Claimed

Agreement, Technicolor has the exclusive right to provide manufacturing, assembly and packaging services to DADC for CDs, DVDs and BDs in Australia and New Zealand and DADC must not, and must ensure entities within the Sony Group do not, manufacture, assemble or pack CDs, DVDs and BDs for delivery to third parties for sale or rent in Australia or New Zealand for 5 years from 12 February 2018 (**Relevant Condition**). It is this Relevant Condition that Technicolor is notifying to the ACCC as it may fall within the definition of exclusive dealing under section 47(2) of the *Competition and Consumer Act 2010* (Cth).

- (f) **[Restriction of Publication of Part Claimed]**
- (g) DADC notified its employees on 9 January 2018 that it would cease directly undertaking replication, assembly and packing services for CDs, DVDs and BDs in Australia from 12 February 2018.
- (h) Importantly, DADC will remain in the Australian market as a provider of replication, assembly and packing services for the film and music industries in terms of having direct relationships with customers in those industries. The only change is that it will not have its own manufacturing capacity in Australia but will instead out-source its manufacturing needs (other than for Sony PlayStation games) to Technicolor. DADC will continue to compete with Technicolor and will offer a full suite of services to its customers in Australia with its replication, assembly and packing services being provided indirectly by Technicolor. This means that there will be no change to the competitive dynamics of the Content Delivery Market, no loss of competitive pressures and no increase in the market power of Technicolor by virtue of the Relevant Condition.
- (i) DADC will also provide replication, assembly and packing services for its Sony PlayStation games from other affiliated manufacturing facilities overseas, and will then import these Sony PlayStation games into Australia.

2.2 Background to DADC as counterparty to Replication Agreement

- (a) DADC is a subsidiary within the Sony Corporation group of companies (**Sony Group**), one of the leading manufacturers of electronic products for the consumer and professional markets² with its businesses including electronics, entertainment, gaming as well as financial services.³
- (b) Within the Sony Group, DADC is part of the global Sony DADC group of companies (**DADC Group**), which offers BD, DVD and CD media replication services as well as digital and physical supply chain solutions to business customers in the entertainment, education and information industries.⁴ The DADC Group has nine manufacturing plants located in eight countries, being Austria, USA, Brazil, UK, Russia, China, Japan (with 2 manufacturing plants), and Australia.⁵ DADC also has one distribution plant in Australia.
- (c) Like Technicolor, DADC also operates in the Content Delivery Market. In particular, it provides replication services in relation to the content provided to it by its Customers and assembly and packing of the CDs, DVDs and BDs. It also provides paper printing of artwork, packing and Australia-wide distribution services as required by those Customers so that those Customers can sell to either wholesalers, retailers, e-tailers or other intermediaries in Australia for on-sale to consumers.

²

https://www.sony.net/SonyInfo/IR/stock/shareholders_meeting/Meeting100/100_Consolidated_Financial_Statements.pdf

³ https://www.sony.net/SonyInfo/IR/library/fr/16q4_sony.pdf

⁴ https://www.sec.gov/Archives/edgar/data/313838/000119312516624169/d168822d20f.htm#tx168822_8

⁵ <http://www.sonydadc.com/metanavigation/locations/>.

Restriction of Publication of Part Claimed

- (d) DADC manufactures in Australia from premises located in Huntingwood, New South Wales. It also has a distribution facility at Erskine Park, New South Wales. DADC's functions involve providing digital content services (e.g. pre-mastering or authoring) and optical media replication services for the entertainment industry in CDs, DVDs and BDs. DADC also provides auxiliary functions to replication such as printing paper parts used in packaging discs and finished goods distribution services. In addition, DADC manufactures discs for use in Sony PlayStation consoles.
- (e) The transaction between Technicolor and DADC will see DADC sell its manufacturing plant at Huntingwood, New South Wales to a third party but maintain its distribution facility at Erskine Park, New South Wales.
- (f) More information in relation to DADC can be found at: www.sonydadc.com.au.

2.3 Overlap in scope of the business activities of Technicolor and DADC

- (a) The areas of overlap between Technicolor and DADC are in the replication, assembly, packing and distribution of DVDs, BDs and CDs. However, the Replication Agreement:
 - (i) relates to replication, assembly and packing services only, not distribution services;
 - (ii) only relates to replication, assembly and packing services provided to film and music content providers;
 - (iii) does not relate to replication, assembly and packing services for Sony PlayStation games;
 - (iv) does not require DADC to transfer any of its Customer contracts to Technicolor - DADC will retain these replication and distribution contracts with its Customers;
 - (v) will enable DADC to continue to offer the full suite of services in the Australian market that it currently offers.
- (b) The manufacturing process for Sony PlayStation game discs requires specialist equipment and proprietary expertise held exclusively within the Sony Group. These manufacturing processes are not sub-contracted to Technicolor as part of the Replication Agreement but will instead be taken over by the Sony Group overseas.

2.4 Detail of Relevant Condition and other key terms of Replication Agreement

- (a) Clause 2.1(a) of the Replication Agreement provides that Technicolor will have the exclusive right to provide manufacturing, assembly and packaging services to DADC for CDs, DVDs and BDs in Australia and New Zealand and that DADC must not, and must ensure entities within the Sony Group do not, manufacture, assemble or pack CDs, DVDs and BDs for delivery to third parties for sale or rent in Australia for 5 years from 12 February 2018.
- (b) [Restriction of Publication of Part Claimed]
- (c) [Restriction of Publication of Part Claimed]

Restriction of Publication of Part Claimed

2.5 Rationale for Relevant Condition

- (a) The Relevant Condition must be considered in the context of DADC's representations to Technicolor about its decision to cease directly providing replication services (other than for Sony PlayStation games) to Customers in Australia. Central to the Relevant Condition and Technicolor's right of supply in clause 2.1(a) of the Replication Agreement is the fact that DADC needs to ensure that it is able to meet its current and future commitments to Customers and continue to be able to operate in the Australian market. Clause 2.1(a) is key to DADC being able to do so.
- (b) From Technicolor's point of view, it is required under the Replication Agreement to comply with the service levels required by DADC. In particular, it must provide quick-turn supply for the benefit of DADC's customers. This quick-turn supply is required despite the fact that DADC's customers do not necessarily order consistently over the course of a year. Therefore, Technicolor has to invest in capacity (in terms of plant and employees) to enable it to be able to meet the service levels DADC requires and to maintain efficiency, it requires exclusivity from DADC.
- (c) Technicolor's rationale for the Relevant Condition is also to secure additional volume for its replication business and to obtain some much needed efficiencies from scale in a rapidly diminishing market.
- (d) Technicolor also submits that a contractual term along the lines of the Relevant Condition is a very standard provision to feature in a replication contract and is consistent with current and long-standing industry practice.

3. Relevant Market

3.1 Market and general industry background

3.2 The Content Delivery Market has been subject to considerable disruption for almost 10 years as sales of content provided in physical optical disc format (DVDs, BDs and CDs) have declined significantly, while at the same time sales of content provided in digital format have significantly increased. This trend has occurred globally and in Australia as well.

3.3 For an industry overview, please see Attachment 1.

3.4 [Restriction of Publication of Part Claimed]

[Restriction of Publication of Part Claimed]

[Restriction of Publication of Part Claimed]

[Restriction of Publication of Part Claimed]
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[Restriction of Publication of Part Claimed]

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[Restriction of Publication of Part Claimed]

Restriction of Publication of Part Claimed

4. No Substantial Lessening of Competition

4.1 The Relevant Condition will not have the purpose, effect or likely effect of substantially lessening competition in Australia.

4.2 **Counterfactual:** Due to DADC's view that digital content delivery is taking demand from physical content delivery and that physical content delivery is in decline, DADC has resolved to cease directly providing replication, assembly and packing services in Australia for physical content. DADC recently made this decision independently of Technicolor which means that notwithstanding the Relevant Condition, DADC will no longer be manufacturing optical discs in Australia from 12 February 2018. From this time, DADC will need to source supplies of optical discs to meet its current and future supply obligations by way of third party suppliers.

Importantly, even after commencement of the Replication Agreement, DADC will continue to offer a full suite of services in Australia albeit it will fulfil replication services indirectly via Technicolor for the term of the Replication Agreement. This means that notwithstanding the Relevant Condition, customers or resellers of optical discs will continue to be able to obtain possible supplies of optical discs from a number of local market participants including DADC, Technicolor, Regency Media, Discworld and Dex Audio.

Even without the Relevant Condition being provided for in the Replication Agreement, the commercial reality of the Content Delivery Market is currently such that DADC would be required in practice to obtain supplies of optical discs to meet its current and future supply obligations by way of a number of sources. Firstly, DADC could choose to import optical discs that have been manufactured offshore by a third party or a related body corporate. Alternatively, DADC would need to engage Technicolor to manufacture these discs locally in Australia. The reason DADC would effectively be required to obtain local replication services from Technicolor and no other local third party replication service provider is that DADC believes Technicolor is the only entity in Australia with sufficient capacity, capability, resources, security and quality certifications that will meet the requirements of DADC's customers, being the major film and music studios.

There is also nothing contractually to prevent DADC from re-commencing the direct provision of replication services in Australia for physical content after the term of the Replication Agreement ends, should the right incentive exist.

4.3 **Constraints on Technicolor:** The following features of the Content Delivery Market will operate to constrain Technicolor notwithstanding the Relevant Condition and to defeat any hypothetical ability or incentive to increase prices/profit margins significantly and substantially or offer a lower level of service by virtue of the Relevant Condition:

(a) **The structure of the market is fundamentally unchanged as DADC will continue to operate fully in the market, despite its decision to close its replication and packing facilities**

DADC has determined that it will close its replication and packing facilities in Australia but it is not exiting the market and will continue to operate as a significant competitive constraint in relation to all aspects of overlap between the parties, as is currently the case. DADC will therefore continue to operate in the supply market for optical discs meaning that amongst other things it will retain its current direct supply contracts with Customers, may continue to enter into new direct supply contracts with Customers and will compete with Technicolor for Customers. There are no restrictions in the Replication Agreement as to whom DADC may supply optical discs.

DADC will also become a major customer of Technicolor in relation to CD replication and will have a significant amount of countervailing power as a result. Prior to entry into the Replication Agreement, DADC had not been a customer of Technicolor.

Restriction of Publication of Part Claimed

(b) **Content delivery is changing quickly and fundamentally – a very dynamic context with the physical channel in decline**

Sales of physical music and film content have been declining globally and in Australia for many years. The DVD/BD market has been declining since at least 2008. Technicolor’s ability to increase price is limited because of the sunset nature of the physical content segment of the market. Technicolor would be contributing to a faster decline in volume if it were to increase prices.

(c) [Restriction of Publication of Part Claimed]

[Restriction of Publication of Part Claimed]

[Restriction of Publication of Part Claimed]

[Restriction of Publication of Part Claimed]
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[Restriction of Publication of Part Claimed]

[Restriction of Publication of Part Claimed]
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(d) **Import competition is a reality**

The AHEDA 2016 Yearbook notes that piracy remains a common source of home entertainment acquisition in Australia, making up 28% of volume share in 2016.⁶ Whilst considerable focus has been given in recent years to direct digital video piracy (i.e. downloading via the internet),⁷ the physical pirated DVD market in Australia remains an issue. This reflects the ease with which physical discs can be manufactured in, and imported from, other countries in the region such as China and Indonesia.

In late 2013, the film industry regulator in the USA, the Motion Picture Association of America (MPAA), named Australia as being among the “*notorious marketplaces for the distribution of illegal film and television shows*”. It singled out an outdoor market in Scoresby, Victoria, as a “*notorious physical market*” with between 10 and 20 individual sellers “*offering counterfeit region one and two DVDs, together with other sellers offering burnt DVDs of recently released titles*”.⁸

Earlier in May 2017, two individuals from Sydney were sentenced for their involvement in a multi-million dollar syndicate which had manufactured, imported and sold pirated DVDs in Australia. The syndicate was in operation up until its discovery in April 2013. The DVDs sold by the syndicate were manufactured in China using DVDs stolen from shops and imported from there into Australia in lots of 1000.⁹

⁶ AHEDA Yearbook 2016, p63.

⁷ See for example <http://mpa-i.org/tackling-piracy-in-australia-village-roadshows-new-and-innovative-strategy/#.WRq958uwcy8>.

⁸ <http://www.smh.com.au/entertainment/movies/notorious-pirated-dvd-market-pinpointed-in-australia-by-us-authority-20131028-2wcl6.html>

⁹ Sydney Morning Herald, ‘Pair give evidence after being charged with largest pirate DVD haul in Australia’, <http://www.smh.com.au/nsw/pair-give-evidence-after-being-charged-with-largest-pirate-dvd-haul-in-australia-20170511-gw2l4s.html>, 11 May 2017.

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The prevalence of piracy is evidence of the ability to import replicated DVDs and BDs into Australia.

Other examples of import competition exist around the world and it should be noted that all DVDs and BDs sold in New Zealand are imported into New Zealand. DADC has advised that but for the Replication Agreement with Technicolor, it would import its requirement of CDs, DVDs and BDs into Australia

Import competition could constrain Technicolor.

(e) **Competitive constraints**

Discworld, Regency Media and Dex Audio operate as competitive constraints in relation to the provision of DVD and CD replication services, particularly in relation to smaller customers. In 2016, Regency Media, Discworld and Dex Audio accounted for 17% of the DVD market in Australia.

Further information about each of these companies is set out below.

Regency Media Pty Ltd ACN 006 495 414 (**Regency Media**) is an Australian company established in 2003. Regency Media is headquartered in Kew, Australia, and has factories in Melbourne and Sydney, as well as in India, Singapore, Taiwan, China and Hong Kong.¹⁰

Regency Media provides DVD and BD replication services for the home entertainment industry, publishers, the government, marketing and promotions agencies, government organisations, and the music industry. It also offers DVD authoring, audio mastering, artwork production, fulfilment and distribution, retail, and disc printing services, amongst others.¹¹

Discworld Pty Ltd ACN 167 635 752 (**Discworld**) is an Australian company established in 2004, which provides replication and other related services in respect of DVDs and BDs. Discworld has production plants and facilities in Australia, Singapore, Indonesia and China.

In particular, Discworld's website states that it adheres to particular quality and security certification standards to ensure its service quality and commitment to copyright protection. Discworld therefore represents a viable competitor to Technicolor in respect of its larger, Hollywood studio customers, who require adherence to these strict standards, as well as its smaller customers.

More information about Discworld can be found at: www.discworld.com.au.

Dex Audio Pty. Limited ACN 005 990 349 (**Dex Audio**) is an Australian company which offers DVD replication and screen printing, as well as audio mastering, graphic design, packaging, assembly facilities and despatch. Its main offices and manufacturing plant are located in Kensington, NSW.

Dex Audio's manufacturing plant can produce over 1 million discs each week. It caters to corporate media, advertising, software, airlines (for their on-board media entertainment systems), and also musicians, local songwriters and bands.

More information about Dex Audio can be found at: www.dexaudio.com.au.

In any case, DADC is not exiting the market so will continue to also provide competitive constraint to Technicolor.

¹⁰ <https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapid=26180676>.

¹¹ <https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapid=26180676>.

Restriction of Publication of Part Claimed

(f) Low barriers to entry and lower barriers to expansion

In a decision published on 2 February 2016, the Competition Commission in South Africa found that the barriers to entry into the CD and DVD replication markets were low.¹² This reflects the fact that the inputs required to operate a replication business can be relatively easily acquired:

- The replication machinery itself can be bought relatively quickly and cheaply on the second hand market.
- The relevant technology in DVDs is held and developed by various membership bodies such as DVD FLLC, DVD MPEGLA, and DVD Forum. However, licences of this technology can be easily obtained by filling in an application form addressed to the relevant body, and paying a relatively low annual fee plus royalty per disc replicated.

Further, whilst larger customers such as Hollywood studios are selective in choosing replicators in light of concerns around security and confidentiality, smaller customers do not require compliance with such standards. As Technicolor caters to smaller customers as well, there are significant competitive constraints on Technicolor to maintain price and quality competitiveness in its replication services in the overall market.

These low barriers to entry also mean that DADC could feasibly and quite readily re-enter the Australian replication market for optical discs with the right incentive.

(g) [Restriction of Publication of Part Claimed]

(h) Inability to bundle

Technicolor will be unable to bundle replication and distribution services to DADC's customers given:

- (A) DADC is proposing to maintain all those customer contracts;
- (B) to the extent those customers decide to switch on contract expiry to Technicolor, those customers have countervailing power;
- (C) the fact that DADC is maintaining its customer contracts and full distribution capability;
- (D) for the smaller customers, there is sufficient competitive constraint by incumbents.

5. Public benefits

Technicolor considers that the Relevant Condition is likely to provide the following public benefits:

- (a) The Relevant Condition will secure additional volume for Technicolor's replication business and will allow Technicolor to maintain some economies of scale in a rapidly diminishing market. On this basis, it is likely to foster Technicolor's business efficiency. [Restriction of Publication of Part Claimed] and the Relevant Condition will help to maintain those jobs and sure up the continued viability of the same scale in a rapidly diminishing market.

¹² See CTP Limited and Compact Disc Technologies (A Division of Times Media (Pty) Ltd) v The Competition Commission, Case No: IM232Feb16, at [7].

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- (b) The Relevant Condition is also likely to foster DADC's business efficiency and will allow DADC to focus its energies on participating in the supply segment of the market in which it will be continuing to operate. It will ensure that DADC does not exit the market entirely and will continue to operate as a significant competitive constraint in the market for the time being in relation to all aspects of overlap between the parties, as is currently the case.
- (c) It will allow consumer choice to be enhanced in a shrinking market as both Technicolor and DADC will continue to operate in the market allowing Customers to buy and source CDs, DVDs and BDs locally for resale to consumers. It may also help to ensure that consumer prices are kept down due to the potential for there to be increased volume of supplies in the retail market.
- (d) Locally manufactured CDs, DVDs and BDs will benefit Australian consumers and retailers given the speed at which these discs can get to market compared to imported product which can potentially be far slower.
- (e) Locally manufactured CDs, DVDs and BDs will also benefit Australian consumers and retailers by helping to maintain a local presence in the retail market for CDs, DVDs and BDs so that production and handling prices and therefore consumer prices can arguably be kept down.

6. Public detriments

Technicolor considers that there will be little or no public detriment likely to result from the Relevant Condition for the reasons outlined in paragraph 4.3 above which can be summarised as follows:

- (a) The structure of the market is fundamentally unchanged as DADC will continue to operate fully in the market, despite its decision to close its replication and packing facilities;
- (b) Content delivery is changing quickly and fundamentally – it is a very dynamic context with the physical channel in decline;
- (c) [Restriction of Publication of Part Claimed];
- (d) Discworld, Regency Media and Dex Audio operate as competitive constraints in relation to the provision of DVD and CD replication services, particularly in relation to the smaller customers;
- (e) There are very low barriers to entry (and re-entry) and lower barriers to expansion;
- (f) Import competition is possible given the right incentives;
- (g) Technicolor will lack the ability to increase prices for customers of DADC given DADC is proposing to maintain its contracts with those customers and simply obtain services via sub-contract from Technicolor; and
- (h) Technicolor has no direct relationship with DADC's customers and consequently will be unable to bundle replication and distribution services to those customers through DADC.

Restriction of Publication of Part Claimed

Dated: 2 February 2018

Signed by/on behalf of the applicant


(Signature)

Laura Elizabeth Hartley
(Full Name)

Addisons
(Organisation)

Partner
(Position in Organisation)

Attachment 1 – Industry overview

1. Background

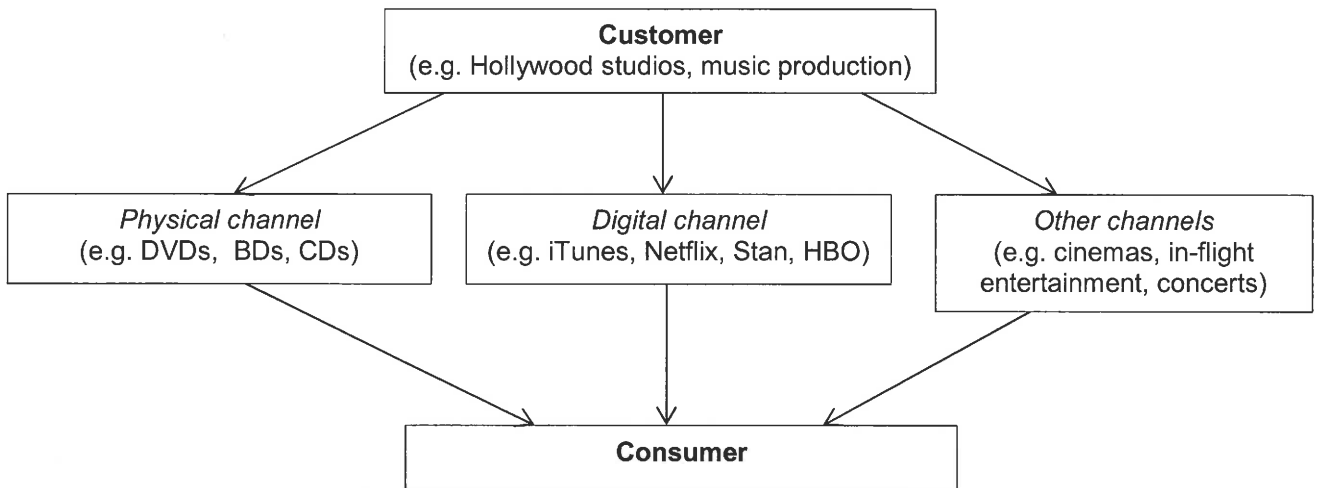
The parties to the Replication Agreement provide optical disc manufacturing and packing services, known as replication services, to facilitate the delivery of studio owned content to resellers (retail) for on-supply to consumers.

Replication involves converting digital content supplied by a Customer into physical discs, i.e. CDs, DVDs or BDs. The replication processes are broadly similar across all types of optical disc. However, the functions of the discs vary according to their type. That is, CDs are used primarily to store music, whereas DVDs and BDs are used to store movies and TV series.

The majority of demand for replication services throughout the world is generated by the major movie studios, large music studios and videogame publishers. The discs, which are made by replicators for Customers are sold by those Customers to wholesalers, retailers, e-tailers and other third party distributors (**Resellers**), for on-sale to consumers.

Customers also use digital platforms, e.g. on-demand movies, digital purchase music, and music and TV streaming services, and other channels to deliver this same content but in digital form to consumers. The content delivery process is reflected in **Figure 1** below.

Figure 1: Content Delivery Market

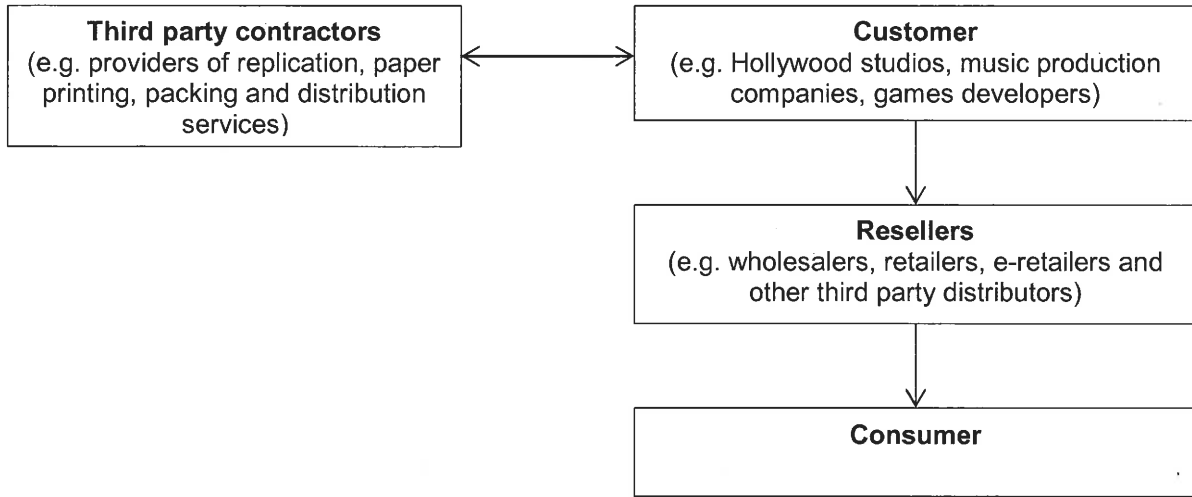


Replication services are provided within the physical channel of the Content Delivery Market. Within this physical channel, the relationships with Resellers are maintained by Customers, and not by providers of replication and other services.

That is, Customers enter into contracts with Resellers for the sale of physical discs containing the audio or audio-visual content owned by Customers. In order to create, package and distribute those discs, however, Customers engage third party contractors such as Technicolor, DADC and others to provide the requisite services.

The structure of the relationships involved in the physical channel of content delivery is reflected in **Figure 2** below.

Figure 2: Parties involved in Physical Channel of Content Delivery Market

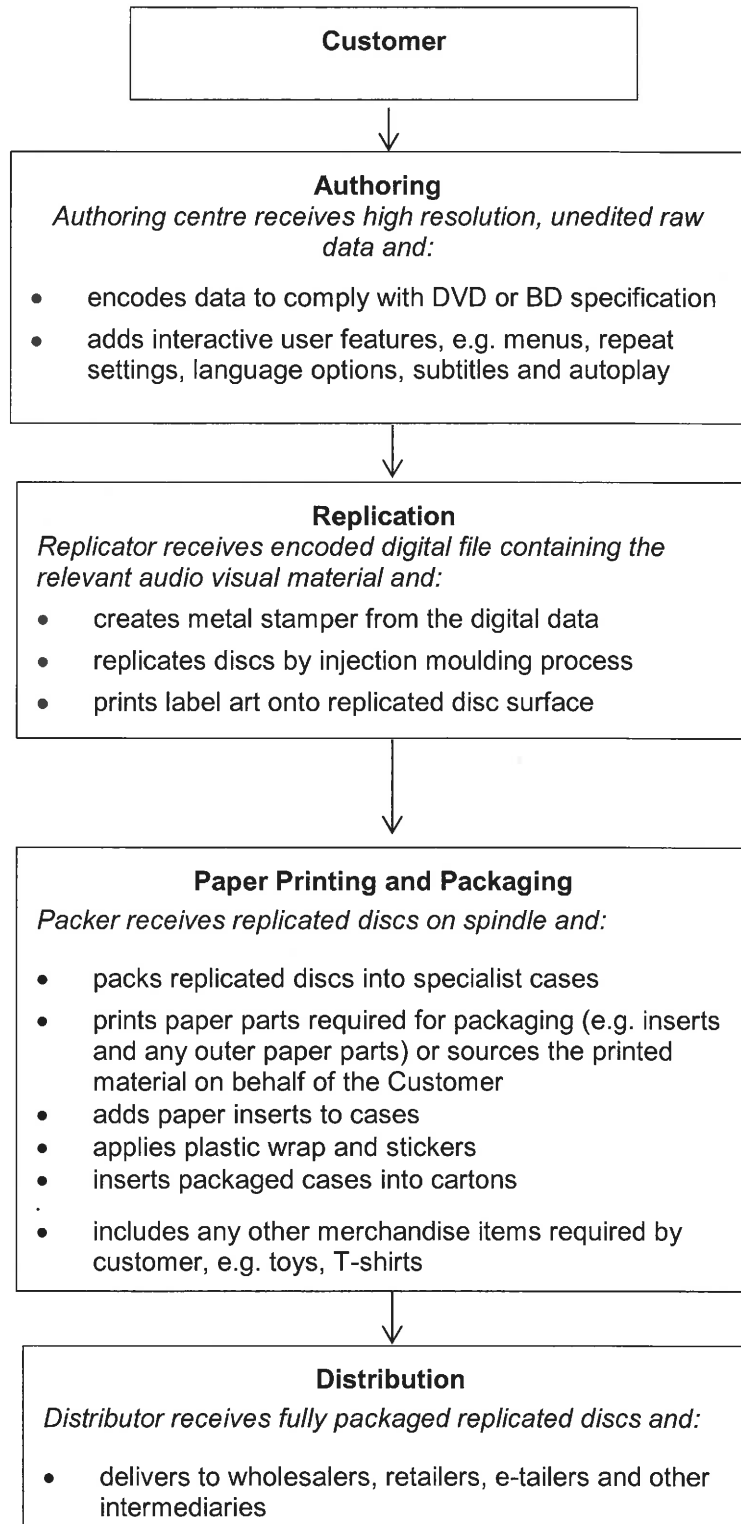


2. The value chain for delivery of content via the physical channel

The replication part of the Content Delivery Market occurs within a much larger value chain that includes preliminary editing of the digital content to be put onto the disc (known as "authoring" or "pre-mastering"), as well as subsequent packaging and distribution of the replicated discs to resellers. As noted above, these services are carried out for Customers by third party contractors.

The value chain is outlined below at **Figure 3**.

Figure 3: Value Chain for Content Delivery via Physical Channel



The processes in the value chain are not required to be, and indeed are often not, carried out by the same parties. This is because different plant and technical expertise are required for each process.

For instance, Technicolor does not have facilities in Australia for printing of the paper parts required for packaging replicated discs. As a result, these functions are sub-contracted to a

third party service provider. The products of these processes may then be delivered to Technicolor or another party for packaging and distribution in accordance with the terms of its arrangement with the Customer.

3. Industry trends

(a) Decline in sales volumes for replicated optical discs

Over the past decade, there has been a marked decline in the volume of optical discs sold globally. In a statement made at the end of 2015, a senior executive of a former large replication business in the USA estimated that there had been a decline of about 20% in CD and DVD production each year.¹³

The same sort of decline has occurred in Australia. At peak volume in 2007, Technicolor was replicating approximately 130 million DVDs in its Australian plant each year. This level has declined each year since. In 2016, Technicolor received orders for only 65 million DVD and BD discs, two thirds of which were ordered to meet seasonal demand around Christmas. Technicolor has predicted a further decline in physical volume for replication of DVDs and BDs of at least 13% each year in Australia, over the next 3 years.

(b) Industry consolidation

As a result of declining volumes, the industry has consolidated around the world. There have been three key examples of industry consolidation over the past three years: in Canada (2014), the USA (2015-2016), and South Africa (2016). In each of these instances, persistent declines in volume sales were cited as being the key reason behind the decision to close down one of the manufacturing operations in the jurisdiction.

In July 2014, Cinram International (**Cinram**), a then leading global manufacturer and distributor of DVDs, CDs and BDs, closed its Canadian production operations. The closing plant's production responsibilities were taken over by Cinram's two existing plants in Pennsylvania and Alabama, USA. At the time, Cinram's CEO Steve Brown said of the move:

*"As you know, the replication industry has been experiencing volume challenges over the last few years, and the Canadian physical media market has been no exception to this decline... These downward trends have been driving consolidation throughout the home entertainment industry."*¹⁴

In February 2016, Arvato Entertainment Inc. (**Arvato**), a global business providing integrated solutions across the value chain for optical discs, closed its replication business for CDs and DVDs in the USA. In order to continue to service existing customers, Arvato entered into agreements to outsource its US production and packaging requirements to CDA, Inc. (**CDA**), a large national provider of CD and DVD replication services. The COO of Arvato, Peter Schaper, spoke to the media at the time of the announcement, saying:

¹³ Citizen Times, 'Arvato closing CD/DVD operation, 120 jobs lost', accessed online at <http://www.citizen-times.com/story/news/local/2015/12/08/arvato-closing-cddvd-operation-120-jobs-lost/76991114/>, 8 December 2015.

¹⁴ The Star, 'Cinram moves production out of Toronto', accessed online at https://www.thestar.com/business/2014/07/25/cinram_moves_production_out_of_toronto.html, 25 July 2014.

“Everybody knew that the day would come one day. And you’re gonna read a lot of news how physical media is dying but when the day comes and when I did announce it yesterday it’s a sad time.”¹⁵

In a decision published in May 2016, the Competition Tribunal of South Africa described the national markets for replication of CDs and DVDs as “*fast declining and potentially dying*”.¹⁶ The Tribunal cited this as being the key reason behind its decision to approve a merger between CTP Limited (CTP) and Compact Disc Technologies (a division of Times Media (Pty) Limited) (CDT), two entities involved in the replication of CDs and DVDs for the entertainment industry in South Africa. The merger involved the sale of CDT’s assets to CTP, including its replication plant. Despite CDT and CTP being described by the Competition Commission as “*the only effective competitors in the relevant markets pre-merger*”, the Tribunal found that the market power enjoyed by the merged firm would be “*relatively brief*”. Further, the Tribunal found that the merging parties would not have carte blanche in terms of setting prices for customers, given that “*the higher their prices the quicker they will speed up the demise of their ailing product. This fact alone should disincentivise any short term price gouging*”.

There have also been a number of very recent changes in the global market. In Europe, Cinram went into liquidation in 2017, as did EDC, another formerly large replicator there. In 2017-18, Technicolor in the US has been in the process of closing its large Olyphant replication and packaging plant. In January 2018, DADC in the US announced it was outsourcing its replication and packing for the US to Technicolor in the US.

The nature of the industry and the trends are an important backdrop to the decision by both parties to enter in the Replication Agreement.

(c) **Rise in digital platforms for music and video**

A significant number of commentators in the media and the broader public have drawn a direct link between:

- (i) volume challenges and consolidation trends in the replication industry; and
- (ii) the rise in digital retail platforms for music and video.

For example, an article by a US paper, reporting on the closure of Arvato’s CD and DVD replication operations in 2015, noted that “*the revolution in digital music and video devastated sales [of CDs and DVDs]*”.¹⁷ An article by The Star, a Canadian paper, commented on the closure of Cinram’s Canadian production operations in 2014 by stating, “*like bricks and mortar CD and DVD stores, Cinram has taken a hit with the advent of online streaming and popular services like Netflix*”.¹⁸ In that same article, Kenneth Wong, a marketing professor from Queen’s University, was quoted as saying that disc manufacturers “*won’t continue to exist in their traditional format. You only have to look at the music industry to see the writing is on the wall*”.

¹⁵ See: <http://wlos.com/news/local/arvato-company-announces-weaverville-factory-closure>, 9 December 2015.

¹⁶ CTP Limited and Compact Disc Technologies (A Division of Times Media (Pty) Ltd) v The Competition Commission, Case No: IM232Feb16.

¹⁷ See: <http://wlos.com/news/local/arvato-company-announces-weaverville-factory-closure>, 9 December 2015.

¹⁸ The Star, ‘Cinram moves production out of Toronto’, accessed online at https://www.thestar.com/business/2014/07/25/cinram_moves_production_out_of_toronto.html, 25 July 2014.

Further, an independent Hong Kong university study published in January 2017 found strong evidence to support the view that video streaming services are displacing physical DVD sales.¹⁹

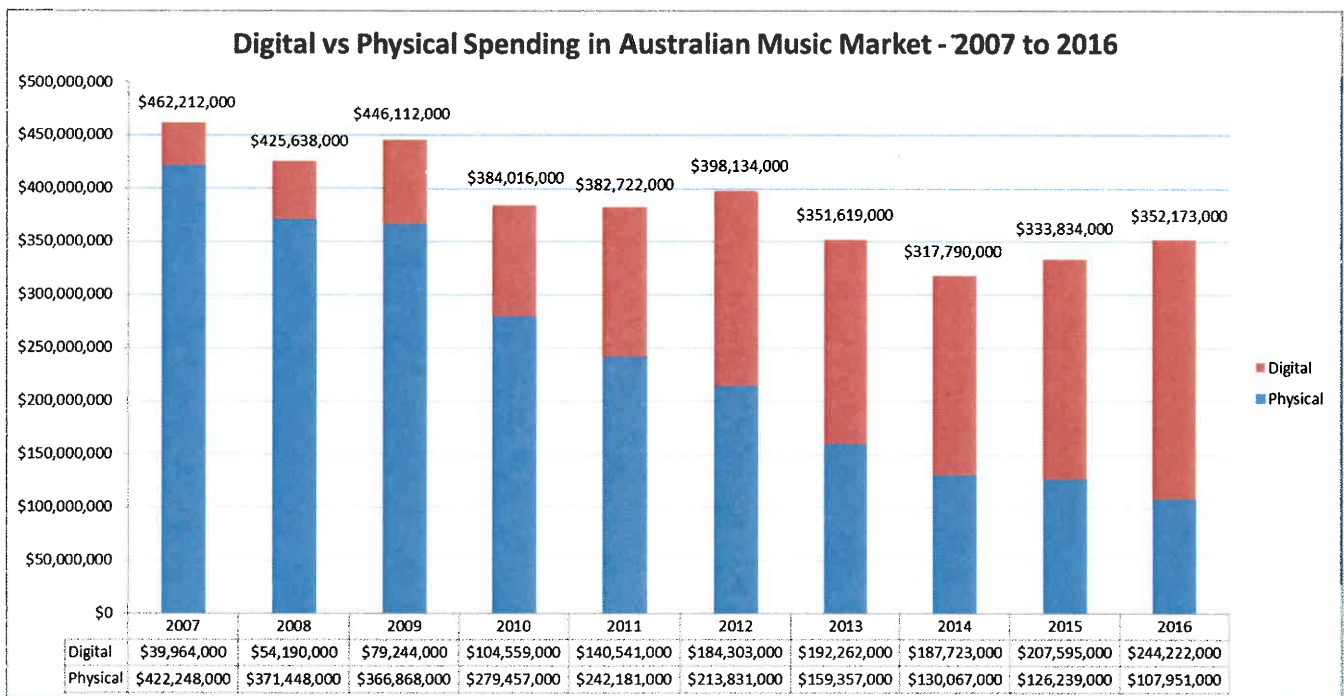
Finally, in February 2017, The Guardian published an article which quoted the owner of Columbia Pictures as attributing an “*acceleration of market decline*” in people buying DVDs and BDs to the global boom in streaming and on-demand viewing services such as Netflix, Amazon Prime and iTunes.²⁰

In light of this, set out below are statistics on trends in Australia and overseas for entertainment content, focusing on the division of market shares for digital sales in comparison to physical sales. Given the difference in the functional nature of CDs as opposed to DVDs and BDs, trends in the music market are separated from those concerning the retail video market (i.e. for movies and TV series).

Australian market for music

Data released by the Australian Recording Industry Association (ARIA) in respect of the wholesale music market for Australia reflects the dominance of digital delivery forms over physical delivery forms amongst Australian consumers. This is reflected in **Figure 4** below.

Figure 4: Digital vs Physical Spend in Australian Music Market from 2007 to 2016



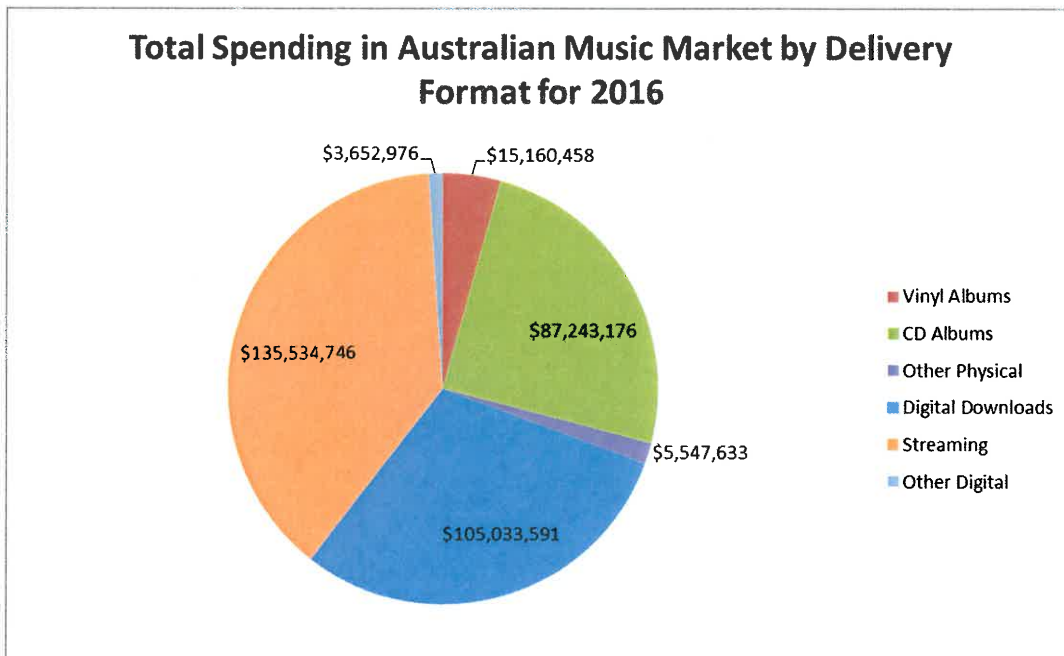
Data taken from 'ARIA Wholesale Figures for the Years Ended 31 December (Physical & Digital)', available online at <http://www.aria.com.au/pages/documents/physdigsalesxvalue.pdf>.

In 2016, total digital sales accounted for nearly 70% of the wholesale market for music in Australia, with streaming making up 38.5% of the market value. In contrast, sales of CD albums, the dominant physical format for music purchases, constituted just 24.8% of total market revenue for 2016. This is reflected in **Figure 5** below.

¹⁹ Yanan Yi, Hailiang Chen, Chih Hung Peng, and Patrick Chau, 'The Causal Effect of Video Streaming on DVD Sales: Evidence from a Natural Experiment', January 2017.

²⁰ The Guardian, 'Falling DVD sales put boot into profits at Sony Pictures', accessed online at <https://www.theguardian.com/film/2017/feb/03/sony-pictures-dvd-sales-profits-streaming>, 4 February 2017.

Figure 5: Total Spending in Australian Music Market by Delivery Format for 2016



Data taken from 'ARIA Releases 2016 Wholesale Figures', available online at: <http://www.aria.com.au/documents/MEDIARELEASE-ARIARELEASES2016WHOLESALESFIGURES.pdf>.

Overseas markets

Research published by IFPI in relation to global music markets in April 2017²¹ shows a growth in streaming revenues of 60.4% during 2016, which constituted the main driving force behind an increase in total digital revenue growth of 17.7% for that period.²² Physical revenues, on the other hand, fell 7.6% in 2016.²³

According to IFPI, digital music now accounts for 50% of total recorded music revenues, whereas physical music accounts only for 34% of the global market.²⁴ The balance of the market is mostly made up by revenues from performance rights, e.g. concerts.

Australian market for video

Data released by the Australian Home Entertainment Distributors Association (**AHEDA**) in respect of the video entertainment market for Australia in 2016 (**AHEDA 2016 Yearbook**) reveals that the physical retail market has been steadily declining since its peak in 2009 as a result of consumers diversifying the way they watch video entertainment content.²⁵ Both DVD and BD spending has been falling each year since around 2012, and IHS Markit predicts that this trend will continue over the next four years (see **Figure 7** below). In 2016, consumer spending on physical video declined 17%.²⁶

The decline in the physical market over time is reflected in **Figure 6** below.

²¹ IFPI, 'Global Music Report 2017: Annual State of the Industry', April 2017.

²² IFPI, 'Global Music Report 2017: Annual State of the Industry', April 2017, p12.

²³ IFPI, 'Global Music Report 2017: Annual State of the Industry', April 2017, p12.

²⁴ IFPI, 'Global Music Report 2017: Annual State of the Industry', April 2017, p12.

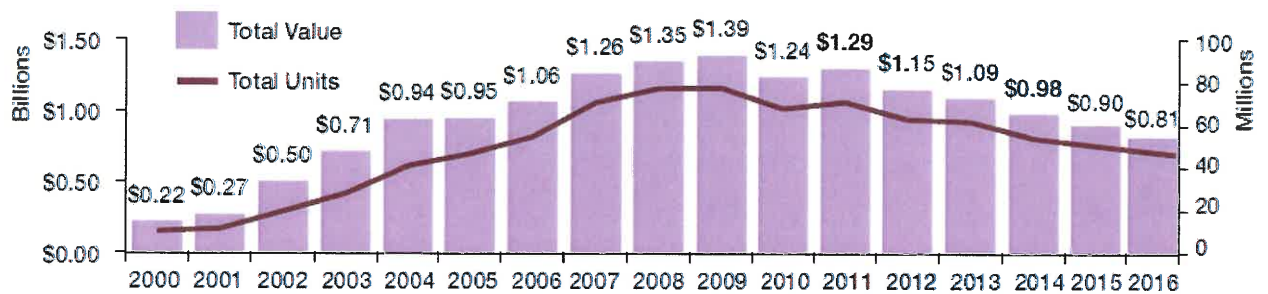
²⁵ AHEDA Yearbook 2016, p44.

²⁶ AHEDA Yearbook 2016, p38.

Figure 6: Physical Disc Retail Market

GfK Retail Tracking: Physical Retail Market size

Source IHS © 2017 IHS



Taken from AHEDA Yearbook 2016

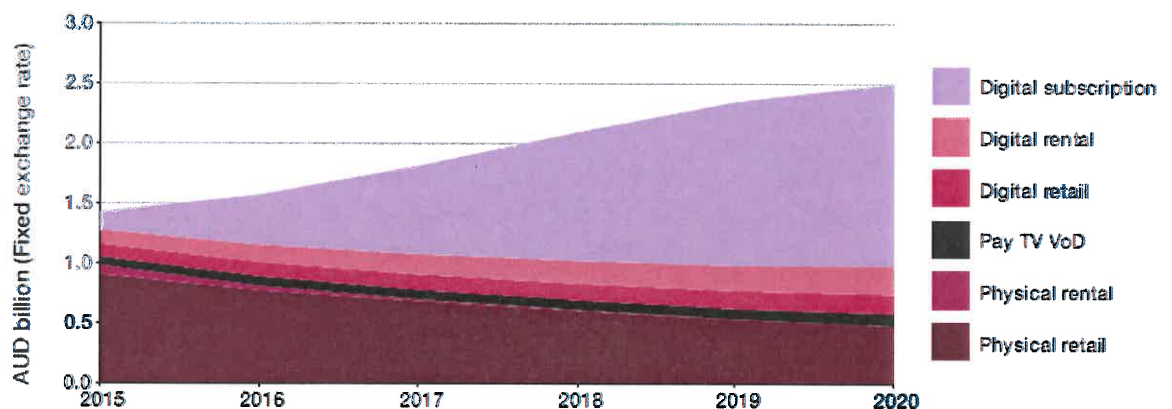
In contrast, the AHEDA 2016 Yearbook notes that digital content is gaining traction in the home entertainment market. Spending on digital video grew as a whole by nearly 70% in 2016.²⁷ Almost 60% of Australians have consumed digital home entertainment in the past month and 36% have watched paid digital in the past month.²⁸

Further, around 70% of home entertainment consumers believe that digital is the way of the future.²⁹ This prediction was backed up in a forecast by IHS Markit, which has predicted a takeover of the physical retail market by digital in 2017 as depicted in **Figure 7** below.

Figure 7: Total Video Spending in Australia

Australia: Total Video Spending, AUD Billion (Fixed exchange rate)

Source IHS © 2017 IHS



Taken from AHEDA Yearbook 2016

Overseas markets for DVD and BD

The trend in the Australian retail market appears to be mirroring closely the trend in the US market. US consumer spending for DVDs and BDs (including retail and rental) has been steadily falling dropping a further 10.4% in 2016.³⁰ In contrast, figures released by The

²⁷ AHEDA Yearbook 2016, p38.

²⁸ AHEDA Yearbook 2016, p58.

²⁹ AHEDA Yearbook 2016, p62.

³⁰ AHEDA Yearbook 2016, p39.

Digital Entertainment Group reveal an increase in total digital spending by over 15% between 2015 and 2016.³¹

At the end of 2016, revenues from physical sales of video content were around US\$5.5bn, constituting 30% of total US home entertainment spending.³² In contrast, revenues from digital formats were over US\$10.3bn, representing 56% of the total home entertainment market.³³ The balance was made up by rental formats, including kiosk, physical subscription and video on demand.

As a reflection of the impact of changing consumer demand worldwide, in January 2017, Sony Corporation announced that it was cutting its outlook for its Q3 FY16 earnings from its home entertainment division by nearly US\$1bn due to a decline in the DVD and BD market which had been "*faster than... anticipated*".³⁴

³¹ DEG, 'DEG Report: US Consumer Spending by Format 2016 Year End' accessed online at http://degonline.org/wp-content/uploads/2017/01/2016-Q4-DEG-Home-Entertainment-Spending_Rev-3.0_01.04.17_-External_-Distribution_Final.pdf, 4 January 2017.

³² DEG, 'DEG Report: US Consumer Spending by Format 2016 Year End' accessed online at http://degonline.org/wp-content/uploads/2017/01/2016-Q4-DEG-Home-Entertainment-Spending_Rev-3.0_01.04.17_-External_-Distribution_Final.pdf, 4 January 2017.

³³ DEG, 'DEG Report: US Consumer Spending by Format 2016 Year End' accessed online at http://degonline.org/wp-content/uploads/2017/01/2016-Q4-DEG-Home-Entertainment-Spending_Rev-3.0_01.04.17_-External_-Distribution_Final.pdf, 4 January 2017.

³⁴ Bloomberg, 'Sony to Take \$1Billion Writedown on Movie Business', accessed online at <https://www.bloomberg.com/news/articles/2017-01-30/sony-says-it-will-take-1-billion-writedown-on-movie-business>, 31 January 2017.

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