



## Merger to monopoly: NewsCorp/Telepiù

Under what circumstances should a competition authority allow a merger that creates a monopoly? As competition policy is predicated on the need to protect consumers from market power, the presumption might be that such a merger should never be allowed. However, there are circumstances in which a merger to monopoly can be the best available option. The European Commission's recent clearance (subject to undertakings) of the merger of the two competing satellite operators in the Italian pay-TV market (Stream, jointly owned by NewsCorp and Telecom Italia, and Telepiù, owned by Vivendi) provides a pertinent example.<sup>1</sup> The acquisition of Telepiù by NewsCorp will create a single unified satellite platform (to be branded Sky Italia), controlled by NewsCorp and with Telecom Italia as a minority shareholder (with a share of just under 20%).<sup>2</sup>

This was effectively the third attempt in two years by Vivendi and NewsCorp to combine their pay-TV assets in Italy. Vivendi had originally been the acquirer and Stream the target, and jurisdiction had fallen to the Italian antitrust authority: after two Phase II investigations, approval had been granted subject to extensive remedies. However Vivendi had been unable to proceed with the acquisition and in the summer of 2002 the roles were reversed: NewsCorp agreed to acquire Telepiù, which required a different notification in Brussels.

### Is pay-TV different?

The Commission's clearance effectively sanctioned the creation of a virtual monopolist in the relevant market, defined as the supply of pay-TV services (cable being only a minor competitor). The creation of a 'quasi-monopolist' is a significant departure from the Commission's usual emphasis on preserving inter-platform competition. But the financial performance of the two companies pre-merger was a significant factor in the Commission's ultimate decision to clear the transaction.

One important feature of DTH (direct-to-home) television is that it is a business with very large sunk entry costs and delayed payback. Both parties had been making very significant losses since entering the Italian market. By the time the Commission reviewed the transaction their cumulative losses were more than €4bn (against combined annual turnover of just over €1bn). Stream TV, as the second entrant, had required continuous cash injections from its parents.

The Commission faced an awkward choice: if the perilous state of the finances of the two firms led to one party exiting the market, monopoly was inevitable. But

sanctioning a merger to monopoly, in a market where the Commission had previously sought to preserve platform-to-platform competition as the best way to maximise consumer welfare and promote innovation, would involve a significant departure from established policy.<sup>3</sup>

### How financial losses drive consolidation

The Commission's change of stance can be explained by the fact that multi-platform competition has proven to be unsustainable in many markets. The large losses for pay-TV operators competing 'head-to-head' in a number of EU countries (including Italy, France, Spain and the UK) and the recent high-profile financial difficulties of European pay-TV operators (ITV Digital in the UK, Quiero TV in Spain and Premiere in Germany) have shown that increased concentration is inevitable when competition drives some operators out of the market.

The dilemma for the antitrust authorities is then whether to accept further 'regulated' consolidation through mergers, or to prohibit these mergers and then allow further 'unregulated' consolidation as financial losses prompt market exit. On the one hand, the benefit of preventing a merger is twofold: ultimately the operator might not fail, and even if it does there are possible benefits to consumers while the firm remains in the market. On the other hand, allowing the merger provides the opportunity to force through a quasi-regulatory framework using competition law. Moreover, there may be other benefits: if the firm fails consumers might be left stranded with unsuitable equipment. And content providers might be adversely affected if long-term contracts are abruptly terminated, especially where the resale value of the rights is significantly lower than the contracted rate.

### The scope for 'regulated' consolidation

Without formally accepting a 'failing firm defence', the Commission's decision in *NewsCorp/Telepiù* (as well as the Italian decision, and a similar decision in November 2002 in Spain in *ViaDigital/Sogecable*) signals that antitrust authorities in Europe have taken the view that the best approach in countries where operators are likely to be driven out of the market is detailed regulation.

In practice, the extensive behavioural undertakings extracted by the Commission in this case (including significant extensions and modifications to those agreed with the Italian Authority) sought to counter the monopoly concern by setting up the blueprint for a full regulatory regime, in the tight timeframe of a merger inquiry. The Commission focused on ensuring access to any possible perceived bottleneck, so as to preserve the possibility for future inter-platform and intra-platform competition.

<sup>1</sup> Lexecon advised NewsCorp and Stream in the course of the Phase II proceedings in Brussels (Case M2876, *NewsCorp/Telepiù*).

<sup>2</sup> The Commission was also concerned at the continuing presence of TI as a minority shareholder. Its concern – later abandoned – related to the elimination of future competition to satellite and the potential for discrimination to the detriment of TI's telecoms competitors.

<sup>3</sup> See, for instance, the decision to prohibit the creation of the Nordic Satellite Distribution JV in July 1995, the decision on Bertelsmann/ Kirch/Premiere in May 1998, and the cases brought by the Commission against UEFA.

It is interesting to note that industries which used to rely on *ex ante* regulation (where future behaviour is subject to pre-determined restrictions, traditional examples being telecoms, gas and electricity) are now moving to a combination of lighter *ex ante* regulation coupled with *ex post* regulation (where past behaviour is scrutinised for its acceptability) through competition law, while industries such as pay-TV that essentially were subject to *ex post* regulation only through competition law, are now moving towards *ex ante* regulation too.<sup>4</sup> Merger control is being used to impose *ex ante* regulation that could not readily be imposed through general competition law.

### The importance of access

Access is the common theme running through the undertakings agreed by NewsCorp and the Commission. The Commission's objective was to ensure that existing competitors (such as the small cable operator) and future entrants (either platform operators or broadcasters) would constrain Sky Italia's competitive behaviour by being entitled to access at each and every real or perceived bottleneck. This had a number of strands.

#### *Intra-platform competition*

First, the Commission has sought to facilitate future intra-platform competition (from other DTH broadcasters) by requiring that third parties be allowed to distribute their own content on Sky Italia's DTH platform. Sky Italia has agreed to offer unbundled access to all technical bottleneck services needed by a prospective competitor on DTH (e.g. its conditional access management services and electronic programme guide). The approach agreed with the Commission, including pricing of access, is similar to the regulation of access to bottleneck services in telecoms and other network industries (including a reference to long-run incremental costs). The main practical effect of these provisions might be to allow content providers – e.g. football leagues, Hollywood studios – to use the threat of setting up their own channels *via* conditional access in order to extract the maximum possible value for their rights from Sky Italia in the future.

#### *Exclusivity and availability of rights*

Second, the Commission insisted that entry by a new DTH pay-TV operator should be facilitated by cutting back the duration of Sky Italia's DTH exclusive rights.<sup>5</sup> The Commission's aim was to ensure that premium content (broadly defined, to include certain sport events and movies) would not be permanently tied up in exclusive contracts on the DTH format with Sky Italia. However this was a delicate and controversial area as it raised complex issues of incentive distortions for contracts between content providers and pay-TV operators. In the end a compromise was reached, but the allowed duration of the contracts remains relatively short.

#### *Facilitation of inter-platform competition*

Third, competition from non-DTH pay-TV broadcasters was to be facilitated by Sky Italia giving up its exclusive rights to content outside DTH. In other words, the Commission thought that inter-platform competition (i.e.

between DTH and other platforms) would be promoted by ensuring that the contract rights acquired by Sky Italia did not extend its exclusivity to exploitation on non-DTH platforms, so that actual (and potential) rivals on other platforms would be free to procure the rights for themselves. This was again in practice a difficult and controversial area. There was a major trade off involved. Restricting Sky Italia might facilitate major large scale entry, but it would hamper Sky Italia's ability to facilitate small scale entry – say, by local cable operators in Italy – since Sky Italia would need to procure rights for their platform in order to supply them wholesale.

#### *Availability of premium channels*

Fourth, the Commission sought to facilitate competition from other pay-TV platforms (e.g. local cable channels) by making available to third parties the right to purchase and distribute any or all of Sky Italia's premium channels. All of Sky Italia's premium content must also be made available – as a package, as well as unbundled into channels – at the wholesale level to third party operators, who can then distribute it without restrictions on their own platform. Premium packages and individual premium channels can be offered for sale to competing operators, at a price at which an efficient entrant can profitably operate as a downstream retailer. This is especially aimed at allowing small-scale operators on competing platforms (such as cable) to offer premium content without having to purchase the rights directly from the rights-holder.

The implicit trade off between facilitation of large-scale entry (point 3 above) and small-scale entry (point 4 above) was never truly resolved.

### Implications for future cases

The Commission's focus during Phase II was to engage with NewsCorp in extensive discussions on the regulatory regime that would bind Sky Italia going forward. While accepting that the precise implementation of the remedies would have to be delegated to the sector regulator in Italy, the Commission's detailed behavioural undertakings amounted in effect to a regulatory blueprint. The architecture of the remedies also raises a number of interesting procedural issues, in particular on the appeal process should competitors eventually find the implementation of the blueprint unsatisfactory, and the concurrent role of the Commission and the sector regulator in overseeing the implementation.

The Commission also pragmatically accepted that a regulated 'quasi-monopoly' in Italian pay-TV was better than the most likely alternative absent the merger: Stream filing for bankruptcy, content providers and consumers suffering from the disruption, and Telepiù emerging as an unregulated *de facto* monopolist. Although the Commission did not consider that the formal requirements for a 'failing firm defence' ('very strict', in the Commission's own words) were met in this case, it did take into consideration the financial reality of the industry. In line with the Commission's broad interpretation of the failing firm principle in the *Arthur Andersen* cases, this suggests that we may have been witnessing the development of an 'ailing-but-not-yet-failing' defence.

June 2003

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<sup>4</sup> See e.g. the regulatory framework on Electronic Communication (Directive 2002/21/EC), OJ L 108, 24.4.2002.

<sup>5</sup> This is consistent with the Commission's efforts to reduce duration of exclusive contracts for premium content.