VERTICAL MEDIA MERGERS: AN ANATOMY OF TWO CASES IN PORTUGAL

BY ANA SOFIA RODRIGUES[1]

1 Ana Sofia Rodrigues is the Chief Economist and the Director of the Studies and Market Monitoring Bureau of the Portuguese Competition Authority. The views expressed in this article are of the sole responsibility of the author and do necessarily represent those of the Portuguese Competition Authority.

CPI ANTITRUST CHRONICLE OCTOBER 2019

Compulsory Licensing: An Underrated Antitrust Remedy
By Richard Gilbert

Restoring Antitrust, Restoring Competition
By John E. Kwoka

Antitrust and Tech: Europe and the United States Differ, and it Matters
By Gregory J. Werden & Luke M. Froeb

Vertical Media Mergers: An Anatomy of Two Cases in Portugal
By Ana Sofia Rodrigues

Business Models, Incentives, and Theories of Harm
By Cristina Caffarra

CADE and the Challenges of the Digital Economy
By Patricia Alessandra Morita Sakowski & Christine Park

Identifying Empirically the Extent of Economic Analysis and the Legal Standards Applied in Antitrust Enforcement: A Methodology
By Yannis Katsoulacos

Why Common Shareholdings Should Not be Considered in Merger Analysis
By A. Neil Campbell

“Multi-Homing by all Means”: Russian Competition Policy Towards Digital Platforms
By Svetlana Avdasheva

The Evolution of Competition Law in Digital Markets in India
By Augustine Peter & Neha Singh

I. INTRODUCTION

Vertical mergers have taken the spotlight in recent years. Vertical mergers may entail efficiencies, such as the elimination of double marginalization. However, economic theory has extensively shown that these deals may also raise competition concerns and bring about price increases or deterioration of quality through foreclosure and/or coordinated effects.

This renewed interest of the competition community in vertical mergers has been prompted by certain vertical deals in recent years. Interestingly, some of these deals were in the media sector.

In 2018, the stakes rose in the U.S. with the AT&T/Time Warner deal, the first litigated vertical merger in over four decades. The DOJ challenged the merger on the basis of a raising rivals' costs theory of harm.[2] However, the concerns raised by the DOJ were dismissed by the District Court,[3] with Judge Leon's notorious ruling.[4] The judgment was affirmed by the Appeals Court in February 2019, on the basis that "*the government's objections that the district court misunderstood and misapplied economic principles and clearly erred in rejecting the quantitative model are unpersuasive.*"[5]

In the midst of this surge of interest in vertical mergers, some have flagged this as a traditionally neglected area of merger control, in particular in the U.S., blaming the excessive influence of Chicago School presumptions. Others have called for a strengthened role for empirical analysis in vertical merger decisions.

More recently, just last September, at the Fordham Competition Law Institute conference, U.S. FTC Chairman Simons stated that "*anticompetitive vertical mergers are not unicorns, and there should not be a presumption that all vertical mergers are benign.*"[6] The need for reinvigorated vertical merger enforcement and the review of decades old U.S. vertical merger guidelines have been called for by some prominent economists, most notably by Steven Salop.[7] Yet it is still to be seen whether the U.S. vertical merger guidelines will indeed be revisited.

2 See the Note prepared for the OECD Competition Roundtable on vertical mergers in the technology, media and telecom sector by Carl Shapiro, who testified in Court on behalf of the DOJ in the AT&T Time Warner merger, available at https://one.oecd.org/document/DAF/COMP/WD(2019)75/en/pdf.

3 *United States v. AT&T, Inc.*, 310 F. Supp. 3d 161 (D.D.C. 2018).

4 See the Note by the U.S. to the OECD Competition Roundtable on vertical mergers in the technology, media and telecom sector, available at https://one.oecd.org/document/DAF/COMP/WD(2019)59/en/pdf.

5 *United States v. AT&T, Inc.*, 916 F.3d 1029 (D.C. Cir.2019).

6 See "FTC Announces Recommendations for SAFE WEB Act Renewal", National Law Review, September 15, 2019, available at https://www.natlawreview.com/article/ftc-announces-recommendations-safe-web-act-renewal.

7 See Salop, S. & Culley, D. (2016), "Revising the U.S. Vertical Merger Guidelines: Policy Issues and an Interim Guide for Practitioners", Journal of Antitrust Enforcement, Vol. 4(1) and Salop, S. (2018), "Invigorating Vertical Merger Enforcement", The Yale Law Journal, Vol. 127(7).

I would highlight two key aspects that trigger skepticism in both judicial decisions regarding the case brought by the DOJ against the AT&T/Time Warner deal. One is the use of a bargaining model as a framework to assess the outcomes of negotiations between content producers and pay-tv providers. The other is, the role of, as both judgements put it, "*real world data*" in the analysis.

This article explores these two aspects, as well as the potential of vertical media mergers to generate coordinated effects, in light of two cases analyzed by the Portuguese Competition Authority (the Autoridade da Concorrência, "AdC").

In Portugal, there have been two high profile media merger attempts: the *Altice/Media Capital* deal, announced in 2017, and the *Sport TV* merger, in 2013. In both cases, the mergers failed to obtain a green light from the AdC. The *Altice/Media Capital* merger was withdrawn by the merging parties in June 2018, following the statement of objections issued by the AdC. The *Sport TV* merger was blocked by the AdC in July 2014.

In the *Altice/Media Capital* merger, the main concern was input foreclosure. In the *Sport TV* case, the main theories of harm were customer foreclosure and coordinated effects. The two cases are thus wide-ranging in terms of the competition concerns that may emerge in vertical (media) mergers. They furthermore provide interesting grounds for a discussion on the role of empirical data used to assess vertical (media) mergers.

In Section 2, I briefly describe the competition concerns identified in the *Altice/Media Capital* merger, highlighting the role of empirical data in assessing potential harm. In Section 3, I describe the *Sport TV* merger and the analysis undertaken in this case, focusing on the coordinated effects theory of harm. Section 4 concludes with some final remarks.

II. EMPIRICAL DATA IN THE *ALTICE/MEDIA* CAPITAL MERGER

In the summer of 2018, following an in-depth investigation, the AdC raised competition concerns regarding a merger whereby MEO, a wholly-owned subsidiary of Altice and the former incumbent, active in all segments of electronic communication services, was acquiring Media Capital, the main media and content company in Portugal.[8]

In 2016, MEO accounted for almost 40 percent of all pay-tv subscribers in Portugal. Media Capital produces widely viewed Portuguese-speaking TV channels and radio stations. The main dimension of the merger was thus vertical.

A key aspect of the analysis related to the relevance of the channels being acquired by MEO. The target firm's channels represented a quarter of average daily share view of all TV channels distributed in Portugal. The programs broadcast on these channels were consistently ranked in the top 10 most viewed programs in Portugal. Excluding football matches, they ranked as the top 6 most-viewed programs. These channels were also highly relevant for advertising, accounting for about 40 to 50 percent of all TV advertising revenues in Portugal in 2016.

The main theory of harm was the risk of input foreclosure. In order to assess this theory of harm, the AdC first analyzed the ability and the incentives of the merged entity to actually withhold key content from MEO's rivals, i.e. total input foreclosure.

In terms of empirical data used to develop the analysis in the case, among the several components of the analysis, I would highlight two key elements, namely consumer departure rates in the face of a foreclosure scenario; and diversion rates, that identify the providers to which departing consumers are likely to switch. The more accurate the estimates for these crucial elements, the more robust the results of the foreclosure analysis.

In carrying out this assessment, the AdC sought to collect data that would provide accurate estimates for these components. In order to estimate the first element, the departure rates, the AdC undertook, in Phase II of the investigation, a consumer survey with 1,550 interviews of households in order to assess how consumers would react if those channels were removed from their current provider's line-up.[9]

8 For a more detailed description on the case, please see the article prepared by the economists that integrated the case-team, Codinha A., M. Costa, M. Ribeiro & P Marques (2018). "*Input foreclosure in telecoms/media vertical Mergers: the MEO/GMC case*", Antitrust Chronicle, August, Vol 2.

9 Several scenarios were considered as to the channels being foreclosed and the competitors to which access to the channels was denied. This article abstracts from detailing these several scenarios.

To estimate the second element, the diversion rates, the AdC collected data from past diversion rates between telecommunications companies, as indicated by number portability data. As triple and quadruple play bundles account for a large share of pay-tv subscribers, these numbers provide good estimates for the providers to which consumers are likely to switch in the event of foreclosure. This is a significant upgrade in robustness vis-à-vis using the market shares of the various providers as proxies for diversion ratios (which is the default option when better data are not available).

As a result, computations of pay-offs in the different scenarios were developed using "real world data" proxies for their key determinants.

In the survey, consumers were faced with a number of scenarios in which Media Capital's channels were no longer available on MEO's competitors' offerings. They were given options ranked 0 to 10 in a closed form answer, ranging from "No, I would definitely not change provider" (0) to "Yes, I would definitely change provider" (10). Intermediate options showed less determined intentions on switching. When computing departure rates, only the answers ranked 10 in the intention of switching were considered, thus excluding all other answers signaling potential switching, namely those ranked 6 to 9.

In addition, the possibility of a reduction in the price of the offer of MEO's competitors in the foreclosure scenario due to the lower quality of their bundle was considered. For this, the survey also included questions to consumers on whether they would switch if the price of the offer of their current provider would decrease. Several price reductions were included in the survey. The highest corresponded to a reduction of around 20 percent in the price of the bundle

Furthermore, in the calculations, it was assumed that subscribers switching to MEO generate a margin equal to MEO's average contribution margin per subscriber per service, and that consumers would maintain the same type of bundle when switching.

Vertical arithmetic, based, amongst other elements, on departure rates from the survey and diversion rates from telecommunications companies' historical data, together with profit margins, showed that the merged entity would find it profitable to engage in total input foreclosure. Estimated gains in profits in pay-tv provision more than compensated for losses in revenues from advertising and customer interaction services and carriage fees.

Once the capacity and incentives for total input foreclosure were established, the AdC assessed the possibility of partial input foreclosure, whereby the merged entity would supply the channels to MEO's rivals, but at higher carriage fees. In this analysis, the AdC used a Nash bargaining framework identical to that used by the European Commission in the *Liberty Global/Corelio/W&W/De Vijver Media* merger and by the U.S. FCC in its investigation of the *Comcast/NBCU* merger. The AdC concluded that the merger strengthened Media Capital's bargaining position in negotiations with MEO's rivals over carriage fees. The application of the bargaining model also showed that post-merger, Media Capital and MEO's rivals would always have an incentive to reach an agreement. However, it also predicted several-fold increases in carriage fees, substantially raising MEO's rivals' costs and softening competition downstream.

The AdC's approach in the *Altice/Media* Capital, namely through customer surveys for estimating departure rates, accounting for the possibility of adjustments in the prices of rivals' offers and their impact on switching, and building on historical data and number portability data to estimate diversion ratios adds robustness to its conclusions. This is an important element in effectively assessing harm from a vertical merger. The fact that the theory of harm was confirmed even under the most conservative hypotheses gave further strength and soundness to the competition concerns identified.

III. THE *SPORT TV* MERGER – COORDINATED EFFECTS IN A VERTICAL MEDIA MERGER

In July 2014, the AdC blocked a vertical media merger, as a result of competition concerns with foreclosure and coordinated effects. Through this merger, PT (MEO)[10] was entering into an existing joint venture, Sport TV. Sport TV was the longstanding monopolist supplier of premium sport channels, until a competitor, Benfica TV, entered the market a few months prior to the merger.

Pre-merger, Sport TV was a 50/50 joint venture between MEO's main competitor, ZON Optimus ("ZON") and a third party (Controlinveste). Post-merger, these two neck-to-neck competitors would each hold a 25 percent share of Sport TV and share control over the joint venture, together with Controlinveste.

At the time of the merger, ZON and PT (MEO) supplied roughly 50 and 40 percent of pay TV subscribers, respectively. The customer foreclosure concerns followed from the fact that, pre-merger, non-vertically integrated pay-tv providers represented 50 percent of the market. As a result, in the absence of the merger, non-vertically integrated pay-tv providers could likely weaken the ability of ZON to block the entry of competitors to Sport TV. However, post-merger, vertically integrated pay-tv suppliers would account for 90 percent of the market, thus raising concerns as to the ability of Sport TV´s shareholders to foreclose rival premium sports channels' access to their platforms. Additionally, as result of the merger, the role of PT (MEO) as a potential promotor of the entry/expansion of premium sports channels would be eliminated. The timing of the merger in what regards market developments in premium sports channels is worth noting: it followed the recent entry of the first competitor to Sport TV – Benfica TV.

On coordinated effects, again, the particular circumstances in the market at the time, in terms of the downstream market of provision of pay-tv services, were also important. The market had evolved from a quasi-monopoly to a quasi-duopoly – of PT (MEO) and ZON (NOS) – in the 5 years prior to the merger. The market structure was thus more prone than ever to coordinated behavior.

Furthermore, the merger created structural links between the two main rival telecommunications companies, increased symmetry in terms of vertical integration, reduced the scope and incentives for differentiation via premium sports content, strengthened and harmonized the degree of information of PT (MEO) and ZON concerning their rivals, harmonized cost structures, increased transparency by creating privileged fora for information exchange, and strengthened barriers to entry as a result of vertical foreclosure effects. In addition to customer foreclosure concerns, input foreclosure was already a concern pre-merger. [11] These vertical concerns fed into the coordinated theory of harm, as they could be instrumental in ensuring the external stability of a coordination mechanism led by PT(MEO) and ZON.

Additionally, the merger would eliminate a relevant source of rivalry and contention between the two main rival telecommunications companies – access to premium sports content. Content, and premium sports content in particular, seem to play an important role in terms of the competitive interaction and rivalry between telecom operators.

As a result, the AdC concluded that the merger would strengthen both the internal and the external stability of a potential collusive mechanism, in a market that was already vulnerable to collusion.

The merging parties put forward a remedies package that was not accepted by the AdC. The remedies were behavioral in nature and can be generally described as provisions envisaging: "Must carry" – rival channels on merging parties' platform; "Must offer" – through a Regulated Offer – regarding the merging parties' channels to the rival pay-tv platforms; and Chinese walls to prevent information sharing between Sport TV and its shareholders, aimed at preventing exchange of sensitive commercial information. The AdC found that the remedies package was poorly specified, vague and allowed too much discretion to the merged entity, posed a high risk of circumvention, could not be effectively monitored, and was likely to create distortions in the market.

10 PT was the predecessor company of Altice MEO.

11 There was a decision by the AdC, in June 2013, fining Sport-TV for price discrimination in the provision of the channel Sport TV to different pay-tv providers.

IV. DISCUSSION AND FINAL REMARKS

Recent years have seen important developments regarding vertical (media) mergers. The competition policy and academic communities have thoroughly discussed this topic. High profile deals have been assessed and decisions rendered. Such opportunities to reshuffle arguments, revisit presumptions and, more generally, rethink merger enforcement, are important to ensure that it is up to standard in protecting competition and consumer welfare.

The use of bargaining models in this type of assessment has been the subject of much discussion following Judge Leon's ruling in the *AT&T/Time Warner*.[12] In the ruling, these models were considered unfit for the purpose of capturing complex negotiations and compared to "Kabuki Dances" and "Rube Goldberg Machines."

Bargaining models, however, try to capture precisely the environment in which negotiations take place. These models systematize the relevant elements that determine the outcome of a business negotiation. It is thus a robust, theoretically established approximation to determine what is likely to influence the bargaining power of each party in a negotiation. How much each side has to gain/lose for achieving/failing to reach an agreement is intuitively expected to influence the outcome in terms of division of gains, or bargaining surplus, between two sides at a negotiation table. The intuitiveness of the bargaining framework is well illustrated in the example developed in Baker (2011)[13] regarding the negotiations between a prospective seller and buyer for the sale of a house.

It seems, thus, fair to say that these concepts are intuitive and familiar to businesspeople that engage in actual negotiations. As a result, it is puzzling that the use of a framework that is designed precisely to replicate business environments, that is grounded in intuitive concepts, and that is well established in economic theory, is questioned. Neglecting this instrument would weaken the accuracy of vertical merger assessment unnecessarily, and widen the gap between the analysis and the determinants of "real world" negotiations.

Furthermore, the robustness of the conclusions drawn from an analysis relying on both foreclosure profitability arithmetic and a Nash bargaining model depends, to a great extent, on the accuracy of the estimates used for the key determinants of the relevant payoffs. This element was key in the competitive assessment of the *Altice/Media Capital* merger by the AdC.

It is however important to highlight that empirical analysis has (at least) a dual role to play in this debate. Not only should it inform the estimates plugged into the theoretical models that have been developed to assess foreclosure concerns, but it can assist in assessing the decisions on vertical mergers.

Recent vertical media mergers have led to different decisions and outcomes, with some having been implemented, others having failed to obtain (conditional or unconditional) clearance, and others having gone ahead subject to a set of remedies. *Ex-post* analysis of the impact of these merger decisions is warranted, and could shed light on the debate.

12 See Caffarra, C., G. Crawford & H. Weeds (2018). "*Kabuki Dances or Rube Goldberg Machines? Vertical Analyses of Media Mergers*". Antitrust Chronicle, August, Vol 2.

13 Baker, J. (2011). "*Comcast/NBCU: The FCC Provides a Roadmap for Vertical Merger Analysis*", Antitrust, Vol. 25, No. 2, Spring 2011.