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

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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

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Introduction

1. The industry chosen, i.e., technology, media and telecom sector is very apt for assessing impact of vertical mergers. A brief summary about the said industry in India is, as follows:

- India is the world's second largest telecommunications market with 1.18 billion wireless, 22 million wireline and around 600 million internet subscribers. The country is divided into 23 service areas for providing retail mobile telephony services. The gross revenue of the telecom service sector in India is estimated to be more than US$ 36 billion. The consumers have benefited from getting high quality products at less prices. It has spurred innovation in technology and new products and services are constantly offered by the market players. Telecom sector is expected to contribute substantially to India's gross domestic product.[1] 1
- Till 2017, there were around 10 active telecom service providers in India. However, owing to the substantial debt burden and intense competition, telecom sector in India has undergone a phase of consolidation in the recent period and pursuant to the same, the number of telecom service providers engaged in providing retail mobile telephony services has reduced from 10 to 5 on pan-India basis and 4 (3 private companies and 1 state owned company) in each licensed service area.
- The Indian media and entertainment industry is a sunrise sector for the economy and is making high growth strides. This industry is on the cusp of a strong phase of growth, backed by rising consumer demand and improving advertising revenues. The industry has been largely driven by increasing digitisation and higher internet usage over the last decade. Internet has almost become a mainstream media for entertainment for most of the people.
- Television broadcasting services as well as distribution of TV channels are capital-intensive businesses. Both requires continuous technology up-gradation, and capability to face competition from within and outside India. There have been M&As in the broadcasting and distribution sector in India both at horizontal and vertical levels.

2. Analysis of vertical mergers and acquisitions (**M&As**) and enforcement policy directed towards such M&As is arguably one of the most contentious issues. The traditional belief (at both theoretical and empirical level) is that vertical mergers are a source for considerable price and non-price efficiencies, thereby resulting in lower price and increase in output / services for the consumers. Thus, competition authorities maintain a cautious approach towards assessment of vertical mergers. The analytical framework for assessing the likelihood of anti-competitive foreclosure (input or customer) in the case of such mergers, involves evaluating integrating firm's ability, incentives, and the effect of such foreclosures, called the AIE framework.

1 http://dot.gov.in/sites/default/files/Telecommunications%20Annual%20Report%202018%20ENGLISH_0.pdf

3. For welfare enhancement, it is imperative that few transactions, which merit detailed investigation, needs to be identified and differentiated from typical vertical merger cases. This requires appropriate formulation of theories of harm, adducing evidence for hypothesized anti-competitive effects, which in-turn requires in-depth economic analysis. Further, balancing efficiencies resulting out of such mergers vis-à-vis the negative price and non-price impact of these mergers is required.

4. Based on the questions specified in the OECD letter dated 13th February, 2019, this paper is divided into 2 parts. Part I deals with the provisions of the Indian Competition Law and regulations for assessment of vertical mergers. It also briefly elucidates regulations, relating to media, telecom and technology sector, framed by Department of Telecom (**DoT**), Ministry of Information and Broadcasting (**MIB**) and the Telecom Regulatory Authority of India (**TRAI**) (sectoral regulator for telecommunications and media in India). Part II provides brief summary of the M&A cases dealt with by the Competition Commission of India (**Commission**) wherein vertical issues in media, telecom and technology sectors were assessed. It also summarises experience gained from the enforcement of vertical mergers.

1. Vertical mergers under the Indian Competition Law and regulations / guidelines of MIB, TRAI and DoT

5. In India, the MIB, DoT and TRAI formulates guidelines and regulations for free and fair functioning of the players in the media, technology and telecom sector. Thus, there are general sectoral regulations / guidelines for checking any anti-competitive behavior on part of the players in these sectors. Further, the Competition Commission of India ("**Commission**"), also intervenes to correct any possible infringement of competition law from ex-post (in the case of anti-trust issues) perspective. Moreover, the M&As require prior approval of the Commission in case the transaction meet jurisdictional thresholds prescribed in terms of value of assets and turnover.

6. The DoT formulates developmental policies in respect of telecommunication services and TRAI regulates telecom services including fixation / revision of tariffs for media and telecom services.

1.1. Provisions in Competition Act, 2002 for media, telecom and technology sector

7. Though no specific guidelines or FAQs concerning vertical mergers have been issued by the Commission, nevertheless the Commission through its detailed order in cases of vertical mergers have made the stakeholders aware of its general policy towards vertical mergers. Furthermore, various other factors mentioned under Section 20(4) of the Act, such as:

(e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;

(f) extent of effective competition likely to sustain in a market;

(g) extent to which substitutes are available or are likely to be available in the market; (h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;

(i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;

(j) nature and extent of vertical integration in the market;

(l) nature and extent of innovation;

(m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

(n) whether the benefits of the combination outweigh the adverse impact of the combination, if any

assists the Commission in proper assessment of cases related to vertical mergers.

8. Moreover, before filing of a merger notification, the Commission prefers a process of consultation, and at the time of such consultation also, if required, the stakeholders are communicated about, *inter alia*, 'ability / incentive / effects framework' for assessment of vertical mergers.

1.2. Provisions of MIB and TRAI for media, telecom and technology sector

9. Since January, 2004, the television industry in India is regulated by the TRAI, a federal regulator with an all India mandate to ensure fair competition within the television broadcasting industry and to facilitate its growth. TRAI regulates both the wholesale level (the level between the broadcaster and the distribution platform operators (**DPOs**)) as well as the retail level (the level between the DPOs and the customer) of the television industry in India.

10. In December 2011, the Government of India passed the Cable Television Networks (Regulation) Amendment Bill, 2011, which obligated cable operators to transmit all channels in an encrypted form using a digital addressable system (**DAS**). This was aimed to replace the then existing analog system in which channels were transmitted in a decrypted form. The new system allowed for greater flexibility to consumers (for instance the customers could pay only for channels they subscribed instead of the entire bouquet offered by cable operators). It also enhanced transparency in the system (for instance increasing accountability of cable operators in terms of reporting the number of subscribers). The digitization of cable TV drive was completed by December 2016.

11. Both MIB and TRAI have issued detailed guidelines that, *inter alia*, cover the media sector. Further, TRAI issued detailed regulations on 3rd March, 2017, namely, Telecommunication (Broadcasting and Cable) Services Interconnection (Addressable Systems) Regulation, 2017 (**Interconnect Regulations**), Telecommunication (Broadcasting and Cable) Services (Eighth) (Addressable Systems) Tariff Order (**Tariff Order**) and Telecommunication (Broadcasting and Cable) Services, Standard of Quality of Services and Consumer Protection (Addressable Systems) Regulations 2017 (**Quality of Service Regulations**) for media sector.

12. As regards the regulation of M&A activity in telecom sector, DoT has issued (i) guidelines for transfer/merger of various categories of telecom service licenses (Merger Guidelines) in 2014; and (ii) guidelines for trading of access spectrum by access service providers (Spectrum Trading Guidelines) in 2015.

2. Cases on vertical merger in media, telecom and technology sector

13. Few such cases are discussed in detail below.

2.1. Amalgamation of Videocon d2h Limited in and into Dish TV Limited

14. The Commission had received a notice for amalgamation of Dish TV India Limited (**Dish TV**) & Videocon D2h Limited (**Videocon d2h**). Both the parties were engaged in direct-to-home (**DTH**) broadcasting services. It was observed that there is horizontal overlap between the parties in provision of DTH services in India. Furthermore, it emerged that Dish TV may have some structural linkages with Essel group inasmuch as some of the entities of Essel group, *viz.* Zee Entertainment Enterprises Limited Ltd. (**ZEEL**) and Zee Media Corporation Limited (**ZMCL**), are engaged, *inter alia*, in business of development of TV contents which is upstream to the business of distribution of TV contents.

15. In this context, the Commission observed that ZEEL and ZMCL are broadcasters, *i.e.* developers of TV content whereas SITI Cable and Dish TV are DPOs. Business activities of broadcasters and DPOs are at different stages or levels of the production / supply chain. Accordingly, the Commission assessed and examined vertical relationship between ZEEL / ZMCL and Dish TV and the likely impact of the same.

16. In this context, submission of third parties, viz., broadcasters and the competitors of the parties were also received who raised certain pertinent issues related to vertical integration of broadcasters and the DPOs. Some of the major issues that were highlighted pertained to:

1. Dish TV is a part of the Essel group and because of that there exists vertical relationship between Dish TV and ZEEL / ZMCL. Further, the resultant entity, post-combination, with a market share of around 45% would have potential vertical relationship with ZEEL / ZMCL.
2. The resultant entity, post-combination, may form bouquets of channels or place other channels to the disadvantage of broadcasters.
3. Owing to high market share of the resultant entity, post-combination, the broadcasters would grant high discount to the resultant entity, as compared to their competitors.
4. Queries were raised about the authenticity of the synergy claims arising from the proposed combination, as Dish TV and Videocon d2h use different technologies for their DTH business.

17. On the issues raised, the Commission observed that both MIB and TRAI have issued detailed guidelines that, *inter alia*, cover the aforesaid areas of concern raised by certain broadcasters and competitors of the parties. Further, the Commission noted that the above regulations of TRAI, namely, Interconnect Regulations, Tariff Order and Quality of Service Regulations, have provisions to address these apprehensions that were raised by third parties.

18. The Commission noted that as per the present regulations, the following obligations on DPOs and the broadcasters are relevant for the issues under consideration. *Under the extant regulatory regime, every distributor of TV content is required to publish on its website: (i) total channel carrying capacity, (ii) list of channels available, (iii) number of channels for which signals have been requested by the distributor of TV content from the broadcaster and an interconnection agreement has been signed, (iv) spare channel carrying capacity, and (v) list of channels for which requests have been received from the broadcaster and an interconnection agreement signed but which are pending distribution due to non-availability of spare channel capacity. Further, the Interconnection Regulations stipulate that every distributor of TV content shall allocate every alternate spare channel capacity on its network to the channels, in sequential manner and this has to take place on a non-discriminatory basis. Further, maximum retail price of channels are fixed by the broadcasters. The Commission also observed that market at the level of broadcasters as well as DPOs is competitive with presence of several big competitors. In view of the above, the Commission observed that the regulatory landscape and presence of other competitors would ensure that there is no adverse impact on competition, on account of vertical relationship in the instant matter.*

19. The Commission, further, noted both the parties use different technologies for their DTH business and given that there is no technical interoperability of set-top boxes and dish antennae among the DPOs, the customers of the respective parties may be forced to bear the cost for such technical realignment. Accordingly, the Commission raised this apprehension with the parties to the combination. In this regard, the parties filed voluntary modification stating that in case of such technical realignment, the cost shall be borne by the parties and not by their customers. They also undertook to submit compliance report for a period of 5 years. The Commission accepted the undertaking submitted by the parties and approved the transaction.

2.2. Acquisition of Den Networks Ltd. and Hathway Cable and Datacom Ltd. by Reliance Industries Limited group

20. The Commission had received two separate notices from certain entities belonging to the Reliance Industries Limited group (RIL) for acquisition of Den Networks Ltd. and Hathway Cable and Datacom Ltd. It may be noted that the acquirer i.e. Reliance Industries Limited group is present in the upstream business segment of broadcasting (i.e. whole supply of TV channels) and licensing of TV content. Whereas both the targets i.e. Den Networks Ltd. and Hathway Cable and Datacom Ltd. had presence in the downstream business segment and acted as DPOs for TV channels through cable (thus, the targets were engaged in the business of aggregation and distribution of television channels). The targets were also engaged in the provision of wired broadband internet services.

21. The Commission had noted that the products / services of the parties exhibit horizontal overlaps in the provision of the various products / services relating to broadcasting & distribution and broadband internet services. The overlapping business segments are aggregation and distribution of broadcast TV channels to homes; retail supply of AV content; provision for wired broadband internet services (Wired-BIS); and supply of advertising airtime on TV channels.

22. In relation to presence of the parties at different stages of the productions chain or provision of services, the Commission noted that the parties exhibit vertical overlaps in the provision of various products / services such as, (a) wholesale supply of TV channels in India (upstream), and aggregation and distribution of TV channels to homes in India (downstream); (b) licensing of audio-visual content (AV Content), including licensing of linear feeds of TV channels in India (upstream) and retail supply of AV content (downstream); and (c) advertising on TV channels (upstream) and supply of advertising airtime on TV channels (downstream).

23. The Commission assessed the above said horizontal overlaps and noted that either the incremental market share in some overlapping segments is not significant to raise any competition concerns, or other competitors would continue to provide competitive constraint to the RIL group, post-combination. With respect to vertical relationships, the Commission noted that for some business segments, the parties have insignificant market shares along with the presence of other players, and for other segments, there are regulatory landscape in place, which would ensure that there is no adverse impact on competition. However, the Commission raised an apprehension that in case RIL group carries out technical realignment, post-combination, the customer of respective party may have to bear the cost of such technical realignment. In response to the Commission's query, the acquirers submitted a voluntary modification which, *inter alia*, stated that in case there is any technical re-alignment which will result in change in customer premises equipment to enable the existing subscribers to continue availing from Den and Hathway the services currently being availed by them, then the parties undertake that the cost of such technical realignment and / or the change in customer premises equipment will not be borne by such customers and the same will be borne by the parties. Further, the parties undertook to provide an annual compliance report for a period of five (5) years. The Commission accepted the said voluntary modification and approved the proposed combination.

3. Cases on vertical merger in telecom sector

24. As mentioned above, the DoT formulates developmental policies in respect of telecommunication services and TRAI regulates telecom services including fixation / revision of tariffs for telecom services. Also, apart from the Merger Guidelines and Spectrum Trading Guidelines, the M&As require prior approval of the Commission in case the transaction meets jurisdictional thresholds prescribed in terms of value of assets and turnover.

25. Amongst the merger and acquisition activity, the most significant was the combination of Vodafone India and Idea Cellular Limited. Apart from the outright mergers and acquisitions, there have been multiple transactions in respect of trading of spectrum. A brief on a few vertical aspects of the transactions is as under.

3.1. Vodafone-Idea merger case

26. On the basis of product overlaps between the Parties in India, the Commission identified following product segments for the purpose of competition assessment.

1. Retail Mobile Telephony Services;
2. Enterprise Services;
3. Internet Service Provider Services (**ISP Services**);

4. National Long Distance Services (**NLD Services**);
5. International Long Distance Services (**ILD Services**);
6. Provision of passive infrastructure services through telecom towers;
7. Provision of passive infrastructure services over fibre optic network;
8. Intra Circle Roaming Services; and
9. Mobile Wallet Services

27. Of the above product segments, some of the product segments have both the horizontal and vertical overlaps *viz.*, NLD Services, ILD Services and Passive Infrastructure Services. The Commission duly examined the impact of the transaction considering both these aspects.

3.2. NLD / ILD Services

28. The customers of NLD Services include (a) different telecom operators to connect their customers either to: (i) other customers (for voice and data) or to the internet (for data); and (ii) to other parts of the Circle they are in, or to other parts of the country where that particular operator does not have its own network infrastructure; and (b) non-telecom operators.

29. The Commission observed that the combined market share of the Parties in India would be around 23 percent for NLD and 18 percent for ILD. As regards the ability and incentive of merged entity to foreclose the market at circle level, the Commission noted that there are at least 9 operators in every circle for NLD and 8 operators in every circle for ILD. Further, there are no long term contracts for provision of NLD/ILD Services and the maximum lock in period for most of the contracts is 12 months. In view of the above, the Commission observed that the merged entity is not likely to have ability or incentive to foreclose the market and that the proposed combination will not materially result in the restriction of choices available to customers for the provision of NLD services.

3.3. Provision of passive infrastructure services through telecom towers

30. The Indian telecom market is characterized by presence of three types of tower companies viz., (i) pure play companies; (ii) joint ventures; and (iii) formed through demerger from a telecom service provider. Vodafone and Idea own standalone tower networks which they use to operate their own networks and also to host other TSPs. Apart from these, Vodafone and Idea hold shares in Indus Towers, a joint venture of the major TSPs. The Commission considered the presence of the parties in terms of standalone towers and tenancies and observed that the same is not likely to result in any foreclosure concerns.

3.4. Provision of passive infrastructure services over fibre optic network (backhaul)

31. Backhaul provides the physical connectivity that TSPs require to connect radio base stations attached to towers to their core networks, and enables customers' voice and data traffic to be handled appropriately. There are various forms of backhaul (of which fibre is one) that are used based on capacity requirements. By entering into backhaul agreements, TSPs are able to secure dark fibre in shared networks, which is required to create capacity bandwidth. Holders of fibre backhaul capacity provide wholesale end-to-end access to their

networks, as well as managed services including fault monitoring and repair services, to TSPs, who operate their networks using this infrastructure.

32. The Commission observed that the Parties maintain their own fibre backhaul networks and are also active in the wholesale provision of fibre backhaul to other TSPs. The Commission considered the market share in terms of length of fibre network owned by the TSPs and non TSPs like Powergrid and RailTel. The Commission noted that the combined market share of the Parties is likely to be around 15 percent and the merged entity will continue to face competitive constraints from other TSPs. Considering the specificities of telecom industry and extent of operations of the Parties, the Commission observed that the Proposed Combination is not likely to result in an appreciable adverse effect in market for provision of passive infrastructure services through telecom towers India.

3.5. Spectrum Trading Transactions

33. Spectrum, a scarce resource, is an essential input for provision of telecom services. Accordingly, it is critical that their should be optimal utilisation of spectrum and in this regard the regulatory framework should allow spectrum pooling, sharing and/or trading. The spectrum trading is expected to lead to greater competition and also lead to spectral efficiencies which leads to improvement in quality of service.

34. As per the Spectrum Trading Guidelines, the telecom company is allowed to hold a maximum of 35 percent of spectrum allocated in a service area and 50 percent of spectrum allocated in a particular band (Spectrum Caps).

35. The Commission, in cases relating to trading of spectrum, has, apart from considering the Spectrum Caps, considered the overall current and prospective availability of spectrum to examine the impact on competition.

4. Conclusion

36. Though the Commission have limited experience in dealing with vertical mergers, however, on the basis of the cited cases from media, telecom and technology sector, it may be seen that the Commission assesses vertical mergers differently from horizontal mergers and applies 'ability / incentive / effects framework'. Moreover, the Commission, while imposing remedies in the case of vertical mergers, if required, factors in the efficiency gains from such mergers and also ensures that the consumers not lose out in case of such efficiency gains by the parties to the transaction.