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

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1. Overview: vertical merger assessment in Portugal

1. In Portugal, mergers are notified whenever certain turnover and/or market share thresholds are met\(^1\) and in this regard no differentiation is made between horizontal or vertical mergers.

2. For the purpose of assessing vertical mergers, the Portuguese Competition Authority (Autoridade da Concorrência, ‘AdC’) will typically refer to the European Commission’s non-horizontal merger guidelines.\(^2\)

3. In general, the AdC considers vertical mergers less likely to result in a significant lessening of competition than horizontal mergers. However, there is a variety of ways in which a vertical merger can raise competition concerns, such as input and/or customer foreclosure, higher barriers to entry and other non-horizontal effects such as access to confidential information. Additionally, coordinated effects might arise from vertical mergers.

4. The AdC usually follows an “ability/incentives/effects” analysis but the analytical framework is flexible and chosen on a case-by-case basis to accommodate all plausible theories of harm (e.g., coordinated effects).

5. Efficiency arguments are considered in the analysis but the burden of proof lies on the notifying parties and should follow the general and cumulative principles set out by the European Commission in its guidelines.

6. As a general rule, the AdC is open to accept remedies to address potential competitive concerns in vertical mergers. However, there is a strong preference towards structural remedies in detriment to behavioral remedies.\(^3\) The AdC tends to accept behavioral remedies only under a rather narrow scope of conditions, since this type of remedies does not act on the causes of the competitive concerns (i.e., market structure and/or contestability) and is limited to restraining the adverse effects resulting from the merger (i.e., it addresses the symptoms of the problems, not the causes).

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\(^1\) According to Article 37(1) of the Portuguese Competition Act, notification is required when: (i) a market share equal to or greater than 50% of the domestic market is acquired, created or reinforced (market share criterion); (ii) the undertakings involved have reached an aggregate turnover in Portugal greater than € 100 million and the turnover in Portugal of at least two of these undertakings is above € 5 million (turnover criterion); and (iii) a market share equal to or greater than 30% but smaller than 50% in the domestic market is acquired, created or reinforced, and individual turnover in Portugal, by at least two of the undertakings involved, is greater than € 5 million (mixed criterion).


7. In Portugal, vertical mergers represent 7 percent of the total number of mergers notified to the AdC since its creation in 2003. In the last five years, vertical mergers are around 12 percent. In the same period, the AdC has challenged 8 mergers, 3 of which were pure vertical mergers or mergers with vertical concerns, including two in the technology, media and telecom (TMT) sector.

8. The most relevant vertical merger cases in the TMT sector in Portugal were the SportTV merger in 2013-14 and the Altice/Media Capital merger in 2017-18. The first was prohibited by the AdC, whereas the second was abandoned by the parties. In the following sections, we will make a brief description of these landmark cases.

2. Input and Customer Foreclosure and Coordinated Effects: the SportTV merger

9. In January 2013, the Portugal Telecom Group (‘PT’) announced it would enter an already existing joint venture between ZON Optimus (‘ZON’) and Controlinvest. At the time, PT and ZON were the two main telecom operators in Portugal.

10. This merger was notified to the AdC and was blocked after an in-depth investigation in which the AdC concluded that it raised serious competitive concerns, due to vertical and coordinated effects. The notifying parties submitted a set of behavioral remedies that did not address adequately the competitive concerns identified by the AdC.

2.1. Background

11. The joint venture – SportTV – was the monopolist supplier of sports premium channels to pay-TV operators in Portugal and was 50/50 owned by ZON and Controlinvest. After the merger ZON and PT would each hold a 25 percent stake, sharing control over the joint venture with Controlinvest, which would retain its 50 percent stake.

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4 Between 2003 and 2018, 62 out of the 924 notified mergers had a vertical nature, including purely vertical mergers and those with horizontal and vertical nature.

5 Period between 2014 and 2018.


8 Currently owned by Altice.

9 Currently named NOS.

10 In July 2013, during the course of these proceedings, a new entrant, Benfica TV, also a premium sports channel provider, entered the market.
12. PT and ZON were the main and closest competitors in the pay-TV markets, both on a stand-alone basis and in multiple-play bundles. At the time of the assessment, ZON and PT represented 50 percent and 40 percent of pay-TV subscribers in Portugal, respectively.

2.2. Assessment

13. The merger raised serious competition concerns both in terms of input and customer foreclosure (vertical effects) and coordinated effects, all of which were deeply related. In fact, the AdC concluded that the vertical effects fed into the coordinated effects.

2.2.1. Customer foreclosure

14. Prior to the merger, non-vertically integrated pay-TV operators accounted for around 50 percent of the market. In the pre-merger scenario, even if ZON intended to implement a customer foreclosure strategy to block potential rivals to SportTV (where it had a 50 percent stake), its rival PT could alone credibly threaten this strategy’s success given its high market share.\(^\text{11}\)

15. After the merger, the non-vertically integrated operators would represent no more than 10 percent of the downstream market, significantly changing the pre-merger situation. In fact, PT’s incentives to promote and distribute a rival channel to SportTV would decrease.

16. Although ZON’s share of SportTV’s capital would decrease, the merger would also reinforce ZON’s ability and incentives for customer foreclosure, since that decrease would be more than offset by the gains of such a strategy related with the absence, post-merger, of customer diversion from ZON to PT (because in this case neither of the companies would distribute rival channels to SportTV).

17. It was thus concluded that SportTV’s shareholders would have strengthened ability and incentives to engage in customer foreclosure strategies due to the merger.

2.2.2. Input foreclosure

18. Although input foreclosure was already a concern in the pre-merger scenario,\(^\text{12}\) the AdC concluded that SportTV’s market position would be enhanced by the merger, resulting in increased ability, by its shareholders ZON and PT, to partially foreclose their pay-TV rivals’ access to sports premium channels.

\(^\text{11}\) In fact, the AdC concluded that pre-merger, ZON would not have incentives for such a strategy given its potential losses from customers switching from ZON to its rivals in the pay-TV markets (most of which would likely go to PT).

\(^\text{12}\) In June 2013 the AdC issued a decision fining SportTV for abusing its dominant position for engaging in price discrimination in the provision of premium sports channels to pay-TV operators from 2005 to April 2011. See PRC/2010/02 – SportTV Portugal decision available (in Portuguese) at http://www.concorrencia.pt/vPT/Praticas_Proibidas/Decisoes_da_AdC/Paginas/PRC201002.aspx and press release relating to appeal confirming the AdC’s decision available (in English) at http://www.concorrencia.pt/vEN/News_Events/Comunicados/Pages/PressRelease_201408.aspx?ls=t=1&Cat=2014.
2.2.3. **Coordinated Effects**

19. The AdC assessed whether the merger would entail a change in the markets’ characteristics in such a way it could enhance the likelihood of the three conditions for coordination being met: (i) ability to reach the terms of coordination; (ii) internal sustainability of the coordination; and (iii) external stability of the coordination.

20. It was concluded that the merger would strengthen several of the market characteristics that enhance the likelihood of coordination: it would deepen the structural links between ZON and PT (creating a privileged channel for information exchange between both companies) and harmonize their degree of vertical integration, their cost structures as well as their level of information on their pay-TV rivals.

21. In this particular case, the merger would also eliminate a long-standing dispute between ZON and PT, namely about the conditions of PT’s access to SportTV channels.\(^\text{13}\)

22. In a coordination mechanism led by ZON and PT, representing around 90 percent of the pay-TV market and with similar market shares, the remaining players, Cabovisão and Vodafone, would likely accommodate, as neither would have the ability nor the incentives to deviate from the coordination. In fact, both had an entangled set of commercial relationships with ZON and PT, namely for the supply of essential inputs, which would widen the scope for retaliation to deviations.

23. This would result in a softening of competition in the pay-TV market, with less aggressive business strategies and lower variety, as the incentives for differentiation of the sports channels portfolio would be reduced.

24. The merger’s vertical effects, discussed previously, would strengthen barriers to entry in both the premium sports channels and pay-TV markets, thus reinforcing the external sustainability of coordination.

2.2.4. **Remedies**

25. The notifying parties proposed a set of behavioral remedies that were considered insufficient to overcome the competitive concerns identified. They were indeterminate in their duration, poorly specified and would have created very significant monitoring and circumvention risks. For these reasons, the AdC prohibited this merger.

26. In order to address the risks of customer foreclosure, it was proposed: (i) a compulsory renewal of all current contracts for pay-TV premium sports channels; and (ii) a set of conditions to engage in new contracts with SportTV where pay-TV operators would have to submit detailed documentation on business-plan and financial feasibility of the project and there would be uniformity of commercial conditions among all pay-TV platforms. This would include extending to ZON and PT any favorable conditions offered to other pay-TV operators.

27. The AdC would be informed of all contracts and subsequent amendments as well as any other information regarding the remedy. Furthermore, it would also be informed of all disputes regarding contracts, renewals and amendments to conditions regarding access to SportTV channel and other premium sports content. The remedy would be in place until the parties’ joint market share in either the pay-TV or the premium sports channels markets fell below certain thresholds.

\(^{13}\) See previous footnote.
28. The AdC concluded, in general terms, that the proposed remedies did not address, \textit{inter alia}, the decrease of PT’s incentives to distribute or promote entry and/or expansion of premium sports channels that could compete with SportTV’s channels. Furthermore, the remedies had a significant risk of market distortion as they would promote standardization of all pay-TV premium sports channels’ grids, enhanced by the uniformity of commercial conditions amongst all pay-TV players.

29. In terms of duration, the remedies would be applicable for an indeterminate period of time, considering they were contingent on market shares thresholds that were not properly justified by the parties. Such indetermination, which reflected the long-lasting nature of the competitive concerns, would accrue very significant monitoring costs to the AdC and could have led to serious and increasing misspecification risks as time passed.

30. In order to address the risks of input foreclosure, SportTV channels would be accessible to all pay-TV platforms on “\textit{fair, reasonable and non-discriminatory terms}” and there would be no exclusivity. This obligation would be, however, contingent on a number of technical qualifications. The AdC would be informed on a series of contractual and dispute related information.

31. These remedies would be applicable as long as the parties’ joint market share in the premium sports channels market exceeded a certain threshold.

32. The assessment concluded that these remedies were poorly specified, which would ultimately lead to high levels of discretion in its application. Furthermore, the list of ‘technical qualifications’ was extensive and non-compliance with one of them would be enough to disqualify applicants.

33. The remedies also posed high risks of circumvention and ineffective monitoring. There would be a significant level of information asymmetry between the AdC and the parties and the assessment of such a large volume of complex information would entail a very high burden (thus increasing the likelihood of Type I and Type II errors).

34. In terms of duration, as in the previous set of remedies, these would be applicable for an indeterminate period of time resulting in the same type of issues mentioned above (see paragraph 29).

35. Finally, in order to address the risks of coordinated effects, the parties proposed a set of behavioral remedies to restrict access by PT- and ZON-designated members of the Board to Sport TV’s commercially sensitive information, as well as to ensure such information would not be shared between Sport TV and PT and/or ZON.

36. It was also proposed that a Monitoring Trustee should be appointed in order to participate in Sport TV’s board meetings and report back to the AdC.

37. Again, the duration of these remedies was indeterminate, raising, once again, the same type of issues identified above in paragraph 29.

3. Input foreclosure in the Media Sector: the Altice/ Media Capital merger

38. In August 2017, a wholly-owned subsidiary of Altice Europe N.V. (‘Altice’), a media and telecoms group, announced it would acquire total control of Grupo Media Capital, SGPS, S.A. (‘MC’), the main media and contents company operating in Portugal.
39. This merger was notified to the AdC and led to an in-depth investigation on the potential negative impact of the merger on competition in the telecom and media markets in Portugal. Altice submitted a set of behavioral remedies which did not adequately address the competitive concerns identified by the AdC. Although Altice decided to withdraw the notification, the AdC was able to conclude, in its competitive assessment, that the transaction would ultimately lead to serious impediments to effective competition in the telecom and media markets, with negative impacts on consumers.

3.1. Background

40. Altice (through the telecom and pay-TV operator MEO) is the former state-owned telecoms company active in all segments of electronic communications services, including the management of the Digital Terrestrial Television network. MEO supplies telecom services (voice, video, data, and internet) supported on both mobile and fixed networks and is active in the retail supply of pay-TV channels through its pay-TV platform and multiple-play services (i.e., bundled services for voice, TV and internet). In 2016, it had 39 percent of all pay-TV subscribers and represented 43 percent of multiple-play services revenues in Portugal.

41. The target, MC, controls, inter alia, the television studio and content producer Plural, Portuguese-speaking TV channels under the TVI brand (TVI, TVI24, TVI Ficção, and TVI Reality), as well as a number of media outlets (radio stations, an internet portal and an online content platform).

42. TVI channels represented, in 2016, one quarter of average daily share view of all TV channels distributed in Portugal. Moreover, TVI programs (mostly produced by Plural) are consistently in the TOP 10 most viewed programs (first 6 out of 10 most-viewed programs in 2016, excluding football matches). Advertising in TVI channels represented 40-50 percent of all TV advertising revenues in Portugal in 2016.

43. Altice and MC supply few services that directly compete with one another. Their main relationship is that MC provides TVI channels to Altice that are subsequently distributed to consumers. Therefore, this was primarily a vertical merger, between one of the main players in the telecoms sector, retail distribution of pay-TV services and multiple-play services, on the one hand, and the market leader for the wholesale distribution of audio-visual content and Portuguese-speaking TV channels, including the top-viewing channel (measured in terms of share of audience and advertising revenues), TVI, on the other.

3.2. Assessment

44. The transaction related to all the levels of the TV value chain and raised competitive concerns in several different vertically-related markets, the most relevant of which concerned the possibility of foreclosing MC’s TVI channels to Altice’s rivals in the provision of pay-TV services (input foreclosure).  

45. In this context, the AdC assessed the possibility that Altice would either prevent rival pay-TV operators from obtaining access to TVI channels or would increase the

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14 Besides input foreclosure concerning TV channels, the AdC assessed the possibility of input foreclosure relating to other products (e.g. advertising), customer foreclosure, as well as the impact resulting from the access to commercially sensitive information.
carriage fees for those channels in such a way that would result in significant impediments to competition in the provision of pay-TV services, whether or not integrated in multiple-play offers.

46. This type of anti-competitive effect has been previously identified, for example, by the FCC in the Comcast/NBCU merger and by the European Commission, in the Liberty Global/Corelio/W&W/De Vijver Media transactions.

3.2.1. Exclusion of Rivals (total input foreclosure)

47. First, the AdC assessed whether the transaction would increase MC’s ability and incentive to deny the provision of TVI channels to Altice’s retail competitors, causing them to become less effective competitors.

48. The AdC concluded that TVI’s main channel and/or TVI24 are important to Altice’s competitors and that there are no good substitutes from other sources that would allow Altice’s rivals to implement effective and timely counter-strategies. Furthermore, the AdC concluded that such a strategy would be profitable for the vertically integrated firm.

49. Foreclosing TVI channels to Altice’s rivals would entail (i) losing carriage fees from the foreclosed rival pay-TV operators; (ii) losing advertising revenues from reduced viewer reach of these channels; and (iii) losing customer interaction revenues, also from reduced viewer reach of these channels.

50. In the analysis, it was assumed that advertising and customer interaction revenues were directly proportional to the subscriber share of each pay-TV platform prior to foreclosure. Thus, input foreclosure strategy would result in a revenue loss corresponding to the pre-transaction advertising revenues of each rival platform reduced by the proportion of subscribers on these platforms that would switch to Altice or other non-foreclosed platforms in order to be able to continue watching TVI channels.

51. Moreover, it was assumed that a reduction in advertising and customer interaction revenues would result in an equal reduction in MC’s profits, given that costs would not change.

52. The gains from total input foreclosure would equate to the additional profits earned by Altice resulting from new subscribers that would switch to Altice’s platform in response to the loss of TVI’s channels in the foreclosed platforms.

53. In order to estimate subscriber switching rates, the AdC had to the determine both the fraction of customers that would decide to leave Altice’s rivals (the departure rate) and the fraction of these departing customers that would switch to Altice (diversion rate).

54. For the diversion rates, historical data collected by pay-TV operators was used. For the departure rate, the AdC conducted a consumer survey with 1,550 interviews where households were asked to qualify (on a scale of 0 to 10, where 10 is “I would switch for sure”) the probability of switching in case their current pay-TV service provider would not offer TVI main channel, TVI24 or both in its channels bouquet.

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15 Namely, the main and generalist channel TVI and TVI24, a 24h news channel.

16 Customer interaction revenues are generated from calls made by the viewers in the course of a particular show or TV contest. These revenues are significant for the main Portuguese channels such as TVI, SIC, and RTP.
55. The results of the consumer survey showed that a majority of Altice’s rivals’ subscribers would not switch from their current providers if TVI main channel, TVI24 or both were withdrawn from the channels bouquet. However, a significant number of respondents showed a very high willingness to switch (considering only level 10 of the survey scale): around 15 percent of respondents in the case of the withdrawal of TVI main channel, 7 percent for TVI24 news channel and 18 percent for both. From this survey, it was thus possible to estimate the actual number of subscribers switching to Altice as a result of a total foreclosure strategy.

56. In order to estimate the incremental profit of each subscriber switching to Altice, the AdC used data provided by the notifying party where the latter estimated incremental profits per type of service. The AdC assumed that subscribers switching to Altice would generate a margin equal to Altice’s average contribution margin per subscriber per service on the rival’s existing customer base.

57. The AdC then assessed the incentives for Altice to engage in a number of input foreclosure scenarios involving the permanent withholding of TVI channels from its rivals. It concluded that Altice would have the ability and incentive to: (i) foreclose TVI main channel to the largest of its rivals; (ii) foreclose TVI24 to each one of its rivals; (iii) foreclose both TVI and TVI24 to the largest of its rivals; and (iv) foreclose TVI main channel and/or TVI24 simultaneously to all of its rivals.

58. In these situations, estimated gains in profits in pay-TV provision more than compensated losses in revenues from advertising and customer interaction services and carriage fees.

3.2.2. Raising Rivals’ Costs (Partial Input Foreclosure)

59. Even though some total input foreclosure strategies would have been profitable, the AdC also assessed the possibility that the vertically integrated firm would be willing to supply TVI channels to Altice’s rivals although at significantly higher prices compared to the pre-transaction scenario, raising rivals’ costs and hampering their ability to compete in the provision of pay-TV services.

60. Given that distribution contracts for TVI channels are negotiated bilaterally between MC and pay-TV operators, the AdC assessed if the transaction would significantly strengthen MC’s bargaining position vis-à-vis Altice’s rivals.

61. In this situation, TVI channels would continue to be widely distributed across most or all rival pay-TV platforms, increasing, on the one hand, revenues from carriage fees and, on the other hand, holding audience levels constant and, consequently, revenues from advertising and customer interaction services.

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17 From 2-play to quintuple play bundles that included pay-TV.

18 For example, if a rival’s subscriber base is composed of 40 percent triple-play customers and 60 percent quadruple-play customers, then the AdC assumed that the average subscriber switching from that rival to Altice would contribute to Altice’s profits taking into account 40 percent of Altice’s incremental profit in triple-play services and 60 percent in quadruple-play services (incremental profit of a subscriber switching from the rival = (0.4 x Altice incremental profit in triple-play services) + (0.6 x Altice incremental profit in quadruple play)).
62. For this assessment, the AdC used a Nash bargaining framework, such as the one used by the European Commission in its assessment of the Liberty Global/Corelio/W&V/De Vijver Media transaction\(^{19}\) and by the FCC in its investigation of the Comcast/NBCU merger\(^{20}\).

63. The AdC concluded that this transaction would substantially increase MC’s bargaining position in negotiations with Altice’s rivals over carriage fees for TVI channels in comparison to the pre-merger situation. This was true for all scenarios taken into consideration (partial foreclosure of TVI main channel, TVI24 or both to each of Altice’s rivals), regardless of whether or not total foreclosure was a profitable strategy.

64. In fact, the bargaining model showed that post-merger, MC and Altice’s rivals would always have an incentive to reach an agreement (i.e., total surplus from reaching an agreement was strictly positive in all situations). The vertically integrated firm would be able to obtain an increase in carriage fees at least as high as the increase in profits from total foreclosure. As for Altice’s rivals, their losses from higher carriage fees would be lower than the ones resulting from lost subscriber revenues.

65. Even when total foreclosure was not a profitable strategy, MC would still be able to extract significantly higher carriage fees because failure to reach an agreement with Altice’s rivals post-transaction would harm MC less than absent the transaction, as post-transaction MC would internalize Altice’s profits.

66. The Nash equilibria post-transaction predicted several-fold increases in carriage fees that amounted to substantial increases in total content acquisition costs for Altice’s rivals.

67. The AdC, therefore, concluded not only that post-transaction the new entity would have an improved bargaining position in negotiations of carriage fees with Altice’s rivals, but also that partial foreclosure would be the most likely result from this transaction, given that it would result in higher profits for the vertically integrated firm.

3.2.3. **Effects**

68. The AdC concluded that the merged firm would have the ability and incentive to implement total and partial foreclosure strategies attaching a higher probability to a partial foreclosure outcome.

69. Higher carriage fees for TVI channels would result in significant overall increases in content acquisition costs to Altice’s rivals, which would have to increase subscriber fees. Furthermore, Altice’s rivals’ ability to acquire competitive content would also be negatively affected.

\(^{19}\) See case M.7194 - Liberty Global / Corelio / W&W / De Vijver Media (decision available at [http://ec.europa.eu/competition/mergers/cases/decisions/m7194_20150224_20600_4264271_EN.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m7194_20150224_20600_4264271_EN.pdf)).

70. In both cases, Altice’s rivals would become less effective competitors, thus increasing the ability of the merged entity to increase prices to final consumers and/or decreasing pressure for high-quality content acquisition and production.

71. Furthermore, the AdC concluded that the transaction would raise barriers to entry, with particular emphasis to potential alternative low-cost online providers, as these providers either would not have access to TVI channels or would have access at less favorable terms than absent the merger.

3.2.4. Remedies

72. The notifying party proposed to adopt a set of remedies. However, since Altice decided to withdraw its notification during the course of the in-depth investigation, the AdC did not adopt a decision including a detailed assessment of the merger and, for this reason, it is not possible to discuss the remedies in further detail.

73. Nonetheless, it can be said that these were purely behavioral remedies (including, but not limited to, must-carry and must-deliver obligations). The AdC considered that, in general, they did not adequately and structurally address the competitive concerns identified in the assessment.

4. Conclusions

74. The AdC’s experience with vertical mergers indicates that, while these mergers may be less prone to lead to anticompetitive effects than purely horizontal mergers, they can give rise to a variety of competition concerns.

75. In the vertical merger cases in the TMT sector described above, the AdC analyzed a number of theories of harm using not only qualitative but also quantitative methods to assess the merger impact.

76. In the SportTV merger, the AdC concluded that the merger would likely lead to anticompetitive effects resulting from customer and input foreclosure, and that the vertical effects fed in and reinforced the likelihood of anticompetitive coordinated effects.

77. In the Altice / Media Capital deal, the AdC concluded that partial input foreclosure, through higher carriage fees, would be the most likely result of the transaction. This would have caused a significant increase in content acquisition costs, hampering Altice’s rivals’ ability to be effective competitors in the provision of pay-TV services, ultimately leading to higher consumer prices and/or decreased service quality. These results would most likely be sufficient, on their own, to justify a prohibition decision by the AdC.

78. In both cases, only behavioral remedies were proposed by the parties. The AdC found that they did not adequately address the multiple competitive concerns raised in both cases. The proposed remedies raised very significant risks of specification, circumvention and monitoring. Even without such risks, these remedies would have no impact on the root causes of the competitive concerns (e.g., market structure and/or contestability).
References

