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Vertical mergers in the technology, media and telecom sector – Note by Canada

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This document reproduces a written contribution from Canada submitted for Item 10 of the 131st OECD Competition committee meeting on 5-7 June 2019.

More documents related to this discussion can be found at

http://www.oecd.org/daf/competition/vertical-mergers-in-the-technology-media-and-telecom-sector.htm

Please contact Mr. Antonio Capobianco if you have any questions about this document [E-mail: Antonio.Capobianco@oecd.org]

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Canada

1. Introduction

1. Canada's Competition Bureau ("Bureau") is pleased to provide this submission to the OECD Competition Committee's 7 June 2019 roundtable on "Vertical Mergers in the Technology, Media and Telecom Sector".

2. The Bureau, headed by the Commissioner of Competition ("Commissioner"), is an independent law enforcement agency of the Federal Government of Canada responsible for the administration and enforcement of the *Competition Act* and certain other statutes.[1] In carrying out its mandate, the Bureau ensures that Canadian businesses and consumers prosper in a competitive and innovative marketplace.

3. This submission describes the Bureau's analytical approach to vertical mergers, including providing examples of vertical mergers that the Bureau has reviewed in the media and telecom sectors, and the Bureau's remedial approach to vertical mergers that presented competition issues.

2. Merger Analysis

4. When reviewing mergers, the Bureau assesses whether a merger or proposed merger is likely to result in a substantial lessening or prevention of competition in accordance with the factors set out in its Merger Enforcement Guidelines ("MEGs").[2] In order for a merger to lessen or prevent competition substantially, the Bureau must find that the merger is "likely to create, maintain, or enhance the ability of the merged entity to exercise market power, unilaterally or in coordination with other firms."[3] The Bureau will evaluate the competitive effects of a merger by considering primarily the merger's effects on price and output, but also its effects on other dimensions of competition, such as quality, product choice, service, and innovation.[4]

5. While the majority of the Bureau's merger reviews assess the effects from the loss of competition between direct competitors ("horizontal merger"), the Bureau also analyzes the effects on competition of mergers between firms that produce products at different levels of a supply chain ("vertical mergers").

6. The MEGs acknowledge that non-horizontal mergers are generally less likely to prevent or lessen competition substantially than are horizontal mergers, and that these mergers can give rise to significant efficiencies. For example, a vertical merger may allow

[1] The full text of the *Competition Act* is available online at: http://laws-lois.justice.gc.ca/eng/acts/C-34/index.html.

[2] The MEGs are available online at: https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/cb-meg-2011-e.pdf/$FILE/cb-meg-2011-e.pdf

[3] Tervita Corp. v. Canada (Commissioner of Competition), 2015 SCC 3 at para 44.

[4] MEGs 2.2

the merged firm to remove or "internalize" existing double marginalization, since there is no longer any need for a mark-up on goods from the upstream firm to its downstream merger partner.[5]

7. However, the MEGs also recognize that non-horizontal mergers, including vertical mergers, can have anti-competitive effects under certain circumstances. In particular, in relation to the potential competitive harm from unilateral effects of non-horizontal mergers they state:

> *"A non -horizontal merger may harm competition if the merged firm is able to limit or eliminate rival firms' access to inputs or markets, thereby reducing or eliminating rival firms' ability or incentive to compete."*[6]

8. In analysing unilateral effects of vertical mergers, the Bureau considers three inter-related questions (i) whether the merged firm has the ability to harm rivals; (ii) whether the merged firm has the incentive (i.e., whether it is profitable) to do so; and (iii) whether the merged firm's actions would be sufficient to lessen or prevent competition substantially. The Bureau refers to this ability to affect rivals as "foreclosure".

9. There are four main categories of foreclosure that the Bureau considers when analyzing vertical mergers. These consist of (i) total input foreclosure, where the merged firm refuses to supply an input to rival downstream firms; (ii) partial input foreclosure, where the merged firm increases the price it charges to supply an input to rival downstream firms; (iii) total customer foreclosure, where the merged firm refuses to purchase inputs from an upstream rival; and (iv) partial customer foreclosure, which can occur when the merged firm is a distributor and can disadvantage upstream rivals with respect to the distribution or resale of their products.[7]

10. In addition to unilateral effects, the Bureau also considers the potential for competitive harm resulting from a non-horizontal merger due to coordinated effects, which could arise from the merger creating increased price transparency in the market, or providing additional ways for the merged firm to punish deviations from coordinated behaviour. In assessing a non-horizontal merger, the Bureau would also consider whether the merger may increase barriers to entry for firms that are not vertically integrated.

3. Merger Remedies in the Canadian Context

11. The Commissioner cannot unilaterally prohibit a merger or impose remedies on merging parties. In the vast majority of merger cases where the Commissioner concludes that a transaction is likely to prevent or lessen competition substantially, a remedy is formalized in an agreement between the Commissioner and the parties to the transaction. Consent agreements are registered with Competition Tribunal ("Tribunal") and have the force and effect of a Tribunal order. [8]

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[5] MEGS, footnote 52.

[6] MEGs 11.4

[7] MEGs 11.7

[8] Where the Commissioner has determined that a transaction is likely to substantially lessen or prevent competition and is not able to negotiate an acceptable resolution with the merging parties,

12. While the Bureau has never challenged a purely vertical merger before the Tribunal, there have been three consent agreements since 2013 that contain remedies to address anticompetitive effects arising from vertical theories of harm. Two of these remedies involve firms that operate in the media and telecom sectors.

13. The appropriate remedy for a particular transaction will depend on the particular circumstances of that case and the theory of harm being considered. However, the Bureau prefers remedies that are structural in nature, or whose primary components are structural. The Bureau considers structural remedies to be more effective for a number of reasons, including their cost and the certainty that they provide. For example, structural remedies do not tend to require long-term monitoring after implementation and they permanently address the harm that would have otherwise been caused by the merger, rather than doing so only for a set duration. Further, a structural remedy addresses both the ability and incentive of the merged firm to harm its rivals, while a behavioural remedy will only address the firm's ability to act on such incentives. Nonetheless, remedies for vertical mergers in Canada have included a hybrid of structural, quasi-structural and behavioural components.

14. In Canada, a structural remedy has been implemented to address competition concerns arising from a vertical merger where it has been determined that the merged firm would have the ability and incentive to unilaterally foreclose competitors. In these cases, the merged firm has divested assets that are critical to the ability of competitors to participate in the market that is affected by the merger.

15. The Bureau has also implemented behavioural remedies to address competitive harm from vertical mergers. For example, firewalls between parts of a business have been included in remedies to address anticompetitive harm arising from increased coordination among firms in a market. Firewalls can address competition concerns relating to coordination by limiting a firm's ability to obtain access to a rival's competitively sensitive information or by preventing the use of the downstream entity to facilitate the sharing of confidential information between the merged firm and its rivals. Firewalls restrict this harm by preventing the sharing of confidential information between business units and by restricting how business units or firms interact with each other.

16. Constructing and enforcing a firewall can be difficult when the merging firms combine into a single entity. Designing a firewall that restricts information flow such that the remedy is effective without hindering the merged firm's operations requires in-depth knowledge of the integrated firm's intended structure. It is likely that, pre-transaction, the merging firms have not finalized the precise post-merger structure of their combined businesses. As a result, there will likely be unforeseen challenges throughout the term of the remedy as the merging parties integrate and adjust their business. Further, enforcement of firewalls generally requires a third-party monitor, paid for by the merged entity but reporting to the Commissioner, that ensures ongoing compliance with the consent agreement through overseeing the use of restricted information within the company. The monitor is also responsible for reporting breaches or potential breaches to the Bureau.

the Commissioner may file an application with the Tribunal. The Tribunal is a separate adjudicative body that has the jurisdiction to hear and dispose of all applications made by the Commissioner under the merger provisions of the *Competition Act*.

4. Vertical Mergers in Media and Telecom

17. The Bureau has reviewed a number of vertical mergers in the media and telecom sectors. For example, in broadcasting, the Bureau has considered mergers that implicate multiple levels of the television programming supply chain, including television production companies that create content, television programming aggregators that own and operate television channels, and television distribution companies that provide programming services to consumers. The Bureau has similarly considered mergers that involved participants at different levels of the telecom supply chain, including owners and operators of telecom infrastructure, providers of telephone and internet services, and operators of wireless telephone retail stores.

18. In each of these reviews, the Bureau considered whether rivals were likely to be partially or totally foreclosed of inputs by the merged firm. In certain instances, the Bureau has also considered other theories of harm posed by vertical relationships, such as whether a merger increases the likelihood of coordination among firms, or whether the merger increases the merged firms' access to confidential business information of rival firms.

19. The remainder of this submission will discuss past cases in the media and telecom sectors where the Bureau considered vertical theories of harm. As noted, the Bureau has entered into two consent agreements in relation to vertical mergers in the media and telecom sectors since 2013 (Bell/Astral and Bell/Rogers/GLENTEL). The Bureau has conducted detailed reviews relating to potential vertical concerns presented by mergers in these sectors in two other instances. In Bell Aliant/Ontera, the merging parties voluntarily undertook to resolve the competition concerns raised by the Bureau, while in TVA/Vision Globale, the Bureau ultimately found that foreclosure by the merged entity would not likely substantially lessen or prevent competition.

4.1. Bell/Astral

20. In the 2013 review of the acquisition of Astral Media Inc. ("Astral") by BCE Inc. ("Bell"), the Bureau assessed whether the transaction might provide Bell with the ability and incentive to foreclose its television distribution competitors from Astral's portfolio of television channels. Pre-transaction, Astral was not vertically integrated, and was Canada's largest independent owner of specialty and pay programming channels, which were licensed to television distributors, including Bell. Bell is Canada's largest telecom company, and had an ownership interest in over 30 specialty television channels prior to the transaction. At the time of the transaction, Bell was one of Canada's largest television distributors.[9]

21. Since Astral was not vertically integrated prior to the transaction, it lacked any economic incentive to foreclose distributors. In addition, Astral's portfolio included numerous channels that were very important to television distributors. Meanwhile, Bell had an incentive pre-transaction to disadvantage rival television distributors in respect of the provision of its own portfolio of television channels. As such, the Bureau found that, following the transaction, Bell would also have an incentive to leverage Astral's portfolio to disadvantage its downstream rivals.

[9] For more information, see the Bureau's position statement released for this matter (https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03544.html)

22. A structural remedy was agreed to between Bell and the Commissioner whereby Bell was required to divest 6 English and 7 French language specialty channels. The divested channels, some of which were referred to as ‘must haves’ for television distributors, reduced Bell’s post-merger shares in programming and specialty services, thus reducing Bell’s ability to raise its television distribution rivals’ costs and restrict current and future competitors’ ability to innovate by launching new programming services and distributing services in new ways. The remedy resulted in the divested channels being sold to Corus Entertainment Inc. (“Corus”), a media company that is not vertically integrated downstream into distribution of television content, and that would not have an economic incentive to harm other television distributors.

4.2. Bell Aliant/Ontera

23. In 2014, the Bureau reviewed the acquisition of O.N. Tel Inc. (“Ontera”) by Bell Aliant Regional Communications Inc. (“Bell Aliant”), which involved two providers of telecom services to rural communities. In particular, the Bureau assessed whether, post-merger, Bell Aliant would have the ability and incentive to partially or fully foreclose its competitors from access to Ontera’s fiber-optic infrastructure. Prior to the transaction, Bell Aliant was a vertically integrated telephone company capable of self-supplying backhaul services, whereas Ontera was not vertically integrated, and instead provided backhaul services to Bell Aliant’s competitors in various local markets. The Bureau was concerned that this foreclosure would likely affect the ability of these local competitors to effectively compete with Bell Aliant, resulting in higher prices, less choice, and lower service quality for wireline telecom services. [10]

24. To alleviate the Bureau’s concerns, Bell agreed to a 20-year contract that granted Eastlink indefeasible access to two of four of Ontera’s fibre-optic telecom strains. This remedy, which provided non-discriminatory access rights to Ontera’s infrastructure, had many of the benefits of a structural in that it did not require a monitor nor did it impose any restrictions on any competitor’s behaviour.

4.3. TVA/Vision Globale

25. The Bureau also considered an input foreclosure theory of harm in relation to the review of the 2014 acquisition of Vision Globale A.R. Ltée (“Vision Globale”) by Groupe TVA Inc. (“TVA”). More specifically, the Bureau considered whether TVA, a major French-language television broadcaster operating six conventional and eight specialty television channels, would have the ability and incentive post-transaction to foreclose other television producers of the services of Vision Globale, a Quebec-based provider of production and post-production services. Pre-transaction, TVA was already vertically integrated and owned production assets that were predominantly used in the production of content for its own television networks. Ultimately, the Bureau found that there was sufficient competition for production and post-production services that TVA would not have the ability to foreclose other television producers following the transaction.[11]

[10] For more information, see the Bureau’s position statement released for this matter (https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03823.html)

[11] For more information, see the Bureau’s position statement released for this matter (https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03867.html)

4.4. Bell/Rogers/GLENTEL

26. The Bureau examined two vertical theories of harm in the telecom sector as part of its review of the 2015 acquisition of GLENTEL Inc. ("GLENTEL"), a retailer of wireless products and services, by Rogers Communications Inc. ("Rogers") and Bell, two large integrated telecom companies that, among other things, provide wireless services to Canadian consumers. In particular, the Bureau considered whether Rogers and Bell would have the ability and incentive post-merger to foreclose competing providers of wireless services from GLENTEL's retail locations, and whether the acquisition would enable coordination through information sharing.

27. Through its review, the Bureau found that the evidence did not support the foreclosure theory of harm. In particular, the Bureau found that GLENTEL typically only sold the products of Bell and Rogers pre-transaction, and that there were a number of retail channels available to wireless carriers outside of GLENTEL. As noted, the other theory of harm considered by the Bureau related to whether, in light of pre-existing market power in the wireless telecom sector in Canada, the joint ownership of GLENTEL by Bell and Rogers could lessen competition between them in respect to wireless services as a result of the carriers obtaining access to each other's competitively sensitive information. For example, Bell and Rogers could obtain advance notice of promotions or subscriber information through GLENTEL which could then have an impact across their operations, resulting in higher prices for wireless services in Canada.[12]

28. In light of the competition concerns presented by this transaction, the consent agreement imposed firewalls and a confidentiality protocol such that Bell and Rogers, competitors in the wireless telecom market, could not share information with each other using GLENTEL's retail business. These safeguards prevent Bell and Rogers from obtaining, through GLENTEL, each other's subscriber information and forward looking pricing, promotion or marketing strategies. Further, it limits the historic sales and revenue information that GLENTEL can share with Bell and Rogers. The Bureau appointed a monitor to enforce these protocols.

5. Conclusion

29. This submission provided an overview of Canada's approach to analyzing vertical mergers~~,~~ and, in particular, mergers in the media and telecom sectors. While recognizing that vertical mergers are less likely to give rise to competitive concerns than mergers between direct competitors, the Bureau's previous experience with vertical mergers demonstrates that vertical mergers can have significant anticompetitive effects that require remedies. Going forward, the Bureau will continue to closely scrutinize vertical mergers, and take enforcement action where appropriate to address harm to competition.

[12] For more information, see the Bureau's position statement released for this matter (https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03924.html)