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

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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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1. This report outlines general merger regulations concerning vertical relations in Chinese Taipei, and also clarifies specific considerations and approaches to assess vertical mergers in the technology, media and telecom sectors.

1. Provisions relating to Vertical Mergers under the Fair Trade Act

1. In respect of merger control, a pre-merger notification regime featuring the ex-ante regulation of market structure has been established under the Fair Trade Act (hereinafter referred to as the "FTA"). It aims to prevent excessive market concentration arising from a notifiable merger, and eliminate potential anti-competitive conduct that may restrict or lessen competition and negatively affect consumer interest.

2. Article 13 of the FTA states that:

> *"The competent authority may not prohibit any of mergers filed if the overall economic benefit of the merger outweighs the disadvantages resulted from competition restraint.*
>
> *The competent authority may impose conditions or undertakings in any of the decisions it makes on the filing cases referred to in Article 11, Paragraph 8 herein in order to ensure that the overall economic benefit of the merger outweighs the disadvantages resulted from competition restraint."*

2. Article 13 specifies two criteria - "*overall economic benefit" and "disadvantages resulting from competition restraint*" for the Fair Trade Commission (hereinafter referred to as the "FTC") to assess mergers. Then the FTC has authority to make a decision to clear the merger unconditionally or conditionally, or prohibit it, depending on it assessment.

3. To increase transparency of merger review standards, the FTC enacted "Guidelines on Handling Merger Filings" (hereinafter referred to as the "Merger Guidelines"), which intended to assist the business community in legal compliance. With the exception of mergers applying the simplified procedure, the FTC suggests a non-exhaustive list of factors that can be considered in the general procedure of merger review when assessing the overall economic benefits and the effect of restricting competition, which may arise out of horizontal, vertical and conglomerate mergers.

4. Specifically, in a case where the FTC finds no significant competition concerns posed by a notified merger after reviewing factors set out in the Merger Guidelines, it may be assumed that the overall economic benefits from the merger are greater than the disadvantages resulting from the competition restraint. Nevertheless, the FTC is required to further evaluate whether the benefits are greater than the disadvantages resulting from the competition restrictions when a likely effect of substantially lessening of competition is identified. For example, market share thresholds may be used as indicators to trigger

further assessment. The FTC may also consult industry-specific regulatory agencies[1] when assessing the overall economic benefits and disadvantages from the resulting competition restraint.

5. According to Points 6 and 7 of the Merger Guidelines, a simplified procedure can be applied to a vertical merger with less than twenty-five percent of the aggregate market share of each party to the vertical merger. Unless stated otherwise in the Merger Guidelines, in simple merger cases it will be presumed that the overall economic benefits of the merger outweigh the disadvantages resulting from the competition restraint. In terms of horizontal mergers, a simplified procedure is applicable if the combined market share of merging parties does not exceed twenty percent. In this regard, the FTC's merger policy seems to be more lenient towards vertical mergers.

6. Point 11 of the Merger Guidelines sets out the following factors to assess whether a vertical merger will give rise to competition concerns:[2]

- The probability of other competitors selecting their trading counterparts after the merger.
- The degree of difficulty for an enterprise not participating in the merger to enter the market.
- The possibility of merging parties abusing its market power in the relevant market.
- The possibility of raising rivals' costs.
- The possibility of any concerted action facilitated by the merger.
- Other factors that may result in market foreclosure.

7. In short, the FTC assesses whether the following anti-competitive effects may occur when conducting an economic analysis of a vertical merger:

- Increasing rivals' costs.
- Creating or lifting entry barriers.
- Facilitating stabilization of any concerted action.
- Assisting merging parties to circumvent price regulation, which applied prior to the proposed merger.

8. The FTC also assesses the overall economic benefits from a vertical merger by focusing on its pro-competitive effect, including saving transaction costs, improving asset

[1] For example, the National Communications Commission (NCC) is a regulatory agency for cable television. To align with global development of digital convergence and trends in regulatory reform as well as combine regulation of telecommunications and broadcasting, ″the Fundamental Communication Act″ and "the National Communications Commission Organization Act" respectively came into effect following decrees of the President on January 7, 2004 and November 9, 2005. Then the NCC was formally established on February 22, 2006.

[2] Point 13 of the Merger Guidelines provides more details on economic benefit considerations and economic efficiency, which are available at https://www.ftc.gov.tw/internet/english/doc/docDetail.aspx?uid=656&docid=2719.

specific investments, avoiding free riding, successive monopoly or double marginalization[3].

9. The FTC also publishes guidance to elaborate on a number of industry-specific economic benefits when reviewing merger cases in the cable TV industry, telecommunications sector and those mergers associated with digital convergence of such sectors.

10. When reviewing a vertical merger that is likely to substantially lessen competition in the cable TV industry, the FTC will further consider whether the merger may: (1) increase sophistication of cable TV digitization; (2) improve the diversify of TV programs; (3) facilitate competition among service providers across multiple platforms; (4) promote development of digital convergence and competition; (5) provide consumers with more options.

11. When considering the overall economic benefits of a proposed vertical merger in the telecommunications sector, the FTC will particularly evaluate whether the merger may: (1) increase productive efficiency, allocative efficiency, and dynamic efficiency; (2) facilitate competition in the relevant market; (3) support the provision of more comprehensive, more diverse and good quality services, and (4) improve international competitiveness.

12. When assessing the overall economic benefits of a vertical merger in connection with digital convergence, the FTC will consider whether the merger may: (1) promote competition in the relevant market; (2) support the provision of more comprehensive, more diverse and good quality services; (3) improve international competitiveness and drive research and development and innovation; (4) give rise to consumption network externalities; (5) intend to pass internal benefits gained from the merger to external stakeholders, and (6) contribute to digitalization of content, diversification of application, and deliver innovative digital convergence services.

13. Between 2011 and 2018, the FTC received and reviewed thirty-three vertical mergers, of which twenty-eight cases were cleared unconditionally and five cases were cleared conditionally. On average, four vertical mergers were reviewed by the FTC every year, which accounted for fourteen point three percent of notified mergers in the corresponding year. In the past eight years, the FTC did not object to any of these vertical mergers. The FTC has observed that in recent years most vertical mergers occurred in the technology, media, telecommunications, financial and insurance services, integrated circuit and IT hardware sectors. The following two examples provide more details on the FTC's analytical process for considering vertical mergers in the technology and cable TV sectors.

2. Cases Examples

2.1. Vertical Merger in the Technology Sector

14. The FTC was notified of a proposed acquisition by Microsoft Corporation (hereinafter referred to as "Microsoft") and Nokia Corporation (hereinafter referred to as

[3] Fair Trade Commission, *Manual of Economic Analysis Involving Application of Competition Law* (March 2016). This manual is only available for internal use.

"Nokia") in 2013[4], where Microsoft planned to acquire the majority of Nokia's Devices and Services (D&S) business and its assets as well as most design patents. In addition, Nokia planned to grant Microsoft a non-exclusive patent license for ten years and an option to extend this licensing agreement in perpetuity. Microsoft also planned to grant Nokia reciprocal rights to use Microsoft's patents in its HERE services (digital map and positioning services).

15. The respective businesses of the two companies involved in the proposed merger included: (i) Microsoft's development and licensing of its mobile operating system for Windows Phones, and (ii) Nokia's mobile phone business. While both parties also developed tablets, this acquisition was treated as a vertical merger case by the FTC due to the fact that Nokia's tablets had not been sold in Chinese Taipei until 2013.

16. For a thorough assessment, the FTC organized discussions with and sought opinions from relevant stakeholders, including the Industrial Development Bureau (Ministry of Economic Affairs), research institutions and industry associations as well as market participants. On the basis of industrial data, stakeholder's opinions and the merging parties' submissions, the FTC weighed the "overall economic benefit" and "disadvantages resulting from competition restraint" in accordance with the Merger Guidelines, and made a conditional decision to clear the proposed acquisition[5]. The FTC concluded that:

1. Input foreclosure: Microsoft was not able to foreclose the input market by refusing to license its mobile operating system for Windows Phones, raising royalties, or granting differential licenses to other downstream mobile device developers. Furthermore, the proposed acquisition of D&S division aimed to develop a third ecosystem in phones in addition to Apple iOS and Google Android. Microsoft had no incentive to implement a vertical foreclosure strategy by refusing to license its mobile operating system for Windows Phones or raising royalties, as that would be contrary to its goal of expanding its mobile operating system.
2. Raising rivals' costs: By acquiring Nokia's D&S division, Microsoft would own its device manufacturing division. To some extent, it provided Microsoft incentives to raise royalties for the "Android Licensing Program" in order to encourage mobile device manufacturers to use more Window Phones instead. By doing so, this proposed acquisition might also increase royalty expenses paid by Android device manufacturers with the aim of raising downstream rivals' costs.
3. Leveraging market power: Microsoft alleged that since 2008 it has provided public access to the Exchange ActiveSync（EAS）protocol documentation and licensed EAS to all Apple devices and around eighty percent of Android devices. As a result of the nature of long-term licensing agreements, Microsoft was not able to increase royalties unilaterally. Microsoft also signed a standalone licensing agreement with individual mobile device manufacturers. In other words, a mobile device manufacturer could choose at its discretion to negotiate with Microsoft independently or join the "Android Licensing Program" for Android device manufacturers. Other than EAS, there are other communication protocols, such as

[4] This case is a foreign-to-foreign transaction, which the FTC's Guidelines on Extraterritorial Mergers can be applied. The Guidelines are available at https://www.ftc.gov.tw/internet/english/doc/docDetail.aspx?uid=744&docid=2720.

[5] The full text of the merger decision (Gong Jie Tzu No. 103001, published by the FTC on February 19, 2014) is available at https://www.ftc.gov.tw/uploadDecision/771dabc1-ec6b-4d37-acf7-cf94f057427b.pdf.

POP3 and IMAP, which support communication between smart mobile devices and an enterprise mail server. Accordingly the proposed acquisition did not enable Microsoft to impose restrictions on EAS licensing.

4. Lifting entry barriers: After selling its D&S division to Microsoft, Nokia would not produce mobile devices, but would still hold most standard-essential patents (SEPs) relevant for mobile devices. Some stakeholders expressed their concerns about possible royalties increases due to post-transaction changes in market equilibrium. In particular, Nokia's ability to set royalty rates would not necessarily be constrained by counterclaims for patent infringement and cross licensing after the proposed transaction. The FTC found that Nokia had an incentive to increase royalties of its SEPs used by mobile devices manufacturers. With increased productions costs, prices of mobile devices were likely to rise, which was considered as a merger-specific disadvantage resulting from competition restraint.

17. To mitigate the competition concerns and ensure that overall economic benefits outweighed disadvantages resulting from competition restraint, the FTC cleared this proposed acquisition with the following conditions: (1) Microsoft should not engage in unfair royalty rate setting or discriminatory practices associated with patent licensing in smart mobile devices that interfere with the freedom for smart device manufactures to choose mobile operating systems.（2）Nokia should license its SEPs under fair, reasonable and non-discriminatory (FRAND) terms on a continuous basis, and ensure that any assignee to whom Nokia transfers its SEPs, also complies with the FRAND requirement. With these two conditions, the FTC concluded that the proposed acquisition did not cause significant changes in the structures of relevant markets (mobile operating systems, smart mobile devices and relevant patent licensing) and did not substantially lessen competition in these markets.

2.2. Vertical Merger in the Cable TV industry

18. Taiwan Optical Platform Co. Ltd. (hereinafter referred to as "TOP"), a domestic multiple system operator (hereinafter referred to as "MSO") notified the FTC that it intended to indirectly acquire sixty-five percent of shares of Eastern Broadcasting Co., Ltd. (hereinafter referred to as "EBC") through its Subsidiary A. Prior to the proposed acquisition, TOP held shares of four cable television system operators while Subsidiary A and EBC provided satellite broadcasting programs through five and eight channels respectively. In the cable TV market, a cable television system operator was required to be licensed from upstream suppliers with satellite broadcasting programs in order to deliver its television programming to viewers. Given that TOP negotiated channel licensing on behalf of the four cable television system operators, and Subsidiary A and EBC were satellite broadcasting program providers, the FTC noted that a horizontal overlap between the activities of Subsidiary A and EBC, and a vertical link between four cable television system operators and EBC were involved in the proposed acquisition.

19. In addition to online public consultation, the FTC made written requests to seek opinions from the National Communications Commission (hereinafter referred to as the "NCC"), the Consumer Protection Committee, industry associations and other stakeholders. After taking into consideration industry related information, public feedback and stakeholders' views, the FTC further assessed anti-competitive effects and overall economic benefits arising from the proposed acquisition in accordance with the Merger Guidelines and Disposal Directions on Cable Television Related Enterprises. On the

vertical aspects of the proposed acquisition, the FTC found certain remediable competition concerns and cleared the transaction with conditions[6]. The FTC concluded that:

1. In spite of the proposed acquisition, remaining satellite broadcasting program providers offered a wide choice of trading counterparts to system operators and MSOs.
2. The proposed acquisition did not make any change to regulatory barriers or investment restrictions on cable radio and television services and the provision of satellite broadcasting programs.
3. The structures of the relevant markets (respectively associated with cable radio and television system operators, multiple system operators, and satellite broadcasting program providers) remained the same. The merging parties faced sufficient post-transaction competition, and thus the probability of abusing market power would not increase with the proposed acquisition.
4. Cable television service and its rates were regulated by the NCC and local governments. The proposed acquisition did not increase the transparency of rates, and thus it would be likely to increase the probability of concerted actions.
5. However, EBC owned the top thirty channels and two of them were the most frequently viewed news channels. In this regard, TOP might have incentives to engage in discriminatory practices when licensing EBC's channels to its own cable television system operators and their competitors. In doing so, the cost of downstream competitors to be licensed for those channels would increase.

20. The FTC found that the proposed acquisition could raise more funds for the merging parties to accelerate the process of improving channel content and image quality as well as development of digital convergence, but only gave rise to a minor impact on cable TV digitalization. Another overall economic benefit proposed by the merging parties was to promote competition with other platform operators. As a cable television system operator owned by TOP had changed the position of a channel without the NCC's approval, and subsequently removed it from the MOD platform, the FTC held more conservative views on this benefit.

21. To mitigate competition concerns and ensure that overall economic benefits outweighed disadvantages resulting from competition restraint, the FTC cleared this proposed acquisition with the following conditions: (1) In principle, merging parties and the companies controlled by them or their affiliates should make the two news channels of EBC available on multimedia content distribution platforms or other platforms for public broadcasting and/or transmission within six months after the merger was effective. (2) The notifying party should submit information as requested to the FTC annually (on June 1) for five years, starting in the year of the proposed acquisition. This information included licensing conditions of channels for original TV programs and programs licensed by copyright holders, regulations on selling channels, and the names and quantities of channels purchased by cable television system operators.

[6] The full text of the merger decision (Gong Jie Tzu No. 106001, published by the FTC on March 7, 2017) is available at https://www.ftc.gov.tw/uploadDecision/f6739a33-ecca-4720-8aec-70314821641a.pdf.

3. Conclusion

22. Merger control under the FTA is of an ex-ante nature. It aims at screening mergers, which may lead to excessive concentration of economic power, or may raise competition concerns. As mentioned above, relatively few vertical cases have been assessed by the FTC under the general procedure of merger review. Most were assessed using qualitative methods rather than quantitative analysis.

1. The substantive criterion used for merger review is whether the overall economic benefit of the merger outweighs the disadvantages resulting from competition restraint. The Merger Guidelines set out general considerations for horizontal, vertical and conglomerate mergers. The FTC also publishes guidance on the cable TV, telecommunications and digital convergence with more details on industry-specific economic benefits.
2. In a case where the aggregate market share of each merging party is less than twenty-five percent, the FTC may review it subject to a simplified procedure. In general, such cases are less likely to be challenged by the FTC. The FTC will conduct further assessment on anti-competitive effects once the aggregate market share reaches twenty-five percent. Regarding horizontal mergers, a simplified procedure is applicable if the combined market share of merging parties does not exceed twenty percent. The FTC appears to be more permissive in vertical mergers.
3. Between 2011 and 2018, the FTC received and reviewed thirty-three vertical mergers. An average of four vertical mergers were reviewed by the FTC every year, representing fourteen point three percent of all notified mergers in the corresponding year. The FTC noted that in recent years most vertical mergers occurred in the technology, media, telecommunications, financial and insurance services, integrated circuit and IT hardware sectors.
4. The FTC provided two vertical merger cases as examples to illustrate its analysis on vertical mergers. In the case of Microsoft's acquisition of Nokia, the FTC considered specific features of the mobile operating systems, and made a conditional decision to mitigate relevant competition concerns (raising rivals' costs and lifting entry barriers) to ensure that overall economic benefits outweighed disadvantages resulting from competition restraint post merger. In the case of TOP's acquisition of EBC in the cable TV industry, it was cleared by the FTC on a conditional basis, which intended to relieve competition concerns in the market where satellite broadcasting program providers competed with each other, and in the market where cable radio and television system operators competed for subscribers. In addition, the conditions imposed on the merger parties also prevented TOP from imposing discriminatory conditions on downstream players when licensing EBC's channels.