Competition policy and regulation in converging telecoms and media markets: how can they work together?

A briefing paper prepared for the Oxera roundtable discussion

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1 Overview

1.1 The communications market is undergoing a substantial wave of change, with a large amount of consolidation taking place, including horizontal transactions within and between fixed and mobile operators (such as Three/O2 in Ireland; Liberty Global/Ziggo in the Netherlands; and BT/EE in the UK); and vertical transactions between network operators and channel/content providers (e.g. Liberty Global/De Vijver Media in Belgium; Telefónica/DTS in Spain). The many drivers for this change include:

- the pressure on margins that many operators are experiencing as a result of retail price competition, rising content costs, and the need to undertake substantial investments in network upgrades;
- a growing consumer preference for bundles and ‘one-stop-shopping’ for communications and media services—with triple-play and now quad-play bundles becoming more popular;
- a change in the balance of power between content and networks, with content becoming ever more important relative to networks/platforms in consumers’ choice of communications provider;
- the emergence of new distribution technologies—in particular, over-the-top (OTT) services and the expanding capabilities of mobile networks to offer reliable high-speed data connectivity.

1.2 This evolution sits against the backdrop of the European Commission’s ‘Digital Single Market’ strategy, which provides a strong political impetus to achieve positive outcomes for consumers while remaining ‘pro-business’. Communications providers (both fixed and mobile) are under increasing political and competitive pressure to provide consumers with an enhanced experience, requiring better connections and a more seamless delivery of high-quality content.

1.3 These commercial drivers and external pressures show no signs of abating. Hardly a day goes by when a transaction is either formally announced or rumoured to be taking place. With further consolidation across Europe expected, the debate at both the national and EU level around the appropriate regulatory treatment of the combined entities will continue to intensify. In the short run, this will test the effectiveness of the EU’s merger regulation regime; in the medium term, the new market structures that emerge are likely to test the suitability of the existing ex ante European telecoms regulatory framework.

1.4 For example, the emergence of concentrated (oligopolistic) market structures—where no single firm has significant market power—can create problems for regulators attempting to impose remedies, given the difficulties involved with demonstrating joint dominance or tacit collusion. At the same time, the Commission has cleared several recent mobile and fixed mergers subject to innovative access remedies without the need to show coordinated effects.

1.5 This apparent contradiction has not gone unnoticed. Indeed, BEREC recently provided guidance on the analysis and regulation of oligopolies. In this, it

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suggestions the possibility that elements of the SIEC (significant impediment to effective competition) test from Merger Regulation could be incorporated into the ex ante telecoms regulatory framework.

1.6 In parallel, the growth in triple- and quad-play bundles is creating new challenges for regulators and antitrust enforcers when applying ex ante and ex post margin squeeze tests, especially where these bundles include premium TV content (such as sports rights) that is not traditionally subject to regulation. Furthermore, as a result of the consolidation trend, an increasing number of operators now own all the inputs required to sell these bundles in the retail market.

1.7 Premium content, in particular, is fast becoming a key driver of customer demand for communications services. When content is bundled with voice, broadband and/or mobile services, concerns can arise over potential leverage of market power from one market to another. But whereas the telecoms regulatory framework provides national regulatory authorities (NRAs) with powers to oversee fixed and mobile markets, including broadband, it explicitly does not provide these powers in relation to pay TV or content markets. Some European NRAs work around this constraint thanks to the broad powers granted to them in national legislation—for example, Ofcom in the UK. For many others, however, this constraint may become more of a problem as the sector continues to converge and consolidate.

1.8 The above discussion naturally gives rise to the two sessions which will be the focus of the roundtable discussion:

**Session 1** the regulatory implications of more concentrated (oligopolistic) markets—revisiting the ‘dominance’ standard with lessons from competition policy;

**Session 2** the challenges posed by media and networks convergence—is content becoming ‘susceptible to ex ante regulation?’

The topics for each of these sessions are addressed in sections 2 and 3 of this briefing note, respectively. Each section provides background on the theme, with questions for discussion suggested based on recent regulatory reviews and competition cases where these issues have been at the forefront.
Summary of the questions guiding the discussion

Session 1: the regulatory implications of oligopolistic markets

- Is there a regulatory ‘blind spot’ that requires NRAs to be given new powers to tackle cases of tight oligopolies?
- Is BEREC’s proposal to adapt the SIEC test from merger control to the telecoms regulatory framework to tackle tight oligopolies on the right track?
- Would it be possible to adapt the SIEC test to deal with tight oligopolies in steady-state conditions (i.e. absent a transaction)?
- Do recent merger decisions show that Merger Regulation is sufficient to tackle competition concerns with tight oligopolies?
- Should the standard of proof for findings of joint dominance be different in the context of ex ante regulation, as opposed to competition law or the SIEC test?
- Should a formal assessment of market power in retail markets be required for the purposes of conducting an analysis of wholesale markets?
- Could a suitably modified market investigations/AEC test regime be the right way forward to address the challenges faced by the existing SMP framework?

Session 2: the challenges posed by convergence

- Are recent developments and observed market outcomes challenging the perceived wisdom that content is different and therefore not ‘susceptible to ex ante regulation’?
- Does the potential for foreclosure issues as a result of vertical integration strengthen the case for Pay TV/ content to be brought within scope of the ex ante regulatory framework?
- Is the risk of vertically integrated operators foreclosing OTTs addressed by the recently approved net neutrality provisions?
- Can competition law be considered sufficient to address the potential concerns arising from content being owned by vertically integrated firms?

Note: These questions are repeated, in context, throughout the briefing paper.
2 The regulatory implications of oligopolistic markets—revisiting the dominance standard

2A Context for discussion

2.1 Changing conditions in the European telecom markets are testing the effectiveness of the existing regulatory framework. Convergence and consolidation trends in the industry are giving way to increasingly concentrated (oligopolistic) markets where no single firm may hold dominance on its own. Whether the conditions for a finding of joint dominance have been met may also not be clear—a task that is not made any easier by the lack of precedents or extensive NRA experiences to draw upon.

2.2 Under the current regulatory framework, without a finding of single or joint dominance, an NRA would not be able to impose any remedies and would be forced to remove any existing ones. This leads to the question of whether there may be an oligopoly 'blind spot' at the heart of the telecoms regulatory framework—in particular, regarding what BEREC has described as 'tight' oligopolies: market structures that cause non-effective market outcomes without explicit collaboration or tacit collusion.\(^3\)

2.3 An analogy has been drawn with ‘gap cases’ in merger control, which led to the adoption of the SIEC test under the reformed EU Merger Regulation in 2004. Under this test, mergers that create a significant impediment to effective competition can be prohibited, irrespective of whether the firms in question hold a position of dominance or market power before or after the merger. Before this, EU Merger Regulation could prohibit only mergers that created or strengthened a dominant position as a result of which effective competition would be impeded. This, it was felt, led to a problem of under-enforcement.

2.4 These issues are far from being just an interesting theoretical discussion that can be addressed later. In the Netherlands, for example, the most recent analysis of the wholesale local access market by ACM (the Dutch NRA) found that Ziggo and KPN held a position of joint dominance in the retail broadband market, but that only KPN was dominant at the wholesale level. This market review followed closely the European Commission’s approval of Liberty Global’s acquisition of Ziggo, which created a cable operator with nationwide coverage to rival the incumbent KPN.

2.5 Tensions are running high, with the Commission issuing a ‘serious doubts’ letter\(^4\) and BEREC issuing an opinion supporting the ACM.\(^5\) This case could become a key benchmark that could shape how NRAs approach similar situations in future. As such, a discussion of these issues cannot come at a more timely moment.

2.6 Below we provide further background, describing the origins of the concept of dominance within the existing telecoms regulatory framework and its underpinnings in competition law. We then explore how changing market conditions in European telecom markets are testing the appropriateness of the dominance standard, which will lead us to one of the key questions for discussion: does the dominance standard in the telecoms regulatory


framework need to be replaced, modified or augmented to deal with the emerging market structures? If yes, what should this new test look like?

2.7 To place these issues into context, we refer to a number of recent regulatory and competition cases (e.g. the Liberty Global/ Ziggo merger in the Netherlands, and the debate between the Commission and BEREC over the ACM’s proposals in the wholesale local access market).

2.8 We also take a closer look at BEREC’s report on oligopoly regulation, and the application of the SIEC test in recent fixed and mobile mergers approved with remedies by the Commission. Finally, we discuss whether the ‘adverse effects on competition’ (AEC) test used by UK competition authorities under their market investigation powers can provide a way forward to tackle the perceived regulatory ‘blind spot’.

2B The dominance standard and its role in the European regulatory framework

2Bi The defining features of the ex ante telecoms regulatory framework

2.9 Since 2002, the use of the dominance standard has shaped regulation of the telecoms sector in Europe. Back then, the reformed telecoms regulatory framework in Europe aimed to align the analysis conducted by NRAs with the process followed by competition authorities under Article 102 of the EC Treaty. NRAs were therefore required to define relevant economic markets and identify whether one or more operators active in these markets hold significant market power (SMP)—a position equivalent to dominance under competition law.\(^6\)

2.10 In practice, however, this is where the similarities with competition law end. Under competition law, holding a position of dominance is not penalised—only abuses of dominance are deemed unlawful; under the telecoms regulatory framework, NRAs are obliged to impose remedies on dominant firms.

2.11 A practical implication of this disconnect between the ex ante telecoms regulatory framework and ex post competition law is that the former does not require any anti-competitive effects or harm to consumers to be demonstrated; rather, such harm is hypothesised to exist in the absence of remedies. This feature explains why, before reaching the stage of imposing remedies in specific relevant markets, NRAs must ensure that such markets pass the three-criteria test for markets susceptible to ex ante regulation and, in particular, the third criterion: that competition law alone is insufficient to address the market failure(s) identified.\(^7\)

2.12 This disconnect has also been evident recently as more regulators have started to impose ex ante margin squeeze test remedies in wholesale access markets. The application of standards and methodologies that go beyond what would be required under competition law have often been justified on the basis that, unlike competition law, ex ante regulation seeks to actively promote market entry.

2.13 It is beyond the scope of this briefing paper to discuss the merits or otherwise of these approaches. For our purposes, it is important to be clear on the key features of the existing telecoms regulatory framework: the three-criteria test to identify markets susceptible to ex ante regulation; and the requirement to impose remedies on dominant firms. This contrasts with the objectives of

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\(^6\) As specified in Article 14(2) of the Framework Directive.  
\(^7\) The first two criteria are: i) the presence of high, non-transitory structural, legal or regulatory barriers to entry; and ii) the market does not tend towards effective competition over the relevant time horizon.
competition law: intervening in cases of an abuse of a dominant position, which in relation to exclusionary conduct can be established when equally efficient competitors are foreclosed from the market.\(^8\)

2.14 We return to this when we discuss the possibility of adapting the regulatory framework by borrowing concepts and techniques from the SIEC and the AEC tests of the European Merger Regulation and the UK’s market investigations regime, respectively.

2Bii How recent developments may be testing the limits of the framework

2.15 Since the introduction of regulation 13 years ago, its scope has decreased considerably. The number of relevant markets susceptible to ex ante regulation has fallen from 18 in 2002, to 7 in 2007 and now 4 in 2014, all of them wholesale markets. Retail price regulation is almost non-existent across Europe, with regulation focusing instead on enduring economic bottlenecks.

2.16 However, the stated ultimate goal of the framework was to give way to infrastructure-based competition, and remove regulation altogether.\(^9\) Providing access to bottlenecks at different points in the incumbents’ networks was expected to allow access operators to build enough scale to gradually roll out infrastructure of their own and one day make the final jump towards building their own networks. While highly successful at creating a vibrant access market, it is perhaps fair to say that the framework has not quite delivered on that ultimate promise—at least in relation to networks aimed at the mass residential market.

2.17 Nevertheless, as explained above, the trend towards convergence and consolidation is reshaping the landscape. Technological convergence and the continued growth in, and consolidation of, cable networks are leading to increasing facilities-based competition in the broadband market—the market share of alternative infrastructure providers increased from 19% in 2005 to 30% in 2014,\(^10\) and in some countries (e.g. the Netherlands, Belgium and Portugal), these have surpassed the incumbent’s market share.

2.18 This emerging competitive landscape could have important implications for the application of the regulatory framework. It could mean that no single operator is found to be dominant and could thus represent an opportunity to finally deliver on the promise of full deregulation. But don’t hold your breath; it will take a brave NRA to put itself out of a job. Or perhaps not a very good one, for it is possible that the emerging market structures result in tacitly colluding oligopolies or ‘tight’ oligopolies that fail to deliver effective outcomes.

2C BEREC’s paper and the SIEC test

2.19 BEREC identifies that, under the existing framework, NRAs have the tools (at least in theory) to deal with tacit collusion—this would be an extension of the concept of single dominance to a position of joint or collective dominance. It notes, however, that there is little precedent of successful findings of joint dominance.


BEREC also identifies that competition problems can arise when firms are not actively colluding or coordinating their behaviour, and notes that the regulatory framework cannot currently deal with these situations. BEREC explicitly denies that it is attempting to play a ‘regulatory joker’ seeking powers to regulate tight oligopolies at its discretion, as well as cases of single or joint dominance. However, it also accepts that significant further work is required to develop the standards and tests that would allow NRAs to address these cases effectively.

**Question for discussion**

- Is there a regulatory ‘blind spot’ that requires NRAs to be given new powers to tackle cases of tight oligopolies?

BEREC lists market features that characterise tight oligopolies as opposed to markets exhibiting tacit collusion, although it notes that this should not be used as a checklist (Table 2.1).

**Table 2.1 Criteria for tacit collusion and tight oligopolies**

<table>
<thead>
<tr>
<th></th>
<th>Tacit collusion (economic theory)</th>
<th>Tight oligopoly (as per BEREC)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of firms</td>
<td>Small</td>
<td>Small</td>
</tr>
<tr>
<td>Barriers to entry</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Market concentration</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Destabilising developments</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Price transparency</td>
<td>High</td>
<td>n/a</td>
</tr>
<tr>
<td>Market shares and cost structures</td>
<td>Symmetric</td>
<td>n/a</td>
</tr>
<tr>
<td>Product differentiation</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Capacity constraints</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Switching costs</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Cross-price elasticity</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Countervailing buyer</td>
<td>n/a</td>
<td>None</td>
</tr>
</tbody>
</table>


BEREC likens the situation facing NRAs to the problem faced by the EU Merger Regulation prior to its reform in 2004. As noted above, the former merger regime could prohibit only those mergers that created or strengthened a dominant position. Rightly or wrongly, it was perceived that this led to an enforcement gap in practice, particularly for mergers of firms that were close substitutes to each other, but where none of the firms was dominant prior to the merger, nor would their combination create a dominant firm.11

It is argued that the new test—the SIEC test—closes the gap, allowing merger enforcers to focus on the competitive effects of the merger itself and how it affects the development of the market as a whole. This allows for a more effects-based approach to the analysis of mergers, including wider ‘equilibrium effects’ beyond the merging parties themselves, which were common in oligopolistic market structures where firms compete by taking account of each other’s actions.12

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12 Ibid., pp. 10–11.
Question for discussion
- Is BEREC’s proposal to adapt the SIEC test from merger control to the telecoms regulatory framework to tackle tight oligopolies on the right track?

2D The SIEC test in practice: recent merger approvals in fixed and mobile markets

2.24 The Commission has approved a number of recent mergers in fixed and mobile markets, subject to remedies. For example, the Orange/Jazztel deal brought together the third- and fourth-largest providers of fixed telecoms services in Spain. Similarly, the acquisition of E-Plus by Telefónica brought together the third- and fourth-largest mobile operators in Germany. While, in Ireland, the acquisition of O2 by Three brought together the second- and fourth-largest mobile operators. In all these cases, the merged entities were not dominant operators and their combination was not expected to result in them becoming so.

2.25 The specific details of these cases differ, but, in broad terms, the Commission found very similar concerns with these transactions: they would lead to the elimination of close competitors and/or important sources of competition in the market, which would reduce operators’ incentives to compete aggressively and would result in higher prices for consumers.

2.26 The set of remedies imposed, while also tailored to the specific circumstances of each market, follows a similar pattern: ensuring access to the network of the merged parties (in some cases, through the divestment of parts of the network) in order to preserve, as far as possible, the competitive conditions that existed prior to the merger.

2.27 These cases illustrate both the appeal of the SIEC test and some of the potential problems of aiming to transpose it to the ex ante telecoms regulatory framework. While the test provides the right tools for regulators to analyse the effects of transactions in cases of tight oligopolies in the absence of dominance or tacit collusion, the precedents and experiences relate to the analysis of transactions leading to a fundamental change in the structure and competitive dynamics of an oligopolistic market. It remains to be seen how such a test would work in ‘stable/steady-state’ market conditions absent a transaction.

Question for discussion
- Would it be possible to adapt the SIEC test to deal with tight oligopolies in steady-state conditions (i.e. absent a transaction)?

2.28 In addition, given the effectiveness of Merger Regulation in dealing with SIECs as a result of mergers in tight oligopolistic markets, the natural question to ask would be why NRAs require a similar tool in an ex ante regulatory context.

Question for discussion
- Do recent merger decisions show that Merger Regulation is sufficient to tackle competition concerns with tight oligopolies?

2E Joint dominance in the Dutch broadband market

2.29 The issues discussed above are far from being just an interesting theoretical exercise, as illustrated by recent regulatory developments in the Netherlands.
2.30 Following the acquisition of Ziggo by Liberty Global, the Dutch market now has two nationwide infrastructures competing to provide retail telecoms markets. The Commission cleared the UPC/Ziggo merger subject to remedies aimed at addressing the merged parties’ increase in buyer power relative to the TV channel broadcasters, as well as their control of the only two premium pay TV linear channels in the Netherlands. The Commission did not, however, find that the merger would result in unilateral or coordinated effects in the retail markets for voice, broadband or pay TV.

2.31 Shortly after the merger was approved, the ACM conducted an analysis of the fixed wholesale local access, notifying its draft decision to the Commission on 31 March 2015. ACM concluded that KPN and Ziggo held a position of joint dominance in the retail broadband market, but that KPN was the only dominant operator in the wholesale local access market.

2.32 Two key features of this case stand out. First, faced with very similar facts, the ACM reached the opposite conclusion to the Commission in relation to joint dominance/tacit collusion in broadband markets. A subtle difference in the ACM’s analysis is that it was undertaken under a ‘modified Greenfield’ approach, which requires that competition be assessed in the absence of regulatory remedies. In this case, this would have excluded competition from access operators (Tele 2, Vodafone) from the analysis of joint dominance. Whether this difference is sufficient to reach a conclusion opposite to that of the Commission is beyond the scope of this briefing paper.

2.33 Of more interest to our discussion is the possibility that the standard of proof for findings of joint dominance under the ex ante regulatory framework could be different to that under competition law, or under the SIEC test in merger control. Indeed, according to the ACM, the test it needs to meet is whether it is ‘reasonable likely’ that there is a risk of joint SMP, not whether there is (a creation or strengthening of) joint SMP. This would appear to contrast with the standard of proof for a finding of SIEC, which is an assessment of the most likely outcome.

Question for discussion
- Should the standard of proof for findings of joint dominance be different in the context of ex ante regulation, as opposed to competition law or the SIEC test?

2.34 The second stand-out feature of this case relates to the apparent inconsistency between the analysis of retail and wholesale markets. In its serious doubts letter, the European Commission stated its view that ACM had not sufficiently explained the discrepancy between its conclusions at the retail and wholesale level, given that cable as an alternative infrastructure to KPN’s network is present in both.

2.35 Somewhat surprisingly, BEREC disagreed with the Commission and considered that it was not necessary for the ACM to explain such a discrepancy. BEREC argued there is no legal requirement to assess SMP at the retail level in order to analyse wholesale markets. As some commentators

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13 Oxera advised Liberty Global during this merger, and has continued to advise Ziggo during the ACM’s review of the wholesale local access market.
have noted, this stems from the fact that the Commission took this position in its review of the Spanish regulators’ analysis of the mobile wholesale access market (Case ES/2005/0330). The Commission may have to reconsider its position on this matter if it wishes to press the point further.

**Question for discussion**

- Should a formal assessment of market power in retail markets be required for the purposes of conducting an analysis of wholesale markets?

2F The AEC test—a potential way forward?

2.36 If we accept BEREC’s premise that the existing SMP regulatory framework can lead to regulatory blind spots and sub-optimal enforcement of tight oligopologies, the ensuing question is how the framework can be reformed to close this potential loophole while maintaining the benefits of the current regime.

2.37 The SIEC test (from the EU Merger Regulation) has been proposed as a possible way forward. Some potential problems lie ahead in attempting to adapt this test for the ex ante framework, including the fact that the test is aimed at capturing the effects of specific transactions, rather than examining markets on an ongoing basis.

2.38 A potential alternative might reside in the AEC test used by UK competition authorities when conducting market investigations. The UK Enterprise Act 2002 introduced market investigations as a complement to the competition law tools (Articles 101 and 102) available to authorities in the UK. In a market investigation, the authority must decide ‘whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services’. Where it does, this constitutes an AEC.

2.39 If an AEC is established, the authority may decide to take proportionate remedial action, taking account of relevant customer benefits. Such action may include structural and behavioural remedies—for example, functional separation or divestments; market opening measures; informational remedies; obligations to provide access on FRAND (fair, reasonable and non-discriminatory) terms; price caps; and/or quality of service requirements.

2.40 In the same way as the SIEC test was aimed at addressing gap cases that the previous EU Merger Regulation was unable to deal with, the UK market investigations regime fills an enforcement gap left by competition law. In its guidance document on market investigations references, the UK’s Office of Fair Trading (OFT) noted:

> Adverse effects on competition that do not involve either agreements between undertakings or abuses of dominance are beyond the reach of [competition law]. Market investigation references are therefore likely to focus on **competition problems arising from uncoordinated parallel conduct by several firms or industry-wide features of a market in cases where the [authority] does not have reasonable grounds to suspect the existence of anti-competitive agreements or dominance.** [Emphasis added]

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18 UK Enterprise Act 2002, Section 134(1).
Furthermore, referring specifically to oligopolistic market structures, the OFT noted that:

Oligopolistic markets in which firms engage in apparently parallel behaviour while falling short of actually concerting their actions (often referred to as tacit collusion) present a more complicated issue. [...] Market features that can lead to adverse effects on competition in an oligopolistic market can be wider than the conditions that the case law has found to be necessary for collective dominance [...] Furthermore, what qualifies as an abuse of collective dominance is underdeveloped in the case law. For these reasons a market investigation reference will be able to address wider competition concerns than could be addressed by a [competition law] case and might, therefore, be a better way of proceeding. [Emphasis added]

As the discussion above illustrates, many parallels can be drawn, not only with the adoption of the SIEC test in EU merger control, but also with the existing ex ante SMP framework itself. For example, under the market investigations regime, the finding of dominance could be one of the features giving rise to an AEC—however, as is the case with the ex ante regulatory framework, an abuse of dominance is not required to establish the existence of an AEC (see Figure 2.1).

Figure 2.1 Required conditions for the imposition of remedies under the different tests

<table>
<thead>
<tr>
<th>Dominance/ SMP</th>
<th>Abuse of dominance</th>
<th>Transaction</th>
<th>Effects on competition &amp; consumers</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

A. Ex-ante regulatory framework

B. Ex-post competition law

C. Merger reviews (SIEC test)

D. Market investigations (AEC test)

Source: Oxera.

Similarly, the market investigations framework provides a broad set of remedial tools to tackle the sources of AECs, much in the same way as the regulatory framework provides NRAs with a set of remedies to address dominance. A key difference, however, is that the tools available under the market investigation regime are potentially much wider and far-reaching.

Overall, it would appear that much can be learned from the UK competition authorities’ experience with the application of the AEC test.

**Question for discussion**

- Could a suitably modified market investigations/AEC test regime be the right way forward to address the challenges faced by the existing SMP framework?

However, for such a modified regime to work effectively, the scope of the ex ante regulatory framework may need to be extended beyond core electronic

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20 OFT (2003, op. cit., paragraph 2.5.)
communications services. In the converged market structures that are developing, the sources of AECs may continue to lie in traditional fixed voice and broadband networks, but may also increasingly be found in the pay TV value chain and content markets more generally, as well as in the joint control of the inputs required to sell bundles of communications services to consumers.

We turn to this issue in the next section.
3 The challenges posed by convergence—is content becoming susceptible to ex ante regulation?

3A Points for discussion

3.1 In this discussion, we will ask whether the regulators’ need for a more wide-reaching test is exacerbated by the growing trend for bundled communications and media purchases.

3.2 In particular, we consider how prime content is starting to be used as a significant differentiator in order to attract bundle subscribers; and whether ex post competition law is sufficient to ensure that content is not used to inhibit effective competition. In the alternative, we consider whether content markets might meet the three-criteria test to be susceptible to ex ante regulation—and whether the scope of the existing ex ante regulatory framework may need to be expanded to include pay TV and content markets.

3.3 This motivates a discussion on whether the changing landscape might be creating the need to bring content regulation within the scope of the European ex ante regulatory framework, or whether the authorities’ existing toolkit is sufficient to tackle these issues.

3B The convergence trend

3.4 The increased use of the Internet protocol (IP) for content services, alongside the growth of network capacity (e.g. fibre roll-outs), has enabled traditional telecoms operators to deliver an ever-increasing array of innovative content-based services (including linear broadcast TV and on-demand services) over their existing network infrastructure. At the same time, technological advances have allowed cable networks—previously designed for one-way only broadcast use—to provide two-way voice and data offerings, at increasingly high speeds.

3.5 The result has been a convergence in the traditional media broadcast and voice/data network industries, with both the traditional telecoms and traditional pay-TV operators now offering consumers a range of bundled service packages, including dual-play (e.g. voice + broadband, or voice + pay TV); triple-play (voice + broadband + pay TV), or even quad-play (including mobile services).

3.6 Adding to this, an increasing number of operators are opting to bolster their core capabilities by acquiring adjacent service providers. This includes transactions that combine fixed-line operators with mobile operators; network operators with channel providers; and/or network operators with content producers. Similarly, while some operators are choosing to acquire established media businesses, others are opting to buy key content rights (e.g. live football rights) and to invest in developing their own content businesses (several examples are included in section 3Civ below).

3.7 In response to these changing offers, consumers’ preferences over electronic communication services are evolving. 44% of EU consumers now purchase their broadband and/or pay TV service as part of a bundle offer. Their motivations for being connected are also changing. Whereas data services previously provided users with predominantly text-based informational materials, consumers are now buying connectivity in order to access a range of

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rich media content and OTT services—and the availability of these is becoming a central factor when selecting a network provider.

3Bi  Ex ante regulatory treatment of content

3.8 The existing EU regulatory framework for electronic communications services does not cover content; instead, from a broadcasting standards point of view, this is dealt with in the Audio-Visual Media Services (AVMS) Directive. As a result, most of the regulatory discussion around content focuses on the nature of the material, rather than the issues of effective competition.

3.9 Regulation of content from this more economic perspective is generally restricted to public service broadcasters (PSBs). For example, in 2009 the European Commission revised its Communication on State Aid that brought restrictions on the release of a new media service by PSBs. Moreover, the majority of regulators across the EU have no ex ante powers to ensure a competitive content sector, with some exceptions, as noted below.

3.10 Back in 2002, when the ex ante regulatory framework was introduced, it was already recognised that the convergence of technologies could have a significant effect on the regulatory landscape. As services delivered over different network technologies (copper, fibre, cable and mobile) were converging (at least in respect of their functionality), the need for horizontal regulation that considered the constraints posed by all infrastructures—not just the traditional telecommunications networks—became apparent. As such, the 2002 framework was not limited to ‘traditional’ public switched telecommunications network (PSTN) networks and services alone, but was extended to cover all electronic communications networks and services.

3.11 Whereas the convergence considered by the 2002 Directive was between network technologies, this might now reasonably include certain premium content, as well as OTT services. Against the backdrop of significant growth in the sale of bundled communications and media services, the practical implication of content being outside the scope of the framework becomes clear. Of the typical triple- and/or quad-play bundle elements, only content/pay TV stands alone as an unregulated element.

3.12 At first glance, content would appear to have very different economic characteristics to telecoms and cable networks. Whereas the latter involve substantial sums being invested in physical networks that are largely sunk and long-lived, investment in content has a shorter life owing to the bidding nature of certain core rights markets. As a result, the perceived wisdom has been that enduring economic bottlenecks in pay TV and content markets are far less common.

3.13 Furthermore, the incentives on the independent content producers and channel providers are such that they generally wish to seek the widest possible distribution. As such, refusal to supply or foreclosure issues have not created major headaches for competition authorities.

3.14 However, recent developments may be challenging these perceptions. Core content has remained far more concentrated in the hands of a few large distributors than might have been expected, many of which also have the assets to supply bundles of communications services. Similarly, as we discuss below, vertical integration might be changing the incentives to maximise distribution of content and channels.
For discussion purposes only

Competition policy and regulation in converging telecoms and media markets: how can they work together?

Oxera

Question for discussion

- Are recent developments and observed market outcomes challenging the perceived wisdom that content is different and therefore not 'susceptible to ex ante regulation'?

3C Possible issues with content and networks convergence

3.15 Being able to give subscribers access to core, high-value content is increasingly becoming an important competitive differentiator for platforms. In combination with the growing convergence of content and network owners, this may give rise to two competition problems:

- as network operators extend their reach into new retail services and content provision, they could leverage their existing market power into upstream/adjacent markets—for example, by favouring their own emergent services over competitors' services (including those provided by OTTs, an issue closely related to the net neutrality debate);

and/or:

- if key high-value content is acquired exclusively by an incumbent network operator, this could be used to cement a dominant position at the network level despite increasing competition from alternative network technologies (such as cable or Long-Term Evolution (LTE) mobile).

3.16 These concerns could arise from the vertical integration occurring within the value chain, as operators go from providing retail network access to providing (and in some cases even producing) the content distributed by those networks. In this case, any firm enjoying sufficient market power at one level might find that it has the ability and incentive to leverage that power into other parts of the value chain through the use of foreclosure strategies.

3Ci Input foreclosure

3.17 A principal concern arising from the convergence of content owners and network operators would be the incentive for those firms to leverage their content advantage to drive subscribers to their communications networks. This might harm consumer welfare as it could create or strengthen a dominant position for the vertically integrated retailer, as well as potentially restrict choice and variety for consumers, who might be forced to choose between the content they want and the platform they prefer.

3.18 The expected efficacy and consumer impact of such a strategy would depend upon factors such as:

- **type of content**: for an input foreclosure strategy to be successful, the content must be sufficiently compelling to drive consumers to switch (ideally the entire bundle—including, broadband and if possible mobile). In practice, this would be likely to mean premium content such as sports, films, or high-quality entertainment. However, other important content (such as niche local language content) could also be considered sufficiently 'must have' for an effective pay TV offer;

- **platform footprint**: an input foreclosure strategy can be effective only if consumers are *able* to switch to the vertically integrated platform. Unless there is sufficient scope to drive switching, any foreclosure strategy is unlikely to be profitable since the content owner must forgo significant
(perhaps national) wholesale revenues in return for potentially minimal retail gains.

3.19 In addition to considering a complete foreclosure strategy, the vertically integrated operator might find it has the ability and incentive to engage in a partial foreclosure, in which the channel is still provided as an input to rivals, but on worsened terms. Compared with an independent channel provider that must maximise its exposure to drive paid-for subscriptions and/or advertising revenues, the vertically integrated channel provider might have an improved bargaining position relative to the retail TV platforms. It is assured carriage on its own platform. Moreover, assuming sufficient footprint and channel quality, any lost revenues from not striking a deal could be partially offset by subscriber switching. As a result, the vertically integrated platform operator may be able to raise its rivals’ costs (and thus soften competition, to the detriment of consumers) by increasing the price of their inputs.

3Cii Customer foreclosure

3.20 Of arguably lesser concern, although also conceivable with a vertically integrated platform operator and content owner, is the risk of incentivising customer foreclosure. Under this strategy, the vertically integrated platform operator might opt to deny rival channels access to its retail TV platform, preventing them from reaching a proportion of potential viewers. Consumers are similarly harmed since, once again, they might be forced to choose between the content they want and the platform they prefer.

3.21 Again, an alternative scenario would be that the vertically integrated provider opts for a partial customer foreclosure strategy, in which it continues to carry the rival channels but on worsened terms. Analogous to the input foreclosure case, the vertically integrated platform operator has an improved negotiating position compared with the independent platform. It is guaranteed access to its own channels, and any subscribers lost as a result of not striking an agreement with the rival channel provider are at least partially offset by the increased viewing share of its own channel.

3.22 Although this would not mean that consumers necessarily lose access to the channels they want, the worsened terms of the channel providers could be expected to feed through into the quality of programming presented by the channel. This could be particularly significant for smaller channels in local languages that are more reliant on the vertically integrated platform for audience share.

**Question for discussion**

- Does the potential for foreclosure issues as a result of vertical integration strengthen the case for pay TV/ content to be brought within scope of the ex ante regulatory framework?

3Ciii Hindering new technologies (OTTs)

3.23 Perhaps most significant, given the speed and direction of the media markets’ evolution, is the risk that a vertically integrated platform operator could have both the ability and incentive to hamper the development of emergent technologies. With ever-increasing Internet speeds via both fixed and mobile networks, OTT entertainment services (such as Netflix) are becoming a significant competitive threat to traditional pay-TV retailers. With considerable revenues still being derived from the provision of pay-TV, vertically integrated platforms might have an incentive to act to protect their position.
3.24 This sort of protectionist strategy could have an impact on consumer welfare, as it might lead to a reduction in the development of new and innovative OTT services that might better match consumers’ changing needs and preferences; and might also limit the development of effective competition in the market for entertainment services, leading to higher prices.

3.25 One means for platform operators to do this is through technological restrictions, akin to customer foreclosure. Given the trend for bundled service provision, an increasing number of people take their broadband Internet from the same provider as their pay-TV service. In principle, this means that the network operator can protect its position by interfering with the transmission of the OTT content across the broadband network. In practice, however, this is technically difficult (requiring complex packet inspection technologies); commercially unappealing (as consumers perceive the restrictions as a low-quality Internet service); and, in certain countries, potentially illegal.

3.26 Alternatively, by taking control of key content inputs, platforms might be able to hinder the growth of OTT services through the same sorts of input foreclosure strategies as discussed above.

**Question for discussion**

- Is the risk of vertically integrated operators foreclosing OTTs addressed by the recently approved net neutrality provisions?

**3Civ** How have these foreclosure issues been tackled recently?

3.27 The sections below summarise how issues around the control of content have been handled in a number of recent cases. Our overarching concern in this section is whether the tools at the authorities’ disposal appear to be sufficient, or whether an improved regulatory regime—perhaps incorporating elements of the market investigation/AEC test—could result in an improved outcome.

**Merger remedies**

3.28 The foreclosure issues discussed above featured prominently in two recent European Commission Phase II merger assessments: Liberty Global/Ziggo in the Netherlands; and Liberty Global/Corellio/W&W/De Vijver Media in Belgium. In both cases, the Commission raised the concern that, following the transaction, certain key content would become vertically integrated. Additionally, in Liberty Global/Ziggo, the Commission considered whether the enlarged platform operator might also have both the ability and incentive to hinder the growth of OTTs by technical means, restricting their access to the merged parties’ broadband network.

3.29 Ultimately, in both cases the Commission’s concerns were allayed with the adoption of commitments from the parties. In the case of Liberty Global/Ziggo, this included the divestment of one of the premium film channels owned by the merged parties; a commitment not to hamper the uptake of OTT services by including restrictive clauses in carriage contracts with channel providers that prevent their content being supplied via OTT (either own or third-party); and a commitment not to hinder the transmission of OTT services onto and over the merged entity’s network.

3.30 In the case of De Vijver Media, the main commitment was to continue to provide rival pay-TV retailers access, on a FRAND basis, to the key local-language content channels, Vier and Vijf. This included a commitment to
provide ‘ancillary’ rights (e.g. catch-up and online rights), as well as anti-
circumvention measures to prevent the parties from lowering the quality of the
FRAND channel offer by moving the most compelling content to an alternative
channel.

3.31 Similar issues featured in the recent Spanish competition authority case
concerning the acquisition by Telefónica of leading pay-TV platform, DTS.
Again, the authority accepted commitments from the parties before clearing the
transaction at Phase II. In this case, the commitments included maintaining the
contracts that DTS had in place with rival platform operators and not impeding
switching by subscribers; providing competitors with a wholesale offer that
includes all premium channels; and guaranteed interconnection capacity for
OTT providers.

**Ofcom pay TV investigation**

3.32 In 2007, Ofcom initiated an investigation into the UK pay TV market to consider
the effect of the vertical integration between the Sky platform and the premium
Sky channels (Sports and Movies) on competition between pay TV retailers.

3.33 Despite having concurrent competition powers under the UK's 1998
Competition Act, Ofcom chose to use its sectoral oversight powers under the
2003 Communications Act to initiate the investigation and ultimately impose
remedies. The aim of its intervention was to ensure effective competition at the
retail level for pay-TV bundles that include premium sports content. It ultimately
achieved this by imposing a wholesale must-offer (WMO) obligation on the Sky
Sports 1 and 2 channels.

3.34 Ofcom chose this legal instrument on the grounds that its ex ante powers as a
sectoral regulator allow for a more timely and comprehensive intervention into
the market to ensure effective competition—more akin to a market
investigation/AEC test. By contrast, its competition powers allow for only an ex
post evaluation of an actual abuse. In its discussion of the appropriate legal
framework, Ofcom cites several shortcomings with a Competition Act
approach:

- following the finding of an infringement, the powers under the Act are limited
to the imposition of financial penalties or directions only such as required to
bring that infringement to an end;
- the imposition of ex post remedies may not be as effective as an ex ante
licence condition;
- even if an intervention under the Competition Act were to resolve the issues
in question (pricing of standard definition channels), it is likely that a series of
further complaints would need to follow to address issues around high-
definition, minimum security requirements, etc.

3.35 Overall, Ofcom determined that, by using its sectoral regulatory powers, it
would be better able to consider how competition across the markets
concerned can be opened up to be fair and effective; put in place a remedy
appropriate to the competitive conditions; and provide greater certainty to the
pay-TV retailers that would be relying upon the remedy.

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Competition policy and regulation in converging telecoms and media markets: how can they work together?

Ofcom’s assessment of BT’s VULA margin

3.36 In the UK, BT has invested significant sums of money in premium sports rights (including FAPL and Champions League matches) and in creating sports channels (under the BT Sport brand) to broadcast this content. Its strategy has been to bundle these channels with the sale of its broadband services, offering them free of charge or at a considerable discount to the prices paid by non-BT broadband customers.

3.37 In its recent decision on the wholesale local access market review, Ofcom imposed an ex ante margin squeeze remedy on BT’s wholesale provision of wholesale fibre access (or virtual unbundled local access, VULA). A key question that Ofcom had to grapple with was whether to include the cost of sports rights and TV channel production in the test, or whether such issues were best dealt with under competition law.

3.38 Indeed, Ofcom had recently conducted—and ultimately closed down—a competition law investigation for an alleged margin squeeze abuse in fibre-based broadband. BT argued that this showed that competition law could be effective at dealing with these issues, particularly for bundled sales that include content where relatively complex effects-based analyses would be required in order to demonstrate consumer harm. Rejecting these claims, Ofcom proceeded to design a test that included the cost of BT Sport in the calculation. It argued that BT’s bundling strategy might have the effect of strengthening its market power in the provision of wholesale fibre access, which was ultimately the focus of the review.

3.39 In its comments letter to Ofcom, the Commission agreed in principle with the inclusion of BT Sport in the test, but warned that the methodology proposed by Ofcom unduly limited BT’s commercial flexibility in the non-regulated pay TV market where BT does not hold a dominant position. It therefore asked Ofcom to remain vigilant that the application of the test would not have unintended consequences in markets where the application of competition law would be sufficient.

Question for discussion

- Can competition law be considered sufficient to address the potential concerns arising from content being owned by vertically integrated firms?

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24 Oxera advised BT on various aspects of this case.
26 Ofcom (2013), ‘Complaint from TalkTalk Group against BT about alleged margin squeeze in relation to superfast broadband pricing’, CW/1103/03/13.