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The Federal Communications Commission and Lessons of Recent Mergers & Acquisitions Reviews

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The Federal Communications Commission and Lessons of Recent Mergers & Acquisitions Reviews

Jonathan Sallet[1]

I. INTRODUCTION

The FCC's actions on big mergers and acquisitions have attracted a lot of comment and I'm proud of what we've achieved. But why did we come to the views that we've held? What were our theories and our core concerns? What forms of analysis did we employ? Some of that is in the public record, some is not. Let me address how we came to take the actions we did.

In the time that Tom Wheeler has been Chairman at the FCC, the Commission has faced the possibility of three telecommunications mergers that I'd like to discuss: First, the suggested Sprint-T-Mobile merger; second, the proposed acquisition of Time Warner Cable by Comcast; and, third, the acquisition of DIRECTV by AT&T. The first was not pursued, the second was abandoned, and the third was approved, with important, pro-competition conditions.

Let's start with the most important lesson. Chairman Wheeler has recited his basic mantra over and over again: "Competition. Competition. Competition." (And I know that the TPRC itself beginning in the 1970s may deserve some of the credit for this way of thinking at regulatory agencies). At the FCC, in every transaction review, the burden is on the applicants to demonstrate that a transaction will further the public interest, and that starts with competition. A central question always is: Will a deal bring more competition for the benefit of American consumers?

Of the three proposed transactions, it is not surprising that the one that was approved is the one that was brought more competitive choices to a highly concentrated market. But that is not the only test. The public interest standard, for example, considers whether a firm will bring better products, other new innovations, or wider deployment to consumers. And it is concerned with more than just standard economic analysis. Diversity, multiple avenues for expression, the importance of broadband access for all parts of society—all of these can be important.

The Commission's charge is broad, but not limitless. In some quarters, the belief exists that political connections or viewpoints are important to our review. In fact, they are not relevant. Others may believe that we are passing judgment on the past practices and customer reputation of firms. We are not; our perspective is entirely prospective: We look to the future to decide whether the outcomes of a transaction will—or will not—advance the public interest.

[1] Jonathan Sallet is the General Counsel for the U.S. Federal Communications Commission. This paper is based on remarks made at the September 2015 Telecommunications Policy Research Conference. The views expressed here are those of the author alone and do not necessarily represent the views of the U.S. Federal Communications Commission.

Finally, the Commission's recent reviews have taken place against the backdrop of changing industries. I will discuss some of those dynamics below; for example, the rise of new forms of online video delivery. But one stands out apart from the rest. 2014 was the first year in which cable companies had more broadband customers than video customers.[2] In other words, the term "cable" industry" is a bit of a misnomer—these are companies who supply more consumers with the ability to connect to the internet than with the ability to watch proprietary Pay TV. This proved to be of importance to both the Comcast/Time Warner and the AT&T/DIRECTV reviews.

Below, I would like to offer personal views as to why these three merger outcomes establish a set of important principles, while dispelling myths as to how the Federal Communications Commission operates in this sphere.

II. FIVE IMPORTANT PRINCIPLES

The shibboleths are easy to state: It has been said—wrongly in each instance—that, because of our public interest standard, the Commission departs from close economic and factual analysis of transactions. As a result, it is alleged that: (i) the Commission does not rigorously examine potential public benefits, especially when proffered by parties as voluntary commitments; (ii) it does not add independent value beyond that supplied by the antitrust agencies; and (iii) it does not ensure compliance with those conditions that are imposed.

It is hard for me to see how this bundle of assertions could have survived the Commission's work in the Comcast/NBC and AT&T-T-Mobile transactions—yes, old ideas die hard—but to the extent any legitimate doubt remains, the last 20-odd months should safely confine these old assertions to the dustbins of history.

To say it another way, the work of the Commission in connection with these three recent transactions has demonstrated five important principles:

1. **Facts and the core methodologies of antitrust are the starting place of the Commission's analysis.** Consider the potential Sprint-T-Mobile merger where the Chairman made plain that a national horizontal merger in a concentrated market would not get a green light in the absence of a serious factual review building on the learnings of AT&T/T-Mobile. Or the use of state-of-the-art merger simulation models considered in the AT&T/DIRECTV transaction to advance the Commission's thinking.
2. **The broader legal standard entrusted to the Commission—namely the requirement that applicants demonstrate that their proposed transactions will further the public interest—is an appropriate means to look beyond the traditional strictures of the antitrust laws (most notably the Clayton Act).** The Commission has traditionally noted that it can take merger-specific steps to enhance, and not just protect, competition.[3] One can view the conditions imposed in the AT&T/DIRECTV order as both protecting

[2] Press Release, Leichtman Research Group (August 15, 2014), *available at* http://www.leichtmanresearch.com/press/081514release.html.

[3] *See, e.g.*, *SBC-Ameritech Order*, 14 FCC Rcd 14712, 14738 (1999).

competition and enhancing it. That transaction was, as the Commission recognized, "a bet on competition."

3. **The Commission closely examines public-interest commitments that applicants offer.** There has been little discussion of the proposed conditions that the Commission declined to accept in AT&T/DIRECTV, but I believe that important lessons can be drawn from the Commission's analysis, including that public-interest commitments are most important when they directly address potential harms from a proposed transaction.
4. **The Commission is putting in place strong mechanisms to ensure compliance with conditions.** The AT&T merger, for example, saw the establishment by the Commission of an independent compliance monitor with enhanced selection criteria.
5. **The Commission brings particular expertise, especially in the economics and engineering of networks, that complements the expertise of antitrust agencies.** In all three of these matters, and perhaps most closely and extensively in the proposed Comcast/Time Warner Cable transaction, the Commission worked in harmony with the Antitrust Division of the Department of Justice in a way, I believe, that improved the work of both agencies.

Before I get into the substantive analysis, let me offer two caveats. First, I am using the term "Commission" in its broadest sense to include not just the Chairman's views but also views of the staff including, as in Comcast/Time Warner Cable, views that were never finalized. That is a very important limitation. Of the three transactions under discussion, only one—AT&T/DIRECTV—was formally presented to all of the Commissioners and resulted in a full Commission order. That is one reason it is especially important to emphasize that these are my personal views.

Second, there is a penchant for using the outcomes of past mergers as a template for pending or future mergers. To be sure, the articulation of principles is designed precisely to allow future conduct to be assessed in that manner. Here I am offering thoughts on Comcast/Time Warner Cable because I believe it is important for the public, and not just the Applicants, to have insight into staff thinking. But any application of what I say here to predict the outcome of any specific pending or future merger review would be inevitably and seriously flawed. That is because, as I have already said, factual analysis matters most of all, and critical facts concerning a Sprint/T-Mobile transaction were never presented to the Commission and the most critical facts concerning Comcast/Time Warner Cable are highly confidential. I personally would place little faith in a prediction of Commission action in any particular case that is not based on a detailed factual analysis—a task made more challenging by the submission of proprietary, confidential business materials to the reviewing agencies.

Let me proceed with a discussion of each of the transactions and then, in conclusion, briefly re-visit the five core conclusions I have offered.

III. SPRINT/T-MOBILE

In early 2014, Softbank, the parent corporation of Sprint Nextel, approached the Chairman seeking early reaction to its potential acquisition of T-Mobile. According to press reports at the time, Softbank believed that a combined company would bring lower prices and deploy more mobile broadband than either company would alone.

In February, Chairman Wheeler and senior FCC staff met with Softbank and Sprint Nextel representatives. Chairman Wheeler told the companies that he would, of course, keep an open mind during any review process but he also responded to their request for an initial reaction. He told them that he was highly skeptical that the acquisition would advance the public interest.

This reaction should not be a surprise. In 2011, the Antitrust Division sued to block AT&T's acquisition of T-Mobile and the FCC staff expressed concern that the loss of horizontal competition, with a merger of two of the largest four competitors, would be harmful. By early 2014, DOJ Assistant Attorney General Bill Baer was able to report that, in the aftermath of the withdrawal of the proposed AT&T/T-Mobile transaction, T-Mobile had taken action to "offer cheaper and better customer contracts," that Sprint "began offering unlimited plans with aggressive prices and innovative service arrangements," and that bigger competitors had responded with improved products of their own.[4]

In other words, in this instance the Commission was being asked to give an early green light to a 4-to-3 merger in a market in which competitive trends were on the upswing in the wake of an earlier 4-to-3 merger proposal (AT&T/T-Mobile) that had been abandoned after a DOJ legal challenge and FCC staff recommendation to designate for an administrative hearing. This is not to say that a serious factual review could not have found merit in the proposal—that's why the Chairman emphasized that he would approach any review with an open mind. It is to say that the Commission is not likely to make casual judgments, before the close examination of facts, especially in markets where the Commission has recently conducted extensive evaluation and determined that the existing market structure enables competition.

In August of 2014, the proposed tie-up was abandoned and Chairman Wheeler said, "Four national wireless providers is good for American consumers." More than a year later, that position has been vindicated.[5] Sprint has announced plans to build out and improve its wireless network.[6] T-Mobile continues its "un-carrier" campaign, reporting continued customer additions, and describing itself as "the fastest growing wireless company in America."[7] And, as of the second quarter of 2015, T-Mobile had increased its market share to 16 percent, catching up to Sprint.[8]

[4] Speech, "Reflections On Antitrust Enforcement In The Obama Administration," Assistant Attorney General Bill Baer (January 2014), *available at* www.justice.gov/atr/file/517761/download.

[5] *See, e.g.*, *How T-Mobile Changed the Wireless Industry – and Our Lives – Forever*, David Poge (Aug. 28, 2015) *available at* https://www.yahoo.com/tech/how-t-mobile-changed-the-wireless-industry-and-127690231194.html; *Sprint Undercuts T-Mobile, Offers iPhone 6S for $1/month with an iPhone trade-in*, Phil Goldstein, Fierce Wireless (Sept. 24, 2015) *available at* http://www.fiercewireless.com/story/sprint-undercuts-t-mobile-offers-iphone-6s-1month-leasing-payments-iphone-t/2015-09-24?utm_medium=nl&utm_source=internal.

[6] Blog, *Closing the Gap on Network Performance*, Jon Saw, Sprint CTO (Aug. 18, 2015) *available at* http://newsroom.sprint.com/blogs/sprint-perspectives/blog-closing-the-gap-on-network-performance.htm.

[7] Press Release, *T-Mobile Reports Double-Digit Revenue Growth and Strong Profitability in Q2* (July 30, 2015), *available at* http://newsroom.t-mobile.com/news/q2-earnings-2015.htm.

[8] Report, *Market share of wireless subscriptions held by carriers in the U.S. from 1st quarter 2011 to 2nd quarter 2015*, *available at* http://www.statista.com/statistics/199359/market-share-of-wireless-carriers-in-the-us-by-subscriptions/. *See also, T-Mobile Reports Profit Alongside Customer Growth, Revenue rose 14% in latest quarter;*

IV. AT&T/DIRECTV

The merger of AT&T and DIRECTV was, in the first instance, a merger of horizontal video competitors. As separate companies, both provided multichannel video programming distribution, or what I will also call Pay TV service, to American consumers. AT&T offered video service under its U-verse brand within portions of 22 states and DIRECTV offered satellite video service to consumers nationwide.

While acknowledging that the merger would result in a loss of horizontal competition in video distribution, the companies argued that—because AT&T's broadband service and DIRECTV's satellite service were complementary—their merger would result in more and better, integrated bundles of broadband and video that could better compete against incumbent cable companies. This, they said, would promote, not harm, competition.

Underlying their conclusion was a view that as standalone companies, neither had the necessary assets to compete over the long term. DIRECTV lacked the broadband capabilities that are key to providing the convenient interactive viewing experiences that consumers demand. And AT&T, which could only offer video in locations where it had deployed its higher speed broadband, had fewer than 6 million video subscribers and a disproportionately slower broadband network than its cable competitors. Because larger MVPDs tend to have lower per subscriber costs for programming, AT&T argued that it paid more for programming than its video competitors—larger satellite and cable companies—thus limiting AT&T's competitiveness and ability to expand service.

AT&T and DIRECTV had tried to overcome these limitations by partnering to offer consumers a so-called "synthetic" bundle of AT&T broadband and DIRECTV satellite. However, the inefficiencies associated with two companies selling what the cable companies provided on their own also precluded effective competition. As one company, AT&T and DIRECTV argued, they could do better, offering consumers more convenient and lower-priced bundles of video and broadband. And, after careful analysis of the facts and economic data, the Commission agreed.

The Commission's econometric analysis was an important aspect of the Commission's review of the AT&T/DIRECTV transaction, and it is carefully and expansively described in the Commission's published Order and technical appendix. The Commission's work, building on AT&T's excellent submissions, marked an important step forward. This was the first time the Commission gave significant weight to this kind of econometric analysis in approving a license transfer, following the Commission's longstanding recognition of the importance of econometrics. It did so for a variety of reasons specific to this transaction, including the strength of the available data, the quality of the merger simulation, and the fact that the companies offered competing and complementary products. Of course, the Commission also examined the documentary and record evidence, which confirmed the conclusions drawn from the economic analysis and independently supported our view that the improved bundle of AT&T broadband and DIRECTV video would promote competition.

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wireless carrier is optimistic for rest of year, WALL ST. J (July 30, 2015), *available at* http://www.wsj.com/articles/t-mobile-raises-subscriber-growth-outlook-1438257047.

The merger simulation analysis is based in large part on the Commission's review of the Applicants' own merger simulations. As with all merger simulations, the Commission considered whether: "Assuming that all industry participants' product offerings remain the same, what price changes arise from the changed pricing incentives created by the proposed transaction?" This involved an analysis of three primary price effects: (1) the "horizontal effect" from the loss of a competitor in the geographic areas where AT&T and DIRECTV both offered video services; (2) a "bundle effect" that results from AT&T and DIRECTV jointly pricing, as a single firm, AT&T broadband and DIRECTV video; and (3) the effect of the reduction in ATT's programming costs to DIRECTV's levels.

Our expert FCC economists adjusted the Applicants' merger simulations, along with using third-party data available to the Commission, and ultimately agreed that the economic modeling supported a conclusion that the transaction was likely to produce consumer benefits. The transaction would put downward pricing pressure on the bundle of DIRECTV's video service with AT&T's broadband service, which, in turn, would put downward pricing pressure on bundles provided by cable companies. AT&T's programming payment reductions would produce further benefits because that reduction would also exert downward pressure on the price of AT&T's video service.

It's important to understand the market structure that provided the backdrop for this analysis. Earlier in the year, the Commission had concluded that high-speed residential broadband requires a minimum of 25 Mbps down and 3 Mbps up. But the same report revealed that about 70 percent of American residential units have fewer than two choices for such broadband.[9] Thus, the proposal that AT&T would be able to offer additional choices and greater competition for high-speed broadband proved important.

While significant, that was only one part of the Commission's public interest analysis. We also concluded that the transaction created the potential for public interest harms in two important respects. First, there was an obvious loss of a Pay TV competitor in the areas of AT&T and DIRECTV overlap. And, second, the record supported our conclusion that post-transaction AT&T would have an increased incentive to use its broadband assets to discriminate against competing online video distributors ("OVDs") such as Netflix or Hulu. AT&T could raise the cost to consumers of using those services, which in turn would favor DIRECTV satellite video or the combined entity's online video products.

To address these public interest harms, the Commission imposed conditions that combined ensure more, faster, and open broadband, some of which I would like to discuss here. Such broadband creates a pathway for online video to replace the loss of horizontal video competition and also solves for AT&T's increased incentive to erect barriers to that competition. Specific conditions also were needed to confirm the public interest benefits of the transaction.

First, under the terms of the FCC Order, AT&T will deploy fiber to the home to 12.5 million locations within four years. When AT&T announced the proposed transaction, it stated that a benefit of the merger was that it could deploy fiber to 2 million additional locations. The

[9] 2015 Broadband Progress Report at ¶ 82.

requirement that they build to 12.5 million locations goes beyond that by capturing all of AT&T's pre-transaction *planned* deployment, its *projected* deployment absent the transaction, and the deployment that the record suggested was profitable as a result of the transaction. This additional build-out is about 10 times the size of AT&T's current fiber-to-the-premise deployment, increases the entire nation's residential fiber build by more than 40 percent, and more than triples the number of metropolitan areas AT&T has announced plans to serve with high-speed broadband.

Second, to specifically prevent discrimination against online video competition, AT&T is prohibited from excluding its affiliated video services and content from data caps on its fixed broadband connections. One of the asserted benefits of the transaction was the launch of affiliated online video services by the merged entity. OVDs would directly compete with these newly offered services and, at the time of the merger, AT&T was alone among the large ISPs in applying set data caps across its fixed broadband connections. This condition prevents AT&T from using those broadband service retail terms to discriminate against new forms of video competition.

In addition, and to bring greater transparency to interconnection practices, the company will be required to submit all completed interconnection agreements to the Commission, along with regular reports on network performance. This will help the Commission address any future concerns about the nature of AT&T's interconnection practices and their effect on competition and consumers. Interconnection, namely the set of agreements that enable internet traffic to move seamlessly between networks is, of course, fundamental to the idea that the internet is a network of networks.

As a group these conditions create the opportunity for more robust broadband and video distribution competition. To ensure that the goals of these conditions are achieved, the Commission required that AT&T employ an independent, outside officer responsible for monitoring and reporting to the Commission any failure to comply with the conditions.

It is important to emphasize that these conditions—alone and in combination—are transaction specific. They remedy public interest harms and ensure public interest benefits. As is often the case in major transaction reviews, when AT&T and DIRECTV announced their proposed merger they offered certain "public commitments." But these were not the starting point for, or the end of, the Commission's analysis. Indeed, the Commission did not impose, as conditions, all of the offered commitments. In particular, the Commission did not adopt as part of its Order the company's commitments to abide by the Commission's 2010 Open Internet Order, since superseded; to offer standalone retail broadband Internet access service "at reasonable market-based prices;" to offer standalone DIRECTV satellite video service at nationwide package prices; or to build out wireless local loop technology to 13 million locations.

It's important to recognize that AT&T is free to move forward, for example, by following through with its plan to deploy wireless local loops in unserved areas. But the Commission's common theme in declining to impose these commitments is that merger conditions should remedy transaction-specific harms or ensure transaction-specific, *verifiable*, public interest benefits.

As I have noted earlier, there has been a perception that the major transaction reviews are an opportunity to bargain—the parties bargain with the agencies to get to "yes" and the agencies bargain with the parties to achieve other goals unrelated to the transaction. The conditions imposed on AT&T belie that perception.

V. COMCAST/TIME WARNER CABLE

We conducted our analysis of the AT&T/DIRECTV transaction alongside our review of the proposed transaction between Comcast and Time Warner Cable.

The core facts of the Comcast transaction were these: Comcast—the nation's largest cable company, Pay TV, and broadband provider—proposed to acquire Time Warner Cable, the second-largest cable company, fourth-largest MVPD, and third-largest broadband provider. The proposed transactions involved (i) the acquisition of Time Warner's cable systems serving approximately 12 million broadband and 11 million video customers, (ii) a sale of certain systems to Charter, (iii) a swap between Comcast and Charter of certain other systems, and (iv) a spin-off of Comcast systems to a new cable company serving approximately 2.5 million subscribers. With the four proposed transactions, Comcast would acquire approximately 8.5 million additional broadband subscribers and approximately 7 million additional video subscribers, and significantly enhance its position in the top markets in the country.

After a careful review of the risk of harm and the potential benefits, staff concluded that the risks decidedly outweighed any benefits. Because the transaction was abandoned before the proposed order was submitted to, much less approved by, the full Commission, there is no public record about the staff's basic theoretical approach or the reasoning behind the staff's view that the transactions should be subject to an administrative hearing that would compel a detailed factual record on which the Commission would then make its final decision.

While the parties to the transaction were, with the Chairman's concurrence, provided an explanation and an opportunity to respond to the staff analysis, there is a gap in the understanding of lawyers, economists, and the public generally as to the staff's core theoretical approach. Initial commentary has been presented in academic settings, but I'd like to use this article to also help fill in the gaps, with the understanding, of course, that confidential material cannot be publicly discussed and that, therefore, this discussion is necessarily incomplete.

Simply put, the core concern came down to whether the merged firm would have an increased incentive and ability to safeguard its integrated Pay TV business model and video revenues by limiting the ability of OVDs to compete effectively, especially through the use of new business models.

An OVD that seeks to successfully compete with a traditional cable system needs a few things. It needs programming. It needs access to broadband providers' networks. It needs to be certain that, once delivered to those networks, its video traffic will find its way to the intended consumer. It may also need access to devices used by consumers. And, it needs to ensure that consumers are not dissuaded from using its OVD services because of retail broadband terms and conditions that might raise the price of online video in a discriminatory way. The AT&T commitment I described above addresses the potential for discrimination in the application of data caps, for example.

The portrait of OVD business models changed markedly during the pendency of the applications and these changes sharpened the focus on potential harms to the basic building blocks of OVD services. What must have seemed publicly as a series of high-profile conflicts between Netflix and large broadband providers in the winter and spring of 2014 gave way in the fall of that year and the early months of 2015 to a new phenomenon—the emergence of a variety of business models offering different flavors of OVD services.

For example, DISH's Sling service offered so-called linear programming of the same kind offered by Pay TV systems, including ESPN. Sony announced its plan to link the supply of programming to its popular gaming console. Owners of programming, including HBO and CBS, launched standalone online services.

The potential for increased consumer welfare as a result of these market developments was obvious—greater competition and potential competition leading to lower prices, greater output, and new innovation. In other words, for the first time, multiple OVD services were launching or planning to launch services to provide consumers the ability to stream live, linear programming—including sports—as part of packages that threatened revenue streams derived from traditional Pay TV packages. In general, these new offerings may allow consumers to purchase smaller bundles or view current programming without the need for a contract with a cable company containing the traditional bundle or a traditional set-top box.

We understood that entrants are particularly vulnerable when competition is nascent. Thus, staff was particularly concerned that this transaction could damage competition in the video distribution industry by increasing both Comcast's incentive and its ability to disadvantage OVDs and thus retard or permanently stunt the growth of a competitive OVD industry. In doing so, consumers would be denied the benefits that innovative competition could bring.

We looked at theory and we looked at facts and we arrived at a series of important conclusions about the nature of the marketplace and competition.

First, we concluded that the following was *not* outcome-determinative: that there was minimal horizontal overlap between the Applicants in the local markets for residential broadband and Pay TV services. This is important. At the outset of the merger review, some commenters said there could be no competitive issue given the lack of horizontal competition in those markets. But we concluded that assessment of the net impact of the proposed transaction required a wider aperture.

Second, we determined that our analysis needed to take into account the fact that both firms participated in national distribution markets, one for broadband distribution and another for Pay TV distribution. While the merging parties did not compete directly in the distribution of programming to consumers in local markets, OVDs do seek to distribute programming throughout the United States, and negotiate for nationwide distribution rights. The ability of the larger merged firm to limit OVD distribution of programming nationwide, for example by negotiating contractual provisions that inhibited an OVD's ability to obtain nationwide online distribution rights, was carefully examined.

Similarly, we also considered a national market for interconnection in which ISPs negotiate with OVDs (and their content delivery networks) over the terms by which the OVDs

would reach consumers. Post-transaction, an OVD might have needed an interconnection agreement with the merged entity in order to achieve national distribution, so we also considered the ability of the merged company to impose terms that would disadvantage the OVD.

Third, staff concluded that, with these markets in mind, the combination of video and broadband distribution assets could increase the merged entity's incentives and abilities to take actions against rivals that would pose a competitive threat to online video entry—that is, current and potential competition. Increased incentives are a direct result of the increased footprint of the merged firm. Without the merger, a company taking action against OVDs for the benefit of the Pay TV system as a whole would incur costs but gain additional sales—or protect existing sales—only within its footprint. But the combined entity, having a larger footprint, would internalize more of the external "benefits" provided to other industry members.

Alongside incentives came ability. Increased bargaining power was the central concern. The combination of distribution assets had the potential to increase the merged entity's bargaining power in both national markets—the market where video distributors negotiate the terms and conditions to distribute video content for programmers and the interconnection market through which broadband providers provide mass-market delivery services to OVDs. Because OVDs are subject to national economies of scale, the merged company could significantly impair an OVD's ability to compete.

Consider the circumstance of a new OVD. Success, and the scale necessary for success, might not require access to every consumer in the country, but foreclosure from big swaths of the nation could erect a significant barrier to OVD entry. Suppose there were two cable companies supplying broadband services, East and West, each with 50 percent of the nation and imagine that an OVD could be financially successful by reaching 50 percent of American households. Prior to a merger of East and West, an OVD would be successful if it was able to compete in either territory. Having two alternative interconnection partners gives an OVD the potential ability to play Cable East and Cable West off each other. But after a merger, that OVD would have to strike a bargain with only one firm, which would give that company the ability to disadvantage the OVD, or perhaps even exclude the OVD from reaching its subscribers.

Fourth, we looked at how any greater ability might be used, and here we came to another, separate conclusion. The effects of the transaction on the national markets for video programming and interconnection were significant in our analysis, each considered independently. But we also considered them among the other levers available to the merged firm that, combined, presented a risk of competitive harm. For example, we considered their competitive effect when combined with data caps and other retail broadband terms and conditions that raised the price of OVDs for consumers.

Staff consideration of the cumulative impact of these levers on competition is itself a critical point. The question was not only whether a single kind of action—access to devices, or data caps, or interconnection, or video programming terms—by itself would degrade competition. It was also whether the merged company would possess the toolkit that would allow it to put sand in the gears of competition through the totality of its efforts. Indeed, for strategic reasons, an entity might have an incentive to spread the effects of anticompetitive actions across multiple forms of actions, and shift their impact over time, in order to attempt to avoid effective

monitoring of their impact. Staff did not believe that its concerns could be remedied through conditions.

Finally, the verifiable benefits of the proposed transactions—such as faster broadband speeds for TWC customers, cost savings, enhanced competition for business customers—were viewed by staff as incapable of outweighing the potential harms. Unlike AT&T/DIRECTV, this was not a transaction in which additional competitive choices would flow to consumers. But as in AT&T/DIRECTV, the staff assessed all of these competition issues in light of consumers' limited broadband alternatives, particularly at higher download speeds. As the Department of Justice noted, in language equally applicable to the FCC staff perspective, "the transaction would [have left] Comcast with close to 60 percent of all high-speed broadband subscribers in the United States, strengthening its ability to block the adoption of innovative products, including 'over-the-top' video services that threaten the traditional cable business model."[10]

The FCC staff, with the Chairman's concurrence, presented these theories and concerns to the Applicants explaining the reasons that they had not met their burden of demonstrating that approval of the transactions was in the public interest, and inviting further dialogue. After listening to the concerns outlined here, as well as important factual analysis that cannot be discussed publicly due to the restraints of confidentiality, the Applicants abandoned the proposed transactions. Thus, the Commission's work remains incomplete but, perhaps like Dickens' unfinished work *The Mystery of Edwin Drood*, the staff's views may be of interest to lawyers, economists, and the public generally.

VI. CONCLUSION

I hope that I've been able to show successfully how the Commission approaches its important statutory responsibilities seriously, and how the staff digs into the facts and applies disciplines of economics, engineering, and law as it formulates its recommendations to the Commission. That requires a lot of effort from all parts of the Commission, starting with the Chairman.

Experts in the Media, Wireline Competition, and Wireless Telecommunications Bureaus—and there are too many to name individually—all contributed invaluable analysis to these questions, under the leadership of Bill Lake, Julie Veach, Matt DelNero, and Roger Sherman. Outside economists Bill Rogerson and Jon Asker, who worked with the Commission's chief economists Tim Brennan and David Waterman and our own excellent internal economics team, pushed the frontiers of both theoretical and empirical analysis.

Of particular note are the attorneys who ran the AT&T/DIRECTV and Comcast/Time Warner merger reviews at the FCC. It is no coincidence that both Hillary Burchuk and Jamillia Ferris had earlier worked in the Department of Justice's Antitrust Division and we gained greatly from their understanding of the two institutions.

I've offered five basic principles that I believe best explain the Commission's approach:

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[10] Speech, "Remarks at the Chatham House Annual Antitrust Conference," Assistant Attorney General Bill Baer (June 18, 2015), *available at* http://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-delivers-remarks-chatham-house-annual-antitrust.

1. Start with the facts and economic analysis.
2. Consider carefully both traditional competition-law principles and the Commission's special charge to examine merger-specific outcomes in light of the potential for enhanced competition and service to the public interest.
3. Require conditions that are needed to address potential harms and offer verifiable benefits to consumers.
4. Make sure that conditions are enforceable.
5. And, very importantly, work closely with the antitrust agencies to provide complementary expertise to the advantage of both. The opportunity to work with colleagues at the Department of Justice is a personal pleasure and, I submit, has led to tangible public benefits.

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The Ad Hoc Approach to Telecommunications Mergers: The Public Interest Compromised?

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The Ad Hoc Approach to Telecommunications Mergers: The Public Interest Compromised?

Warren Grimes[1]

I. INTRODUCTION

It is difficult to find consistency in the U.S. Justice Department's ("Antitrust Division") responses to the wave of telecommunications mergers. AT&T was barred from purchasing T Mobile. Comcast was warned not to acquire Time Warner Cable. Other comparably sized mergers have been given the green light, albeit some with conditions, including Comcast's purchase of NBC Universal and AT&T's acquisition of Direct TV. More mergers are in the works.

Each case has unique features. The Antitrust Division's differing decisions may be rationally and perhaps persuasively explained.[2] Case-by-case analysis is, after all, the best way of dealing with the horizontal and vertical intricacies of this vital industry. Or is it?

If the goal is to make competition work in providing consumers meaningful telecommunications choices and universal access, the Antitrust Division and the Federal Communications Commission must articulate clear goals and be resolute in implementing them. In particular, mergers must be judged by the unique conditions in this industry, with sensitivity to the importance of the industry to quality of life and the needs of consumers. Generalized merger guidelines are not adequate to protect competition in this vital industry. Telecommunications-specific goals should be articulated in guidelines that are tested in public debate and, after implementation, guide industry firms, enforcers, and the courts in addressing telecommunications mergers.

Merger enforcement policy in the U.S. telecommunications industry has special importance because of the nation's commitment to minimize government control and regulation in the supply of vital telecommunications services. With the FCC on watch, no one could claim the U.S. telecommunications industry is unregulated. Still, more than most nations, telecommunications remains in the hands of private firms that make decisions relatively free of government interference. The intent is to let privately competing firms supply consumers with high tech choices when telephoning, texting, transmitting data, e-mailing, or obtaining video programming (by over-the-air broadcast, cable, or internet). This free market approach has succeeded in some cases—and failed miserably in others.

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[1] Irving D. & Florence Rosenberg Professor of Law, Southwestern Law School.

[2] *See* Assistant Attorney General Bill Baer, *Video Competition: Opportunities and Challenges*, Keynote Address at *Future of Video Competition and Regulation*, Duke Law School (Oct. 9, 2015), *available at* <http://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-delivers-keynote-address-future-video-competition>

II. BRIEF HISTORY AND CURRENT STATUS

A bit of historical perspective is helpful. For traditional land-line telephone service, universal access was obtained only with the help of government subsidies needed to reach small town and rural customers. By the 1950s, this goal had been largely achieved, but customers dealt with a single regulated monopoly provider. With some delay, a similar model evolved for traditional cable television, where most consumers could obtain this service from a local monopolist provider by the 1970s. The monopoly model, even with some constraining regulation, offered only minimal consumer choice and generated substantial discontent.

Technology helped to generate competition for telephone service and was potentially helpful for cable as well. For example, by the 1970s, there was competition in providing long distance service for land-line customers. By the end of the 20th century, wireless cell phone service provided a meaningful alternative, to the point that it has displaced much of the demand for land-line service. Today, there is meaningful competition in cell phone services, thanks in part to maverick firms such as T Mobile that have given consumers choices in purchasing cell phone service, including relatively low cost and unbundled plans that allow the consumer to purchase a phone separately from a subscription plan.

The market mechanism has so far failed for two other telecommunications services: cable television and high speed internet access. Most urban consumers have a choice of two or three cable providers, but no meaningful choice in avoiding an elephantine bundle of 180 or more channels, only 18 of which the average subscribing household actually watches.

There are enormous costs to this forced bundling. The lack of choice means consumers pay more—lots more. The growing cost of the expanded basic bundle (already averaging roughly $100 per month) is attributable in significant part to expensive sports programming, which half or more subscribers do not watch. Even among sports enthusiasts, many are forced to pay for sports programming that they do not watch. Some analysts claim that bundling is an efficient way of delivering cable programming. That may be, but Canadian consumers with greater choices pay substantially less per month for cable programming. Using the Canadian system as a base, one estimate is that U.S. cable consumers overpay somewhere between $27 to $34 billion each year.[3]

A second cost of the bundling system is that cable customers, through no fault of their own, suffer blackouts of popular programming, with some of these blackouts lasting months or even years. In Southern California, the majority of fans of the Los Angeles Dodgers have, over the past two seasons, been unable to receive Dodger telecasts because of an intractable bundling dispute. Time Warner Cable owns the television rights to the games and insists that the telecasts be included in the expanded basic bundle at an additional cost of roughly $5 a month, notwithstanding that most cable consumers won't watch the games. Most cable distributors are willing to carry the games on an a la carte basis, but have refused to add to the unwieldy and very

[3] Warren Grimes, *The Distribution of Pay Television in the United States: Let an Unshackled Marketplace Decide,* 5 J. INT'L MEDIA & ENTERTAINMENT L. 1, 16-17 (2014).

pricey bundle. Meanwhile, most Dodger fans, through no fault of their own, cannot watch the televised games. None of this could happen if forced bundling ceased.[4]

For high speed internet access, the competitive situation is no better, a matter of special concern because internet streaming is increasingly chosen as a way around the pricey TV bundles. Even in urban areas, almost all consumers have only one or two choices for obtaining broadband access. Under the FCC's new high-speed internet standards, 70 percent of all broadband users have no choice or only one choice.[5] Although FCC Chairman Tom Wheeler has made internet availability a priority, as long as hard-wired connections are required the likelihood of a quick fix providing consumers meaningful competition is slim. Even for a consumer with two choices, tacit parallel supracompetitive pricing and look-alike offerings will continue to be the norm.

III. CREATING A MORE COMPETITIVE TELECOMMUNICATIONS INDUSTRY

So what would a more competitive telecommunications industry look like? Here are three goals that should guide telecommunications antitrust policy, including treatment of mergers.

A. There Should Be a Minimum of Four Providers for All Major Telecommunications Services.

This goal has been achieved for cell phone service and was within reach for cable TV. By approving the AT&T acquisition of Direct TV, the Government lost ground on this goal for cable. For high speed internet, where most consumers, if they have access at all, have only one provider that can meet the FCC's standards, creating meaningful choices and competition will be more difficult.

The government's conditions imposed on the AT&T acquisition of Direct TV were intended to generate more broadband access. The FCC and the Justice Department apparently concluded that, for the future, broadband access is more important than choice among cable providers. That may be correct. Competition, however, cannot be mandated. Assuming that AT&T promptly expands its broadband network as promised, it is still likely to be a monopolist or duopolist in most markets it serves, a condition unlikely to lead to aggressive price competition and varied low cost options.

The government may have given up a bird in the hand (competition in cable distribution) in pursuit of an elusive bird in the bush. Will the government enforcers continue to sacrifice competition in one telecommunications market for uncertain competitive benefits in another market? Shouldn't merger policy be designed to preserve competition in all significant markets? More access and more competition is needed in the market for broadband, but that goal should be independently and comprehensively addressed, not through ad hoc settlements in merger cases that compromise competition in other important markets.

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[4] Consumers also lack choice in buying cable boxes and continue to pay yearly fees averaging $231 per year to rent these units from the distributor. CONSUMER REPORTS, 12 (Nov. 2015).

[5] Address of Assistant Attorney General Bill Baer, *supra* note 2.

B. Abusive Bundling Practices Should Be Prohibited.

Antitrust enforcers (and the FCC) have missed opportunities to prohibit the noxious bundling practices in cable TV, with the result that disgruntled subscribers have paid billions in overcharges over the past decades.[6] These bundling practices are under siege as many younger consumers vote with their wallets not to subscribe to cable TV.

The bundling system, however, may endure for some time yet, particularly since some of the same firms implicated in the bundling practices also control broadband access, the major alternative for streaming video programming. In addition, multi-product and vertically integrated firms bundle various telecommunications services (cable, cell phone, broadband) in ways that undercut consumer choice and harm equally efficient firms that lack integration potential.

C. Vertical Integration Issues Must Be Taken Seriously.

Antitrust analysts have long paid lip service to the axiom that effective competition is superior to regulation. Unfortunately, when assessing telecommunications mergers, the agencies have not been resolute in protecting the conditions needed for effective competition. An example is the 2011 Comcast acquisition of NBC Universal. The merger combined the largest cable and broadband distributor with NBC's very substantial video programming content. The vertical restraint issues involved in this transaction were quickly recognized. Content providers expressed concern that the combined entity would favor its own content in making distribution decisions. The agencies, however, gave the green light to the transaction, subject to conditions, including one that required Comcast not to "unreasonably discriminate" in providing broadband service to content providers.[7]

Did this condition provide meaningful protection? The twentieth century history of the Bell System's discriminatory favored treatment of the integrated firm's products and services ought to have been a strong warning. Two events since that 2011 merger suggest the futility of this sort of regulatory decree. The first is that Netflix, a major independent content provider, felt compelled to sign an expensive agreement with Comcast to ensure that Netflix customers continued to receive favorable internet access through the Comcast pipeline.[8]

The second is the FCC's decision to implement net neutrality regulations to ensure equal and non-discriminatory access. The Comcast acquisition of NBC Universal contributed to the support for regulation (Netflix and other content providers joined the push for net neutrality). That regulation, if it survives judicial review, will be less effective and more costly to implement than a regime in which distributors are barred from owning or controlling content. Had the

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[6] Grimes, *supra* note 3.

[7] Department of Justice Press Release, Justice Department Allows Comcast-NBCU Joint Venture to Proceed With Conditions (January 18, 2011), *available at* <www.justice.gov/opa/pr/justice-department-allows-comcast-nbcu-joint-venture-rpoceed-conditions>

[8] *Comcast and Netflix reach Deal on Service*, N.Y. TIMES (Feb. 23, 2014), *available at* <http://www.nytimes.com/2014/02/24/business/media/comcast-and-netflix-reach-a-streaming-agreement.html?_r=0>

Antitrust Division and FCC stood resolutely against vertical integration, there likely would be little need for broad-based net neutrality regulation.

IV. THE NEED FOR INDUSTRY SPECIFIC GUIDELINES

The idea of industry specific guidelines is not new. Although not specifically addressing mergers, the Antitrust Division and the FTC have already issued specialized guidelines for the healthcare industry. Other prime candidates for narrowly tailored guidelines are industries most affecting quality of life, including food and drink industries and telecommunications. Each of these industries involves the sale of essential products and services to consumers. Concentration levels in these industries are of greater concern not only because of quality of life issues but also because consumers typically cannot exercise countervailing power. Consider the steel industry, where many downstream customers are themselves large firms, such as the automobile industry. The countervailing power that could discipline steel prices is absent when products and services are sold directly to consumers.

The first set of antitrust guidelines came in 1968, under the leadership of former Assistant Attorney General Donald Turner. The Merger Guidelines Turner championed were intended to anchor antitrust law in economic principles, providing certainty and manageability for attorneys, enforcers, and counselors. Those goals have been elusive for a variety of reasons. Certainly one reason is that industry-specific conditions generate widely disparate anticompetitive concerns.

The Antitrust Division has substantial expertise and interest in competition in telecommunications services. The recent address of Assistant Attorney General Baer, focusing on the need for competition and neutrality among internet pipeline providers, is helpful.[9] But more is needed. The goal of achieving clarity and certainty would be fostered by guidelines specifically addressing telecommunications mergers and other related competition issues. Levels of concentration that may be tolerable in some industries are objectionable in an industry so vital to consumers. Vertical integration that may be relatively unproblematic outside telecommunications is troublesome when providers of popular content wield substantial leverage over distributors.

Guidelines, perhaps jointly issued by the FCC and the Justice Department, could also lessen the propensity of government enforcers to compromise away the public's strong interest in competition. Any merger investigation brings the intense involvement of agency staff on the one side and well-schooled attorneys for the merging parties on the other side (many of these attorneys are former agency staffers). Faced with conflict, there is a tendency for any Government official making enforcement decisions to compromise. An agency head may prefer a compromise solution rather than face the costs and risks of litigation. That tendency would exist, with or without specific industry guidelines. Nonetheless, if the agency's guidelines address an issue with clarity and force, the impact of the merging parties' push for a compromise will be dulled. Enforcers will have increased resolve in adhering to competition values.

There will always be a need for case-by-case analysis of mergers. Merger enforcement, however, will strongly benefit from area-specific guidelines. Specific telecommunications

[9] Address of Assistant Attorney General Bill Baer, *supra* note 2.

antitrust guidelines could generate more competition, give the consumer more choices, and provide more clarity to industry participants than the current ad hoc approach to telecommunications mergers. Government regulation is clearly a second best choice, but the United States will continue to slide down the slippery slope toward more regulation unless there is a resolute antitrust telecommunications policy implemented by area-specific guidelines.

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The Commission's Merger Enforcement in Mobile Mergers: Brave New World for Non-coordinated Effects?

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The Commission's Merger Enforcement in Mobile Mergers: Brave New World for Non-coordinated Effects?

Nikolaos Peristerakis, Lodewick Prompers, & Mar García[1]

I. INTRODUCTION

In the wake of the replacement of the traditional dominance standard by the significant impediment of effective competition ("SIEC") standard by the European Commission (the "Commission") in 2004,[2] there was a general consensus among practitioners and enforcers that the new test would not lower the intervention threshold for merger control enforcement, but would merely fill in a gap.[3]

The gap related to mergers in non-collusive oligopolies[4] and, more specifically, mergers between particularly close competitors in differentiated product markets with high barriers to entry and expansion that do not result in a dominant position.[5] The same consensus remained five years on, when leading practitioners and enforcers concluded that the SIEC had not materially changed the intervention threshold.[6]

However, after 2007, it appears that there was a shift in the Commission's enforcement in mergers occurring in oligopolistic markets, particularly in mergers involving mobile network operators ("MNOs"). As discussed below, the Commission has significantly expanded the scope of non-coordinated effects to capture (i) mergers between parties that are not each other's closest competitors, but merely close competitors (see section II); and (ii) even to mergers between parties that are not close competitors, but where one of the parties is an Important Competitive

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[2] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ L 24, 29.1.2004, p. 1–22 ("EUMR").

[3] *See* "Implications of the recent reforms in the antitrust enforcement in Europe for National Competition Authorities," speech at Italian Competition/Consumer Day, Rome (December 9, 2003). *See* also Philip Lowe's speech at the RBB/FIPRA seminar "The future shape of European merger control," Brussels, February 17, 2003.

[4] *See* the Commission's contribution to the 2002 OECD roundtable on Substantive Criteria used for Merger Assessment, section 3.2 at page 313: "In non-collusive oligopolies, the increase of post-merger prices above competitive levels is not the result of co-ordination between the oligopolists, but stems from the fact that the merger removes a substantial competitive constraint each of the merging parties was facing previously. *Whereas before the merger, the two merging parties exercised a competitive constraint on each other, in the sense that if one party would raise price, it would lose customers to the other party and vice versa, the merger lifts these constraints.*" (emphasis added).

[5] Philip Lowe's speech at the RBB/FIPRA seminar "The future shape of European merger control," Brussels, (February 17, 2003). *See* also S.A. Ryan (DG Competition, Directorate B), *Reform of the EU Merger Control System — a comprehensive package of proposals*, (1) COMM. COMP. POL'Y NEWSLETTER, 10 (Spring 2003); and M. Loughran (DG Competition, Directorate B), *EC Merger Control Conference — highlights of proceedings*, COMM. COMP. POL'Y NEWSLETTER, 83 (Spring 2003).

[6] N. Levy, *The EU's SIEC test five years on: has it made a difference?,* EUR. COMP. L. J. (April 2010).

Force ("ICF") (see section III).[7] It is clear that with these considerably broader substantive tests, the Commission can now challenge mergers—such as the Airtours/First Choice merger—that it was not able to challenge under the old dominance standard (see section IV).

II. FROM "CLOSEST" TO "CLOSE" COMPETITORS

Before the adoption of the 2004 EUMR, there was a widely held view that when the merging parties would not become dominant as a result of the transaction, non-coordinated effects could only arise if the following conditions were met: (i) the merger involves a differentiated product market,[8] (ii) there are high barriers to entry/expansion and repositioning; and, most importantly, (iii) the parties were each other's closest competitors.[9]

A. Closest Competitors

In the 2001 Green Paper on the review of the EUMR, the Commission provided as a typical example of a gap case the scenario in which a merger involves the second and third largest players in a market, in which they are the **closest** substitutes. In that case, even if the firms would remain smaller than the market leader, they could still exercise market power and unilaterally raise prices.[10]

Even though the Commission's HMG under the EUMR[11] use the term "close," as opposed to "closest," the HMG acknowledge that non-coordinated effects are more likely to arise when the parties are closer competitors: The greater the level of rivalry, the higher this risk of anticompetitive effects becomes.[12]

In line with this approach, the Commission concluded in *T-Mobile/Orange Netherlands* (2007)[13] that the merger did not raise non-coordinated effects concerns, as the Commission

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[7] *Triton/Logstor*, Commission Decision of 28 May 2014 in Case COMP/M.6922.

[8] As the Commission notes in its Horizontal Merger Guidelines, products may be differentiated in various ways. There may, for example, be differentiation in terms of geographic location, based on branch or stores location; location matters for retail distribution, banks, travel agencies, or petrol stations. Likewise, differentiation may be based on brand image, technical specifications, quality, or level of service. The level of advertising in a market may be an indicator of the firms' effort to differentiate their products. For other products, buyers may have to incur switching costs to use a competitor's product. *See, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings*, OJ 2004/C 31/03 5.2.2004, (hereinafter "HMG") (at footnote 32).

[9] DANIEL GORE, STEPHEN LEWIS, ANDREA LOFARO, & FRANCES DETHMERS, THE ECONOMIC ASSESSMENT OF MERGERS UNDER EUROPEAN COMPETITION LAW 162 (2013).

[10] Green Paper on the Review of Council Regulation (EEC) No 4064/89, of 11 December 2001. *See* paragraph 166: "One of the more specific hypothetical questions that has occasionally been raised about the reach of the dominance test in the Merger Regulation is the extent to which it would allow for effective control in some specific situations where firms unilaterally may be able to raise prices and thus exercise market power. The type of example that tends to be cited is of a merger between the second and third largest players in a market, where these firms are the **closest** substitutes. In such a scenario the merging firms may remain smaller than the existing market leader. The argument goes that the SLC test would be better adapted to addressing such a situation, in particular if the market characteristics would not be conducive to a finding of collective dominance. While interesting as a hypothetical discussion, the Commission has so far not encountered a situation of this kind," (emphasis added).

[11] HMG, *supra* note 8 at pp. 5-11.

[12] *Id.* at, ¶ 28.

[13] Commission decision of 20 August 2007 in Case COMP/M.4748.

investigated and found that Orange and T-Mobile were not each other's "closest"[14] or "particularly close" competitors.[15] The Commission based its conclusion on (i) the parties' different business strategy and target customers and (ii) churn data (20-30 percent churn rate).[16]

B. The Move to Close Competitors

Despite its findings in *T-Mobile/Orange Netherlands*, the Commission has since taken the view that it is sufficient that the parties are merely "close competitors."[17] This shift has lowered the intervention threshold for merger enforcement based on non-coordinated effects.[18]

Even though the Commission has still occasionally used the "closest competitor" standard in mergers involving non-telecom sectors,[19] it has eventually moved to the considerably broader "close competitor" standard in mobile mergers:

- In *Hutchison 3G Austria/Orange Austria* (2012),[20] the Commission referred to "closest competitors," but also suggested that mere closeness of competition could suffice to raise non-coordinated effects.[21]
- In *T-Mobile/Orange UK* (2010)[22] the Commission dropped the term "closest competitors" altogether and concluded that the transaction would not raise competitive concerns as the parties were not "particularly close" competitors.[23]
- In the *Hutchison 3G UK/Telefónica Ireland* (2014) case,[24] the Commission reconfirmed that it is not necessary to show that the merging parties are each other's closest competitors on the relevant markets, but it is sufficient that the parties are merely close competitors.[25]

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[14] *Id.* at ¶ 35.

[15] *Id.* at ¶ 41.

[16] *Id.* at ¶ 42: KPN captured a significantly higher number of customers switching away from Orange (30-40 percent).

[17] *See,* e.g., *BASF/Ciba*, Commission decision of 12 March 2009 in Case COMP/M.5355, ¶126: "the market investigation showed that **no sufficient close substitute to bismuth vanadate**, which is considered as a specific pigment, **exists**. … Given these factors and the Parties' high combined market shares in the market for bismuth vanadate, the Commission considers the transaction raises serious doubts as to its compatibility with the common market in relation to bismuth vanadate." (emphasis added)

[18] *BASF/Ciba*, inter alia, ¶¶ 135 ("the market investigation provided no indications that would confirm BASF's claim that its own and Ciba's indanthrone blues are not close substitutes") and 145 ("BASF submits that, regardless of the high combined market shares, the transaction will not lead to competition concerns, since Ciba is a niche player in the market and BASF and Ciba's products are not particularly close substitutes. Furthermore, the parties are aware of several companies considering or preparing market entry. In that regard, the market investigation corroborated that new entries are foreseen within the next three years. However, it did not confirm that BASF and Ciba's products were not close substitutes.")

[19] *See*, e.g. *Porsche/Volkswagen*, Commission decision of 23 July 2008 in Case COMP/M.5250, ¶ 59 (the sports cars of Porsche and Volkswagen were not considered as the *closest* substitutes). However, the Commission has also used the "close competitors" standard outside the telecommunications sector. See e.g., *Western Digital Ireland/Viviti Technologies,* Commission Decision of 23 November 2011 in Case COMP/M.6203, in particular ¶¶ 560 to 568.

[20] *Hutchison 3G Austria/Orange Austria*, Commission decision of 12 December 2012 in Case COMP/M.6497.

[21] *Hutchison 3G Austria/Orange Austria,* where the Commission indicates that the parties were at least the closest competitors on certain variables, or particularly close competitors (¶¶ 176 and 225-226). However, other recitals of the decision suggest that mere closeness is enough (*see*, e.g., ¶¶ 177-178).

[22] *T-Mobile/Orange UK,* Commission decision of 1 March 2010 in Case COMP/M.5650.

[23] *T-Mobile/Orange UK*, ¶¶ 54-58 and 64.

The lower intervention threshold based on a "close competitor," as opposed to the "closest competitor" standard, creates legal uncertainty and raises a number of questions that currently remain open, such as: How close do the merging parties need to be in order for non-coordinated effects to arise? What kind of quantitative and qualitative evidence should be used to established closeness? Are there specific diversion ratios above which closeness would be established? How "close" is "close"?

Such uncertainty is further exacerbated by the Commission's increased use of the concept of an ICF in recent mobile telecommunications mergers (see section III below).

III. THE INCREASED USE OF THE CONCEPT OF IMPORTANT COMPETITIVE FORCE

In recent years, the Commission has by-passed the requirement of closeness of competition altogether, relying instead on the concept of the elimination of an ICF to challenge mergers in oligopolistic markets.

The concept of an ICF is, as such, not new. Indeed, the HMG identify the elimination of an ICF as one of the factors that may influence whether significant non-coordinated effects are likely to result from a merger.[26] In particular, the HMG state that an ICF would typically be a firm that has more of an influence on the competitive process than its market share would suggest. The HMG provide as examples: (i) a recent entrant that is expected to exert significant competitive pressure on the other firms in the market, and (ii) an important innovator with important pipeline products.[27]

In mobile telecommunications mergers, the concept of ICF was originally assimilated to that of a maverick. In the 2006 *T-Mobile/Tele.ring*[28] decision, an early gap case, the Commission indicated for the first time that the elimination of a maverick would amount to the elimination of an ICF.[29]

Expansion of the Concept of ICF

However, in recent cases, the Commission has expanded the scope of an ICF beyond traditional mavericks. In *Hutchinson 3G UK/Telefónica Ireland,* the Commission found that the target could be considered as an ICF even if it was not the most aggressive competitor in the

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[24] *Hutchinson 3G UK/Telefónica Ireland,* Commission decision of 28 May 2014 in Case COMP/M.6992.

[25] *Hutchison 3G UK/Telefónica Ireland*, ¶ 200: "Furthermore, contrary to the Notifying Party's claims, the Commission is not required, for the purposes of finding non-coordinated effects in the absence of dominance, to show that Three and O2 are each other's closest competitors on the relevant markets."

[26] HMG, *supra* note 8 ¶ 26.

[27] *Id.* ¶¶ 37-38.

[28] Commission Decision of 26 April 2006 in Case COMP/M.3916.

[29] Indeed, already in its Decision of 30 July 1997 in Case COMP/M.877 – *Boeing/McDonnel Douglas*, the Commission noted: "Although (…) the market share of MDC has been continuously declining, it appears that the impact of MDC on the conditions of competition in the market for large commercial aircraft was higher than reflected by its market (…).This is confirmed by a study (…) in which (…) it was found that the MDC presence led to a reduction of over 7% in the realized price." (at ¶ 58).

market, let alone a maverick.[30] In particular, the Commission noted that a market player does not need to "stand out" from all the other competitors in order to be considered an ICF for the following reasons:

1. The Commission does not have a higher burden of proof to find a SIEC based on the elimination of an ICF compared to the burden of proof for closeness of competition or dominance;[31]
2. In contrast with prior cases, there is no need for the target firm to be a maverick or an otherwise "unique" firm in its aggressiveness or market positioning in order to be considered an ICF. [32]

With such a broad interpretation, virtually every firm active in an oligopolistic market with high barriers to entry could be viewed as an ICF. Indeed, in *Hutchinson 3G UK/Telefónica Ireland*, the Commission found that in a concentrated market, such as the Irish mobile telecommunications market, all MNOs are "arguably important," given that they all contribute to competition to a "certain degree." The Commission argued that the fact that other MNOs (other than the merging parties) are also competing aggressively on the market does not invalidate the conclusion that one of the merging parties is an ICF.[33] In other words, the Commission does not consider that there is any need to show that the alleged ICF's offers are significantly better than those of its competitors or that the alleged ICF is uniquely positioned in terms of exercising a competitive constraint on the market as a whole, like a maverick would.[34]

In addition to expanding the concept of an ICF, the Commission has in recent cases taken the position that the elimination of an ICF could by itself be sufficient to establish non-coordinated effects. In *Oracle/Sun Microsystems*, the Commission developed the elimination of an ICF as a stand-alone theory of harm, detached from the finding of a dominant position or closeness of competition. Up until then, the Commission had never used the elimination of an ICF as a stand-alone theory of harm, but instead used the elimination of an ICF merely as an

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[30] Commission Decision of 28 May 2014 in Case COMP/M.6992. The Commission reached similar conclusions in *Telefónica Deutschland/E-Plus* (Commission Decision of 2 July 2014 in Case COMP/M.7018). For conciseness, this article will focus on the arguments made in *Hutchinson 3G UK/Telefónica Ireland*.

[31] *Id.* at ¶ 205.

[32] *Id.* at ¶ 205, 208. *See* also Commission Decision of 21 January 2010 in Case COMP/M.5529, ¶¶ 164-165. In this specific case, the Commission was faced with a transaction that involved the largest and strongest proprietary database vendor (with substantial market power) acquiring the largest open source database (My SQL). It was the open source nature of the services offered by Sun which the Commission considered relevant while analyzing whether Sun could be considered an ICF. This analysis is highly case-specific and therefore provides little general guidance on the definition of an ICF. More specifically, the Commission's investigation showed that MySQL had the potential to exert an important and growing competitive constraint on Oracle and other proprietary database vendors due to *inter alia* its specific modular architecture, its business model resulting in low pricing and absence of lock-in, and the other strengths it derives from its open source nature. *See* Commission Decision of 21 January 2010 in Case COMP/M.5529, ¶ 170.

[33] *Hutchinson 3G UK/Telefónica Ireland*, ¶ 283.

[34] *Id.* at ¶ 303.

"aggravating factor" in situations where either the merged entity would achieve a dominant position or the parties to the merger were particularly close competitors. [35]

The Commission concluded, however, that under the SIEC test the elimination of an ICF was in itself sufficient, and that it was no longer required to show that the parties were close competitors.[36] The Commission adopted the same approach in *Hutchinson 3G UK/Telefónica Ireland*.

IV. HAS THE INTERVENTION THRESHOLD LOWERED FOR MERGERS IN OLIGOPOLISTIC MARKETS?

The developments set out above beg the question whether the SIEC test introduced in 2004, at least as applied in mobile telecommunications mergers, has lowered the intervention threshold and is enabling the Commission to go after mergers that it would not have been able to challenge under the traditional dominance standard.

In this context, it is important to note that the landmark *Airtours* judgment of the General Court, which concerned a 4-3 merger being challenged on the basis of a coordinated effects theory, substantially raised the burden of proof for the Commission to establish coordinated effects.[37] In that case, the Commission took the position that the Airtours/First Choice merger raised collective dominance concerns because the merger would create a market structure which would create an incentive for the three remaining large players post-merger to restrict output. The Commission took the position that it was sufficient that the merger would make it rational for the three remaining oligopolists to adapt themselves to market conditions and act—individually—in ways in which will substantially reduce competition between them.[38]

It is noteworthy that the theory of harm used by the Commission in *Airtours*—a case that was presented as a coordinated effects case—is quite similar to the concept of non-coordinated effects in the HMG. A central piece in the Commission's theory of harm in non-coordinated effects is the accommodating responses of the rivals, especially in those cases where the Commission relied on the concept of an ICF as opposed to the concept of closeness of competition. In *Hutchinson/Telefónica Ireland*, the Commission emphasized the likely accommodating reaction of competitors following the merger as a key factor for its finding of

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[35] Commission Decision of 21 January 2010 in Case COMP/M.5529, ¶¶ 160-161.

[36] More specifically, the Commission noted that: "… beyond the concept of dominance, concentrations involving the elimination of important competitive constraints that the merging parties had exerted upon each other, as well as a reduction of competitive pressure on the remaining competitors, may, under certain circumstances, even in the absence of a likelihood of coordination between the members of the oligopoly, result in a significant impediment to effective competition. (…) the Commission is not required, for the purposes of the assessment of this case, to show that the merging parties are the closest competitors on the relevant market. Closeness of competition is only one of the factors listed in the Horizontal Guidelines as conducive to influence whether significant non-coordinated effects are likely to result from a merger." (Commission Decision of 21 January 2010 in Case COMP/M.5529, ¶¶ 163-164. Referring explicitly to recital 25 of the EU Merger Regulation).

[37] Commission Decision of 22 September 1999 in Case COMP/M.1524. In this case, Airtours' proposed acquisition of First Choice would reduce the number of major tours operators in the United Kingdom from four to three, while no firm would be individually dominant post-merger. The General Court, on appeal, annulled the Commission's decision (Case T-342/99) and associated collective dominance with coordinated effects.

[38] *Id.* ¶¶ 54-56.

non-coordinated effects concerns.[39] Indeed, the use of the term "non-coordinated" instead of "unilateral" was to emphasize that the Commission would focus not only on whether the combined firm would increase prices (or restrict output) post-merger, but also on whether other firms would find it profitable to raise their prices as a result of the diverted customer demand from the merged group to other competitors.[40]

It is also interesting that the concept of a maverick, which was originally assimilated to the concept of an ICF, demonstrates that the Commission is applying concepts typically limited to coordinated effects concerns under the banner of non-coordinated effects. In its analysis of non-coordinated effects in *Hutchinson/Telefónica Ireland*, the Commission in fact noted the link between the two.[41] This seems logical. In order to sustain collusion, the coordinating parties need to deviate from the behavior that would be optimal in the short run, i.e. given the prices of the competitors it would be profitable to set the price below the collusive level. The existence of a maverick can thereby render the ability of other firms to coordinate impossible.[42]

V. CONCLUSION

The Commission appears to have significantly lowered the intervention threshold for challenging mergers on the basis of non-coordinated effects well beyond what was originally anticipated back in 2004. This appears to be clearly the case for mobile telecommunications mergers.

The Commission is now essentially carrying out an analysis of the post-merger incentives for the merging parties and their competitors. Against this background, it becomes even more crucial what type of evidence the Commission is using to conclude what the post-merger incentives will be.

Against this background, the reliance on price pressure tests such as GUPPI/UPP to assess post-merger incentives will virtually always lead to the conclusion that the post-merger incentives of the merging parties and their competitors will be to increase prices,[43] because these tests will always show a price increase. An increased reliance on this type of tests, originally

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[39] *Hutchinson 3G UK/Telefónica Ireland*, ¶¶ 588 onwards. Interestingly, the Commission notes in its decision: "Despite Vodafone's claims during the Oral Hearing and written submissions that it would continue to effectively compete post-merger, the Commission therefore considers that Vodafone's likely strategy would be a moderate price increase (inferior to that of the merged entity) in order to optimize profits from this additional demand." The Commission refers to the finding that competing firms have incentive to raise prices as a response to a price increase by another firm "strategic complementarity" of pricing decisions and considers this a general characteristic in standard models of oligopolistic competition.

[40] ICN Report on Merger Guidelines at Ch. 3 (April 2004).

[41] *Hutchinson 3G UK/Telefónica Ireland,* ¶¶ 731 ("the merger will remove Three in its maverick role from the market") and 739 ("After the merger, the threat of Three disrupting coordination will be removed").

[42] CRA Competition Memo: *T-Mobile/Tele.ring: analyzing mavericks and efficiencies in "the first gap case"* (15 August 2008), *available at* http://ecp.crai.com/ecp/assets/Telering_Mobile.pdf. *See* also Jonathan B. Baker, "*Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*," 77 N.Y.U. L. Rev. 135 (2002).

[43] GUPPI stands for gross upward pricing index and UPP for upward pricing pressure. These concepts are used to measure predicted price increases post merger.

designed as a screen that would be used in lieu of market shares, significantly lowers the intervention threshold.

It remains to be seen whether the Commission will expand the use of non-coordinated effects and, in particular, the concept of an ICF, in sectors outside the mobile telecommunications sector. What is clear, however, is that the intervention threshold has been significantly lowered for mergers in oligopolistic markets.

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Competition in the Spanish Telecommunications Sector: Mergers, Football Rights, and Other Regulatory Issues

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Competition in the Spanish Telecommunications Sector: Mergers, Football Rights, and Other Regulatory Issues

Pedro Callol[1]

I. BACKGROUND: BUSINESS AND REGULATORY ENVIRONMENT

Spain is the fourth largest Euro zone economy with a domestic market of 47 million people. The recent recession has hit Spain hard, more than many other national economies in Europe. The telecommunications industry has weathered the crisis by competing fiercely in costs and consumer-oriented offers. One feature of the national market is the omnipresence of a historic incumbent, Telefónica, which is also one of the world's largest operators and number three in Europe by turnover.

Notwithstanding the presence of this giant, the market is considerably dynamic and it offers opportunities for international players, with various companies having gained a foothold in recent years. There have been a number of important mergers and acquisitions lately, as well as purely financial transactions and IPOs, with companies attempting to gain scale, better profitability levels, and access to finance.

A key event in Spain from the regulatory standpoint was the creation a couple of years ago of a new regulatory Authority, the National Competition and Markets Commission ("NMCC"), by the NMCC Act. The NMCC gathers the role of national regulatory Authority in various network industries (including the telecommunications), as well as the role of national competition Authority. This means that, at least in theory, decision making at both the regulatory and competition enforcement levels should be better coordinated, with some cross-consultation procedures having been eliminated (*e.g.*, the report from the regulatory Authority previously required prior to a merger control decision in the telecommunications sector) and most importantly with competition and regulatory decisions emanating from a single Authority. Reality is more complex than that though, and it is perhaps fair to say that the current catch-all structure is not unanimously applauded by the legal and business community.[2]

An additional important regulatory development specific to the telecommunications market was the approval of a new Telecommunications Act a year ago. The Telecommunications Act is the main piece of sector legislation in Spain, dealing with the granting of licenses and authorizations, access to network, spectrum policy, and enforcement. In overview, an attempt has been made to cut red tape and costs. For instance, not all operators are required to fund universal service obligations (only those which gross income exceeds the Euro 100 million benchmark). Market definition for the purposes of establishing *ex ante* obligations to operators with significant market power is entrusted to the NMCC.

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[2] For more information on these matters, *see* a short study on regulatory convergence *available at* http://callolcoca.com/wp-content/uploads/2013/09/Ever-doubted.pdf.

The telecommunications market is a priority for the NMCC, as will be seen below. Some key questions remain on future regulation, which will likely influence the future of the industry. For instance, it is worthwhile mentioning the current controversy surrounding prospective regulation by the NMCC of the new generation fibre networks. The NMCC is considering maintaining compulsory network sharing of new generation fibre to the home in most of the territory (with the exception of the cities where there are three or more suppliers, which happens only in very few instances) with Telefonica having threatened to interrupt investment in next-generation networks should this regulatory model prevail. This discussion is likely to be solved this year and it could have a dramatic impact on the shape adopted by investment in new networks.

In this short article we would like to touch briefly on three points: (i) the increasing importance of media content as a key component of the retail offerings of bundled telecommunications services, (ii) prominent competition matters in the sector in Spain, and (iii) mergers and acquisitions. In order to keep the conversation limited, we are not discussing other issues that have been hot, such as the recent spectrum allocation for digital television.

II. MEDIA CONTENT AS KEY DRIVER OF COMPETITION IN THE TELECOMMUNICATIONS SECTOR; IN PARTICULAR, THE ISSUE OF FOOTBALL BROADCASTING RIGHTS

Soccer or football is extremely popular in Spain. The revenues generated by the television broadcasting of prime football events in Spain may reach up to Euro 1.4 billion according to some estimates; nearly 1 million people are official members of the football Federation. And it suffices to only see the national television news to understand that football is widely regarded as having premier social interest and is the object of media, society, and government attention and regulatory agency scrutiny.

By the time of the merger to monopoly of the two existing pay-TV platforms in 2002, the Competition Authority had recognized that football and premium movie content were key assets to enable competition in the pay-TV market.[3] As a result of that merger, the duration of exclusivity agreements for the distribution of premier football and movie rights through the merged entity was limited to three years. But such limitations in the form of merger remedies were restricted in scope to agreements not yet in force at the time of the merger clearance (since neither the Hollywood majors nor the football clubs were parties to the 2002 merger review procedure and, therefore, the at the time existing agreements could not be affected by the merger decision).

To achieve required additional scope, two investigations followed suit a few years after 2002. One investigation was against Sogecable and the Hollywood majors based on a complaint brought by ONO, the cable operator, which argued that the output deals between the majors and Sogeable amounted to a bundle of long-term exclusivities, which made competition unfeasible for new entrants.

The second investigation took place against the first division football clubs on the one hand, and Sogecable and Mediapro (a later entrant who succeeded in accumulating substantial

[3] NCA merger Decision of 29 November 2002, case N-280.

football broadcasting rights) among others, on the other hand. This latter investigation dealt with the (also) long-term exclusivities granted in the upstream market for commercialization of football rights by football clubs to Sogecable and Mediapro. The Competition Authority limited future (post-2010) football rights commercialization agreements between football clubs and pay-TV platforms to three seasons.[4]

The latter investigation and ensuing antitrust decision against football clubs and pay-TV operators was hotly contested (among other things, on the grounds that the 2010 Media Act allowed content exclusivities for up to four, not three, years) and litigation ensued. Nobody was really happy and it became increasingly apparent that the existing model of individual marketing of football rights and the litigious environment surrounding it had to pave the way for a commonly agreed self-regulation or regulation enabling a centralized marketing system in line with that of other EU countries.

The Government finally agreed it was time to regulate and, in May 2015, the Government passed Royal Decree-Law 5/2015, of urgent measures in relation to the distribution of the exploitation rights of audiovisual contents of professional football competitions **(**"REAC"**).** The REAC puts an end to long and complex negotiations among stakeholders and aims to redistribute income from the sale of broadcasting rights by establishing and regulating the collective sale of broadcasting rights by Spanish professional football competitions.

Under the REAC, football clubs must, going forward, assign their broadcasting rights to a pool managed by an organizing entity (*i.e.* the Football League or the Spanish Football Federation depending on the competition). The organizing entity will implement: (i) joint selling (through licensing agreements not lasting longer than three years, following the NCA practice in this area as explained above); and (ii) distribution, pursuant to the regulated criteria contained in the REAC, of the income generated by the joint selling of rights. According to the income distribution criteria of the REAC, the difference between the club that receives the least and the club that receives the most income shall not be greater than 4.5 times.

The REAC may produce, as a result, a reduction of the differences of income between the most popular football clubs (Real Madrid and FC Barcelona) and the least popular. But a more orderly system of exploitation is also expected to increase the total revenue generated by the football rights.

III. COMPETITION ENFORCEMENT IN THE TELECOMMUNICATIONS SECTOR

The telecommunications industry, with its strategic and consumer-oriented character, and by displaying network effects and a trend towards concentration is an obvious candidate for competition enforcement and this is confirmed by the case of Spain.

On March 6, 2014 the NMCC decided to end proceedings against Telefonica, Vodafone, and Orange for allegedly abusing a collective dominant position. Subsequent to a complaint by British Telecommunications ("BT"), the NMCC had initiated disciplinary proceedings against Telefonica, Vodafone, and Orange for an alleged collective margin squeeze in the market for wholesale voice call origination services. In particular, BT claimed that Telefonica, Vodafone,

[4] NCA Decision of 23 April 2010, case S/0006/07.

and Orange had consistently narrowed the operating margins for Mobile Virtual Network Operators ("MVNOs") when setting the prices for (i) wholesale voice call origination services, (ii) call termination services in their national mobile telephone networks, and (iii) retail prices for mobile call services.

According to the NMCC, in order to determine the existence of a margin squeeze, the equally efficient operator test should be applied. The application of the test in this case resulted in negative margins; therefore, the NMCC initially concluded that an alleged margin squeeze had taken place. However, the NMCC considered that the equally efficient operator test was not applicable to abuse of collective dominant position cases unless it could be evidenced that, regardless of the wholesale offer adopted by the MVNO, the end result would invariably be a price squeeze. This conclusion was based on the fact that, in its assessment, the Investigation Directorate of the NMCC had omitted the fact that the MVNOs had the possibility of changing their host operator in order to configure a viable offer (in the reasoning of the NMCC, the operator could have configured a viable offer to compete with Telefonica by switching to Orange as wholesale supplier).

In other words, the individual price-squeeze test is not appropriate in collective dominance situations, where the reasonable test is one of "collective exclusion." Given both that the MVNOs had viable offers at the upstream/wholesale level and that the reality of the market showed new entry by MVNOs at the time of the alleged abuse, no exclusionary effects produced by the margin squeeze were proved.

On December 19, 2012 the NMCC found that Telefonica, Vodafone, and Orange had infringed Articles 2 Competition Act and 102 TFUE through abusive conduct in the wholesale telephone short messaging ("SMS") markets. According to the NMCC, each of these operators had a monopoly in the services for SMS termination in their own network, enabling the three mobile operators to fix higher prices freely in the termination of SMS. Given that termination is a cost that is passed on to consumers, it enabled operators to maintain higher retail prices in SMS. The NMCC condemned the operators involved for an exploitative abuse of dominant position, setting record fines totaling EUR 120 Million.

Another interesting case has been the more recent EUR 26 million fine on Telefonica for imposing permanence obligations (which, if breached, led to an increasing scale of penalties) on small and medium enterprises, acting as a sort of exclusivity banning clients' mobility.

It is perhaps worthwhile mentioning—because of its Iberian dimension—the EUR 79 million fine imposed on Telefonica and Portugal Telecom by the European Commission for agreeing not to compete with each other on the Iberian telecommunication markets. In the context of the acquisition by Telefonica of the Brazilian mobile operator Vivo, which was until then jointly owned by Telefonica and Portugal Telecom, the parties had deliberately agreed to stay out of each other's home markets (*i.e.,* the parties inserted a clause in the contract indicating they would not compete in each other's home market). This was regarded as contrary to Article 101 TFEU and confirmed by the Court of First Instance and the Court of Justice in Luxembourg.

IV. MERGERS AND ACQUISITIONS

As indicated above, intense activity in the mergers and acquisition market has occurred in Spain. Some of these mergers and acquisitions have been substantial corporate moves aimed to counter Telefonica's market power. Notably, Telefonica itself has carried out a strategic acquisition granting it access to premium content, which as anticipated is a key driver of competition in the world of multiple play bundled offerings in the telecommunication markets.

In April 2015 the NMCC approved the acquisition of Distribuidora de Televisión Digital S.A. ("DTS"), Spain's largest pay-TV operator (created the result of a prior merger-to-monopoly between Sogecable and Via Digital in 2002, see point 2 above) by Telefonica. The NMCC approved the transaction subject to commitments offered by Telefonica. Telefonica proposed a five-year duration commitment package (renewable for three additional years). The commitments may be summarized as follows:

1. Telefonica commits not to hinder the mobility of its current and future pay-TV customers by establishing any limitations to such mobility and to honor existing DTS contracts with other electronic communication operators for the distribution of the DTS television signal.
2. Telefonica will make available to other pay-TV operators the wholesale supply of a maximum of 50 percent of premium channels comprising Telefonica's supply (channels with exclusive rights over premium movie and football content) and at a price enabling the replicability of Telefonica's retail supply, preventing potential margin squeeze situations.

   The exclusive exploitation of the premium media content acquired by Telefonica is limited to two years and to certain types of broadcasting windows, while other windows (such as movie video on demand and TV catalogue) are prevented from being acquired on an exclusivity basis. Moreover, the resulting entity will limit to three years the duration of its contracts for the acquisition of content and shall waive the preferential acquisition rights of contents (again, in line with CNMC precedents and policy since the 2002 Sogecable/Via Digital merger decision).
3. Telefonica will enable third pay-TV operators to access Telefonica's broadband client base in competitive conditions. Telefonica commits to providing third-party access to its internet network in Spain, with capacity and sufficient guarantees of quality and in FRAND terms, which is clearly relevant for OTTs.

The Telefonica/Digital+ merger is clearly a strategic bet by Telefonica relying on content as a key competition driver. The merger conditions have been criticized by operators as being too soft and it is no wonder that the merger is currently being contested in court.

In July 2014 the European Commission cleared unconditionally the acquisition of ONO, a national cable operator, by Vodafone. The European Commission concluded that the transaction would not raise competition concerns, as the parties' activities were largely complementary: ONO's main activity was related to fixed telecoms, whereas Vodafone was mainly active in mobile telecommunications. Vodafone and ONO's activities displayed some overlaps in a number of markets in the fixed and mobile telecommunications in Spain and the

merger gave rise to a number of vertical and conglomerate relationships in the fixed and mobile telecommunication markets in Spain, in particular in relation to the provision of bundled multiple play services. However, the European Commission found that the impact of the transaction on these markets was likely to be limited because of the availability of alternative operators (such as Telefonica, Orange, and Jazztel) and the regulatory obligations in relation to wholesale access on mobile and fixed services.

In May 2015, the European Commission approved the acquisition of Jazztel by rival Orange. The European Commission had concerns that the takeover could have led to higher prices of fixed internet access services for Spanish consumers. To address the Commission's concerns and enable the entrant of a fourth nationwide operator, Orange submitted commitments based on different technologies:

- Divestiture of an independent fibre-to-the-home network covering 700,000–800,000 building units located in five of the largest Spanish cities, which is similar to the size of Orange's existing FTTH network in Spain.
- Granting the purchaser of the FTTH network wholesale access to Jazztel's national ADSL network for up to eight years, for an unlimited number of subscribers, allowing the purchaser to compete immediately in the majority of the Spanish territory as aggressively as Orange and Jazztel do today.
- Granting to the purchaser of the FTTH network wholesale access to Orange's mobile network including 4G services, unless the purchaser already has access to a similar mobile network.

V. CONCLUSION

The telecommunications business is a dynamic part of the Spanish economy and has continued to attract attention of regulators, as illustrated by the intense activity in the enforcement, merger control, and regulatory arenas. The Spanish case is a good example of how regulatory decisions can impact business, leaving remaining open questions, for instance, on key areas such as the (prospective) regulation of new generation fibre networks.

On the mergers and acquisitions front, some consolidation has taken place in Spain as illustrated by the examples pointed out above (and some others such as the Ibercom/Masmovil and Orange/Symio mergers). The European Commission's concerns in the Jazztel transaction came as a bit of a surprise in view of the existence of powerful competitors such as Telefonica, and were justified, at least informally, by the *maverick* nature of Jazztel and perhaps the fact that there had been a prior acquisition increasing market concentration (Vodafone/ONO).

This case may have been the first powerful signal of a change of policy from the Almunia era, where the Commission had voiced clearly that it would favor consolidation in the European telecommunications industry. The new Vestager administration seems to be positioning itself as far less liberal (not only on merger matters, as it appears when viewing, for instance, the course taken by the ongoing Google investigation) and less prone to market concentration. It remains to be seen whether this apparently radical shift in industrial policy from the European Commission will cast its shadow on national markets such as Spain and also influence decisions at the local level.

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Magic Numbers and Merger Control in the Telecommunications Sector

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Magic Numbers and Merger Control in the Telecommunications Sector

Pranvera Këllezi[1]

I. ON NUMBERS AND MERGER CONTROL

"There is no magic number,"[2] stated the European Commissioner Margrethe Vestager in early October of this year. The statement followed the withdrawal of the merger planned by Telenor and TeliaSonera, after the European Commission ("EC") objected, which would have merged the second and third largest Danish mobile operators and reduced the number of mobile network operators ("MNOs") to three. It was also a response to the calls for consolidation in the mobile telecom sector and the argument that markets with four mobile operators could not keep up with investments. While four is a must for some regulators,[3] "three is the magic number," according to the industry.[4]

A few years ago, the number "three" seemed to have magical powers, this time for the Swiss Competition Commission who blocked the merger between the second and the third largest mobile operators in 2010,[5] which would have created a MNO duopoly. Switzerland does not have the luxury of having four mobile network operators;[6] the same investment imperative was raised by telecom companies to justify a sustainable telecom market with only two players. This shows that after ongoing consolidation toward three MNOs, the industry would put forward the same arguments for a sustainable "magical duopoly" case in Europe.

Competition is not about numbers, but rather it is about effective competition at the retail level. Yet, numbers count for the assessment of anticompetitive effects and remedies, since merger control focuses on structure, the loss of competition prevailing before the merger, and replacement of that loss. When one competitor disappears, the remedies somehow have to replace its impact. Even the absorption of the smallest competitor may change market equilibrium, since such small

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[2] "Competition in telecom markets," speech held on 2 October 2015, at the 42nd Annual Conference on International Antitrust Law and Policy, Fordham University, available at http://ec.europa.eu/commission/2014-2019/vestager/announcements/competition-telecom-markets_en.

[3] *Four is a Magic Number*, THE ECONOMIST, (March 15, 2014), *available at* http://www.economist.com/news/business/21599012-operators-both-sides-atlantic-hope-break-spell-four-magic-number?fsrc=email_to_a_friend.

[4] *Together We Stand*, THE ECONOMIST, (August 22, 2015), *available at* http://www.economist.com/news/business/21661660-eus-new-competition-chief-will-have-rule-wave-mergers-together-we-stand.

[5] Swiss Competition Commission, decision of 19 April 2010, France Télécom SA/Sunrise Communications AG, DPC 2010/3, p. 499.

[6] Tele2, the smallest MNO, was acquired in 2008 by Sunrise, the third largest MNO. The Swiss Competition Commission cleared the merger without opening an in-depth investigation (DPC 2008/4, Sunrise/Tele2, p. 668).

players are often those that compete aggressively on the market to gain scale (the "mavericks") and disrupt coordination.[7]

But numbers are not the only factor taken into account; each merger assessment is case-specific, meaning specific to the conditions prevailing in the national market. Competition authorities have to deal not only with increased concentration and the risk of coordination, but also with the consequences of the integration of broadband and fixed telephony as well as bundling of services (triple or quadruple offers).

The assessment of telecom mergers follows a classical analysis of the merger's impact on market shares and market concentration, and on the loss of competition compared to the situation before the merger, and, therefore, the ability of the new entity to raise prices or lower output and quality. Cost savings and investments play a role in the assessment of ability of efficiency gains to offset the loss of competition.

Recent Telecom Merger Cases:

Year	Merger	Concentration	Position of merging parties before merger	Clearance and Remedies
April 2010	Orange/Sunrise (Switzerland)	3 to 2 merger in the MNOs market	2nd and 3rd	Prohibition
December 2012	Hutchison 3G Austria/Orange Austria (M.6497)	4 to 3 merger in the MNOs market	3rd and 4th	One upfront MVNO agreement, wholesale MNVO access agreements for up to 30 percent of its network capacity, spectrum divestiture, national roaming, and preferential rights to sites
July 2014	Telefonica Deutschland/E-Plus (M.7018)	4 to 3 merger in the MNOs market	3rd and 4th	Lease of spectrum, national roaming, divestment of building sites and shops (NMO Remedy); up to three upfront mobile bitstream access agreements for 30% of its capacity (MBA Remedy); wholesale access agreement to 2G/3G and 4G networks (non-MNO Remedy)
May 2014	Hutchison 3G UK/Telefonica Ireland (M.6992)	4 to 3 merger in the MNOs market	2nd and 4th	One upfront MVNO agreement, spectrum divestment, improvement of existing network sharing agreements
May 2015	Jazztel/Orange (M. 7421)	4 to 3 merger in the fixed telecommunica tion market	3rd and 4th	Divestment of FTTH network, wholesale access to ADSL bitstream service

[7] One of the first cases in mobile telecommunications was dealt with in the EC decision of 11 November 2000, M.2016, France Télécom/Orange (mobile telecommunication market in Belgium).

September 2015	Telenor/TeliaSonera (M.7419)	4 to 3 merger in the MNOs market	2nd and 3rd	Withdrawal / abortion[8]
Ongoing	Hutchison UK/Telefonica UK (O2) (M.7612)	4 to 3 in the MNOs market	2nd and 4th	In-depth investigation by the EC,[9] CMA (UK) asked referral
October 2015	BT Group (Vodafone UK)/EE (UK)	4 to 3 in the MNOs market	1st and 3rd	Provisional clearance by the CMA (UK); final decision expected by January 2016
Ongoing	Liberty Global/BASE Belgium (M.7637)	No change in the MNO market	3rd MNO and the largest MVNO	In-depth investigation by the EC[10]

II. INVESTMENTS AND COST SAVINGS

One of the underlying premises of competition law states that **competition drives investment**. This basic premise is challenged by telecom operators, who allege that without merging, some of them would not be able to undertake the necessary investments. But how is this linked with numbers and cost savings? In order to recoup investments, operators have to increase their customer base and, therefore, scale. Increasing scale via mergers and eliminating duplication of networks allow them to achieve fixed-cost savings. Scale and investment create barriers to entry, which protect existing MNOs from potential competition.

Along with frequency scarcity, this argument explains the "natural" concentration in the mobile communication market. This is understood from a competition policy standpoint, as is also the fact that barriers to entry and existing concentration are sufficient to protect current operators' business and allow them to invest. Other sectors do not benefit from such protection. At this point, it is not clear how higher concentration correlates to (more) investment, since reducing the numbers from four to three would not necessarily increase investment, but would very likely increase wholesale and retail prices. This possibility of increased prices explains the EC's doubts on the rationale of consolidation, saying higher concentration is driven by the expectation of higher revenues[11] rather than the need for cost savings. In the end, competition policy is not the right tool to handle investment incentives; challenges to introduction of new technologies should be considered in sector specific legislation applicable to the industry, not in individual merger control decisions.

Retail competition is important. It is that competition that keeps prices down for consumers, particularly when concentration or cooperation reduces it at the infrastructure level. While telecom operators allege that scale allows them to invest and realize cost savings, the

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[8] Statement by Commissioner Vestager on announcement by Telenor and TeliaSonera to withdraw from proposed merger, EC press release of 11 September 2015.

[9] Commission opens in-depth investigation into Hutchison's proposed acquisition of Telefónica UK, EC press release of 30 October 2015.

[10] Commission opens in-depth investigation into proposed acquisition of BASE Belgium by Liberty Global, EC press release of 5 October 2015.

[11] *See* EC decision of 2 July 2014, Telefonica Deutschland / E-Plus, M.7018, ¶ 541.

competition authorities assess first whether these cost savings will reach consumers[12] or whether they would be "passed-on" and, second, whether there are other ways to achieve the same goal without increasing further market concentration.

Cost efficiencies can be achieved without consolidation. Competition authorities claim that such efficiencies can be achieved through network-sharing agreements, an alternative that allows cost efficiencies in infrastructure and investment, while preserving the same number of operators running their own network. The difference between network-sharing agreements and consolidation is that with network sharing, the number of MNOs is safeguarded as are the benefits of competition at the wholesale and retail levels. Mobile operators without networks ("MVNOs") and other service providers diversify the retail offer and put pressure at the retail prices.

III. REMEDIES AND COMPETITION AT THE RETAIL LEVEL

Market maturity and convergence is challenging growth in the mobile telecommunication market. Free voice telephony and text messages are challenging fixed and mobile operators' margins; these operators should, in turn, invest and price differently their broadband and 3G/4G connections. Increased concentration enables higher prices and improves operators' profitability.

The focus of competition policy is on consumers and, therefore, retail pricing. The majority of remedies aim at lowering barriers to entry to newcomers, MNOs, and MVNOs, in order to maintain the same level of competition pressure at the wholesale and retail level. Spectrum divestment, upfront sale of capacity to MVNOs, and wholesale access guaranties are designed to enable existing or new mobile operators to increase their offers at the retail level without having to invest in a network.

Safeguarding competition between MNOs has an impact on the basic costs of MVNOs and their negotiation power in a regulatory setting, which generally does not grant mandatory access to the networks of MNOs. Access remedies ensuring MVNOs or other service providers access to the networks of MNOs are highly regulatory in nature, and create inequality between MNOs. The new entity has to respect its commitments, which is not the case for other operators. On the other hand, while they define access conditions to the network of the new entity, such remedies have no bearing on the market behavior of other MNOs, nor on the virtual network providers. Such remedies may be imperfect to correct market coordination.

Competition authorities have been reluctant to impose behavior or pricing remedies at the wholesale or retail level. The EC does not use price caps or price monitoring remedies. Although they might help control unilateral price increases by the merging parties, such caps cannot do much on the coordination effects due to price increases by other operators in the market.

Another issue is implementation of remedies. When network access and spectrum are not used by new competitors, remedies cannot function and significant competition is lost in the merger. This was apparently the case in Austria after the Hutchison 3G/Orange merger in 2012, where the remedies were not able to create a newcomer and replace the loss of competition.

[12] Cost efficiencies related to fixed infrastructure are not reflected in prices, and cannot be fully "passed-on" to consumers, contrary to efficiency gains in variable costs, according to the European Commission. This point is highly debated by telecommunication operators.

According to OECD, the clearance of the Hutschison acquisition of Orange Austria by the European Commission resulted in higher prices of about 10 percent for some offers.[13] OCDE states that "prior to the merger, Austria had one of the least expensive markets for mobile communication services in the OECD." This is no longer the case after the clearance of the merger by the EC, contrary to the view of the Austrian competition authority. The Austrian precedent may impact future cases.

The particularities of national markets call for more involvement of national competition authorities, and highlight the limits of the one-stop-shop merger control in Europe. Referrals to national competition authorities might allow them to design better remedies and, if necessary, introduce price caps or price monitoring mechanisms, if such authorities can supervise these measures. If not, prohibition might be the only remedy.

Mergers have lasting impact on market structure. The regulatory remedies which have been used in recent times might be highly regulatory and difficult to enforce, and are not effective tools to control price increase. Investment imperatives cannot be addressed by merger control. These difficulties explain the temptation of the EC and other competition authorities to go back to the source of merger control and preserve market structure by preserving numbers.

[13] OECD, *Wireless Market Structures and Network Sharing*, OECD Digital Economy Papers, No. 243 (2014), *available at* http://dx.doi.org/10.1787/5jxt46dzl9r2-en, at 31: "After the merger prices jumped from Q2 2012 to Q1 2013 with an 8 to 10 index points across the board, or a 12% increase for some offers."

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Services of General Economic Interest in the Telecommunications Sector

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Services of General Economic Interest in the Telecommunications Sector

Aleksander Maziarz[1]

I. INTRODUCTION

EU law does not provide a definition of Services of General Economic Interest ("SGEI");[2] simply, it gives a wide discretion in the introduction of these services and their performance to the Member States. But this does not mean that every service can be regarded as SGEI; such status can be given only to those services which are indispensable for every member of society. Moreover, such services need to be supported by the state because of the market failure in their provision. Simply put, companies would not deliver such services to every interested citizen because they would be unprofitable. When the market is unable to provide society with essential needs there is a place for state intervention in the form of SGEI.

The concept of SGEI is very misty. It gives a lot of room for interpreting which service can be regarded as a SGEI. The European Commission states that Member States are, in general, free to define such services.[3] However, the Court of Justice of the EU ("CJEU") has stated that Member States are not unlimited in their recognition of SGEI and that they cannot do it in an arbitrary manner.[4] In several judgments, the CJEU has pointed out that the classification of a service as a SGEI by a Member State may be challenged by the European Commission in the event of manifest error. In another judgment, the Court has stated that such services relate primarily to an individual Member State.[5] It means that recognition of a SGEI may differ from one Member State to another.

The telecommunication sector is one of the sectors of economy in which SGEI can be provided. But because there is no clear guidance which services in this sector can be regarded as a SGEI per European court judgments a Commission decision is needed. The aim of the article is to answer which telecommunication services can be classified as a SGEI, and if it is possible to find common elements of such services.

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[2] "Services of general economic interest are economic activities that public authorities identify as being of particular importance to citizens and that would not be supplied (or would be supplied under different conditions) if there were no public intervention" (as described by the European Commission at http://ec.europa.eu/competition/state_aid/overview/public_services_en.html).

[3] European Commission, Green paper on services of general interest, COM(2003) 270 final.

[4] Case T-442/03, SIC v. Commission [2008] ECR II-1161, ¶ 195; T-289/03 BUPA and others v Commission,]2008] ECR II-8, ¶ 166; T-17/02 Fred Olsen, SA v Commission [2005] ECR II-02031, ¶ 216.

[5] Case C-159/94 Commission v France [1997] ECR I-5815, ¶ 56.

II. SGEI AND UNIVERSAL SERVICES IN THE TELECOMMUNICATIONS SECTOR

First we need to draw a clear distinction between universal services and SGEI. The concept of universal services comes from the European Union. The European lawmaker decides which services are so basic and needed by society that they should be provided in every Member State. So it is up to the European legislator to decide which services are universal services.

SGEI are services which are defined by an individual Member State, and they can cover the whole territory in any given Member State or even part of it. They are introduced by an act of public authority—e.g. an administrative decision, normative act, or agreement.[6] The proper assignment of a SGEI label is only possible when an exemption of applicable competition rules to undertakings providing that SGEI is necessary. Moreover, there must not be any infringement of the development of trade to an extent contrary to the interests of the European Union.

It can be said that SGEIs are defined locally by every Member State while universal services are defined for the whole European Union. The second difference is that universal services are defined in directives while SGEIs are defined by different public acts of Member States. Only in case of a SGEI is it necessary to fulfil the conditions set by European lawmaker. Many authors claim that those terms are used interchangeably, which is clearly misleading. Neergaard states that universal services express the interests of the European Union, while SGEIs express the interests of particular Member States.[7]

In the telecommunications sector there are plenty of directives introducing universal services. One of the first directives was Directive 98/10/EC of 26 February 1998 on the application of open network provision ("ONP") to voice telephony and on universal service for telecommunications in a competitive environment.[8] This Directive required Member States to ensure the availability of telecommunications services for all users in their territory irrespective of geographical location. The Directive required affordability of these services to be assured, especially for such user groups as the elderly, people with disabilities, and people with special social needs. Their provision had to be guaranteed throughout the territory of the Member States for every user at an affordable price.

Directive 2002/22/EC of 2002 on universal service and users' rights relating to electronic communications networks and services[9] recognized as universal services (i) access to fixed networks, (ii) directory inquiry services, (iii) public directories, and (iv) public pay telephones. Moreover, Member States were obliged to designate companies to provide universal services. This directive was later amended by Directive 2009/136/EC amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector, and Regulation (EC) No 2006/2004 concerning cooperation between national authorities responsible for the enforcement of consumer

[6] Case C-475/99 Firma Ambulanz Glöckner v Landkreis Südwestpfalz, ECR [2001], p. I-8089.

[7] THE SERVICES DIRECTIVE, CONSEQUENCES FOR THE WELFARE STATE IN THE EUROPEAN SOCIAL MODEL, 73 (U. Neergaard, R. Nielsen, & R.M. Roseberg, eds. 2008).

[8] OJ L 101/47, 01.04.1998.

[9] Universal Service Directive; OJ L 108/77, 24.04.2002.

protection laws.[10] New provisions broadened the scope of universal services in telecommunications, including connections (supporting voice, facsimile, and data communications at data rates that are sufficient to permit functional internet access); providing public pay telephones and other public voice telephony access points; telephone directory inquiry services; and emergency services.

III. CASE LAW ON SGEI IN THE TELECOMMUNICATION SECTOR

One of the first cases concerning the SGEI and the telecommunication sector was *British Telecom*.[11] In that case the CJEU stated that British Telecom had a statutory monopoly on running the telecommunications network and was obliged to ensure phone and telex connections. Moreover, British Telecom had imposed schemes by which it specified charges and conditions of usage of the network. In one such scheme British Telecom limited the services of private message-forwarding agencies. In this case the CJEU did not agree that British Telecom, as a monopolist, had abused its powers in order to limit competition.

It can be said that the running of a public telecommunication network is more important that the existence of competition which can provide services at lower prices. In this case we can see that the Court had divided services into two categories. The first category, which was considered as a SGEI, consisted of running a telecommunications network. The second category were services which were not standard at the time. In order to protect the proper provision of a SGEI this second category of services could be sacrificed. Why? Because such "premium" services allow for extra revenue, and they give greater profits. But such profits should be used in order to guarantee the provision of a SGEI.

In *British Telecom*, there is only one conclusion. At that time, such services like telex were relatively new, and by limiting competitors from providing them technological progress was also limited. Once more, then, it can be concluded that the provision of a SGEI was the most important task and other values such as competition or technological progress were simply less important.

The second case which concerned operating a public telephone network was the *RTT* case.[12] In this case two findings about SGEI in the telecommunication sector were made. First, the CJEU found that operating a public telephone network, which is available for all users, is a SGEI. However, the Court also found that excluding competition rules in the marketing of telephone devices could not be justified by the provision of a SGEI within the meaning of Art. 106 (2) TFEU—the production and sale of such devices should be freely available for other companies. However, in order to ensure the safety of users and protect the safety of operators of public networks against damages, required compliance with technical specifications of such equipment can be required.

This position was also expressed by the Court in the case of *France v European Commission*.[13] Here the Court found that assigning a single company, which sells a certain type

[10] OJ L 337/11, 18.12.2009.

[11] Case 41/83 Italy v Commission [1985] ECR 873.

[12] Case C-18/88 RTT v GB-Inno-BM [1985] ECR 873.

[13] Case C-202/88 France v Commission "Telecommunications terminals," [1991] ECR I-1223, ¶ 51.

of equipment, the right to determine the technical specifications of that equipment and mandating the use of those specifications puts that company in an advantageous position against competitors. It emphasized that the exclusion or restriction of competition was not justified by performing a public service. Such measures limit not only competition but also limit consumers' choices when buying products. Such rights also limit the choice of technology provided on the market, because it is doubtful that the holder of exclusive rights would offer as wide a range of equipment as would be produced by different companies.

The Court found that this market failure is the key factor to take into account when introducing a SGEI, but other factors have to also be taken into account. It can be even argued that in this case the Court used a test of proportionality and considered what was essential for the provision of SGEI. It put on the scales SGEI and intra-Community trade and checked which one was more important.

In these two cases we can see that there is always tension between providing SGEI and expanding monopolies. In accordance with Art. 106 (2) TFEU undertakings providing SGEI are subject to the rules contained in the Treaties insofar as the application of those rules does not constitute legal or factual obstacles to the provision of such services. This means that every SGEI must be in accordance with the rule of proportionality. According to Sierra's analysis of the principle of proportionality, this presupposes a very strict interpretation thereof. The SGEIs will be allowed only those restrictions that are necessary to meet the objectives of SGEI.

This leads to the conclusion that if the provision of those services is possible by means of other, less restrictive means it cannot use the exclusion contained in Art. 106 (2) TFEU.[14] We can see that in the *RTT* case the Court found that a provision of SGEI was not enough to limit the market for telecommunications equipment. Such limitation would be justified, however, if e.g. profits from such a market were necessary to cover losses connected with the provision of SGEI.

In recent years the European Commission has considered whether operating a high-speed broadband network constitutes an SGEI. In the *Colt Telecom* case, the French government recognized as a SGEI the operation of a high-speed broadband network in an area close to Paris. The area in which this service operated was very wealthy, and was also covered by other networks. In that case the SGEI was not the only service provided; there were already available services which enabled access to the internet.

This latter factor was crucial for CJEU. The Court underlined that market failure is a necessary element for classification as a SGEI. The court stated also that such services must be universal and compulsory in their nature. High-speed connectivity can be regarded as a SGEI only if the whole population is covered.[15] This case shows the problem of overlapping an SGEI with similar services that are already on the market. The problem would be easy if broadband networks did not cover all areas. In such a situation the Member State could introduce an SGEI in order to fill the gaps in the coverage.

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[14] J. Buendia Sierra, Exclusive Rights and State Monopolies under EC Law Article 86 (former Article 90) of the EC Treaty, 304 (2000).

[15] Case T-79/10 *R* COLT Télécommunication France v Commission [2010] ECR II-00107.

But in the *Colt Telecom* case there is one more issue to discuss. It can be agreed that access to the internet is so essential that every member of society should have access and thus such access can qualify as a SGEI. Broadband networks enable high-speed access to internet connections and could be regarded as a way of providing a SGEI—even high-speed internet can be regarded as SGEI. There is no clear answer as to which of this two services could be classified as a SGEI. If we consider the technology in proving an SGEI in the *Colt Telecom* case, it must be observed that there were other operators that already provided similar services.

But we have to keep in mind that SGEI is a very dynamic concept and it changes over time. It can be argued that nowadays access to high-speed internet connections is essential for a given society. But such finding should be made based on actual needs of society. In the European Commission's Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband it is stated that, in metropolitan areas in general, such services exist, and there is no need for a SGEI.[16]

These guidelines provide two examples of cases concerning SGEI and broadband connections in metropolitan areas. In the first case, described more fully below, the Commission refused to classify as a SGEI the roll-out and operation of Metropolitan Area Networks ("MANs"), which were introduced in Ireland.[17] The Commission found this initiative to be a private-public-partnership, which was business-oriented. In the second case, the Commission found that broadband services were provided only for business parks and public sector organizations, excluding sectors that were inhabited by citizens.[18]

A very different view on broadband services was made in the *Limusin* case. This case concerned providing such services in rural and remote areas. The Commission found that providing broadband services in such areas classified as a SGEI. This finding was made on the basis that there was a market failure in not providing services to these areas—and that broadband services were essential for society.[19] This finding was supported in the Community Guidelines for the application of State aid rules in relation to the rapid deployment of broadband networks. Broadband deployment can be classified as a SGEI, especially in the case of rural and underserved areas where there are hardly any providers.[20]

Another case concerning SGEI in providing broadband network was *Pyrénées-Atlantiques*, which concerned granting a 20-year public service concession providing broadband services to cover the entire Pyrénées-Atlantiques region of France. The Commission had no doubts that such a service consisted a SGEI. It underlined that concessions were required to build a network infrastructure that was open for every other network operator and available for every end user, even though France Telecom's services partly covered that region. Again it was

[16] OJ C25, 26.01.2013, p.1.

[17] European Commission decision No 284/2005-Ireland, C(2006)436 final.

[18] European Commission decision No 890/2006 – France, "Aide du Sicoval pour un réseau de très haut debit," C(2007) 3235 final.

[19] C. Koenig, EC Competition and Telecommunications Law (2009).

[20] European Commission, Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks, OJ C 235/7, 30 September 2009.

confirmed that services can be classified as SGEIs in situations where is there is a market failure in providing such services.[21]

In the *Deutsche Telekom* case the CJEU stated that a telecommunications company that is preforming SGEI can abuse its dominant position by margin squeezing, and charging its competitors prices that are higher that prices offered to end-users is incompatible with Treaty rules. The Court found that there was no justification for Deutsche Telekom to do so and such pricing practices were not connected with assigning a SGEI status to this company.[22] The Court found that such a practice was a form of abuse of dominant position that aimed at limiting competitors.

It has to be underlined that SGEI is a form of public intervention on the market, which aim is to guarantee the provision of specific services. This means that there is no possibility of creating public-private partnerships or other forms in which public bodies participate in providing this service. An example from the telecommunication sectors is the *MAN* case, which concerned building a high-speed broadband infrastructure in Ireland in over 120 towns where there was no such infrastructure.[23]

The Commission found that in this case there was a public-private partnership entrusted with providing a SGEI.[24] There were also more elements missing that were needed to classify the MAN project as a SGEI. First, there was no obligation to provide services to citizens. The project assumed that public bodies would choose an infrastructure operator to offer services to telecommunication companies. This meant that the project was business-oriented and no obligations were designed for citizens. In the cases mentioned above there was a clear public mission for the SGEI, but in this case it was just a business, which helped provide telecommunications services to those areas which were cut off.

IV. CONCLUSIONS

In the telecommunications sector there are plenty of universal services defined by the European lawmaker. But it does not mean that there is no place for a SGEI. As mentioned above, universal services are introduced in every Member State while SGEIs can be introduced only in one Member State or even in part of it. This means that a SGEI can reflect those needs of a given local community that are different from those in other parts of the European Union. Technological progress results in telecommunication services that are recognized as premium in one area, while in another area the same service is a standard that is needed by everyone. Such needs can be reflected by a SGEI but it has to be underlined that a SGEI must be provided for every citizen interested in these services.

In many cases the CJEU or European Commission found that it was right to classify as a SGEI the operation of a public telecommunication network but in some cases it challenged certain special or exclusive rights that were given to the companies performing the SGEI. Very often the CJEU has to determine what values can be sacrificed in order to guarantee the

[21] Case N 381 / 2004 - Haut débit en Pyrénées-Atlantiques - France.

[22] Case T-271/03 Deutsche Telekom AG [2008] ECR II–477.

[23] Commission Decision 284/2005.

[24] Koenig, *supra* note 18.

provision of SGEI; for example, in many cases it has clearly recognized that the sale of telecommunication equipment cannot be recognized as SGEI. This means that a SGEI cannot be provided at any cost and that competition limitations have to be proportionate.

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The Role of Economic Analysis in the Comcast Time Warner Cable Merger

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The Role of Economic Analysis in the Comcast Time Warner Cable Merger

David S. Evans[1]

Earlier this year, Comcast abandoned its proposed merger with Time Warner Cable in the face of opposition by the U.S. Department of Justice and the Federal Communications Commission. This article briefly discusses the economic analysis presented and points the reader to interesting material in the filings that may have relevance to other mergers and antitrust cases.

During the roughly fourteen months, between the announcement of the merger on February 13, 2014 and its collapse on April 24, 2015, economists working for Comcast, and economists working for several companies that opposed the merger, presented significant theoretical and empirical evidence to the agencies. They debated whether the merger would substantially lessen competition or tend to create a monopoly (the standard for the Justice Department) or cause public harm (the standard for the FCC).

Until the end, the media accounts of the merger focused on Comcast's claim that the merger was innocuous because Comcast and Time Warner claimed they did not operate in the same local markets and therefore did not compete. If that were the economic crux of the matter the merger review process would not have taken so long. They really don't compete for cable households. Like other American cable companies providing services for households they seldom operate in the same market as another cable company. In fact, most American households face a choice between one cable company and one telecom company.

Much of the analysis focused on two key characteristics of the merging parties:

1. Both provided broadband services; they were Internet Service Providers ("ISPs"). As ISPs they were two-sided platforms that were intermediaries between internet content providers—which include online video distributors ("OVDs") such as Netflix—and households.
2. They both also provided linear programming and pay television services; they were multi-video programming distributors ("MVPDs"). OVDs have encouraged American households to "cut the cord" with cable or to reduce the size of the bundle of channels they buy.

These features led to two key issues on the broadband side.

First, would the merger increase interconnection fees for OVDs, and possibly other internet content providers, and thereby cause harms that would give the Justice Department and FCC concerns under their respective mandates? That led to a consideration of bargaining

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between large ISPs and OVDs, the examination of empirical evidence concerning whether larger ISPs charge higher interconnection fees, and whether Comcast even has the incentive or ability to impose interconnection fees. That was the key horizontal issue.

Second, would the merger increase the ability and incentive of Comcast to foreclose OVDs because they competed with Comcast's MVPD business? That led to an examination of whether OVDs were complements that Comcast wanted to embrace because it could make more money on the ISP side or extinguish, if it could, because it would lose more than that on the MVPD side. While some of that analysis involved economic theory, much of it was based on the interpretation of Comcast actions and business documents. Those were the key vertical issues.

There is much fodder in this case, including the analysis of two-sided platforms, monopoly bottlenecks, bargaining theory, vertical restraints, and the use of natural experiments to test hypotheses. As the economist working for Netflix in opposition to the merger I naturally have my own views on the questions posed above and the weight of the evidence. But regardless of whether you agree with me, or with the conclusion reached by the two authorities that reviewed the evidence, there is a lot of interesting material in the filings that may have relevance to other mergers and antitrust cases, including:

- The main Neflix filings, as well as the main Comcast filings, which include declarations by Comcast's economists; [2] and
- Many of the key submissions to the FCC and a link to the entire FCC record. The FCC, unlike the Justice Department, has an obligation to provide a public record of non-confidential material.[3]

[2] *Available at* https://www.competitionpolicyinternational.com/the-comcast-time-warner-cable-merger-economic-and-legal-submissions-by-netflix-in-opposition-to-the-merger

[3] *Available at* https://www.fcc.gov/transaction/comcast-twc.

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Are "Free" Relevant Markets Actually Free?

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Are "Free" Relevant Markets Actually Free?

Fernando Herrera González, PhD[1]

I. INTRODUCTION

The internet has changed our lives in several aspects; in fact, without fear of exaggeration, those changes can be described as revolutionary. One of the things we have started to get used to from the internet is the ubiquitous provision of free services. We can search information for free, we can receive and send messages for free, we can talk with distant relatives for free, we can play games and watch movies for free, and so on.

It is easy to get used to getting things for free. It is also easy to forget that this is something we humans have never enjoyed in our history. We are used to having to pay a price for everything we need, a dear price just to survive for most of our history. The preponderance of free services constitutes a good indicator of the revolution the internet presents in the minds of many people.

So, is there in the end "such a thing as a free lunch"? The economist Milton Friedman (awarded the Nobel Prize in 1976) famously titled one of his books *There's No Such Thing as a Free Lunch.* Has the internet changed the way economic laws work or has this phrase just been refined to the current "If you're not paying for something, it is because you're the product"?

II. BACK TO BASICS: INTERCHANGE IN ECONOMIC THEORY

Individuals have needs. In order to satisfy those needs, they require resources, whose specific nature depends on the concrete need to be covered. Resources can only be obtained from the surrounding world, through investment in effort and time.

Fortunately, in the early stages of our history, someone discovered that resources could also be obtained by interchange with other individuals. Talking about revolutionary changes, this discovery led to the possibility of specialized work and vast increases of productivity and wealth for all humanity.

Our focus is on the analysis of these transactions. As already stated, individuals may obtain resources to satisfy their needs by interchange with other individuals. A voluntary interchange will only happen if both individuals think that they are going to profit from it (not necessarily in monetary terms, it may be in psychic terms).[2] In other words, a voluntary interchange happens when the marginal utility of the received good is higher than that of the given good, for both individuals. The received good satisfies a need of higher rank in the hierarchy of each individual than that satisfied by the given good.

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[2] *See* M.N. ROTHBARD, MAN, ECONOMY, AND STATE, Ch. 3 (1962).

When an interchange happens, a price appears. The price may be defined as the ratio of exchange between two commodities, expressed as the number of units of one of the commodities. Prices are historical phenomena that only appear when an interchange is consummated.

There are three more concepts related to an interchange. The revenue is the utility provided by the goods received in exchange of the given good. The cost of the transaction is the utility renounced because of the interchange; that is, the utility that could have been obtained if the given good would have been allotted to the next need in the ranking of preferences. The profit is the difference between both magnitudes and, as can be seen, is subjective and not quantifiable.

Economic theory goes on to explain how prices are formed.[3] The main point to retain here is that the concept of interchange is general for any kind of good, and that prices can be expressed in any of the commodities interchanged. So, if two rabbits are exchanged for a sack of flour, it can be said both that the price of a rabbit is/has been half sack of flour and that the price of a sack of flour is/has been two rabbits.

Of course, direct interchange as described above has considerable limitations; it is difficult to match the preferences of two individuals, both in terms of desired goods and desired quantities. These limitations may be overcome by the use of a generally accepted good as a means of interchange. This good is known as money and gives rise to what is usually called indirect exchange. Individuals may so exchange their products for money, and later exchange the money for the good they require, which is certainly more effective that looking for someone who is interested in the product and ready to give in exchange the required good.

The use of money is another revolutionary change, and one that has also allowed the creation of vast quantities of wealth for societies. For our purpose, the main thing to note is that most economic transactions currently have money as one of the interchanged commodities. Because of that, we have grown used to express prices in monetary units. So, we say that the price of a rabbit is 10 Euros, but it is very strange to hear that the price of 1 Euro is 1/10 of a rabbit.

However, monetary transactions are just a subset of economic transactions, those in which money is used. But they are by no means the only type of interchanges, as already discussed. The fact that there is no money involved in the transaction does not mean that the transaction is free for any of the involved parties, as the above example of interchange of two rabbits for a sack of flour shows.

III. NEW MARKETS, NEW TRANSACTIONS

With this in mind, let us turn back to the supposed zero-priced[4] activities on the internet. Are they considered zero-priced because they actually constitute a gift from one party to the

[3] *See*, for example, E. VON BÖHM-BAWERK, THE POSITIVE THEORY OF CAPITAL, (Translated into English by W. Smart, 1891).

[4] In the rest of the paper, the term "zero-priced" is preferred to "free" to avoid ambiguities in a regulatory context. In this context, a free activity may be understood as an activity not subject to Government intervention.

other? Or is it because no money, but other assets, are interchanged? Is the lunch actually free or isn't it?

The paramount example of a "zero-priced" activity on the internet has always been the provision of searching services to users. This is how respectable giants such as Yahoo or Google started their activities. By now, it is clear that their business model is based on advertising; they get their revenues from people who want to advertise products or services to third parties.

Google offers us a zero-priced use of its search engine and other web applications, because that is how Google attracts our attention to its advertisements. The business model of Google roughly involves two types of transactions:

1. Google offers an audience of possible customers in exchange for money from the advertisers.
2. Google offers web services in exchange for the attention (requiring time) from the users.

As can be seen, none of these transactions is zero-priced for the involved parties. The only difference between them is that one involves money, the other does not. Both are economic transactions that are carried out in the respective markets.

The business model of search engines is quite well known and has been used (and is still in use) by free-to-air television and radios. A similar model is used by several digital media. In summary, they provide contents in exchange for our time and attention. They are not giving us their contents for free, but in exchange a commodity: time.

More complex are other business models proposed on the internet, because in some cases they have not yet proved their viability. It is the case of the business model of WhatsApp: they provide (nearly) zero-price instant messaging and (for some months now) voice calls between its customers. While some say that the subscription fee required per user (currently, U.S. $0.99 per year) is enough to make the business profitable, there are others that think the business model could be explained in the value of the data they acquire when the customers send messages. These suspicions arise as a consequence of the high value put on WhatsApp by Facebook, which seems difficult to explain just taking into account the revenues from subscription fees. The same suspicions seem applicable for the recent launch of Windows 10, given at zero price to users of previous Microsoft operating systems.

Be it time or data, it is clear that users are exchanging some commodity for internet services, and in consequence that these services are not zero-priced. Of course, if a concrete individual does not value his time or his data, the services will appear as free for him, even if it is clear that the service provider would likely not provide the service if it were not paid for in this kind of commodity.

Recall that for a voluntary transaction to take place it is necessary that both parties value that which they receive more than what they give away. This is compatible with one of the parties not conferring any value to the given commodity, but that does not make the transaction less economic or costly.

Summing up, it seems that the internet has given birth to new business models based on non-monetary transactions. They rely on economic transactions in which time and possibly

personal data is exchanged for information services and contents. These interchanges are of the same nature as the more widespread monetary transactions, and cause concrete markets to exist— and these markets of course may be analyzed with the usual technics.

IV. TIME AS A RESOURCE

For the moment, we will focus on time, whose nature as a valuable limited resource is well established by millennia of human experience. Personal data, the other commodity that seems to be traded in zero-priced activities, requires a more detailed and complex analysis, which is beyond the scope of this article.

It is scarcely worthwhile to recall that time is limited. Each individual only has a certain time to live, and most part has to be dedicated to physiologic needs (at least, with the current state of the art). The available time after these basic needs is distributed among several activities, according to the preferences and requirements of the individual.

As every action attempted by individuals requires time, it is obvious that it is impossible for us to do every possible activity. Therefore, time constitutes another scarce resource to consider when taking decisions. Besides, time has one feature that most economic resources do not have: time is irreversible and cannot be "stored," at least with the current state of technology. The time which is not used elapses, and can never be used.[5]

When an individual chooses Google to search for some information, or YouTube to watch a content, or Facebook to contact some friends, he is purposely allocating time to the activity. The internet service provider may use part of the allocated time to its own purposes, such as showing advertisements.

Depending on the subjective value of time for the individual with regard to his goals, he may be ready to "waste" some of this time auditioning the proposed advertisements, or not. For example, if Google is especially effective in searching results for the intended purpose, the user may be more willing to spend time with the advertisements. This partly explains the dynamics of innovation in this field; quicker and more accurate results are the propelling force for search engines.

If one has a couple of hours to spare for entertainment, some providers may be ready to provide content in exchange for some time attending advertisements. Others try to exchange the content for money, assuming that the individual values his time high enough to prefer avoiding the advertisements.[6] Once again, the value that each individual assigns to his available time is the key to explaining the different business models.

Once established the value that time has for zero-price internet services, it can be expected that, if there is freedom of entry, a fierce competition appears for time. Do not forget that time cannot be stored nor its production increased, so its value can only increase as a result of possible alternative activities. How is this competition manifested?

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[5] For a more detailed analysis of the economic features of time, *see* M. J. Rizzo, *Time in Economics*, THE ELGAR COMPANION TO AUSTRIAN ECONOMICS, 111-117 (P.J. Boettke, ed. 1994).

[6] Of course, other features may have more relevance for the value of content and the ability to exchange it for money: quality, novelty, uniqueness of the event… In any case, time will be required to consume the content.

As time increases its value, internet providers are able and obliged to "pay" more for this time. They pay for our time with more services, as is easy to assess when analyzing the evolution of successful enterprises as Google or Facebook.

Google, for example, has incorporated to its original zero-price search service, a plethora of zero-priced web services (e-mail, maps, hosting, cloud, videos, pictures…), together with software for PCs (Chrome), a mobile operative system (Android), and apps. And the trend goes on, as the already quoted example of Microsoft with Windows 10 shows.

In any case, the above examples are just empirical evidence of the theoretical analysis exposed: time is a scarce resource and has a different value for each individual. In consequence, time may be (and in fact is) used as medium of exchange with which to pay apparently zero-priced services.

V. CONCLUSION

Internet free markets have posed some challenges to competition and regulatory authorities. Some authorities have wondered if this zero price could be a case of predation, but fortunately for the users the idea has not progressed, at least for the moment. Others consider that a free market, being free, may not pose competition problems, as is the case of the European Commission in the acquisition of WhatsApp by Facebook.

The authorities' main problem has normally been how to measure the market in the absence of a price for the service. Academics have proposed to tackle the issue by means of the theory of "two-sided markets,"[7] in which zero prices in one side of the market may be rational (and not predatory) and explained by the revenues obtained in the other side of the market.

This paper shows that these problems have their roots in the narrowing of the concept of economic interchange: most authorities and economists seem to consider that a transaction is economic only if money is exchanged. They confuse economic transactions with monetary transactions.

Plenty of the new business models that are flourishing on the internet are based on economic transactions that are not monetary, but are not free (zero-priced) either. It has been shown that payment can be made with time and with personal data.

So, if these markets need to be analyzed for competitive or regulatory purposes, the unit of measure should be coherent with the kind of transactions going on in those markets. If time (or data) is the money in those markets, then it just seems logical to use it for competitive assessment, for example, in the application of the SSNIP[8] test (and thus the scope of the relevant market), and in the calculation of market shares.

It has also a clear impact in merger regulation thresholds. As these thresholds are defined in terms of currency, they ignore the amount of revenues in time and data that the involved firms may have. Because of that, a redefinition of these metrics seems in order.

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[7] *See* J.C. Roche & J. Tirole, *Platform Competition in Two-Sided Markets,* (1) J. EUR. ECON. ASSOC. 990–1029 (2003).

[8] Small but Significant Non-transitory Increase in Price.

Of course, none of these processes seem easy, and plenty of obstacles lie ahead. But citizens deserve the same effectiveness of competition policy, regardless of whether they pay with money, with their time, or with their data.