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

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This document reproduces a written contribution from Brazil 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

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Brazil

1. Vertical Merger in the Technology, Media and Telecom Sector in Brazil

1. According to the Brazilian Law No. 12.529/2011, article 88, §5º, the mergers that result in the elimination of competition in a substantial part of a given relevant market; the ones that might create or reinforce dominant position; or the ones that might result in the dominance of a relevant market shall be prohibited. The law does not specify what type of merger may lead to these results, and therefore CADE has reviewed all types of mergers, including vertical ones.

2. CADE has only issued horizontal merger guidelines[1] so far. However, it has reviewed many cases involving vertical integration in the past years. CADE typically uses the framework of assessing the ability and incentive to foreclose. In some occasions, it has also analyzed possible coordinated effects from vertical mergers.

3. Out of 2,335 mergers reviewed since 2015, Cade intervened in 33. Of the total number of mergers reviewed, 95 contained aspects of vertical integration. in which 11 were cleared with commitments by the parties, 1 cleared with remedies and 1 blocked.

4. CADE has reviewed a few cases in the sectors of Technology, Media and Telecom over the past few years. The most important were Disney/Fox[2], Telefônica/GVT[3] and AT&T/Time Warner[4]. All three were cleared with commitments submitted by the parties. The first case was mostly horizontal. The second had a few vertical issues regarding the parties' networks and telecom services, but the main competition issues were horizontal. Finally, AT&T/Time Warner was mostly a vertical merger in Brazil, raising several issues of unilateral and coordinated effects.

2. AT&T/Time Warner

5. The proposed merger between AT&T and Time Warner was submitted to CADE in March of 2017. CADE cleared the merger subject to behavioral remedies submitted by the Parties, since de merger raised concerns regarding the vertical integration of a programmer and a pay TV operator that could lead to foreclosure and coordinated effects. Besides higher prices for pay TV consumers, CADE was also concerned about non-price effects, such as a decrease in diversity and plurality of pay TV content.

6. AT&T is a large American telecommunication company that owns Sky, a pay TV operator that offers TV content through satellite dishes in Brazil. Time Warner is also an

[1] Cade. "*Guia de Análise de Atos de Concentração Horizontal*", 2016. Available in Portuguese at: http://www.cade.gov.br/acesso-a-informacao/publicacoes-institucionais/guias_do_Cade/guia-para-analise-de-atos-de-concentracao-horizontal.pdf.

[2] Merger case No. 08700.004494/2018-53, approved by Cade subject to remedies on February 27th, 2019.

[3] Merger case No. 08700.009732/2014-93, approved by Cade subject to remedies on April 6th, 2015.

[4] Merger case No. 08700.001390/2017-14, approved by Cade subject to remedies on October 18th, 2017.

American company operating mainly in the media sector through content production and programming. In Brazil, Time Warner offers a variety of channels for pay TV operators. The merger would therefore result in a vertical integration, since Sky uses the channels offered by Time Warner as inputs.

7. The pay TV market in Brazil is fairly concentrated. Net (owned by the Claro Group) has approximately 50% of market share and Sky has almost 30%. Two other operators have each one between 5% and 10%.The rest of the market is composed by very small local operators that do not have more than 1% of market share each.

8. For the programming market, CADE considered two scenarios. In the first, all the channels compete for audience and, therefore, are on the same relevant market. Depending on the data used, Time Warner has between 20% and 30% of market share and is the second largest programmer in Brazil. The first group is Globo, a Brazilian company, with a market share of 30% to 40%. The second scenario divided the market into different types of channels or genres, such as sports, news, children's, varieties and movies. Time Warner has important channels in most of the relevant markets and its market shares varied from less than 10% in the varieties genre to more than 50% in the international news genre.

9. After the investigation, CADE concluded that the resulting company would have both the capacity and the incentive to foreclose both the upstream and the downstream markets. The authority found that Time Warner's channels were essential for the operators. Time Warner offered important channels, with great audience, such as TNT, CNN, HBO, Cartoon Network and Esporte Interativo[5] (a Brazilian sports channel). All operators in Brazil distribute Time Warner's channels and all of them stated that the channels were crucial to maintain the pay TV operation. Likewise, all programmers consulted confirmed that distribution by Sky was very important to maintain a channel in Brazil. The General Superintendence concluded that the merged company could adopt a series of conducts that could weaken competition in both markets and even completely foreclose the pay TV market for small and new programmers. This would not only affect prices but would also diminish the diversity, plurality and possibly the quality of the content watched by consumers.

10. CADE was also concerned about the coordinated effects of the merger. Globo – the largest programming company in Brazil – has minority interest shares in both Net – the largest pay TV operator – and in Sky, which is owned by AT&T. Although Globo was not allowed to decide in matters of content in Sky, it had the right to veto content acquisition in Net, which allowed the companies to operate in a vertical integrated way. Thus, CADE concluded that the vertical integration could increase the probability of collusion, since it would allow the flow of information among the largest groups in both markets and increase the symmetry of the two largest groups in the industry.

11. Therefore, the merger was cleared subject to behavioral remedies that were proposed by the parties. The remedies included mechanisms to avoid discrimination by the parties, a system of arbitration and the imposition of a "Chinese Wall" between the companies to avoid the sharing of sensitive information.

12. There are also two other government bodies currently analyzing this merger: ANATEL – the telecom regulatory agency – and ANCINE – responsible for the regulation of cinema and TV content. Law no. 12,485/2011, which establishes the regulation for pay

[5] Turner discontinued this channel for pay TV operators on August of 2018. However, it kept some of its content in its streaming service.

TV operation and over which both agencies have jurisdiction, prohibits vertical integration between programmers and pay TV operators. Thus, these agencies are reviewing the merger under this law. At the time of this report, none of these agencies had issued a decision about this merger.

3. Challenges on the Review of a vertical integration on Media and Telecom sectors

13. The experience with the AT&T/Time Warner merger, and to some extent with other mergers in the Telecom sectors, poses important challenges for the antitrust authorities that are not usually observed in more traditional industries.

14. One important challenge is the speed with which the market changes. For example, CADE has had to consider in a number of cases if streaming services are a good substitute for pay TV services. The streaming service companies not only have had an important influence in the production sector, but also have adopted a model of verticalization, in which the same company produces and distributes content. Although CADE has considered that streaming services and pay TV are not part of the same market, it has acknowledge that its position has to be constantly reviewed, due to the rapid changes in these sectors.

15. Other important challenge on this sector is the relevant non-price effects that have to be considered in these mergers. The recent wave of verticalization means that the same company will produce, organize and distribute content to end consumers. This can affect both the diversity and quality of content that is available to the consumer. These non-price effects are not always ease to assess and their impact to consumers, although important, are also hard to measure.

16. Regarding specifically vertical integration in the media, IT and telecom sectors, the efficiencies usually observed in traditional industries may not be so straightforward in these rapid changing markets. The nature of the products and services are very peculiar (for example, often goods that are non-rival and have very low marginal costs) and the markets change very rapidly. This may in turn affect the quantity and specificity of efficiencies possibly generated by vertical mergers.

17. Finally, the intensity with which these sectors innovate make even the near future difficult to predict. Therefore, the authority has to be extra careful in its analysis of these industries.