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EU competition law, convergence, and the media industry

Miguel Mendes Pereira^{*}
European Commission
DG Competition - Media and Music Publishing Unit

I wish to thank the Law Society, and in particular its European Group in the person of Tom Usher, for inviting me to speak here today.

I will present to you a number of cases the European Commission has dealt with in the past two years which illustrate the way EU competition law has accompanied the latest developments in one of the fastest changing industries in the past decade: the media industry.

“Convergence” has become all too familiar to most of us as the main driving force behind the recent changes occurred in the media industry. Logically, EU competition law could not stay immune to the consequences of convergence in the media industry, and the assimilation of its consequences is apparent - I would hope - in the cases I will refer to in just a minute.

However, as it so frequently happens with notions that turn into “buzzwords”, the many meanings attributed to the term “convergence” are often ambiguous and, as such, unhelpful in order to describe the evolution of the media industry. Let me therefore turn, first of all, to the two meanings of the term “convergence” that I consider to be most relevant from a competition law point of view.

1. Technical convergence

Technical convergence mainly concerns the possibilities offered by digital technology.

Those possibilities are reflected, for example, in the infra-structures required to deliver contents like movies or music. With the current digital technology, huge amounts of data may be transmitted to a large number of users through different networks (mobile networks, Internet, B2B sites). This allows for the dematerialization of media products traditionally sold as physical products (newspapers, films, CD's) by transforming them into packages of bytes.

At the same time, digital technology allows for the convergence of traditionally separate media into a single product, putting together text, sound, video and voice in what has become known as *multimedia*. Access to TV broadcasting, or rather webcasting, on the Internet is already nowadays a reality and listening to an MP3 music file on a cellular phone or on Personal Digital Assistant is nothing new.

^{*} The opinions expressed are personal and only engage the author.

2. Economic convergence

Audio-visual products were never cheap but the growing competition induced by the proliferation of TV channels has inflated production costs. It is sufficient to compare, for example, the price paid for the broadcasting rights of the World Cups of 1990, 1994 and 1998 – 241 million ECU – with price paid for the same rights in respect of the World Cups of 2002 and 2006 – 1,7 billion Euro – to have an idea of the increase in the price of audio-visual contents. Only large companies seem to be able to afford such astronomical costs.

In face of barriers of such dimension, media companies have shown a trend towards concentration.

What is particularly new about these alliances and mergers in the media industry is the search of not only the traditional economies of scale but, above all, the search of economies of scope. This translates into an attempt to use the same product in a number of different ways: pure entertainment and telecommunication, or entertainment and information, or information and telecommunication.

„Create Once, Place Everywhere!“, or simply “C.O.P.E.” seems to be the current motto for the media industry, illustrating the need for media producers to place their products in the largest possible number of different platforms.

This is the underlying reason for alliances and mergers between companies which are active in sectors of the economy that used to be separate such as television and telecommunications. Operations like AOL/Time Warner, Vivendi/Seagram/Canal+, Vivendi/Vodafone for the creation of portal Vizzavi or the acquisition of Dutch entertainment producer Endemol by the Spanish telecom company Telefonica clearly illustrate this trend.

The main feature of this type of concentrations is the vertical integration of the different levels of production and distribution of media products that leads to companies which are able to, for example, produce films or music, register them in DVDs or CDs and distribute them not only to “brick and mortar” shops but also through the cable or satellite networks they own. Vertically integrated companies are in a position to exploit their products at every single level of the value chain.

3. The legal framework

Let me now turn to the legal framework within which some of the relevant cases have been assessed.

Most “convergence issues” from a competition law point of view have been dealt with by the European Commission under the Merger Regulation, i.e. in respect of concentration operations notified under the EC Merger Regulation. The test applied by the Commission when assessing these operations was therefore a dominance test.

As you know, pursuant to Article 2 (3) of the Merger Regulation, “a concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it, shall be declared incompatible with the common market.”

I will focus here on three particular cases: the Vizzavi joint venture between Vodafone, Vivendi and Canal+, the AOL/Time Warner merger and the Vivendi/Canal+/Seagram merger.

The analysis carried out by the Commission in these operations was directed at assessing how an economic convergence between two or more previously separate media companies leading to vertical integration would eventually translate into market power of the new entity such as to, due to technical convergence, significantly impede competition in the relevant markets.

I would argue that convergence from the point of view of competition law may give rise to three different issues:

- a) the “gate-keeper” issue;
- b) the “source issue”; and
- c) the “path issue”.

4. The gate-keeper

A gate-keeper role is played by a company possessing a certain technology, know-how or technical standard allowing it to exert a significant degree of control in respect of the access to a given market. This degree of control is relevant from a competition point of view only where the market power of the gate-keeper is significant and where the technology at stake is an essential input for any potential new entrant to be able to enter the market. A gate-keeper will be able to engage in exclusionary practices vis-à-vis its competitors and/or excessive pricing vis-à-vis its customers.

A clear gate-keeper issue arose in the AOL/Time Warner merger in the year 2000. AOL is the leading Internet access provider in the US and the only provider with a presence in most EU Member States. Time Warner, on the other hand, is one of the world’s largest media and entertainment companies with interests in TV networks, magazines, book publishing, music, filmed entertainment and cable networks.

The Commission found that the new entity resulting from the merger would have been able to play a gate-keeper role and to dictate the technical standards for on-line music delivery, i.e. streaming and downloading of music from the Internet. This could happen in two ways.

First, AOL/Time Warner would be in a position to develop a closed proprietary formatting technology for all the downloads and streaming of Time Warner and Bertelsmann tracks. The formatting language of AOL/Time Warner could become an industry standard and competing record companies wishing to distribute their music on-line would be required to format their music using the new entity’s technology. Because of its control over the relevant technology, the new entity would be in a position to control downloadable music and streaming over the Internet and raise competitor’s costs through excessive license fees.

Alternatively, AOL/Time Warner could format its music (and Bertelsmann’s) to make it compatible with its own software Winamp only, ensuring at the same time that Winamp could support and play different formats used by other record companies.

Let me explain what this software is about. A downloaded or streamed track needs to be played by means of specific software, so called “music player”. By formatting its music and the music from Bertelsmann to make them compatible with its own software Winamp only, the new entity would cause Winamp to become the only “player” in the world capable of playing virtually all the music available on the Internet. By refusing to license its technology, the new entity would impose Winamp as the dominant music player as no other player would be able to decode the proprietary format of TW and Bertelsmann music. As a result of the merger, the new entity would control the dominant player software and could charge supra-competitive prices for it.

Consequently, AOL/TW could end up holding a dominant position on the emerging market for on-line music delivery.

5. The “source issue”

The second issue is the “source issue”.

A given company may hold a significant degree control over the source of the different businesses at stake in the relevant markets, i.e. of the primary input at the top of the value chain of the product. In the media industries, this will generally refer to the company producing the audio-visual product (films, music, TV-programmes) and/or holding the corresponding copyrights.

The control exerted at the source will become relevant from a competition law point of view where the amount or breadth of products and/or copyrights is such as to allow the company to gain a competitive advantage by means of exclusionary or discriminatory practices vis-à-vis its competitors, and, naturally, where these products are the very same that the competitors wish to sell to their customers.

In AOL/Time Warner, for example, the combined entity would not only possess one of the largest music libraries in the world (Warner Music is one of the 5 music majors) but would also, due to contractual links, have preferential access to the library of Bertelsmann Music Group, also part to the group of the 5 music majors. This would result in the combined entity controlling the leading source of music publishing rights in Europe.

The problem was aggravated due to the simultaneous notification of the projected merger between EMI and Time Warner. The preferential access by AOL/Time Warner to the music copyrights of EMI, Warner and Bertelsmann would have put in the hands of the new entity half of all the music content available in Europe for on-line delivery.

A similar “source” problem arose in the Vivendi/Seagram merger in respect of both music and films. Vivendi is a leading company in the telecommunications and media sector, with interests in mobile telephony networks, cinema production and distribution, and pay-TV services. Seagram was a Canadian company which, among other interests, controlled the Universal music and filmed entertainment businesses.

In terms of content, the merged entity would have the world’s second largest film library and the second largest library of TV programming in the EEA. It would also

be number one in recorded music combined with an important position in terms of publishing rights in the EEA.

The position of Vivendi/Universal concerning music rights became particularly relevant in respect of the Vizzavi portal, a portal run by a joint-venture between Vivendi and Vodafone. The Vizzavi joint-venture had itself been notified to the Commission just some months before the Vivendi/Universal merger.

As we will see in just a minute, the “source” issue may raise particular competition concerns where combined with a “path” issue.

6. The “path issue”

Let me now turn to the third issue.

There may be a “path issue” where a company exerts a significant degree of control over the path to the customer, i.e. the distribution channel. Traditional distribution channels for media products are the physical distribution networks through which physical goods such as books, CDs, video-tapes or DVDs are distributed to the retailer. I guess that also free-to-air (analogue) terrestrial television broadcasting has to be regarded nowadays as a traditional distribution channel. More recent distribution channels are satellite broadcasting, cable networks, mobile telephony networks and, naturally, the Internet.

A “path issue” may arise from a competition law perspective where the degree of control exerted by the path-owner allows it to engage in exclusionary or discriminatory practices vis-à-vis its competitors, excluding them from the path to the customer or forcing them to seek less efficient paths.

The Vodafone/Vivendi/Canal+ joint-venture for the development of the Internet portal Vizzavi presented a clear “path issue” in respect of Internet access. As regards Internet access via mobile phone handsets, the issue arose in respect of the significant market position of Vodafone in the market for mobile telephony in a number of European countries. Vodafone already had a very significant customer basis in these countries and therefore a solid path to the future customers of the JV was already established. As regards Internet access via TV set-top boxes, a similarly solid distribution channel was also owned by Canal+ in respect of its customer basis for pay-TV services. The concern therefore arose in respect of the ability of both Vodafone and Canal+ to migrate their customer basis from the mobile telephony and pay-TV markets to the Internet access markets by using the already existing distribution channels or paths.

The same “path issue” arose during the Vivendi/Seagram merger, which was notified some months after the Vizzavi joint-venture. The issue here concerned the addition of the Universal music library to the distribution channels of Vodafone and Canal+ and its possible impact on two emerging markets: the market for on-line music delivery and the market for horizontal Internet portals.

Finally, in AOL/Time Warner the “path issue” concerned the so called “AOL Community”. At the time (2000), AOL had 23,2 million subscribers world-wide (this figure rose in the meantime to 34 million this year). Its two instant messaging services

had tens of million of members, ICQ over 85 million and Instant Messenger over 60 million. This features made AOL the leading Internet Service Provider in the world, the leader in the USA and the only one with a significant presence in most EU countries.

Any one of the issues I referred to previously may not be in itself relevant from a competition law perspective if taken individually. It may even be the case that the companies involved in an operation that is under scrutiny by the Commission are not dominant in any of the relevant markets at the time of notification. Convergence in the media industry, however, has forced the Commission to provide an answer to the following question: *what happens if all these issues CONVERGE simultaneously in the same case?*

7. Leveraging

A classic competition concern that may arise nonetheless in a “convergence case” is the leveraging ability of the parties, i.e. their ability to transpose their market power in a given market into a neighbouring market, thereby creating or strengthening a dominant position. This problem may become particularly acute in cases where the parties extend their activities into different product or services markets, something that is explicitly sought for by media companies wishing to distribute their products across different platforms.

In the Vizzavi case, the creation of the JV raised concerns in respect of the ability of the parties to leverage their market power in the market for mobile telephony into the market for mobile Internet access. The stated purpose of the Vizzavi portal was to create a “horizontal, multi-access Internet portal”, providing customers with a range of web-based services across a variety of platforms (PCs, mobile phones, TV set-top boxes).

On the basis of the market position of Vodafone in a number of EU countries and of Vivendi in France for mobile telephony services, the position of the JV parties in the market for mobile Internet access would be strengthened by the Vizzavi branded and integrated approach to Internet across various platforms, which would allow for cross-selling and bundling of offers. This would allow the new entity to leverage a strong position in the mobile telephony market into a dominant position on the mobile Internet access market.

As regards Internet access via TV set-top boxes, the same concern arose in respect of the ability of Canal+ leveraging its strong market position in the pay-TV market into the market for Internet access via set-top boxes.

In both situations there would be a certain degree of control by the parties over a path being translated into a dominant position on new paths being developed.

A clear vertical leveraging issue arose still in the Vizzavi case, as regards the buying power of the J-V parties. Already before the operation, Canal+ was an important buyer of content for pay-TV, such as TV-programming, sports and films. Furthermore, it had a large customer basis accustomed to pay for content. The Vizzavi portal would combine a powerful new Internet access mechanism with paid-for content. Given the dominant position that the parties would acquire on the Internet

access markets which I mentioned before, the operation would allow the parties to leverage their market power in the markets for Internet access into the market for the acquisition of paid-for content for the Internet. Moreover, the structural link between Vivendi and Canal+ and AOL France (55%) made the concern in respect of the increase in the bargaining power of the parties even more serious.

The leverage allowed for by the operation would naturally work in detriment of the parties' competitors in the markets for mobile telephony and pay-TV.

The concerns identified in the Vizzavi operation were strengthened when Vivendi and Canal+ notified some months later their acquisition of Seagram, the Canadian company owning the music and films business of Universal.

The Commission considered that Canal+ would further increase its dominant position on a number of European pay-TV markets at national level. Already before the operation Canal+ enjoyed an almost monopolistic position in respect of the acquisition of the exclusivity on Hollywood films produced by the major studios (in France, Spain and Italy). The acquisition of Universal Studios would further strengthen Canal+'s position as purchaser of Hollywood films, not only in respect of Universal itself but also in relation to other studios due to underlying financial links. Due to the vertical integration of Universal and Canal+, Canal+ would be able to leverage its position in order to secure the renewal of the exclusive agreements for pay-TV with all of the Hollywood studios and in fact also to enter into new deals.

The bargaining power of Canal+ vis-à-vis the film studios would therefore be increased, allowing Canal+ to further foreclose the pay-TV markets where it already was active.

8. Network effects

Let me now turn to another issue that often arises in "convergence cases": network effects. A network effect may, in simple terms, be described as the self-multiplying power of a network. Network effects may result from the control exerted by a company over both the source and the path.

In AOL/Time Warner, the Commission found that the distribution strength of AOL combined with the content of Time Warner and Bertelsmann would create network effects in respect of both content providers and consumers:

- for content providers, the AOL Internet community would become an essential outlet for the distribution of their products;
- on their side, consumers, would be deprived of any incentive abandon AOL.

The network effects would work both ways: more subscribers would bring more content and more content would bring more subscribers. Newcomers would also be attracted to AOL community because the larger the community, the more the possibilities to chat and communicate through AOL.

The reason for this lies at the critical mass of content owned by Time Warner and Bertelsmann (namely their huge music library) combined with the huge Internet community formed by AOL subscribers and the members to its Instant Messaging

services. The critical mass of content owned by TW and Bertelsmann would attract further music from other record companies. Competing record companies would feel obliged to distribute their products through AOL's on-line outlet, which would end up having access to all the available music.

Furthermore, AOL would be able to bundle TW and Bertelsmann music content (or filmed entertainment content) with Internet access and other proprietary services and give its subscribers preferential access to that content, allowing for instance its subscribers to access new releases before they were made public through other distribution channels. Attractive content such as music or films could also be used as promotional tools or loss-leaders in order to subscribe to Internet-access services. Consequently, the more subscribers AOL would attract, the more important it would become as a carrier for content providers seeking to secure maximum distribution.

9. Solutions

Having gone through some of the competition problems raised by convergence in the media industry, let me now conclude by explaining how the Commission tried to solve these problems.

The Commission had to achieve a balance between two conflicting elements:

- on the one hand, the Commission was aware of the reasons that lead companies to seek vertical integration;
- on the other, it became aware of the serious competition problems to which some of these concentrations gave rise.

The approach taken by the Commission was therefore not to prohibit these operations but rather approving them subject to strict conditions. As regards the projected EMI/Time Warner merger, as you may know, the parties abandoned the operation further to a statement of objections issued by the Commission and therefore no final decision was taken.

The main concern of the Commission was to ensure access, access to the source, access to the path and access through the gate. In parallel, the Commission imposed the severance of structural links that aggravated the source or the path problems.

In the Vizzavi J-V, the project of the parties provided for the Vizzavi portal to be the default portal on Vodafone and SFR mobile phone customers, as well as on Canal+ set-top boxes. The Commission imposed the possibility of customers changing the default portal on their devices, as well as the possibility of competing telecom operators accessing the customers' devices. This commitment by the parties prevented them from bundling their offers on a fully exclusive basis and prevented them consequently from leveraging their market power in a way such as to gain dominant positions in the markets for Internet access and Internet portals.

In the Vivendi/Seagram/Canal+ merger, the parties undertook to grant access to Universal's music content to any third party on a non-discriminatory basis, therefore reducing the concerns in respect of the Internet portals market and the on-line music market. The parties also undertook not to offer more than 50% of the Universal's film

production to Canal+, thereby reducing the concerns in respect of the foreclosure by Canal+ of the pay-TV markets.

As regards the severance of structural links, Vivendi undertook to divest from BSkyB in which it held a 25% stake. As you may know, the Fox studio is owned by the same group controlling BSkyB. The severance of this link to Fox, namely through their joint venture UIP for the distribution of films in Europe, significantly reduced the impact of the acquisition of Universal.

In AOL/TW, you may recall that the competition concerns started at the source, due to the breadth of music copyrights that the new entity would control. Warner Music, combined with Bertelsmann music due to crossed shareholdings, and in addition the EMI library (should the EMI/TW merger be approved), would put in the hands of the new entity a huge amount of content that rendered the gate-keeper role played by AOL in respect of music player software and the path control over the AOL community as serious competition concerns. The abortion of the EMI/Time Warner merger already reduced significantly the competition concerns. Therefore, the attention of the Commission was focussed on the structural link between AOL and Bertelsmann in AOL Europe and AOL France. In this respect, AOL undertook to put in place a mechanism pursuant to which Bertelsmann would exit from AOL Europe. Once solved the problem at the source, the other concerns were partially dissipated.

As regards online music delivery, AOL also undertook not to take any action that would result in Bertelsmann music being available online exclusively through AOL or being formatted in a proprietary format that was playable only on an AOL music player. Once the source problem was solved, the operation which lead to the creation of the first wholly integrated vertical media company of the “new economy” could be approved.

CONCLUSION

In conclusion, I would say that the answer of the Commission to the question “how to enforce competition rules in the convergence era” is simpler than one might think. The keyword is access and the approach consists in ensuring that, no matter how far companies integrate, access is granted in respect of those inputs or those paths that may foreclose a given market or contribute to the creation of a dominant position.

Some of the questions put to us by the convergence trend in the media industry are undoubtedly new. Most of the underlying competition problems, however, have not significantly changed.

Last but not least, the recent evolutions in financial markets seem to indicate that the pace of concentration in the media industries has diminished and also that the expectations of most market players have changed. We may therefore be soon confronted with competition issues related to “consolidation” rather than “concentration” in the media industry, and this circumstance will certainly raise new questions. If so, I hope it will give us the opportunity to meet again and debate what could become the “after-math of convergence”.

Thank you very much for your attention.