

MERGER CONTROL, LEVEL PLAYING FIELD AND MARKET REGULATION

€-KONOMICA'S NEWSLETTER #2

The Commission and the Spanish competition authorities have examined two similar mergers in the pay-tv markets in Spain and Italy respectively.

Both decisions deal with similar material situations and the assessment of the impact of the respective merger on competition is largely based on common grounds.

However, the decisions adopted by each authority are widely divergent as to the type of conditions needed to address the competition concerns. The conditions imposed to authorize the mergers create a very different environment for cable operators to compete in the Italian and Spanish markets for pay-tv and, more importantly, in the telecommunications services market.

The Spanish merger was of community dimension, but was referred to the Spanish authorities at their request.

In the context of streamlined and increasing use of referral mechanisms, the pay-tv mergers raise the question of how to ensure the maintenance of a level playing field across national markets within the EU.

A second important issue raised by the decisions relates to the increasingly thinner frontier between addressing merger control issues on the one hand and market regulation on the other.

1. Competition in the pay-tv market.

Competition authorities in Europe have been actively involved in the still emerging pay-tv markets. Nothing surprising in it, since the model companies have adopted to develop the pay-tv market in Europe has tended to establish a position of monopoly from the outset.

In a first stance, owners of rights to broadcast content tried to join with monopolistic owners of transmission infrastructures to develop a pay-tv service. The European Commission outright forbid a number of this type of operations.¹

The Commission considered at the time that a monopolistic supply would not develop the pay-tv market in Europe, and time has proven the Commission to be right. In Europe, pay-tv has reached much lower rates of penetration than in the US and European companies have not been able to reach profitability. The US has maintained a strict enforcement of competition law in relation to exclusivity and mergers in the pay-tv market, and the market has developed much quicker.

The battle for the monopoly to supply pay-tv services shifted then to the acquisition of exclusivity in premium content, basically football matches and blockbuster, mass marketed and widely distributed films (i.e. those produced by the major Hollywood studios).

Premium content is the main driver to develop a subscriber base, and is crucial for the viability of a pay-tv sufficiently differentiated from a "free" television. With no premium content, subscribers are not ready to pay a fee for a service they may otherwise obtain for "free". Exclusivity in premium content therefore ensures the development of a monopolistic supply of pay-tv services.

The supply of premium content is monopolistic or imperfectly competitive. In this situation, the bidding for the acquisition of exclusivity over premium content and an optimistic anticipation of monopolistic rents in the downstream pay-tv

¹ For instance MSG Media Service (IV/M469) [1994]; Nordic Satellite Distribution (IV/M490) [1995]; Telefónica/Sogecable/Cablevisión (Case IV/M 709) where the notification was withdrawn in the last days of the second phase.

market has resulted in escalating purchasing prices.

The larger the scope for the exclusivity sought, the higher the costs to acquire that exclusivity. The scope may be measured along four dimensions:

- The technology used to broadcast that content (satellite, cable, Internet, terrestrial digital television).
- The commercial modalities of exploitation (programming window, pay per view).
- The material extent (number of studios producing films, number of output deals, number of teams and football matches).
- The time length of the contracts.

The search for a broad scope in exclusivity covering all four dimensions has led to purchasing costs that as a rule have not been recovered through the fees charged to subscribers. This implies generalised financial difficulties of pay-tv providers and has led to bankruptcies (ITV in the UK, Quiero TV in Spain) or mergers such as Canal Plus merging with Via Digital, its main competitor in Spain, and with Stream, its main competitor in Italy.

Both mergers of Canal Plus in Spain and Italy resulted in a near monopoly for pay-tv services in their respective national markets, and were authorised by the Spanish authorities and the Commission after imposing a number of conditions and after carrying a largely common assessment as to the merits of the cases.

The most substantial point of divergence between both decisions is with regard to the technological scope of exclusivity on premium content that the merged entities may have in Spain and Italy².

In Italy, the Commission has limited exclusivity on premium content to satellite transmission. Cable operators, terrestrial digital televisions or Internet providers may acquire broadcasting

² There are a number of differences in the limitations imposed along the other dimensions of exclusivity, but these are secondary and their analysis would require an extensive text.

rights directly from their owners, build their own pay-tv product and compete with the dominant satellite broadcaster if they so wish.

In Spain however, the Spanish authorities have allowed the merged entity to retain exclusivity on premium content for all technologies of transmission, albeit limited over the other dimensions, in particular time.

In Spain, cable operators or terrestrial digital televisions are not allowed to include in their pay-tv products the weekly programming of codified football matches or the programming of recent films (so called first window) unless they negotiate a licence with the merged entity and near monopolistic pay-tv supplier in Spain.

Cable operators, terrestrial digital televisions or Internet service providers in Spain are confronted with a different environment to compete than their Italian colleagues as a consequence of diverging merger decisions.

The effects of the discrimination are not limited to the pay-tv market. In fact, the effects are even more important in telecommunications markets such as voice telephony or broadband access to Internet.

2. Spillovers in telecommunications services.

Technological development has built content and delivery of content into strategic variables of competition in the telecommunications markets.

A pay-tv service plays a strategic role in the offer of telecommunication services to final users, and consequently, in the competition of cable operators as new entrants with the still dominant telecommunication incumbents in Europe.

If cable operators would have access to premium content, they could develop a truly interactive and attractive pay-tv service for their potential customers. By so doing, they would be in a position to exploit the technological advantages of cable over satellite or over other technologies.

Also, mixed bundling of a pay-tv service with telephony voice services and broadband access to Internet is necessary if cable operators want to compete on an equal footing with incumbent telecommunication operators.

Indeed, Telefónica and Telecom Italia have the possibility of (mixed) bundling the three services over their telecommunication network thanks to the ADSL technology.

So the discrimination of cable operators in Spain relative to their Italian colleagues also applies to the telecommunications services markets. Since cable operators are able to acquire directly rights over premium content in Italy, they can fully exploit the commercial and technological competitive advantages of cable, and thereby compensate the relative disadvantage of having to deploy a cable network with a sufficient coverage. In Spain, the exclusive rights of the merged entity prevent cable operators from fully exploiting those advantages.

They will only have partial access to content, and will need to rely on the dominant pay-tv operator to have full access to premium content. The dominant pay-tv operator will have however no incentives to grant that access to potential competitors at competitive conditions.

The merger to a near monopoly has reduced those incentives, because in the absence of any real competitor in the pay-tv market, the opportunity cost of refusing access to content is eliminated and the cost of licensing in terms of future losses of actual and potential subscribers has increased.

The development of cable services will face significantly more obstacles in Spain than in Italy, as a result of different merger decisions regarding largely similar situations.

3. Market regulation under merger control.

The two merger decisions differ also in their approach to the type of conditions that may be

required to approve a merger and in fact reflect a different conception of merger control itself. The Commission addresses the root of the problem, exclusivity, and severely limits its scope. This type of condition is self-monitoring: if the condition were breached, actual and potential competitors would immediately face restrictions in their access to content and ask for intervention by the authorities.

In contrast, the Spanish authorities prefer to regulate the future conduct of the merged entity. Because exclusivity is not really restricted, the Spanish authorities have considered necessary to impose a long list of thirty-four conditions on the merged entity to deal with the anticompetitive effects that may result from the combination of:

- A near monopolistic position in the supply of pay-tv services.
- Exclusive access to key premium content and the use of exclusivity to deter entry or control the access to key content by new entrants with any technology.
- Mutually reinforcing effect of dominance as a seller of pay-tv services and as a buyer of content.

The Spanish conditions include *inter alia* a price cap based on the rule of target inflation minus x for the following five years. It amounts to a price regulation mechanism that will require the continued intervention of the administration to monitor and authorise prices paid by final consumers for pay-tv services.

In addition, the conditions regulate the future relations between the merged entity and Telefónica, who will maintain a minority, but significant holding in the share capital of the merged entity and contributes to a large extent to its debt financing and overall financial viability.

The purpose is to ensure that Telefónica does not use such position in the merged entity to obtain a privileged access to exclusive premium content for its distribution with ADSL.

These conditions would not have been needed either if the technological scope of exclusivity would have been limited to satellite only or if the

shareholding had been divested. Both alternatives would have required (i) less complexity in the conditions imposed, (ii) less continued monitoring by the administration of strategic agreements and commercial policies of the merged entity and its shareholders, and (iii) less intervention by the authorities in the future.

The option to regulate in detail future conduct through the imposition of conditions is somewhat in contradiction with the objectives pursued under merger control. It raises the question if merger control is designed to remove the source of anticompetitive effects that may arise from a merger or rather a question of limiting its anticipated effects and consequences by regulating future conduct.

The purpose of merger control cannot certainly be one of regulating markets in detail to the extent that mergers take place in any given market. Does it make sense, for instance, to regulate the price of a luxury consumer good as pay-tv?

There are certain requirements that a condition imposed under a merger procedure have to fulfil.

If a condition implies continued monitoring in the future and additional recurrent decisions by the authorities, then the authority is regulating rather than addressing structural issues.

It is not just a matter of debating if behavioural conditions are appropriate under a merger

procedure. Measures on exclusivity may both arguably be regarded as behavioural or structural. It is rather a question of to what extent merger control may bring in the regulation of a particular market.

And there are several reasons to take a cautious stand:

- As a backlog of such cases develops over time, the merger authority will find itself with no resources to monitor and follow up a wide number of markets.
- An external event as a particular merger is not a tool to prioritise what markets are in need of regulation.
- Merger authorities may not have all the information necessary to regulate a market properly.

The main conclusion that may be drawn from the analysis of the decisions in the pay-tv market is that:

- Decentralisation and increased referrals of mergers may indeed result in substantially discriminatory enforcement of competition law across Member States.
- Conditions imposed under merger control should require a follow up only as to its effective implementation and be self-monitoring by market participants there onwards.

Claudio Coello 28, 3º dcha. B 12
28001 Madrid

Tel: +34 91 578 19 89
GSM +34 679 43 46 94

Email: juan.briones@e-konomica.net

Juan Briones Alonso
Asesor en Política de Competencia
Advisor on Competition Policy

€-Konomica

266 Avenue de Tervuren, bte 13
1200 Bruxelles

Tel: +32 2 735 90 57
GSM +32 477 62 6640