The Commission closes probe into pay-TV industry in Italy approving News corp/Telepiù merger deal

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On 2 April 2003, after an in-depth investigation, the Commission gave the green light to the merger between the two existing satellite pay-TV platforms in Italy subject to a complex package of conditions which will be applicable until 2011. The investigation revealed that the survival of two operators in pay TV market in Italy would have been very unlikely.

The background and the transaction

On 16 October 2002, The News Corporation (News corp) notified a transaction to the Commission whereby it would acquire sole control of Telepiù from the Vivendi group and would subsequently merge Telepiù with Stream, the pay-TV platform it controls. For the third time in two years the Italian satellite pay-TVs attempted to merge their activities. The two previous in-depth examinations of similar proposed transactions were made by the Italian anti-trust authority.

The situation of the Italian pay-TV operators has been characterised by severe financial difficulties since the beginning of their operations (1991 for Telepiù and 1998 for Stream). These financial strains have various explanations, which may go beyond simple economic reasons. In Italy the penetration of pay-TV services is lower than in other large European countries (UK, France and Spain). This is inter alia due to a widespread nation-wide free-to-air TV offer and, to a lesser extent, the piracy of pay-TV broadcasts.

Newscorp will hold 80,1% and Telecom Italia will have a percentage not exceeding 19,9% of the share capital in the new entity and a member in the board of directors.

The analysis

Market definition

The Commission established, similarly to previous analyses in the sector, that in Italy pay-TV is a relevant market distinct from free-to-air TV. Although there are twelve existing nation-wide free-to-air broadcasters (mainly Mediaset and RAI channels) and an array of local broadcasters which may influence the degree of penetration of pay-TV services (and hence the profitability of pay operators), Italian consumers are ready to pay an ‘extra fee’ (the subscription) in order to obtain the ‘extra utility’ (i.e. the specific content) of pay-TV services. In addition, from the supply-side viewpoint, pay-TV is differentiated from free-to-air TV on the basis of the type of content (i.e. premium content), the program schedules and the business model.

Overall effects of the merger

The concentration would have led to the creation of a lasting near-monopoly in the Italian pay-TV market, would have raised barriers to entry in satellite pay-TV and would have created a monopsonist position in Italy as regards the acquisition of some types of premium programme content (particularly the exclusive rights to certain football matches that take place every year where national teams participate — i.e. the Italian Serie A and Serie B — and blockbuster movies). This would have foreclosed third parties’ access to premium content, the driver of pay-TV subscriptions and the key to successful pay-TV operations.

Horizontal effects in pay-TV

Although it is possible to provide pay-TV services via various broadcasting systems (satellite, cable, DTT, and in the future x-DSL technologies), the Italian pay-TV market is essentially limited to DTH (direct-to-home) satellite transmission, where both Telepiù and Stream were active. The only existing competitor of the combined platform is a cable operator (e.Biscom) which has limited capacity (it reaches consumers in a limited number of major Italian cities). DTT technology is in its infancy in Italy.

Vertical effects in pay-TV

The merger would have raised barriers to entry as regards satellite DTH pay-TV; News corp would have become the ‘gatekeeper’ in respect of the only available technical satellite platform (1). Furthermore, the merger would be likely to lead to

(1) X-DSL (Digital Subscriber Line) are high-speed broadband interconnections; DTT means Digital Terrestrial Television.

(2) The technical platform can be defined as the system controlling conditional access and the provision of the related technical services. Technical services that can be provided through the platform comprise conditional access management, transit through the decoders and inclusion in the pre-defined list of services (automatic tuning), digitalisation and encryption, satellite up-link and particularly, access to the Electronic Programme Guide (EPG).
the use of the Newscorp proprietary standard for the conditional access system (CAS), a technology that allows broadcasters to encrypt the digital transmission signal. All potential DTH competitors wishing to set up an alternative DTH pay-TV would depend on the combined entity for access to technology (CAS) and/or to infrastructure (technical platform).

The possession of the only technical platform and of a proprietary CAS, which is most likely to be ‘the standard’ CAS would have raised further barriers to entry to the market for pay-TV services. It would have increased the incentive and the ability of the combined platform to pursue exclusionary strategies or raise rivals’ costs in order to foreclose the market and maintain its monopolistic position for DTH pay-TV.

**Foreclosure of premium content**

As a consequence of the merger, Stream and Telepiù exclusive rights (on all means of transmission) and in particular for premium films (all output deals with Hollywood Majors and main Italian film producers), and for football (all contracts with Serie A and Serie B teams in particular) would have accrued to the combined platform. The merger would therefore have impeded potential third parties’ access to ‘driver’ content for pay-TV.

Furthermore, as a consequence of the existence of black-out rights on second-window releases by the combined platform, third parties would have been foreclosed from access to this ‘second-tier’ content, which potentially offers a more affordable way to develop pay-TV operations.

**Failing company defence argument**

Late in the procedure, Newscorp argued that the conditions for the so-called ‘failing company defence’ were met in this case since, in the absence of the merger or in the hypothesis of the merger being blocked, Stream would inevitably exit the market and Telepiù would then be in a position comparable to that of the combined platform after the merger. In effect, according to Newscorp, there would have been no ‘causal link’ between the merger and the deterioration of the competitive structure of the market, due to the transaction.

The ‘failing company defence’ is a legal and economic concept accepted by competition authorities and used twice in the past by the Commission (1). In particular, the existence of a causal link between a concentration and the deterioration of the competitive structure of the market (caused by the merger) can be excluded and the merger be regarded as ‘rescue merger’, if the competitive situation in the market resulting from the concentration is expected to deteriorate in a similar fashion even if the merger were prohibited. The Commission applied the following criteria in order to verify whether the condition for a ‘failing firm defence’ were met in this case: 1) the failing company would be shortly forced out of the market if not taken over; 2) there would be no less anti-competitive alternative to the merger; 3) in the absence of the merger, the assets to be purchased would disappear from the market, or the acquiring company would gain the market share of the acquired company.

In the present case the first two of these very strict legal requirements were not met (the third being left open). It is worth noting that the alleged failing company (Stream) is a ‘division’ of Newscorp (the acquiring company). Clearly, this was not a case of the whole Newscorp exiting the market, but rather of a decision to be taken by Newscorp’s management to abandon a non profitable business (Stream).

However, whilst rejecting the ‘defence’, the Commission took due account of the chronic financial difficulties faced by both companies, of the specific features of the Italian market and of the disruption that the possible closure of Stream would cause to Italian pay-TV subscribers. Overall, it was considered that an authorisation of the merger subject to appropriate conditions would be more beneficial to consumers than a prohibition decision followed most probably by the closure of Stream by its owners.

**Undertakings**

The challenge was, therefore, to obtain sufficient and adequate conditions from the merged satellite pay-TV platform to ensure that the market would remain open and that the combined entity would be subject to competitive constraints. Barriers to entry had to be lowered to the maximum extent possible to favour actual competition and the emergence of potential competitors capable of disciplining the merged entity.

The underlying philosophy of the undertakings accepted by the Commission is aimed at ensuring, in the long term (until 2011), third party access to

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(1) Cases TV/M.308 Kali+Salz/MDK/Treuhand and M. 2314 BASF/Eurodiol/Pantochim. The Commission’s decision in Kali+Salz/MDK/Treuhand was also subject to a judgement of the Court of Justice, joined cases C-68/94 and C-30/95, France c. Commission, in which the Court set out its interpretation of the ‘failing firm’ doctrine. Other cases where this concept was indirectly considered are the so-called ‘Andersen mergers’ of 2002.
premium content, to the technical platform and to CAS and at ensuring that the combined platform had no involvement in alternative means of transmission (such as DTT). At the same time, an effective system of implementation is put in place with a key role entrusted to the Italian Communication authority.

Regarding *access to premium content* (in particular football and movies), Newscorp waived its exclusivity and protection rights on means of transmission other than DTH. Therefore, all operators (actual and potential) on cable, DTT, x-DSL, etc. will be able to buy those contents directly from rights owners. As regards on-going contracts, rights owners are granted a unilateral termination right which ensures that potential DTH operators would be able to contest those rights vis-à-vis the combined platform. As regards future contracts, their duration will be limited (2 years for football contracts, 3 years for movie contracts), in order to allow, at regular intervals, ‘contestability’ for rights to premium content.

A system of ‘wholesale offer’ of premium content is put in place in order to allow third parties active on means of transmission other than DTH to gain critical mass and to be able to negotiate at a later stage directly with content providers. This offer is to be unbundled (in terms of content), non exclusive and is to be based on the ‘retail-minus’ pricing principle.

Furthermore, in order to favour possible entry of an alternative DTH operator, Newscorp undertook to grant full access to its platform (and to related technical services) to third parties on fair, transparent, non discriminatory terms. This encompasses *inter alia* fair licensing of Newscorp’s CAS and the possibility for free-to-air and pay- DTH channels to be included in the EPGs (electronic program guide) of the combined platform.

Newscorp undertook to *divest* Telepiù’s digital and analogue terrestrial assets and related frequencies, and will refrain from DTT activities in the future (both as a network and as a retail operator). The fact that the purchaser of those assets and frequencies will have to be a company wishing to include pay-TV elements (one or more channels) in its business plan is a factor that further favours the emergence of potential (and, in the future, actual) competition in the relevant market also from that means of transmission.

It is essential that this complex package of undertakings is *effectively implemented*. To achieve this a dispute settlement mechanism which involves, for the most important issues of the package (access to platform and premium ‘wholesale offer’), arbitration by the Italian Communication authority is put in place. Other aspects of the remedy package are subject to international arbitration.

**Minority participation of Telecom Italia**

Telecom Italia maintains a minority shareholding (around 20%) in the combined platform and has a member in the board of directors (‘the link’). Pre-merger Telecom Italia was active in the pay-TV business as a 50/50 partner of Newscorp in Stream, and was/is the dominant player in Italy in various markets where convergence between the media and telecom services is taking place.

Although theoretically this link could have had adverse effects on competition, the investigation carried out by the Commission allowed to conclude that there was insufficient evidence that adverse effects would materialise after the merger as a result of the link. In particular, through this operation Telecom Italia will reduce its stake to a non-controlling participation in the merged entity, and is effectively exiting the market for pay-TV. The evidence was not sufficient to show that, on the one hand, through this link a competitive constraint (represented by the telecom incumbent) in pay-TV vis-à-vis the combined platform would have been sterilised or removed. On the other hand, the evidence was insufficient to show that the link would strengthen the pre-merger dominant position held by Telecom Italia in some telecom services markets in Italy.

Newscorp offered a set of behavioural undertakings regarding its relationship with Telecom Italia which included no positive discrimination vis-à-vis Telecom Italia and no bundling of pay-TV and Internet broadband access services. The Commission took note of those commitments, without making them a condition for the clearance decision.
### Conclusion

The authorisation of the transaction subject to a complex package of commitments in this case is a function of the situation existing in the Italian pay-TV business, in which the survival of two operators is very unlikely. In this situation, the prospects of the closure of Stream by NewsCorp’s management were particularly serious. In the event of closure consumers would have had to face a situation in which there would be only one operator in Italy and where that operator had no restraints on its business behaviour. For this reason, the Commission decided to authorise the present transaction conditionally. Although the merged entity will enjoy a near monopoly position, the strict package of remedies will impose severe restraints on the merged entity for a long period. At the same time, conditions are put in place in order to favour the emergence of new competitors in the medium term both on DTH and on other means of transmission.