

European University Institute
Department Of Law
October 1999

Thesis Submitted For The LLM Degree

CONTROL OF
STRATEGIC ALLIANCES
PURSUANT TO EUROPEAN
COMPETITION LAW



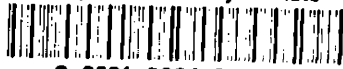
A Case Study In The Telecommunications Sector

Written By:
Anne S. Pantazi
LLB (Bristol), Barrister-at-law (ICSL, Lincoln's Inn)

Supervised By:
Professor Giuliano Amato

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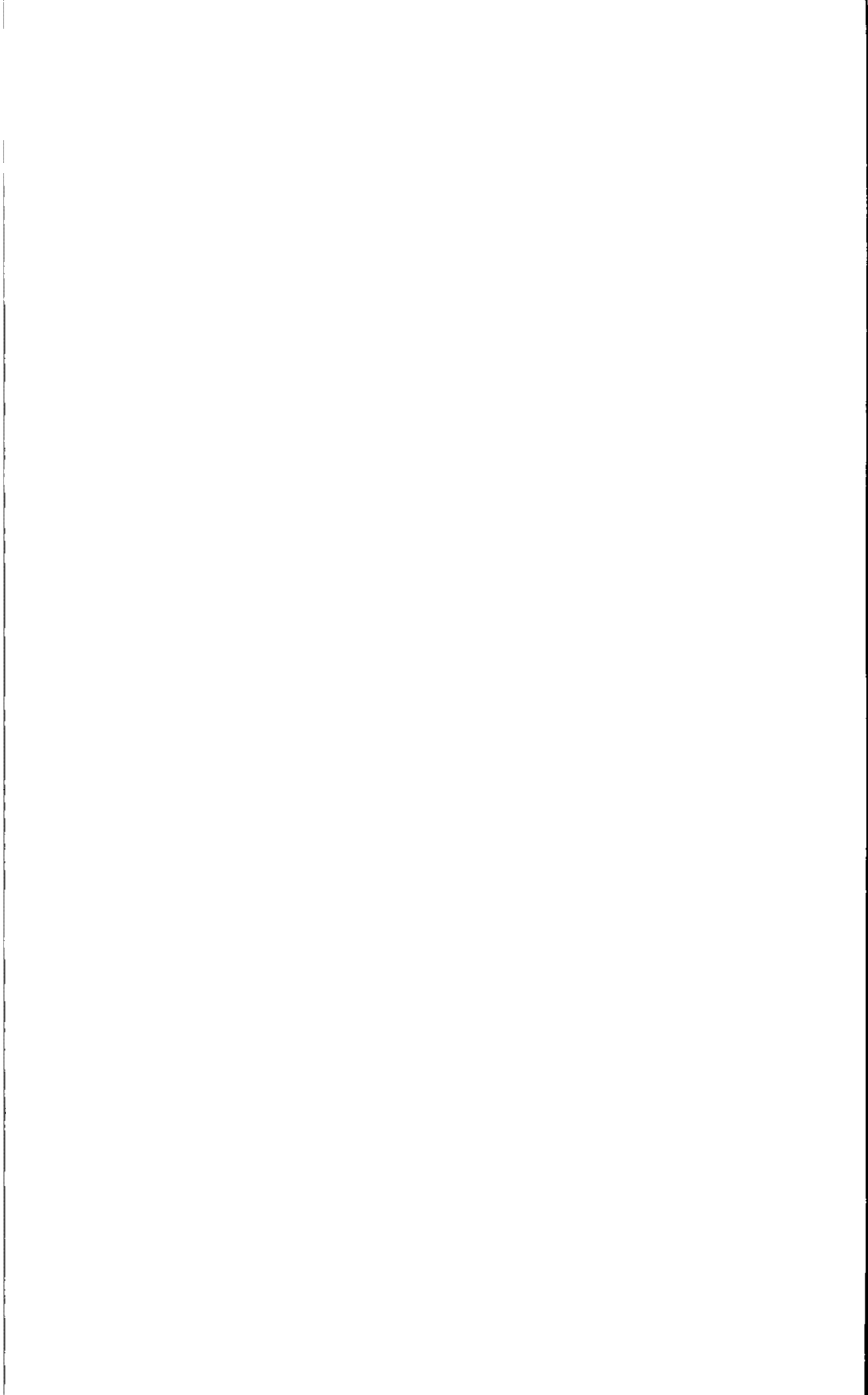
Professor Giuliano Amato

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To my parents
for their invaluable support,
Sotiris Yiangou
for his indescribable contribution,
and my flatmates
for their tolerance.



Acknowledgment

I am greatly indebted to my supervisor, Prof. Giuliano Amato for his encouragement and his consistent and valuable advice. I would also like to thank F. E. Gonzalez-Diaz, Head of Unit, Merger Task Force, DGIV, European Commission, as well as Demetri Giotakos, Jonathan Denness and Mario Toddino, also of the Merger Task Force, for providing me with their useful comments at an early stage of my research. The last but not the least, I would like to thank Prof. Christian Joerges, Prof. of Law at the European University Institute, for his support throughout my academic studies for the LLM degree.

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*“While significantly improving the status quo,
the amended Merger Regulation will continue to raise
important issues of interpretation with regard to joint ventures.*

*However,
the relatively limited Commission decisional practice under Article 2(4) to date appears
to show that*

*the adoption of the Regulation 1310/97
may constitute a new and welcome point of departure
for a more economically driven analysis
of the possible anti-competitive spill-over effect
resulting from the setting up of a joint venture.”*

F.E. Gonzalez-Diaz, 1999,
“Joint Ventures Under EC Competition Law: The New Boundaries”,
not yet published.

INTRODUCTION

Background To The Research Question

Progressively, literature on, and review of, European Competition Law has been witnessed to express an interest in taking firms' strategic behaviour seriously when examining competition issues. Juan Briones, in examining the treatment of mergers in oligopoly markets under European Competition law, concludes that *"the approach to oligopolies now takes into account more explicitly elements related to the strategies of the market players as well as conduct-related information, which are factors that perhaps played a lesser role under a purely structural approach based on a rigid interpretation of the paradigm structure-conduct-performance"*.¹ He emphasizes that this approach to competition issues makes sense since, under oligopoly conditions, firms recognise their interdependence and the need to take into account other firms' reactions when making their decisions.

A 'structuralist' approach to competition essentially incorporates a static, one-dimensional model where structure determines conduct, which, in turn, leads to certain levels of performance. The Chicago School of economists rejects that causality from structure to conduct to performance as too simple. They argue that the linkages are much more diverse: the iterative or dynamic process by which firms implement their decisions, taking into account their rivals' assessments and responses to their actions, is an integral part of the competitive fabric. *"To ignore this crucial adjustment process, as the structuralist approach tends to do, is to ignore much that is relevant, especially for interpreting the conduct"*.²

Rhonda Smith and David Round pick up this theme and extend it further in the context of an issue within the ambit of Article 82 (ex Article 86) of the Treaty of Rome, hereinafter "the EC Treaty",³ namely the unilateral firm conduct of predatory

¹ "Oligopolistic Dominance: Is There A Common Approach In Different Jurisdictions? A Review Of Decisions Adopted By The Commission Under The Merger Regulation", [1995] ECLR 334-347 at 334.

² See Rhonda Smith & David Round, "Competition Assessment And Strategic Behaviour" [1998] ECLR 225 at 227.

³ The Treaty of Amsterdam (Amsterdam, 2nd October 1997) amended the Treaty on European Union, the Treaties establishing the European Communities and certain related Treaties. In doing so, it

pricing causing the abuse of a dominant position.⁴ They start from setting out the factors, which are considered in order to determine whether a firm has market power under a “structuralist” approach to the assessment of dominance, namely (1) market concentration, (2) height of barriers to entry, (3) extent of product differentiation, (4) extent of vertical integration. They highlight that such a “structuralist” approach does not take into account “behavioural”, strategic or dynamic factors, except by implication and that *“where it does consider whether the conduct investigated is likely to raise entry barriers, it is less likely to look more broadly at the firm’s conduct especially in other markets”*.⁵ They conclude their work by urging for greater consideration of strategic behaviour in future competition analysis.

From the European Commission’s side, Alexander Schaub has admitted, while explaining that *“(c)ompetition policy dictates that we allow normal ‘performance-based’ competitive behaviour on the part of the dominant companies, whilst preventing ‘defensive’ and anti-competitive behaviour”*, that *“the distinction between the two is both complex and dynamic”*.⁶

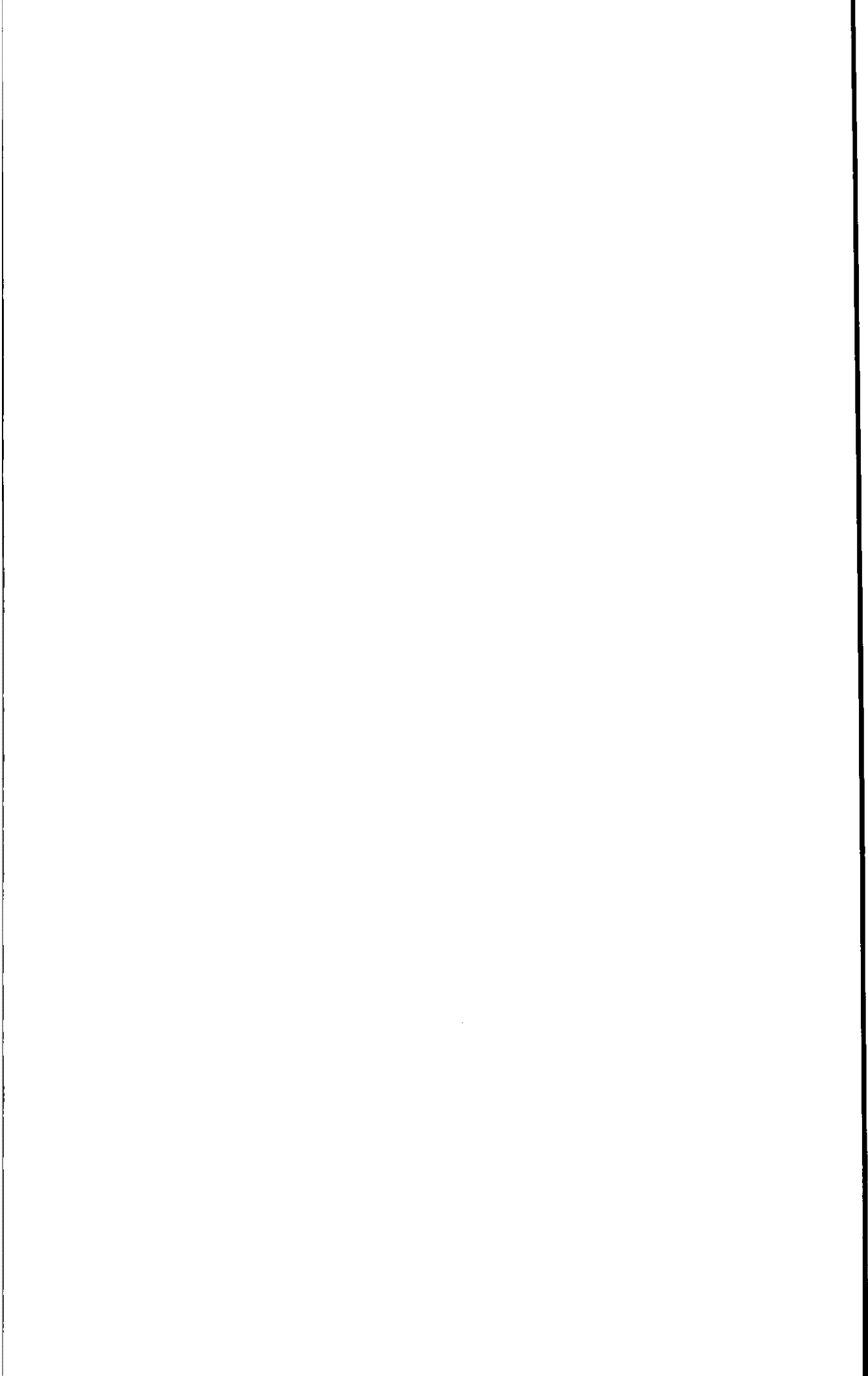
M. E. Porter accepts that the starting point for competition analysis ought to be the “industry”. He explains that in any industry whether it is domestic or international, whether it produces products or provides services, the rules of competition are embodied in five competitive forces: (a) the entry of new competitors; (b) the threat of substitutes; (c) the bargaining power of buyers; (d) the bargaining power of suppliers; (e) the rivalry of existing competitors.⁷ The strength of the five forces varies from industry to industry and can change as an industry evolves; that is, the strength of each of the five competitive forces is a function of *industry structure* - the underlying economic and technical characteristics of an industry.

renumbered the Articles of the Treaty of Rome, and Article 14(2) of the Treaty of Amsterdam required that since its entry into force (1st May 1999) the new numbering shall be employed. Hence reference to Articles of the Treaty of Rome in this thesis will be in compliance with Article 14(2). For reasons of clarity, the old number may at times be mentioned in parallel.

⁴ *ibid.* at p. 225

⁵ *ibid.* at p. 227

⁶1996, “Competition Policy In The Telecommunications Sector”, Competition Policy Newsletter, Spring 1996, No. 1, Vol.2



Yet, he points out that, if the five competitive forces and their structural determinants were solely a function of the intrinsic industry characteristics, then competitive strategy would rest heavily on picking the right industry and understanding the five forces better than competitors. *"In fact", he highlights, "a firm is not a prisoner of an industry's structure; firms through their strategies can influence the five forces".*⁸ Often firms make strategic choices without considering the long-term consequences for industry structure. He emphasizes that *"the ability of firms to shape industry structure places a particular burden on industry leaders, since their actions may have a disproportionate impact on structure, because of their size and influence over buyers, suppliers and other competitors".*⁹

He warns that the competitive strategies adopted by firms vary, and should vary, according to the nature of the industry they compete in. In this context, he describes two models of industry: on the one hand, the *"multidomestic"* industry, where competition in one country is essentially independent of competition in other countries, and hence the competitive advantage of a firm is largely specific to each country; on the other hand, the *"global"* industry, where a firm's competitive position in one country is significantly impacted by its position in other countries in which the rivals compete.

Research Question And Methodology

Intrigued by the above stream of thought, this thesis intends to examine whether European Competition Law adopts a 'structuralist' approach to competition, and therefore tends to disregard the strategic behaviour of firms, when it comes down to the very assessment of *Strategic Alliances* ("SA"). Hence, the primary objective of the thesis is to identify those features which are peculiar to a SA - as distinct from a common form of alliance - and to which features European Competition law should be, unless it is already, adapted.

⁸ "Competitive Advantage: Creating And Sustaining Superior Performance", 1985, The Free Press, New York, at pp.4-7

One would think that the words Strategic Alliance (“SAs”) - are as widely and clearly understood as broadly and frequently they are used. The difficulty to define with precision what a SA is, from a legal point of view, is acknowledged. In fact, literature on European Competition law appears to use the term SA as a generic one, encompassing a variety of corporate transactions ranging from collaboration agreements with no equity participation to full function joint ventures - whether cooperative or concentrative, as the distinction used to be - to acquisitions¹⁰. In Part [I] of the thesis, the author will make an attempt at throwing some light on what exactly a SA is. It is submitted that, at best, we can derive guidance on the concept of SAs from management science.

In the author’s opinion, it would be rather unfortunate to advocate for the introduction of the pragmatic, strategic reasoning of firms into the legal reasoning, whilst failing to demonstrate that certain strategic behaviour can reasonably be foreseen. For the same reason, Part [II] seeks to put in context that which is argued in Part [I]. The author identifies the telecommunications sector as an attractive playing field for SAs. It is a sector, which has experienced rapidly evolving technological changes, which have urged the firms to exploit new capabilities.¹¹ Besides, the sector-specific regulatory framework, which was prescribed by the European Union for its Member States, posed a strategic challenge for the leading firms: to deploy certain strategies before regulation-induced competition was injected into the monopolistic structure of the sector; and, to formulate other strategies to maintain their leadership, after the market would have officially ceased to be monopolistic. The reader is addressed to this strategic challenge. Drawing from these sector-specific developments, a model is suggested in Section 3.5 for the purposes of the “strategic

⁹ *ibid.*

¹⁰ See M. A. Pena- Castellot, “The Application Of Competition Rules In The Telecommunications Sector: Strategic Alliances”, *EC Competition Policy Newsletter*, Spring 1995, Vol.1, p.1 at p.2: “Some alliances include acquisitions either of unilateral stakes or of cross-shareholdings in the capital of the participating companies, as in the BT-MCI case[...].”

¹¹ The author wishes to clarify that, albeit technological developments stifled both the phenomena of globalisation and convergence, only SAs which have been concluded in response to convergence will be analysed.

analysis” of SAs in this sector. In essence, this model expands on the model which was set out in Section 1.6.

Part [III] aspires at describing the legal instruments, which are available within the European Competition Law regime and can be implemented for the purposes of controlling SAs. The author is particularly interested in SAs which are set up in the form of full-function joint ventures, because, first, SAs are most frequently set up like that; secondly, they are more durable than SAs set up as partial-function joint ventures, and therefore their effects are likely to be felt to a greater extent; finally, they do bring into question the structure of the industry and their parents' position therein, hence raising the issue of whether the SA executes a defensive strategy of the parents targeted at reinforcing their leading position, and consequently influencing the structure of the industry. Having said that, the legal instruments which are relevant for our purposes, and thus will be discussed in Part [III], comprise the EC Merger Regulation, Council Regulation 4064/89 of 21 December 1989 On The Control Of Concentrations Between Undertakings as amended by Council Regulation 1310/97 of 7 July 1997, and Article 81 (ex Articles 85) EC Treaty.

The author wishes to bring to the surface several aspects of the methodology of the European Commission which indicate that a 'structuralist' approach to competition is adopted, and at the same time to suggest in what respects such practice may be modified to capture the strategic behaviour of firms. It is submitted that there is room within the wording of the legal instruments for such modification. In particular, the author submits that the concept of 'market power' may be reinterpreted to take into account the strategies of firms aimed at giving themselves an exclusive position on the market: it is argued that the concept of 'dominance' which the ECMR prohibits, justifies such reinterpretation. Further, the author suggests a different way of looking at the likelihood of co-ordination of the parents' behaviour. Always focused on the strategic intent of the parents, the author commends on the relationship between the ancillary restraints (non-competition clauses) attached to the joint-venture agreement, the competitive behaviour of the parents and, in turn, their market power. The themes discussed are extricated from a case study in the telecommunications sector.

PART [I]

STRATEGIC ALLIANCES: ANALYSING THE PHENOMENON

1. The Concept of Strategic Alliances

1.1 *What is the rationale for alliances*

Generally speaking, alliances are sought to be concluded in the following circumstances: (a) where a company can no longer afford the risks of 'bet your company' investment opportunities (*risk sharing*); (b) where the industry has high fixed costs, and therefore the company needs greater scale to compete globally (*economies of scale*); (c) where the company lacks a basic understanding of customers and applications, as well as the infrastructure to distribute its product to such customers (*market segment access*); (d) where the company faces critical technology gaps and cannot afford the time and / or the resources to build it itself (*technology access*); (e) where the company has a viable product but the opportunity of supplying it is attractive only in a foreign market which it is difficult for it to penetrate (*geographical access*); (f) where the company is facing ever-increasing development costs (*funding constraints*); (g) the company needs an infusion of top-quality management (*management skills*); (h) the company wants to strengthen value-added (*value-added barriers*). In the aforesaid circumstances, concluding an alliance will be preferred to making an acquisition, provided that there are acquisition barriers. Such barriers may arise due to the following factors: (a) the massive size of the prospective ally who controls the desired capability renders it unlikely to consider seriously an acquisition; (b) geographical distance causes cultural differences; (c) the owner is reluctant to lose control; (d) it may be desirable to accede a subset of the partner's capabilities rather than all, i.e. even less relevant, capabilities. Albeit alliances are seen as precursors to a broader relationship, which may entail a full legal merger, both parties acknowledge that trust building and strategy formation demand to be evolved gradually and thus a less rigid form of integration is chosen.

It is important to clarify that these drivers for alliances may not be the same for both / each partner; in fact, their relevance will vary by industry as well as by company within an industry. Thus, (a) in capital intensive industries, the key driver is risk sharing and economies of scale, whereas in labour intensive industries there are few drivers to ally; (b) where the products of the industry are differentiable, market access and technology access are the key drivers, whereas in industries for commodity-like products, economies of scale trigger an incentive to ally; (c) where the rate of change within, or of, the industry involves high technological complexity, technology access will be the driver whereas in industries where the rate of change involves low technological complexity, economies of scale may drive the desire to ally; (d) interestingly, in young industries with embryonic structure, risk sharing and funding constraints will be reasons to ally by contrast to mature industries with well established structures where market access will be the determinant; (e) *emphasis added*, in global industries, geographic access will be the key driver for concluding alliances and the same will apply to a strategic industry - that is where the industry carries a political significance.

1.2 What is a SA

John R. Harbison & Peter Pekar, JR.¹² define a SA as a cooperative arrangement between two or more companies in which (a) a common strategy is developed in unison and a win-win attitude is adopted by all parties; (b) the relationship is reciprocal with each partner prepared to share specific strengths with the other, thus lending power to the enterprise; (c) a pooling of resources, investment and risks occurs for mutual gain.

What distinguishes an alliance from a 'strategic' alliance is the existence of '*strategic intent*', which ought to be discerned.¹³ The existence of different strategic

¹² "A Practical Guide To Alliances: Leapfrogging The Learning Curve. A Perspective For U.S. Companies", 1993, Booz-Allen & Hamilton, p.3

¹³ Source: Peter Lorange & Johan Roos, Strategic Alliances: Formation, Implementation And Evolution", 1992, Blackwell, at Ch. 2: "The Formation Process", p.27.

intentions among SA partners is healthy.¹⁴ A proviso to this is necessary: different strategic intentions ought to be revealed by each side at the very initial stage of the formation of the alliance and must be reconcilable and compatible so that there is room for cooperation. As a common denominator, though, strategic intent envisions a desired leadership position and establishes the criterion the alliance will use to chart its progress. Strategic intent provides consistency to short-term action while leaving room for reinterpretation as new opportunities emerge; while strategic intent is clear about ends, it is flexible as to means. Strategic intent assures consistency in resource allocation over the long term. Clearly articulated corporate challenges focus the efforts of individuals in the medium term. Competitive innovation helps reduce the competitive risk in the short term. This consistency in the long term, focus in the medium term and inventiveness in the short term provide the key to leveraging limited resources in pursuit of ambitious goals. Strategic intent implies a sizeable stretch for an organisation; current capabilities and resources will not suffice.¹⁵ *Hence a strategically adopts a different approach to competitor analysis than a sole competitor does.* Typically, competitor analysis focuses on the existing resources (human, technical, financial) of current competitors; the only companies seen as a threat are those with resources to erode margins and market share in the next planning period; the pace at which new competitive advantages are being built rarely enters in.

1.3 Why are alliances increasingly strategic

The 1970s was the era of *product performance*, in which, albeit alliances generally focused on getting access to the latest technology and selling the product internationally, the key selling point was product performance. In most cases the boundaries between industries were very clear-cut, so a broader set of capabilities did not need to be assessed. In the 1980s, the emphasis shifted to *positional focus*: companies sought to build industry stature, consolidate position and often gain

¹⁴ see Ohmae, K., "The Global Logic Of Strategic Alliances", 1989, Harvard Business Review, 67, 2, March-April, pp. 143-54.

¹⁵ Gary Hamel & C. K. Prahalad, "Strategic Intent" in "Global Strategies: Insights From The World's Leading Thinkers", 1994, Harvard Business Law Review (ed.)

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economies of scale and scope. Nowadays, the emphasis is on *capabilities*. Industry lines are blurring and competitive boundaries are also blurring: the trend towards global markets links together formerly disparate products, markets and geographical regions. In these newly defined arenas, positional assets are not enough, and new capabilities are required to succeed. The name of the game is to maximise delivered value, to minimise total cost and to gain advantage. Rapid technology shifts and tailoring to accommodate rapid product innovation both put pressure on management to act faster and smarter with fewer resources. In this environment, companies need to select, build and deploy the critical capabilities that will enable them to gain competitive advantage, enhance customer value and drive their markets. The emphasis should be on future differentiates, not historical ones. *The competitive focus must switch from how to compete better with current capabilities to how to select and build better future capabilities. Competition is no longer for position itself but for change in position. Positional assets, such as facilities, market share and brand franchise are transitory, while capabilities are not. The goal is to focus on the capabilities that the firm can use to constantly renew and extend its position.*

1.4 Capabilities And Competitive Advantage

What is '*competitive advantage*'? A firm may possess two types of competitive advantage: *low relative cost* - its ability to perform the activities in its value chain at lower cost - and / or *differentiation* - performing in a unique way relative to its competitors. The ultimate value that a firm creates is what buyers are willing to pay for what the firm provides, which includes the physical product as well as any other services or benefits. Hence, *competitive advantage* is a function of either providing comparable buyer value to competitors but performing activities efficiently (low cost) or of performing activities at comparable cost but in unique ways that create greater buyer value than competitors and hence command a premium price (differentiation). What are '*capabilities*'? They are *know-how* leveraged by cost-effective, responsive business processes and systems for innovation and delivery of enhanced customer value. They are intrinsically cross-functional. They are based on *horizontally organised teams* working together according to well-designed, pre-engineered processes, and empowered by policy to make decisions within an established

framework of rules. *Competitive advantage in capabilities demands sharp focus on supply chain management, internal capability management and customer relationship management.*

J. R. Harbison & P. Pekar JR.¹⁶ contend that no company alone can afford to build advantaged capabilities against all aspects of its innovation and delivery activity. A SA is, accordingly, *instrumental* to achieving competitive advantage in capabilities in four respects: (a) by combining efforts relative to *suppliers* in order to create a stronger bargaining power and developing favourable long term contracts; (b) by combining efforts vis-à-vis *customers* in order to offer a fuller range of products and maintaining a stronger sales force; (c) by combining efforts to develop and exploit *new and / or complementary technology* in order to leapfrog the competitors; (d) by combining efforts to achieve a *size* that preempts new entrants.

1.5 *What institutional form a SA may take.*

What determines a SA's institutional form – in other words, its organisational structure - is how much of its resources a company is willing to put into and to retrieve from a SA.¹⁷ Four archetypes of SAs may be depicted on this basis. If the parents put in merely a minimum set of resources, often on a temporary basis, which are plowed back to the parents in their entirety, an *ad hoc pool* type of SA makes most sense. If the parties are willing to put in more resources but the values created within the SA are still disbursed back to the partners, a *consortium* type of SA is appropriate. Where the parents put in a minimum of strategic resources, entering an arrangement to jointly create strategic value through a common organisation and the resources generated are not distributed to the parents except as financial results (dividends etc), the archetype is the so called *project-based joint venture*. The *full-blown joint venture* archetype occurs where both parties put in resources in abundance, allowing the resources that are generated in the strategic alliance to be retained in the alliance itself.

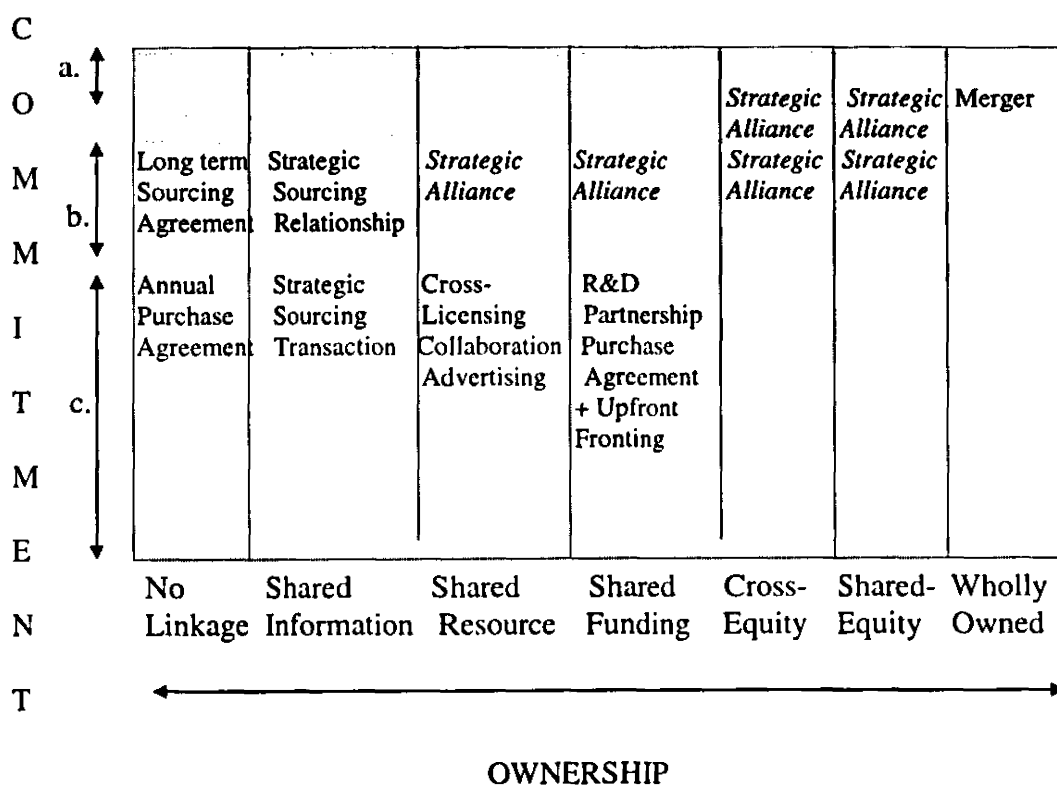
¹⁶ see n. 1 above, at p.4

¹⁷ see n.6 above at p.10



This type of SA can be characterised by the creation of a free-standing organisational entity with a more self-determined strategic life.

Hence, the institutional form with which a strategic alliance may be endowed depends on the variables of *duration of commitment* that is made by the parents and the *content of commitment*. The diagram that follows illustrates the relationship between these two variables.¹⁸ It demonstrates that at the end of the day, the parties to an alliance may be *partners* or *owners*. Further, the diagram enables the reader to distinguish between transactional relationships or mergers and strategic alliances.



- (a) represents permanent commitment
- (b) " long-term "
- (c) " transactional "

The author invites the reader to refer back to subsection 1.2: it was therein explained that the strategic intent of the SA itself normally envisages a long term plan

¹⁸ Source: <http://smartalliances.com/chartofweek002.html>



for the SA, over and above its short term plan.¹⁹ It is for this reason that, more often than not, the organisational set up chosen for a SA is that of a full-blown joint venture.

1.6 SAs are the means, not the end.

The author shares and superimposes the view expressed by P. Lorange & J. Roos that the institutional form for a SA is chosen "*regardless of the underlying strategic intents of the parents*".²⁰ P. Lorange & Johan Roos submit that a SA is the means to an end, not the end per se; it is not a phenomenon of its own, with its own strategic life and value. That is to say, a SA should always be seen from the perspective of the parents. A two dimensional test is employed to this end. *First*, what is the strategic importance of the particular business within which the SA is being contemplated - how does it fit the overall portfolio of a partner? Is the business of the prospective SA part of the core activities of the prospective partner, or can it be seen as more peripheral? *Secondly*, what is the firm's relative position in the business: is it a leader or a follower? What is its market share, technology etc.? Applying the test, four scenarios are conceivable, as illustrated by the table below.

Strategic Importance In Portfolio	Market Position	
	<i>Leader</i>	<i>Follower</i>
<i>Core</i>	<i>Defend</i>	<i>Catch up</i>
<i>Peripheral</i>	<i>Remain</i>	<i>Restructure</i>

First, when the business of the SA is core within the parent company's overall portfolio, and the firm enjoys a relative leadership in this business, the typical motive to enter into SA is *defensive*. The major rationale is to impede access to market and/or

¹⁹ The author attaches emphasis in order to keep the concept of 'strategic intent' of the SA distinguished from the concept of the 'strategic intents' of the parents / partners.

²⁰ see n. 2, Ch. 1: "Strategic Alliances In International Business - Conceptual Framework of Strategic Alliances".

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technology, as well as to secure resources. Many firms in this situation enter into a small SA with an entrepreneurial embryonic organisation in order to keep track of a new technology or a particular state-of-the-art development in the field. Secondly, when the business still falls within the core area of a firm's portfolio, but the firm is more of a follower in the business segment, the primary motive for a SA is often to *catch up*. Thirdly, when the business plays a relatively peripheral role in the overall portfolio but the firm is a leader, the main rationale is to *remain*, that is to get the maximum efficiency out of the firm's position. Fourthly, if the firm is more of a follower in the business area and if the particular business plays a relatively peripheral role in the parents' portfolio, the main motive for cooperative strategies is to *restructure* the business with an eye toward creating some strength and value which might enable the parent company eventually to unload the business.

The author of this thesis highlights that it may be inferred from the aforesaid that to control the phenomenon of SAs, it is necessary to comprehend the parents' strategic intents, rather than the strategic intent of the SA itself. Thus, albeit a SA may be set up in the name of, for instance, "promoting technical and economic progress", it is necessary to look into the underlying strategic intents of the parents before we are convinced that "the end justifies the means" (where "means" is how they name it, and "end" what they pursue)!

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2. SA and Parents' Strategies

Drawing from the aforesaid, this section aims at putting a SA in the perspective of its parents' strategies. It is submitted that, for the purposes of assessing whether a SA is pro-competitive or anti-competitive, only a *defensive* strategic intent entertained by the parents should raise concerns. Hence, only those business strategies that may serve a defensive strategic intent will hereinafter be discussed.

2.1 *Defensive Strategy*

For every firm the challenge derives from two sources: new entrants and established competitors which are repositioning. The single best defence to such challenge rests with a competitive strategy: seeking to *increase* one's competitive advantage. However, more often than not, a leading firm may decide to resort to a Defensive Strategy ("DS"), instead: seeking to *sustain* its competitive advantage. DS aims at influencing a challenger's calculations of the expected return from entry or repositioning, causing the challenger to conclude that the move is unattractive. Thus, DS rests with an acute understanding of, on the one hand, how a challenger views the leading firm and, on the other hand, how the challenger organises its entry or repositioning.

It is suggested that the process of entry or repositioning essentially consists of four periods: (a) pre-entry / repositioning; (b) entering / repositioning; (c) sequencing; (d) post-entry / repositioning.²¹ *Pre-entry* is the period before an entrant has commenced its entry, during which it examines the industry by market studies and contacts with investment banks. *Entering* is the period when the challenger actually invests in establishing a base in the industry. *Sequencing* is the period during which an entrant's strategy evolves into its long-run target strategy. During this period an entrant may take such actions as broadening its product / services line, vertically integrating, or widening its geographic coverage. *Post-entry* is the stage when investment by the entrant has shifted to that needed in order to maintain or defend its position within the

²¹ see M. E. Porter, "Competitive Advantage", 1985, The Free Press, NY, at p.482

industry. By analogy, repositioning involves the same actions on the part of the repositioner.

An important principle of DS is "*to take defensive action before exit barriers have arisen*". Exit barriers are reflected in the level of commitment (investment) that a challenger puts to its entry or repositioning. Such barriers tend to arise as the challenger commits to specialised assets, long-term contracts, horizontal strategies and investments in technology. The goal is therefore to cast a shadow on the challenger's decision making as regards the viability of such commitment. Another principle of DS is "*to shape a challenger's information and assumptions*". This principle is based on the assumption that the challenger *learns* about the market during the pre-entry / repositioning stage *from the leading firm*. The last but not the least, DS is premised on the principle that "*there is a high payout to anticipating which firms represent the most likely challengers and what their logical avenues of attack might be*". On this premise, a leading firm is prepared to reduce short-term profitability in order to raise the long-term sustainability of a firm's position.

How is DS implemented? There are several tactics. First and foremost, there is the tactic of "*raising structural barriers*": *Tactic (A)*. Secondly, the tactic of "*increasing expected retaliation*": *Tactic (B)*. Thirdly, the tactic of "*lowering inducement for attack*": *Tactic (C)*. In turn, each of these tactics varies in the way it is implemented. Such actions as will be described hereinafter do not constitute an exhaustive list. For the purposes of this thesis, and due to the word limit, only *Tactic A* will be analysed.

Tactic (A) may take the form of "*blocking channel access*". This is when a firm makes it more difficult for a challenger to gain access to distribution channels: not only the target firm's own channels but also other channels that may be a substitute or a springboard for the challenger's entry in the market. In this respect *bundling* or *unbundling* may be appropriate to reduce vulnerability to challengers. Similarly, developing attractive after-sales service support of the firm's products / services may prompt a challenger to forego investment in the relevant channel. Besides, *Tactic (A)* may take the form of "*defensively increasing scale economies*". This occurs when a

firm boosts its spending rate on technology development, thereby speeding up the rate of technological change, and hence increases the challenger's required technology development requirement, which is amortised over a smaller base of sales. Further, Tactic (A) may take the form of *"foreclosing alternative technologies"*. For instance, it may maintain a participation in alternative technologies by forming alliances with other firms, which possess expertise in alternative technologies, or it may license *good* competitors to employ alternative technologies.²² Moreover, Tactic (A) can consist in *"tying up suppliers"*. Structural barriers increase, if a firm forecloses or limits a challenger's access to the best sources of raw material or other inputs, whether this is brought about by backward integration or partial or complete ownership of such suppliers, or encouraging suppliers to customise their value chain to meet a firm's needs. Finally, a firm may pursue Tactic (A) by *"defensively pursuing interrelationships with competitors that a challenger may not match"*.

2.2 Complementary Products Strategy

The demand for a complementary product increases as the demand for the basic product increases. The demand for the complementary product increases as the selling price of the basic product decreases, and opposite. The same market rules apply to complementary services. In this respect, complementary products / services may *interrelate* distinct industry segments. Strategically important complements are those that possess the following two characteristics: (a) they are or could be associated with each other by the buyer; and (b) they have a significant impact on each other's competitive position. Thus if the buyer needs divert from the basic product, demand for its highly associated complement will drop. Such a complement may be a single product or service or a group of products or services. A complement will not be strategically important for a firm unless it has a material effect on the overall cost or differentiation of the group of related products or services.

Once strategically important complements are identified, the strategic issue arises for a firm to choose, first, whether it should supply complementary products itself or allow outside suppliers to provide some of them, and, secondly, how to

²² As regards what constitutes a "good" competitor, see M. E. Porter, ante. At p.212

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compete in the complementary products. In response to these questions, three important strategic practices have been developed: (a) *control over complementary products* – offering a full range of complementary products rather than leaving some of them to be supplied by others; (b) *bundling* - selling a group of distinct but complementary products together only as a bundle, at a single price; (c) *cross-subsidisation* – selling one product at terms that deliberately promote the sale of complementary products.

2.2.1 Bundling

In simple words bundling means that all buyers are provided with the same package of products and services, regardless of differences in their needs. Therefore, it is not desirable unless it has some countervailing benefits that overcome the fact that it is sub-optimal for some buyers. In particular, bundling may be necessary when the interface among complementary products is not standardised. Compatibility among items in the bundle is facilitated, if the same firm provides the whole package of items needed jointly to meet the buyers' needs. Besides, bundling may simplify the buyers' shopping task by offering them a single point of responsibility for any defects, servicing and payment. On the other hand, bundling enhances the opportunity for a firm to exercise price discrimination and increase its total profits where different buyers have different price sensitivities for the individual parts of the bundle. "Mixed" bundling causes buyers to buy the whole bundle even though they would not buy all the parts individually, simply because the firm offers the whole bundle at a total price which is lower than the sum of prices of the individual items. *Also, bundling carries the implication of raising or increasing entry and mobility barriers by way of forcing a competitor to develop capabilities in all parts of the bundle rather than being able to specialise in one item.*²³ Moreover, there is not much incentive for competition among a group of bundled competitors since, if all competitors offer the same bundle and the only industry price is the bundle price, the ability to recognise mutual dependence among firms is higher. Notwithstanding the above, a bundled competitor

²³ M. E. Porter, ante. at p.429

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will be vulnerable, if the advantages of bundling can be duplicated by focused competitors who form alliances among themselves.²⁴

2.4.2 Cross-subsidisation

The underlying idea is to *deliberately* sell one product at a low profit or even a loss in order to sell more profitable complements and thus increase total profit. Cross-subsidisation may also involve misallocating *costs* of less regulated businesses to the regulated one, where higher costs can be used to "justify" requests for higher rates. Hence, cross-subsidies pose anti-competitive effects whenever a regulated firm also operates in unregulated markets; but it is more likely to escape regulatory detection when markets are closely related.²⁵

Conditions favouring cross-subsidisation include the existence of: (a) sufficient price sensitivity in the basic good so that discounting the basic good will increase its sales volume, and thereby more than recoup profit through the induced sales of the profitable, complementary good; (b) sufficient price insensitivity in the profitable good so that raising its price does not greatly reduce its sales volume, and thereby recoup profits lost from discounting the basic good; (c) strong connection between the profitable and basic good so that buyers cannot cherry-pick by purchasing only the low-priced basic good; (d) barriers to entry into the market for the profitable good. It is noted that insensitivity of demand to price in the profitable good is a function of the price it creates for the buyer and the threat of substitution for it; perceived or actual compatibility may connect the goods; the connection between the goods depends on the possibility of substituting for the profitable good.

For the purposes of this thesis, it is important that the reader is aware of the possibility that the object or the effect of the SA is to facilitate the parents with exercising the practices of bundling and cross-subsidisation.

²⁴ see M. E. Porter, ante. at p. 430.

²⁵ quoting from P.J.J. Welfens & G. Yarrow, ante. at p.231

2.3 Technology Strategy

It is common ground that technological developments are one of the prominent drivers of competition and structural change in an industry. In turn, it is important to understand the Technology Strategy ("TS") of competitors. *TS is concerned with choices about which technologies to invest in, whether to seek technological leadership in them, and how to license technology.* It is crucial for a firm to be in the position to forecast the path of technological change as an industry evolves. The technology in different value activities can be related: this underlies a major source of *linkages* within the value chain. Such linkages may exist with suppliers' technology and buyer's channels, too. A firm's technologies may also be interdependent with its buyers' technologies.

From a TS point of view, the crucial question is "when does technology affect a firm's competitive advantage?". *Competitive advantage will be affected if technology significantly determines the firm's relative cost position or differentiation.* For instance, this occurs where technological change itself lowers cost or enhances differentiation *and* the firm's technological lead is sustainable. Pioneering the technological change may lead to a variety of advantages in cost or differentiation that remain even after its technological lead is gone. If the technological change is diffused, it can potentially improve the overall industry structure, and therefore, albeit it may not yield competitive advantage to any firm, it may affect the profit potential of all firms.

Firms often confront a choice between attempting to improve an established technology for performing a value activity or investing in a new one. Technologies seem to go through a life-cycle in which early major breakthroughs or improvements give way to later incremental ones. In fact, modest improvements to several technologies or sub-technologies involved in a value activity may add up greater competitive advantage than breakthroughs. *It is not in the interests of this thesis to elaborate any further on this, albeit it, admittedly, is an important issue. More important for the purposes of this thesis is to consider the reasoning underlying the choice-making of a firm as to whether to seek technological leadership.*

Technological *leadership* basically refers to a firm seeking to be the first to introduce technological changes that support its generic strategies. Technological *followership* is taken to refer to the conscious and active strategy in which a firm explicitly chooses not to be the first on innovations.²⁶ *It is suggested by the author of this thesis that this question should be examined in a wider context: the link between TS and DS of a firm.* In Section 1.7 of this thesis, “foreclosure of alternative technologies” was cited as a form of the defensive tactic of “raising structural barriers to an industry”. It is submitted that “foreclosure of complimentary technologies” may serve equally defensive objectives. Finally, it is contended by the author of this thesis that the strategic choice between technological leadership and followership may trigger an alliance between firms where one firm decides to become a leader but lack the funds or capabilities to do so alone. It was already stated (in Section 1.7) that “*concluding technology interrelationships between competitors*” may have the defensive objective of raising entry barriers to potential competitors that cannot match such interrelationships.

In principle, the choice between technological leadership or followership is determined by the interaction of three factors: (a) *the sustainability of the technological lead* – the degree to which a firm can sustain its lead over competitors in a technology; (b) *the first-mover advantages* – the advantages a firm reaps from being the first to adopt a new technology; (c) *the first-mover disadvantages* – the disadvantages a firm faces by moving first than waiting for others.

Arguably, technological lead can be sustained, if either competitors cannot duplicate the technology, or the firm innovates as fast or faster than competitors can catch up with. More precisely, the sustainability of technological lead can be described as a function of four factors: (1) whether the particular technology is being developed inside the industry or is coming from outside it; (2) whether the firm has a cost or differentiation advantage in performing technology development; (3) whether the firm has unique technological skills vis-à-vis competitors; (4) the rate at which the leader’s technology diffuses.

First, where important sources of technology are external to an industry, for instance, where they come from suppliers, buyers, or completely unrelated industries, sustaining a technological lead is generally more difficult. External technology sources disassociates a firm's access to technology from its technological skills and R&D spending rate, because getting access to such external developments is open to many other companies. *"Technological leaders in industries with key external sources of technology must capture the best of those sources through coalitions or exclusive arrangements in order to sustain their lead, or have a superior ability to adapt externally developed technology to the industry."*²⁷ Secondly, a firm is more likely to sustain a technological lead, if it has a cost or differentiation advantage in performing technology development. Scale economies or learning effects give large-share firms a relative R&D cost advantage. A firm's relative cost advantage may also be strongly influenced by the transference of skills or sharing of cost of R&D; hence, *"technological leaders often aggressively pursue technological interrelationships, entering new businesses with related technologies."*²⁸ Thirdly, a firm with unique technological skills vis-à-vis competitors is more likely to sustain its technological lead. Technological skills are a function of, inter alia, management, culture, organisational structure and systems, company reputation with scientific personnel. Such skills influence the output from a given rate of spending on technology, regardless of scale, learning or interrelationship effects. Nevertheless, superior technological skills or cost advantages in performing R&D can be nullified, if competitors can easily copy what a firm develops. Diffusion may occur by way of *direct observation* by competitors of a leader's products and methods of operating; or by way of *technology transfer* through buyers, suppliers or vendors; or by personnel losses to competitors. *The rate of technological diffusion is partly intrinsic to an industry and partly under a firm's control. Successful technological leaders are thus aggressive in trying to slow down diffusion. To this end they often vertically integrate, building new or modifying old technology in-house.*²⁹

²⁶ See M. E. Porter, ante. at p. 181

²⁷ M. E. Porter, ante. p. 183

²⁸ *ibid.* at p. 184

²⁹ *ibid.* at p.186



If a technological lead cannot be sustained, technological leadership can only be justified, if the initial lead translates into *first-mover advantages*. These allow a leader to translate a technology gap into other competitive advantages. They rest on the role of *timing* in improving a firm's position vis-à-vis sustainable sources of cost advantages or differentiation. The first mover grabs the opportunity to *define* the competitive rules. In particular, a first mover will be the first to serve buyers and thus establish a relationship of loyalty, enhancing the brand name and creating switching costs, thereby locking in later sales. Besides, a first-mover will define the standards for technology, forcing followers to adopt them. It will enjoy at least a temporary advantage in access to purchased inputs or other resources before the market forces reflect the full impact of the change it is pioneering. In any event, the first mover will preempt the ability of competitors to reposition or expand. Of course, the above mentioned advantages need be balanced against the *first-mover disadvantages* of uncertainty of demand, changing buyer needs, technological discontinuities and the cost of obtaining regulatory approval.

2.4 Horizontal Strategy

DS may be part of a broader Horizontal Strategy ("HS") of a firm. HS coordinates the goals and strategies of distinct but interrelated *business units* competing in different industries; by analogy, it coordinates the goals and strategies of distinct but interrelated *segments* within an industry. It is founded on the assessment of a firm's competitive advantage in existing business units / industry segments and its *sustainability* by selecting new industries / segments of industries to enter based on interrelationships with existing business units / industry segments. The formulation of a HS is nowadays becoming a must for firms as technology is breaking down barriers between industries and driving them together. At the same time that technology is creating interrelationships, it is also reducing the costs of exploiting them.

As more and more firms seek out, or are forced to, pursue interrelationships, there is an increasing presence of *multipoint competitors*. The latter comprise firms that compete with each other not only in one business unit or industry segment but

rather in a number of related business units or segments. Where a firm has multipoint competitors, it ought to view its competitors across the board rather than at the distinct business unit or industry segment level because competitive advantage will be determined across the board. Most significantly, firms pursuing a HS identify potential competitors / entrants in an industry with *"those firms for which that industry is: (a) a logical way to create or extend an important interrelationship; (b) a necessary extension to match the interrelationship of competitors"*.³⁰

2.4.1 Segment Interrelationships & Synergies

Industry segmentation is the division of an industry into sub-units for purposes of developing competitive strategy. Industry segmentation will be taken, for the purposes of the following analysis, to be broader than the familiar notion of *market* segmentation. The latter concept is concerned with identifying differences in buyer needs and purchasing behaviour, allowing a firm to serve segments that match its capabilities with distinct marketing programs. On the other hand, industry segmentation combines buyer purchasing behaviour with the behaviour of costs, both production costs and costs of serving different buyers. It addresses the question, *"what segments of an industry a firm should serve and how it should serve them"*. Attention to segmentation from a strategic perspective is increasingly important as technology developments are altering the old rules of segmentation with implications for both firms adopting focus strategies to competition and those adopting broadly-targeted competitors strategies.

Defining an industry as a function of the range of products or services supplied and the range of buyers served, industry segmentation is an imperative, if one takes into account that differences amongst the products / services as well as amongst buyers may affect the weight of the competitive forces carried by each distinct *combination* of products / services and buyers. The competitive forces in issue are (a) supplier power, (b) buyer power, (c) threat of substitution, (d) threat of new entrants and (e) rivalry between existing competitors. Hence, industry segments stem from structural differences within an industry, whether these have been perceived by

³⁰ see M. E. Porter, ante. At p. 363.

existing competitors or not. Thus, industry segmentation should include *potential combinations* of products / services and buyers as well as those combinations that already exist. To illustrate the aforesaid, the diagram that follows is employed:

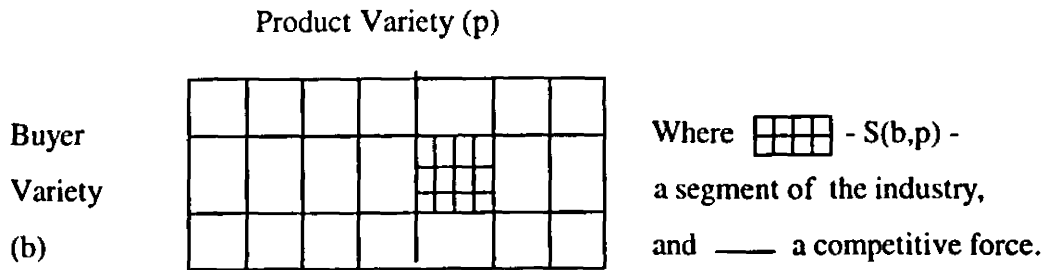


Fig. Industry Segmentation

Identifying a new way of segmenting an industry can be a major opportunity. A firm can design a focus strategy around a product variety, buyer group, channel or geographic subdivision that has not been previously recognized. A firm that recognizes such a new segment, whether narrower or broader than the existing ones, can often gain a sustainable competitive advantage preemptively.

The attractiveness of a segment is a function of its structural attractiveness - its size and growth - and the match between a firm's capabilities and the segment's needs. Rivalry in a segment involves both firms focusing exclusively on the segment and firms that serve other segments as well. The structural analysis of a segment is usually influenced heavily by conditions in other segments, more so than the structural analysis of an industry is affected by other industries.

Segments are *related* where activities in the value chain can be shared in competing in them: hence, the concept of *segment interrelationships*.³¹ In simple words, strong interrelationships exist, if all competitors in one segment also compete in another. In other words, strongly related segments are those where the shared value activities represent a significant fraction of total cost or have an important impact on differentiation. It is noted that in most industries, the pattern of segment

interrelationships is not symmetric: that is to say, some segments have stronger interrelationships than others. *Strong interrelationships among segments define the cluster of segments a firm should serve. Besides, they may define the logical paths of mobility for firms in the industry from one segment to another.*

Segment interrelationships may produce synergies where "the benefits of sharing value activities exceed the cost of sharing".³¹ Sharing value activities leads to the greatest benefit, if the cost of a value activity is subject to significant economies of scale or learning, or where sharing allows a firm to improve the pattern of capacity utilisation of the value activity. Sharing activities among segments is also beneficial where it increases differentiation in the value activity or lowers the cost of differentiation. The benefits of interrelationships amongst segments are offset by the costs of co-ordination, compromise and inflexibility in jointly serving segments with shared activities. The net competitive advantage of competing in multiple segments versus focusing on one or a few is a function of the balance between the advantages of sharing value activities and the costs.

Hence, the author of this thesis submits that when we appraise SAs which are conclude between competitors with strong segment interrelationships, it is important to look into whether any genuine synergies arise out of sharing such interrelationships before dismissing the risk that they constitute pure tools to a defensive strategy.

2.4.2 Business Unit Interrelationships

There are three possible types of interrelationships among business units: *tangible* interrelationships; *intangible* interrelationships; and *competitor* interrelationships. *Tangible* interrelationships arise from opportunities to share activities in the value chain among related business units due to the presence of common buyers, channels, technologies and other commonalities. *Intangible* interrelationships involve the transference of management know-how among separate

³¹ this concept was enunciated by M.E. Porter, ante., at p.258

³² *ibid.*

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business units. Businesses that cannot share activities may nevertheless be similar in generic terms, such as in the *type* of buyer, *type* of purchases, *type* of production process, etc. *Competitor* interrelationships stem from the existence of rivals that actually or potentially compete with a firm in more than one industry. These multipoint competitors necessarily link industries together because actions toward them in one industry may have implications in another. Competitor interrelationships may exist even in the absence of tangible and / or intangible interrelationships, but they may also co-exist. A multipoint competitor may compel a firm to match a tangible / intangible interrelationship to avoid facing a competitive disadvantage. M. E. Porter clarifies that, bearing the aforesaid in mind, "*synergy*" is not only one idea, but three fundamentally different ideas – thus, it is mistaken to refer to it as synonymous with, and to test it on the basis of, the competitive advantage accruing from intangible interrelationships, only.³³ For the purposes of this thesis, it is material to examine Competitor interrelationships and the synergies that may accrue from them. The other two types of interrelationships are explicated in order to cover for the possibility that all three co-exist.

2.4.2.1 Synergy From Competitor Interrelationships

a. Multipoint Competitors In Related Industries

In examining the potential for synergy accruing from competitor interrelationships, it is material to distinguish between multipoint competitors in *related* industries and multipoint competitors in *unrelated* industries. The presence of four or more firms competing in two or more distinct industries is a strong, though not a perfect, indication that the industries are related.³⁴ A firm's competitive advantage in any business unit that faces a *multipoint* competitor is more a function of its *overall* position in a group of related industries than its market share in any one industry because of interrelationships. This is so because competitive advantage in one business unit can be strongly affected by the extent of potential interrelationships with other business units in the competitor's portfolio. Yet, the extent to which

³³ ante., at p. 325

³⁴ see M. E. Porter, ante. at p. 354.

interrelationships are actually achieved is what determines their effect on competitive advantage, not the potential to share. Besides, when the related industries that are jointly contested do not overlap exactly, the comparison between a firm and a competitor must centre on the firm's whole range of interrelationships relative to the competitor's. Each shared activity must be analysed for the competitor as a whole, and compared to the firm's cost or differentiation in that activity. *Hence, the most strategic implication of multipoint competition in related industries is that competitor analysis must encompass the competitor's entire portfolio of business units instead of examining each business unit in isolation.*³⁵

b. Multipoint Competitors In Unrelated Industries

Where a firm faces a multipoint competitor in industries that are *unrelated*, the strategic issues revolve around how actions in one business unit can lead to reactions in another and how equilibrium with the competitor can be reached in several contested industries. Multipoint competitors need more information about each other to avoid mistaken interpretations of moves. Destabilising events in one industry can spread to others. Competing in a number of industries opens up greater possibilities for signalling, making threats, establishing blocking positions, and taking reciprocal actions. For instance, a firm threatened in one industry might retaliate in another industry where its response will be more cost-effective; this may be the case where its market share in the industry wherein it retaliates is small. *Apparently, it is wrong to assume, as between multipoint competitors, that each industry is a separate battlefield.* In fact, the threat that a competitor can retaliate in several industries (and inflict a higher cost on a competitor) may also tend to deter a competitor from making a threatening move in the first place. A further stabilising factor in multipoint competition can be the asymmetry of positions of the competitors in the different industries. Such asymmetry reduces the risk that the high-share competitor in one industry will seek an even greater share, since it remains vulnerable to retaliation in the industry wherein it has a smaller share. Hence, multipoint competitors are viewed in their totality for the purposes of formulating a corporate strategy vis-à-vis them.

³⁵ See M.E. Porter, ante. At p.361; the emphasis is added by the author of this thesis.

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c. *Single Point Competitor With Diversified Interrelationships*

From a competitive advantage point of view, it is equally important to consider *single-point* competitors with different patterns of interrelationships. A competitor with a different pattern of interrelationships is both an opportunity and a threat. It is a threat because the competitive advantage gained through interrelationships cannot be easily replicated, since a firm may be not in the same appropriate group of industries or be able to match the interrelationships. A smart competitor with different interrelationships will attempt to shift the nature of competition in each industry in the direction that makes its interrelationships more strategically valuable than the firm's. A competitor with different interrelationships might also attempt to reduce the ability of a firm to achieve its interrelationships. For example, a competitor may shift its strategy in a way that raises the cost of compromise, as described above, for the firm to achieve its type of interrelationships. *Hence, the essence of the competitive game between firms pursuing different forms of interrelationships is a tug of war to see which firm can shift the basis of competition to compromise the other's interrelationships, or to enhance the value of its own.*

2.4.2.2 Synergy From Intangible Interrelationship

Intangible interrelationships produce competitive advantage if the improvement in cost or differentiation in the business unit receiving the know-how exceeds the costs of transferring it. But even where the benefits from transferring know-how far exceed the cost of transferring it, competitive advantage will not be produced unless the transference of know-how does take place, for example through interchange between managers or the personnel in the affected business units. It appears that more often than not personnel in the receiving business unit may be wary or unsure of the value of know-how from a 'different' industry and thus openly resist to receiving it. Business units with know-how may view it as highly proprietary and thus decline to transfer it. This implies that a formal conducive organisational setting is needed to sustain commitment to achieving intangible interrelationships. This is the reason why synergy may prove to be a disappointment to firms with an eye to this type of interrelationships.

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2.4.2.3 Synergy From Tangible Interrelationship

Tangible interrelationships may be divided into five sub-categories: (a) *market* interrelationships- they involve the sharing of primary value activities in reaching and interacting with the buyer, from outbound logistics to service; (b) *production* interrelationships - they involve the sharing of upstream value activities; (c) *procurement* interrelationships - they involve the shared procurement of common purchased inputs; (d) *technological* interrelationships - they involve the sharing of technology development activities throughout the value chain; (e) *infrastructure* interrelationships - they involve sharing such activities as financing, legal, accounting and human resources management.

Tangible interrelationships lead to synergies, if sharing lowers cost or enhances differentiation enough to exceed the costs of sharing. Sharing does not necessarily lower cost. It only has the potential to reduce cost, if a value activity is driven by economies of scale, learning or the pattern of capacity utilisation. Sharing enhances uniqueness directly, if the shared activity is more valuable to buyers because it increases convenience. Whether the products sold to a common buyer are substitutes or complements can also affect the advantage of sharing market-related activities. For instance, offering substitute products to buyers can reduce the risk of substitution because losses in one product can be compensated in the other. Complementary products usually have correlated demand that facilitates the efficient utilisation of shared value activities and other practices such as bundling. Further, the net competitive advantage of a technological interrelationship will differ depending on the industry and strategies of the business units involved.

Some light is thrown hereinafter on what constitute the costs of sharing, namely the cost of *coordination*, the cost of *compromise* and the cost of *inflexibility*. Coordination is necessary in areas such as scheduling, setting priorities and resolving

problems. It involves costs in terms of time, personnel and money. Such costs differ widely according to the complexity of sharing. For instance, a shared sales force requires continual coordination whereas joint procurement may require nothing more than periodic communication to determine the quantity of a purchased input required per period by each business unit. Further, coordination costs vary in size in accordance with the size of the business units: the smaller the business unit, the higher the coordination cost is felt. The cost of *compromise* consists in the cost entailed by performing a shared activity in a consistent way, even though that may not be optimal for either of the business units involved. For instance, attempting to share a logistical system among business units producing products of widely differing sizes, delivery frequencies and sensitivities to delivery times may well lead to a logistical system that is inappropriate to any of the business unit's needs. The cost of compromise is normally reduced if an activity is *designed for sharing* than if previously separate activities are simply combined or if an activity designed to serve one business unit simply takes on another with no change in procedures or technology. The cost of *inflexibility* may take two forms: first, potential difficulty in responding to competitive moves and, secondly, exit barriers. Sharing can make it more difficult to respond quickly to competitors because attempting to counter a threat in one business unit may undermine or reduce the value of the interrelationship for sister business units. In addition, exiting from a business unit with no competitive advantage may harm other business units sharing an activity with it.

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3. *Concluding Remarks: PART [1]*

- Competition is no longer for positioning; it is for manoeuvring whilst retaining a strong position.
- Hence a SA is all about developing future capabilities by means of sharing one's strengths with another's.
- X's strengths + Y's strengths + Z's strengths do not necessarily = Benefit for C (where C - Consumer).
- Rather, X + Y + Z may = no P (Potential Competitor of X, Y), no P1.2 (Product, Price Choices that P would offer to C).

- How can we detect whether this is the strategic intent of X, Y,...?

Test: (a) is the activity of the SA, *core* to X's portfolio of activities? If yes, then; (b) is X leading already in the relevant industry / or industry segment? If yes, then X wishes to defend against P (or Y, Z). Same test should be applied to Y, Z. If either of them can be shown to intend to defend, then concerns should be raised. But concerns should also be raised, if the activity of the SA is *peripheral* to X's or Y's or Z's portfolio of activities, whereas X, Y, Z are leading already in the relevant industry / industry segment. In such a case the strategic intent is to remain. The means employed to achieve this do not add to C's welfare.

- Which other factors ought to reinforce the finding of a defensive strategic intent?

(a) the possibility that X, Y, Z may be aided with exercising *bundling* by means of the SA: this is a possible outcome where X, Y, Z have been potential competitors and they now decide to offer several products as a bundle and the only industry price is that bundle price; they can afford to do so not only because there is no competition amongst them any longer but also because they know that P will only enter, if P can develop capabilities in all parts of the bundle; this will only be possible if P can find other partners! Are there any potential partners left?

(b) the possibility that X, Y, Z may be aided with exercising the practice of *cross-subsidisation* by means of the SA: this is a possible outcome where the product / service to be launched on the market is *complementary* to the products / services that X or Y or Z already offer, and the SA sells it at a low profit in the short term in order that the parents can sell their products / services at higher profits; C is most likely to bite the cherry where, for instance, SA offers the infrastructure required for C's enjoyment of the parents' services!

(c) the possibility that the SA will give to X + Y + Z technological leadership, which will be sustainable, and thereby give them the ability to set the standards for technology and shape the consumption demand of C; this is problematic where X, Y, Z have been potential competitors on technological innovation and now, because of the SA, C is denied the opportunity to choose between the independent results from X's, Y's, Z's innovation process.

(d) the fact that X, Y, Z operate in the same business unit but in different industries, e.g. where X is a TO and Y is a Broadcaster and the relevant business unit is that for network operation, i.e. infrastructure provision; or where X, Y, Z operate in the same industry but in different industry segments, e.g. where X is a fixed-line telephony service provider and Y is a mobile telephony service provider; this fact should raise concern where the SA is set up to create an economic link (interrelationship) between the industries or industry segments, respectively – that is to say, where the industries or industry segments are not already interrelated; also where the SA is set up to increase the link between the industries or industry segments by bringing together multipoint competitors who enjoy common interrelationships.

(e) The fact that the SA brings together partners who operate in a highly regulated industry with partners who operate in a less regulated or non-regulated industry, e.g. where X is in cable TV network operation, Y is in content creation and Z is in software development. This fact may enhance the prospects for X, Y, Z to exercise the practices described in paragraphs (a), (b) above.

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PART [II]

STRATEGIC CHALLENGES & STRATEGIC INTENTS IN THE TELECOMMUNICATIONS SECTOR

4.1 *Introduction*

The reciprocity in the relationship between industry structure and strategic behaviour of the firms participating in that industry is a theme which has been, and is still being, replicated in the telecommunications sector. Significant restructuring by way of SAs has been witnessed in this sector in the geographic region of the European Union over the last ten years. Often academics, politicians, regulators and lawyers who commend on it, choose as their starting point the sector-specific regulatory package that the European Commission adopted with an eye toward liberalisation and hence the opening up of the sector to competition.³⁶ They describe the transition from a natural monopoly situation to free and fair competition; also, the change of the pattern of the industry from a multi-domestic one to a global one.³⁷ They usually depict the influence on this regulatory package of the divestiture of AT&T pursuant to the Modified Final Judgement, which was issued by the Department of Justice of the

³⁶ The regulatory package includes the following European Commission Directives: The Terminal Equipment Directive 88/301/EEC of 16 May 1988, 1998 OJ (L 131) 73; The Telecommunications Services Directive 90/388/EEC of 28 June 1990, 1990 OJ (L192) 10; The Satellite Communications Directive 94/46/EC of 13 October 1994, 1994 OJ (L 268) 15; Cable TV Network Directive 95/51/EC of 18 October 1995, 1995 OJ (L256) ; The Mobile And Personal Communications Directive 96/2/EC of 16 January 1996, 1996 OJ (L 020) 59; The Full Competition Directive 96/19/EC of 13 March 1996, OJ (L 074) 13. The reader should be familiar also with the European Commission Notice on "The Status Of Voice Communications On Internet Under Community Law And In Particular Under Directive 90/388/EEC", in 1998 OJ (C 06) 4.

³⁷ E.g. see Wolf Sauter, 1997, "Competition Law And Industrial Policy In The EU", Clarendon Press, Oxford, at p.165. The concepts "multidomestic" and "global" are used here in the sense that M. E. Porter, ante. Uses them; see section 1.7 of the thesis.

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Supreme Court in the United States back in 1982.³⁸ They indicate that divestiture need be included in the European regulatory package.³⁹

However, the author submits that, for the purposes of this thesis, we had better go through the developments, which have taken place in this sector, from *the standpoint of firms* rather than *the regulators' standpoint*. The target is to reveal what strategic challenges the firms faced in anticipation of the impact of liberalisation on the structure of the industry and consequently on their market power and what strategies they could be foreseen to deploy in response. Moreover, it is important to keep in track what strategic challenges firms face since the 1st January 1998, the official date by which Member States have been directed to introduce full competition in their markets for telecommunications services.⁴⁰

In line with this, it is suggested that the starting point, which is more appropriate for the purposes of this thesis, is to analyse *convergence* as the dynamic for industrial restructuring. Convergence as a phenomenon, which still evolves, throws light to the significant role that the competition for technological innovation plays for the entire telecommunications sector. It presents a challenge for existing and potential competitors. Indeed, one should address the question "what has the fear of the telecommunications operators ("TOs") been in the recent years?" With hindsight one can say that they did *not* fear that liberalisation would allow any other firms to enter and compete with them, at all, on the provision of the *existing* markets of services, infrastructure or equipment; instead, they feared that liberalisation would

³⁸ See further, P.J.J. Welfens & G. Yarrow (eds.), 1997, "Telecommunications And Energy In Systemic Transformation. International Dynamics, Deregulation And Adjustment In Network Industries", Springer; David E. M. Sappington & Dennis L. Weisman, 1996, "Designing Incentive Regulation For The Telecommunications Industry", The MIT Press & The AEI Press; Marcellus S. Snow, 1986, "Marketplace For Telecommunications: Regulation And Deregulation In Industrialised Democracies", Longman.

³⁹ See on this point, Arthur D. Little, "Cable Review – Study On The Competition Implications In Telecommunications and Multi-Media Markets", cited in Commission Communication Concerning The Review Under Competition Rules Of The Joint Provision Of Telecommunications And Cable TV Networks By A Single Operator And The Abolition Of Restrictions On The Provision Of Cable TV Capacity Over Telecommunications Networks, OJ (C 071) 004, of 07/03/1998.

⁴⁰ See Commission Directive 96/19/EC of 13 March 1996, 1996 OJ (L 074) 13. Eventually the Commission decided that Ireland and Portugal could have the benefit of a derogation from this obligation and therefore the deadline for them was extended to the 1st January 2000; Greece was also granted a derogation expiring on the 31st December 2000. The derogation was justified, in each case, on the ground that these Member States had less developed networks.

allow other firms to gain an interest in investing in the development of *alternative* or *complementary* types of services, infrastructure and equipment and thereafter in competing with them in *new* segments of the industry.

In fact, good strategic thinking would enable a TO to perceive this challenge not only as a threat but also as an opportunity. The factor determining where to draw the line proved to be the *timing* of taking action. If they acted *before* the completion of the liberalisation scheme, then they would enjoy *first mover advantages*. Any increase in capacity flowing from improvements in the existing technologies or the introduction of novel technologies would be *allocated* amongst them and if they decided to leave a portion for new entrants, that would still be *controlled* by them.

This leads us to the following point. How could they turn this challenge into an opportunity in the post-liberalisation era? By expanding their activities to "*future markets*", including the digital pay-TV market, the market for technical and administrative services related to the operation of digital pay-TV, the dial-up Internet access market. What would be so interesting about these markets? The fact that consumers would need to acquire certain facilities that would be, *literally speaking*, essential for them in order to enjoy the services they paid for, albeit those facilities would not be *legally speaking* essential. On the one hand, *switching costs* would be involved on the part of consumers; on the other hand, competition law would not police possessing control over those facilities.⁴¹

What would be the cost incurred in taking such actions? The cost of compromising with the fact that they would need to *ally* rather than to go ahead alone, and consequently the cost of co-ordinating with their allies. Who should be their allies? Convergence is the guide!

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4.2 Definition of "Convergence"

The term "convergence" eludes precise definition, but it is most often cited as bearing the following meaning: the ability of different *network platforms* to carry essentially similar kinds of services, or the coming together of *consumer devices* such as the telephone, television and personal computer. However, convergence of consumer devices is today much less real than network convergence.⁴² Besides, *technical* convergence ought to be distinguished from convergence in relation to *content*, which is less likely to happen.⁴³ The result of technical convergence is the shift toward multimedia. *Multimedia* is taken to refer to services, which provide more than two kinds of data such as images, text, video and audio through the same apparatus and which allow viewers to interact with the data.

4.3 Convergence As A Function Of Technological Developments

The Green Paper On Convergence has detected and revealed the technological developments that underpin the potential for convergence. The technology in question is subdivided in three categories: (a) digital technology; (b) network technology; (c) Internet technology.

4.3.1 Digital technology

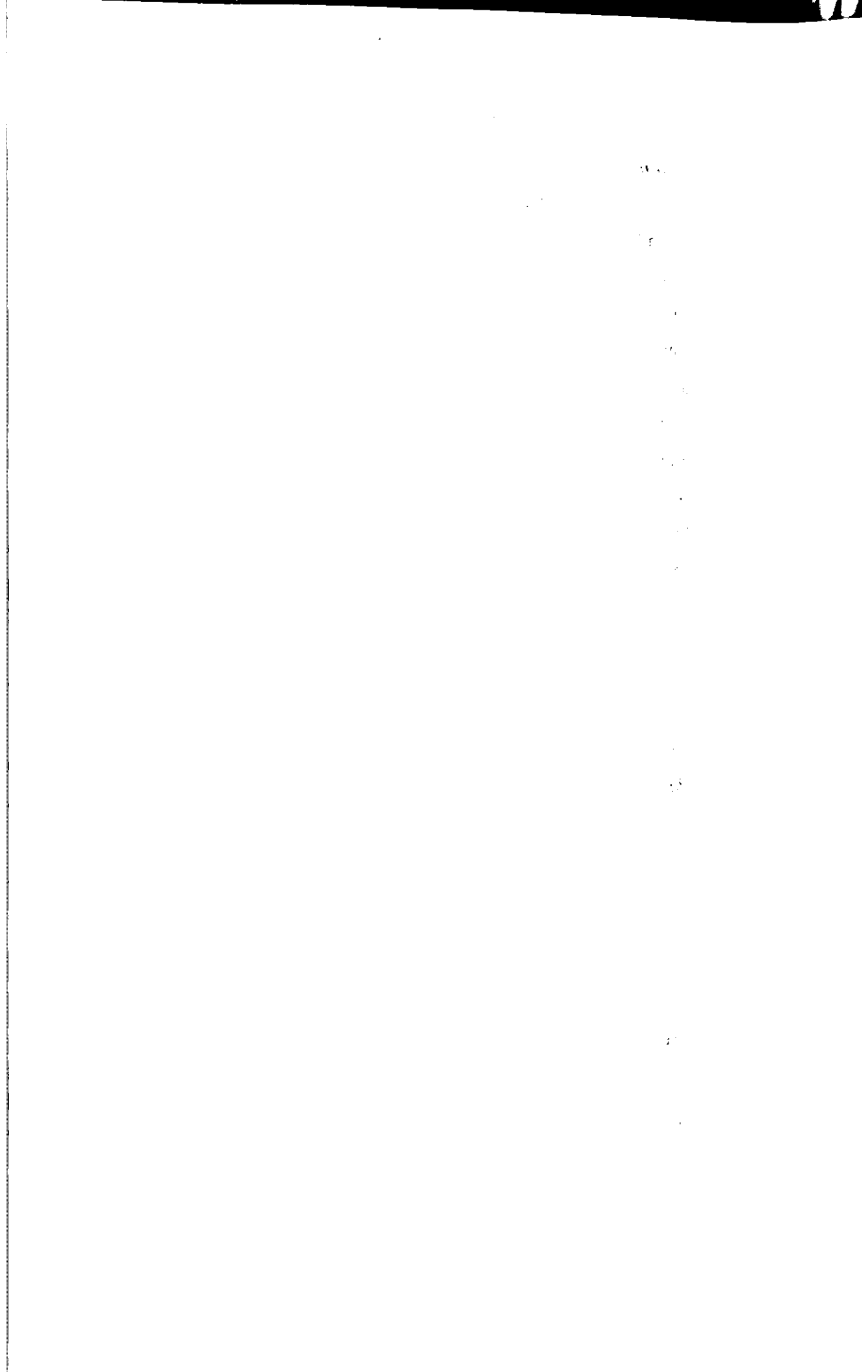
Digital technology supersedes progressively the analogue technology. It is admitted, though, that digitalisation will not be completed in the short to medium term. There is a not insubstantial number of Member States that still undergo a transitory phase.⁴⁴ Having said that, crucial remains the potential for development of

⁴¹ This point will be elaborated further in Section 3.7 of this Part.

⁴² see Green Paper On The Convergence Of The Telecommunications, Media And Information Technology Sectors And The Implications For Regulation (henceforth, "the Green Paper On Convergence"), Brussels, 03/12/1997, COM(97) 623 final, at p.1

⁴³ John Temple Lang, "Media, Multimedia And European Community Antitrust Law", ch. 18 in Journal of International Antitrust Law And Policy, Fordham Corporate Law Institute, at p.403, n.46. J. T. Lang adds that such type of convergence would be likely to lead to more complicated regulatory questions, such as "whether audiovisual content made available through telephone lines should be subject to media regulators".

⁴⁴ See Linsey Mc Callum, "EC Competition Law And Digital Pay Television", February 1999 EC Competition Policy Newsletter, p.4 at p.10.



digital source encoding and *digital transmission*. The ways in which audio-visual material is produced, delivered and consumed are evolving. Content is becoming "*scaleable*". The basic building block is the Motion Picture Experts Group ("MPEG") family of standards. Once encoded in this format, images may be modified, manipulated or transmitted in the same way as any other digital information: the networks handling such information are indifferent to whether they are image, sound or text.

Digital transmission is what opens up the possibility of delivering high-quality audio and video signals over a variety of different network infrastructures. Digital transmission may be carried over broadcast networks (whether satellite, cable) or over terrestrial (whether wired or wireless). When applied to broadcast transmission networks, the most significant impact of digitalisation is the immediate *expansion of capacity* in the form of, inter alia, distribution of many more channels, digital bouquets and thematic channels, near video on demand (NVOD) and pay-per view. A digital channel is inherently more flexible than an analogue channel, and therefore it can deliver services in the form of data, graphics, moving pictures or combinations of these. It is clarified that digital television shares these developments with digital radio: the latter offers exciting possibilities for the combination of radio and images or links to Internet sites which advertise and sell CDs.

4.3.2 Network Technologies

There are two main terrestrial network technologies: the *wireline* and the *wireless* technologies. Wireline technology transmits information across wires of various forms, including twisted pairs of copper wire, coaxial cable and fiber optics cable. A *copper wire pair* is considered to be a *narrowband* technology in that it is incapable of carrying a broadband signal in the absence of state-of-the-art compression methods. Thus, copper wires are capable of carrying only voice and slow-speed data traffic such as facsimile and standard communications software programmes. On the other hand, *coaxial cable* and *fiber optics cable* are known as *broadband* technologies because they are capable of carrying video signals, high resolution facsimile and other messages with high information content. High-speed

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networks based on optical fibres are capable, in combination with modem server technology, of operating cost-effectively in a virtual broadcast mode.

There appears to be a great interest in replacing narrowband with broadband terrestrial networks just as there is significant interest in replacing voice messages with higher data content messages. Already existing network technologies include the narrow-band Integrated Services Digital Network ("ISDN"), x-Digital Subscriber Loop ("xDSL") and Asynchronous Transfer Mode ("ATM"). The narrow-band version of ISDN was standardised over the last 30 years by TOs who wished to digitise the customer access network. xDSL refers to the current technology which exploits the existing telecommunications network copper-pair cable for high-speed data transmission.⁴⁵ ATM is a high speed switching technology operating at a basic transport level and is capable of transporting telecommunications traffic of different characteristics (voice, data, video) over the same network.. It has been designated by ITU as the basis for broadband ISDN. The capabilities of these technologies are enhanced by the *compression techniques* implicit in the MPEG standards, allowing networks of limited transmission capacity to carry services previously considered possible only on sophisticated and more costly wide-band infrastructures.

Wireless technologies employ airwaves and transmit information across the wirewaves using satellite, microwave radio, cellular radio and, in the not too distant future, personal satellite communications services (PSCS). Satellite is known as a broadband technology because it can also carry messages with high information content, but its technical properties are more conducive to one-way applications, like telephone conversations. The geocentric satellite orbit is 22,300 miles above the surface of the earth; unavoidably, communications are subject to delays, which are problematic for interactive voice and computer applications.

The practical example of how fixed and mobile telephony networks are converging is only part of a wider trend towards the full integration of wired and

⁴⁵ ADSL - where "A" stands for "Asymmetric" - runs typically at 1.5Mbps in the downstream direction; HDSL - where "H" stands for "High-Speed" - runs at 6MBps. Both of these are now superseded by higher speed technologies.

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wireless technologies, which is the key goal of the next generation of digital mobile communications systems.⁴⁶ This will offer users a platform on which to receive a seamless set of voice, data, multimedia and audio-visual services wherever they are. Wireless local loop can offer a cost-efficient alternative to the existing copper wire. The fixed-mobile network convergence should allow users to access a consistent set of services from any fixed or mobile terminal via any compatible access point. In this new network environment, roaming agreements will have to be extended to different kind of networks, i.e. PSTN, cable TV, mobile networks, etc.⁴⁷

In addition to mobile communications based on cellular technology, personal satellite communications services will be offering increased global mobility. This concerns both narrowband services⁴⁸ and ("Internet in the sky") broadband services.⁴⁹ Geostationary platforms (Astra, Eutelsat) are also moving into these new services. These satellite-based systems interworking with existing fixed or mobile networks will offer global coverage, particularly in remote or developing regions.

4.3.3 Internet Technology⁵⁰

The above mentioned network technologies have been superseded by higher-speed technologies, predominantly by the Internet Protocol ("IP") which may ride on top of transport protocols such as ATM. IP has developed into the *de facto* network protocol for the Internet. It is able to route and transport all the elements of a multimedia service (text, image, motion video and sound). IP is also used in Intranet products, providing an infrastructure for multimedia applications within a company or other closed user group. The Internet can best be described as a network of networks interconnected on an open basis using IP, usually running over transmission links

⁴⁶ see Green Paper On Convergence at p.6: see 1994 Mobile Green Paper, COM(94) 145 final, 27/4/94; and the Commission's Communications On Universal Mobile Communications, COM(97) 217, 29/5/97 and COM(97) 513, 15/10/97.

⁴⁷ see Robert Verrue, Director General, DGXIII, European Commission in "Telecoms liberalisation: Future Key Issues From The European Point Of View.", speech made at Verband Alternativer Telekom - Netzbetreiber (VAT), Third Forum, Vienna, 27/01/99, at p.9 The seminal shift between mobile and fixed has been most obviously borne out by the merger between Vodafone / Airtouch.

⁴⁸ eg. The services offered by the ICO, Iridium and Globalstar alliances.

⁴⁹ eg. the most advanced projects are Europe-led Skybridge and US-led Teledesic.

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leased from TOs. The capacity of the Internet's infrastructure increases rapidly: for instance, from 56kbit/s in 1986, it rose to 45 Mbit/s in 1993, to 155Mbit/s in 1996. The open non-proprietary approach to standards for the Internet has made it easy for companies to take advantage of, and build on, the advances made by others in the industry. For instance, it is argued that the rapid development of WWW ("World Wide Web") is due to the open approach to browser development taken by vendors such as Netscape, Microsoft and Sun.

Over time, the percentage of data traffic on networks is likely to substantially overtake the volume of voice traffic. In the medium term (3-5 years), this points to a shift away from circuit-switched services towards packet-switched networks which *may increase competition in infrastructure services*. The Internet has the potential to become *the competitive platform for many traditional services*, be they public voice telephony or broadcasting, mainly because the use of the IP allows the integration of different services on the same network, which is much cheaper than running in parallel several networks (for example, voice telephony and cable-TV networks) and brings clear marketing advantages (i.e. package of services, one-stop-shopping, etc.).⁵¹

4.4 The Emerging Value Chain

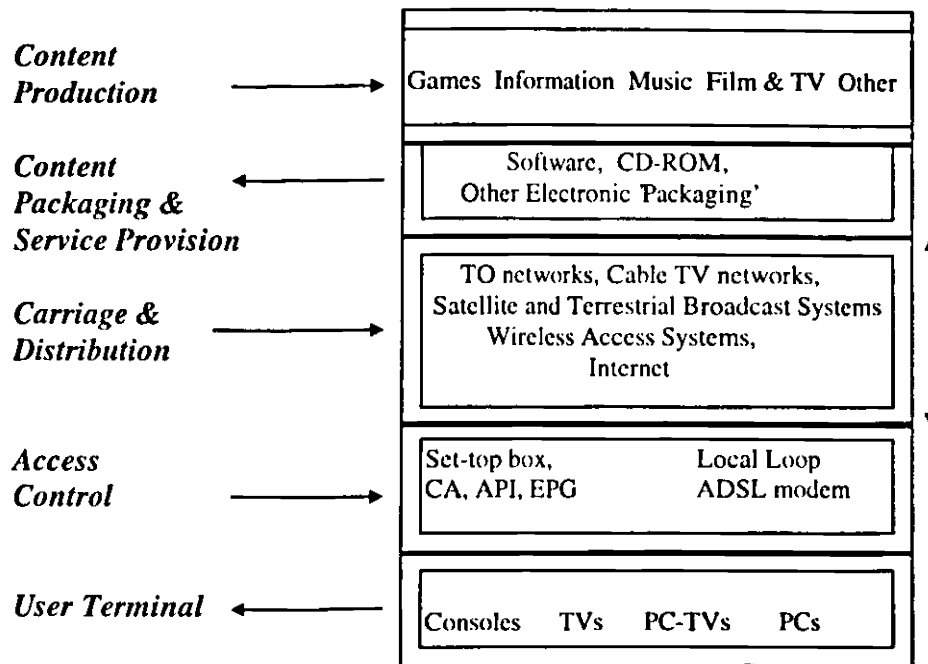
The following diagram, observed vertically, from top to bottom so that it links the end product to the end user, is taken to represent the value chain emerging from technological convergence.⁵² The third ring of the value-chain, namely carriage and distribution, depicts technical convergence as it was analysed above.

⁵⁰ For the purposes of this thesis, explaining why Internet technology is a dynamic for convergence suffices. For a very detailed analysis of how Internet functions, see Philip Rutley, "EC Competition Law In Cyberspace: An Overview Of Recent Developments", [1998] ECLR 186

⁵¹ See Robert Verrue, ante. (<http://europa.eu.int/comm/dg13/telecomlib.htm>) Beyond traditional services, the Internet is also becoming an important platform for electronic commerce. According to OECD, on-line business done at world-wide level is estimated to be worth close to \$22 billion in 1997. It is forecasted that this figure could increase up to \$270 billion by 2001-02 and \$800 billion by 2003-05.

⁵² Source: www.analysis.co.uk

See also the Green Paper on Convergence, at p. 2.



4.5 Convergence As A Driver for Industrial Restructuring

Gradually, technical convergence has become nearly synonymous with the phenomenon of network operators, that is carriers and distributors, tending to expand their business activities in one or more rings, along and across the value-chain. Karel Van Miert notes that *"we have seen some gigantic partnerships, agreements and mergers springing up in Europe and the rest of the world: on the one hand, between alternative or complementary networks, on the other hand between the content producers and packagers of information and the carriage networks. The Internet could develop into a link between current networks and the digital delivery systems of the future. The issue is to control the gates between the components of the future systems. We must move towards multimedia without creating new communications*

super monopolies".⁵³ At the same time, Paul Knott warns that "if multimedia is the future for telecoms, IT and entertainment rolled into one, TOs cannot afford to wait and see what the future holds or for other organisations to take the initiative; awaiting them is a price estimated to be worth ECU 800 billion in EU alone and by capturing 1-2% of this could double the turnover of one of the larger European TOs".⁵⁴ Herbert Ungerer highlights that, progressively, the challenge from convergence goes beyond the traditional telecom / media convergence debate: "(t)he new Internet and e-commerce markets will link together telecoms / logistics / distribution and financing, and often supply - be it production of goods, services or of content. One may expect a wave of new mergers and alliances during the coming months in these fields, as customers will want to have fully packaged services".⁵⁵

There is consensus that the telecommunications services that will be provided over the next decade extend to an instantaneous combination of voice, data, and image services upon reasonable demand. Herbert Ungerer, acknowledging that the telecommunications sector is faced with a 'watershed' as regards who will lead into the future (that is the traditional fixed, mobile or Internet), indicates that the marketplace seems to have already decided. According to investment banks nearest to the field, it is estimated that within two years the value of mobile assets will account for up to 30% of the valuation of telcos, Internet assets up to 28% and only some 40% will account for traditional telephone, even if telephone will still account for 60-70% of actual turnover. *For the purposes of this thesis, though, it is not as important to know who will be the winner but rather how the players along and across the value chain will go about winning.* In order to give a full picture of the evolving playing field, the following diagram is employed.

⁵³ see *sopra.*, "Mapping The New Open Telecommunications Marketplace", at p.5

⁵⁴ see "Multimedia: Strategic Implications For Telecoms Operators", Paul Knott, April 1997, Analysys Publications, Cambridge UK

⁵⁵ This view is expressed in "Local Loop Unbundling", Keynote Address, London Business School, London, 14/6/99; at <http://europa.eu.int/comm/dg04/speech/1999/en/sp99011.htm>

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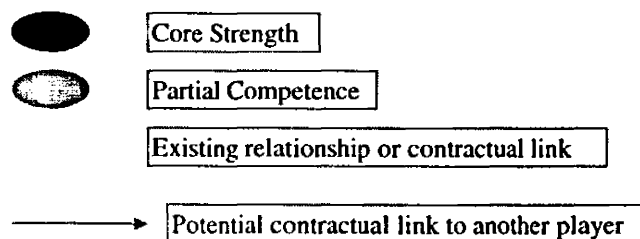
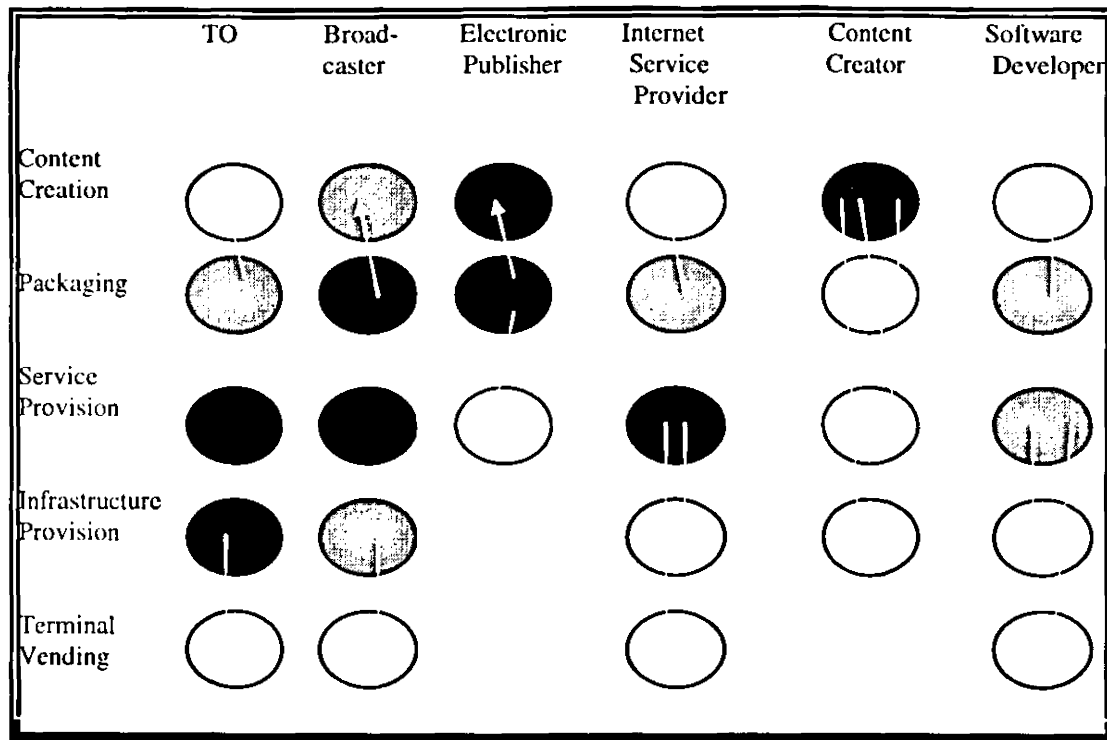
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Location Of The Major Players In The Value Chain & Interrelationships⁵⁶



It is suggested that one needs to look into the position of the telecommunications organisations ("TOs") vis-a-vis broadcasters, electronic publishers, Internet service providers, content creators and software developers: *"the horizontal taxonomy"*.⁵⁷ At the same time, one needs to look into the capabilities of

⁵⁶ Source: Squires, Sanders Depsey LLP and Analysys Ltd. This diagram is also exhibited in the Green Paper On Convergence, ante. at p.12

⁵⁷ The author notes that due to the development of optical fibre networks and digitalisation in place of analogue signals, other players such as electricity and railway companies have entered the

each player in content creation, packaging, service provision, infrastructure provision and terminal vending: *"the vertical taxonomy"*.

It is common ground that in the light of convergence, a firm ought to acquire good links to, and knowledge about the needs of, the customer or end- product / service user in order to gain a competitive advantage. Three broad alternative modes of acquiring the requisite links and knowledge are identified: (a) through pure market forces; (b) through inter-firm cooperation; (c) through development / vertical integration within the firm.⁵⁸ The above diagram, which was cited in the Green Paper On Convergence, traces the already existing relationships or contractual links, as well as the potential contractual links amongst the players *only vertically*, for instance, Internet service providers and content creators, or TOs and terminal vendors. The limitation of what is depicted in the above diagram is, therefore, identified with the failure to trace already existing or potential links between players *horizontally* such as links between infrastructure providers, for instance, TOs and broadcasters, or links between service providers, for instance, TOs, broadcasters and internet service providers. In other words, the links, which are traced in the Green Paper, appear to assume that in response to convergence, players will opt for vertical integration or development internal to the firm. However, in reality, the mode of horizontal inter-firm cooperation has often been chosen as a response to technological convergence.

The author of this thesis is mostly interested in revealing the strategic thinking behind the choice of how to play the game in response to convergence. It is submitted that their choice shall reflect their strengths and weaknesses in the relevant business. It is reiterated that in Section 1.6 of Part [I] of the thesis, it was demonstrated that strategies underlying alliances are a function of (a) the significance of embarking upon an activity to the overall business portfolio of the prospective partner and (b) of the relative strength or weakness of that actor in the overall business. Thus, the major

telecommunications sector in so far as it concerns network operation. However, mainly for the reason of consistency in analysis with the value-chain depicted in subsection 3.4, they are not mentioned in this diagram.

⁵⁸For a detailed strategic analysis of these options on the basis of real data, see Martin Fransman, "AT&T, BT and NTT: vision, strategy, corporate competence, path-dependence, and the role of R&D", Ch.14 in "Global Telecommunications Strategies And Technological Changes", 1994, G. Pogorel (ed.).

virtue of the above diagram resides in enabling the reader to see the strengths and weaknesses of each player and hence to predict possible strategic intentions.

By way of example, content creators may wish to ally with infrastructure providers; considering that provision of infrastructure is only peripheral to content creators' business activity, it will *prima facie* appear that they wish to restructure their activities. Yet, it is more likely that their strategic intent is to control distribution and have direct contacts with customers: to share a strength possessed by the infrastructure providers. On the other hand, TOs may wish to go into content and interactive services, a core business activity of broadcasters, *prima facie* with an eye at generating profits for investment in infrastructure development where they are primarily competent. If, to do so, they ally with broadcasters, a careful reading of their respective positions will reveal that the underlying strategic intent is defensive: to preempt potential competition in infrastructure innovation, and thereby to defend potential competition from the provision of new services, which arguably would have accrued from alliances of broadcasters with other players.

To conclude, for the purposes of analysing the parents' strategic intent in cases of SAs driven by technological convergence in the telecommunications sector, it is important to bear in mind: (a) what is the relevant value-chain like (Section 4.4); (b) what is the relevant playing-field like (Diagram in Section 4.5); (c) which is the core competence of each player (this point will be elaborated further from Section 4.6 onwards). The reader is requested to keep this analytical framework in mind. This Part will not proceed with discussing real cases of SAs: this task will be carried out by Part [III] to this thesis which will seek to demonstrate, simultaneously, the extent to which European Competition law detects, and punishes, the defensive strategic intents of the partners to an alliance.

4.6 Liberalisation And TOs' Strengths

The diagram in the preceding sub-section illustrates that TOs possess a core strength in service provision and infrastructure provision. Apparently, the diagram does not distinguish between the incumbent TOs and those TOs who entered the

market post-liberalisation: there exists an important difference in the size of the market power of these two classes of TOs, if the latter possess any market power at all! It is crucial to understand that an incumbent TO will tend to expand horizontally, for instance, through a SA with a broadcaster in order to eliminate competition arising not only from the size of that broadcaster but also from the (actual or potential) entry of another TO.

Nor does the diagram distinguish between the types of infrastructure: cable TV, satellite, terrestrial fixed or mobile. The competition related to each and every of these types of infrastructure is also important to grasp in order to assess realistically the “strength” of a TO. It is clarified that the extent to, and ease with, which their transmission capacity can be increased by means of digitalisation is not the same: hence, their competitiveness is also different.

To fill in the gap of the diagram cited above, one needs to recall why liberalisation in the European telecommunications sector was thought desirable. Liberalisation was envisaged to aid and enhance the process of convergence by introducing competition in the third ring of the value-chain, that is amongst the various types of networks for carriage and distribution of content.⁵⁹

4.6.1 The Death of Incumbent TOs As Natural Monopolists

The industrial structure that prevailed in the telecommunications sector up to the 1990s in the European Union was that of regulated national monopolies.⁶⁰ This

⁵⁹ This view is held by the author of this thesis. But the reader should note that “The Results Of The Public Consultation On The Green Paper On Convergence” [Com(97)623] were evenly balanced between those favouring competition in infrastructure provision and those favouring competition in the provision of services. This issue is inextricably linked to whether unbundling access to networks is necessary. For instance, Incumbent TOs argued that liberalisation was introduced to increase competition in infrastructure provision and thus unbundling the local loop would act as a major disincentive to investment in new infrastructure for all parties, incumbents and new entrants alike. On the other hand, those-favouring service-based competition argued that opening access to infrastructure is essential for the development of a large variety of information society content services. Having said that, the author should clarify that she does not share the Incumbent TOs’ argument albeit she shares the viewpoint that liberalisation aimed at introducing infrastructure competition. .

⁶⁰P. J. J. Welfens & G. Yarrow, ante., at p. 214, explain why state intervention (regulation) is necessary in “natural monopoly” markets: “...an unregulated monopolist would set an inefficiently high price, and therefore inefficiently low input. Even if competition were viable (if rivalry among firms would not be so intense as to reduce price to marginal cost and hence below average cost), competition in a natural

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industrial structure had been justified on the basis of a "*natural monopoly*" argument. A natural monopoly exists when it is less costly for a single firm than for several firms to supply any relevant quantity of the service. Therefore, natural monopolies arise in industries characterised by fixed costs that are large relative to the relevant market demand.⁶¹ Indeed, the provision of telecommunications services⁶² was originally based on a *stable* technology that was developed in the last quarter of the nineteenth century: analogue and copperwire. This technology required large investments in infrastructure. Besides, the service provided was a basic one and the industry was characterised by the positive externalities generated by the large number of interconnected users (*network effect*). Hence, a single network was perceived as optimal both from the perspective of the provider and the users of services involved on the rationale that with each additional user, the value of the service would increase and its cost would be reduced.⁶³ In each relevant national market, the TOs held a *dominant position* for the provision of transmission capacity for telecommunications services because they were *the only ones* with a public telecommunications network covering the whole territory of the Member State in question.

Alternative infrastructure was necessary for the development of data communications, value-added services and new services such as interactive television and video-on-demand as well as multimedia services ("the non-reserved services").⁶⁴ In the light of the technological developments - in particular digitalisation, the introduction of fabric-optic cables and data-compression systems, alternative

monopoly industry would prevent full exploitation of scale economies. In theory, government intervention could increase efficiency: to fully exploit scale economies, the government might allow only one firm to operate, and require it to set a lower price and higher output than would obtain under no intervention."

⁶¹See P. J. J. Welfens & G. Yarrow (eds.), "Telecommunications And Energy In Systemic Transformation. International Dynamics, Deregulation And Adjustment In Network Industries", 1997, Springer, at p. 214

⁶²Pursuant to Article 1 of Commission Directive 90/388/EEC of 28/6/90, "Telecommunications services" comprise "services whose provision consists wholly or partly in the transmission and routing of signals on the public telecommunications network by means of telecommunications processes, with the exception of radio broadcasting and television".

⁶³ see Wolf Sauter for a description of the transition from the 'natural monopoly' situation to the 'open market' situation'; in "Competition Law And Industrial Policy In The EU", 1997, Clarendon Press, Oxford, at p.165

⁶⁴ By virtue of the Directive 90/388/EC, they were declared services non-reserved to the national telecommunications organisations. Member States were required to make the supply of such services subject to a licensing or declaration procedure subject to objective, non-discriminatory and transparent conditions

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infrastructure, such as cable TV networks and satellite, could be employed and hence any justification for a single network and a "one-supplies-all" situation was removed. Indeed, delay in the development of multimedia services in Europe was attributed, generally, to the restrictions that Member States imposed on the use of alternative infrastructure for the provision of those services and, specifically, to the restrictions on the use of cable TV networks.⁶⁵

4.6.2 Attack From Operation Of Cable TV Networks

A "cable TV network" comprises any wired-based infrastructure approved by a Member State for the delivery or distribution of radio or television signals to the public.⁶⁶ In fact, in many Member States, potential providers of multimedia services had to rely on transmission capacity ("leased lines") supplied by the telecommunications organisations, which were often already engaged in the provision of such services, and hence competitors. Besides, the networks of the telecommunications organisations, failed to meet all potential market demand for transmission capacity for the provision of such services.⁶⁷ Hence, the mere obligation imposed on TOs to provide leased lines was not sufficient to avoid restricting access to the market in non-reserved services.⁶⁸

It is essential to grasp the characteristics peculiar to the market for infrastructure.⁶⁹ *First and foremost, the market for infrastructure is highly capital intensive.* Taking into account the amount of investment needed to duplicate a network, there is an incentive to use the existing networks rather than to enter the market for provision of infrastructure, or to innovate: that is to say, high investment cost constitutes a potential barrier. Indeed, given the restrictions on the number of services which cable TV operators could offer, they often postponed investment in their networks and, especially, the introduction of optical-fibre which could be profitable, if they were to spread over a larger number of services provided. *Secondly,*

⁶⁵ see para. 13 of Preamble to Directive 95/51/EC

⁶⁶ this is the definition adopted in Article 1(1)(b), Directive 95/51/EC

⁶⁷ see Communication To The Council And The European Parliament On The Consultation On The Review Of The Situation In The Telecommunications Sector, of 28 April 1993, at p.5, point 2.

⁶⁸ see para. 13 of Preamble to Directive 95/51/EC

⁶⁹ see para. 13, Preamble to Commission Directive 95/51/EC

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asymmetry of information is a feature of the market. The telecommunications operators benefited from detailed information on telecommunications flows (such as the subscribers' usage patterns and the price elasticity of demand in each market segment, such information being instrumental to target specific groups of users) which were not available to potential new entrants.

In response to the persisting reality in the market for high-capacity infrastructure, the European Commission directed that Member States should abolish all restrictions on the use of cable networks for the provision of telecommunications services. In compliance with this direction, Member States were further required to authorise the interconnection of cable TV networks with the public telecommunications network and abolish any restrictions on such direct interconnection by cable TV operators.⁷⁰

*Hence, the risk for the incumbent TOs of potential competition from alternative infrastructure operators and new services to which they should adapt their strategies. The MSG alliance is a classic example of TOs adapting their strategies in anticipation to the realisation of this risk.*⁷¹

4.6.3 Attack From Satellite Technology

Parallel to the regulatory reforms in relation to the operation of the cable-TV network, the European Commission aimed at introducing competition in the field of communications via satellite. At the time, there remained many Member States which maintained exclusive rights granted to the national public undertakings to engage in the importation, marketing, connection, maintenance of satellite equipment and in the provision of satellite communications services. The term "*satellite communications services*" encompasses services whose provision makes use, wholly or partly, of satellite network services. "*Satellite network services*" include the establishment and operation of satellite earth station networks; at a minimum, these services consist in the establishment, by satellite earth stations, of radio-communications to space

⁷⁰ Article 1(2), Directive 95/51; further, see subsequent sub-section of this thesis.

⁷¹ See Part [III].

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segment ("up-links") and in the establishment of radio-communications between space segment and satellite earth station ("down-links").⁷²

Such special or exclusive rights were generally granted to the TOs that already enjoyed a dominant position in the provision of telecommunications services by making use of terrestrial networks or to one of the subsidiaries of such organisations. Inevitably, they used to make their investment decisions with an awareness of their exclusive rights, which put them in a position to opt to give priority to terrestrial technologies: for instance, they would give preference to the development of optical fibre terrestrial links. *"Satellite communications were used chiefly as a technical solution of last resort"* in cases where the cost of terrestrial alternatives were prohibitive or for the purpose of data broadcasting and / or television broadcasting, *"rather than being used as a fully complementary transmission technology in its own right".*⁷³

The European Commission realised the need for allowing new entrants to exploit satellite technology and promote technical progress in the field. It decided that Member States should withdraw all exclusive or special rights limiting the number of organisations allowed to provide satellite communications services, provided the harmful interference between satellite communications systems and other space-based or terrestrial systems be avoided.⁷⁴ Consequently, it directed the abolition of all existing exclusive rights in relation to satellite earth station equipment in so far as the essential requirement of "efficient use of frequencies"⁷⁵ was satisfied. In turn, this step made it necessary to recognise the right to connect such equipment to the switched

⁷² NB: para. 17 of the Preamble to Directive 94/46/EC states that *"the provision of satellite network services for the conveyance of radio and television programmes is a telecommunications service"* for the purposes of Directive 90/388/EEC. Instead, *"voice telephony"* via satellite, i.e. the direct transport and switching of speech via satellite earth station networks, is excluded from the *"telecommunications services"* for the purposes of Directive 90/388/EC. *"Satellite earth station network"* refers to the configuration of two or more earth stations which interwork by means of a satellite. See Article 2(1)(iv) Directive 94/46/EC.

⁷³ see para. 14 of Preamble to Directive 94/46/EC

⁷⁴ see para. 12 of Preamble to Directive 94/46/EC.

⁷⁵ the avoidance of harmful interference between satellite communications systems and other space-based or terrestrial systems

networks operated by the telecommunications organisations so that licensed operators could offer their services to the public.⁷⁶

Besides, at the time of issue of the Directive, the charges for using space segment capacity were still very high in many Member States because the capacity could be acquired only from the signatory for the Member State in question.⁷⁷ Such exclusivity, permitted by some Member States led to a partitioning of the Common Market to the detriment of customers requiring capacity. To remedy this situation, the Commission required that Members ensure that any regulatory prohibition or restrictions on the offer of space segment capacity to any authorised satellite earth station network operator be abolished.⁷⁸ It was emphasized that *"the best solution to avoid distortion of competition and to allow full use and best allocation of the existing international, national and private space segment capacity would be to ensure that users obtain direct access to space segment capacity, while its providers should obtain the right to market it directly to users"*.⁷⁹

*Hence, the risk for incumbent TOs of potential competition in the field of allocation and distribution of a source, which becomes increasingly scarce as the demand for it increases. The NSD alliance is a classic example of TOs adapting their strategies to preempt such competition.*⁸⁰

⁷⁶ see para. 9 of Directive 94/46/EC. See further, subsequent sub-section of the thesis.

⁷⁷ Most of the available capacity is been offered by the International Satellite Organisations ("ISOs"), for example, Intelsat, Inmarsat, Eutelsat, Intersputnik.

⁷⁸ see Article 2(3)(b) Directive 94/46/EC.

⁷⁹ see "Towards Europe-wide systems and services - Green Paper On A Common Approach In The Field Of Satellite Communications In The European Community", COM(90)490 final, 20/11/1990. H. Ungerer in "The Transformation Of The International Satellite Organisations - Some Aspects From A European Perspective" (speech published at <http://www.europa.eu.int>) commented upon this step saying that *"it was clear at the time, and it became clearer so during the subsequent period, that allowing International Satellite Organisations (ISOs) to act freely as commercial providers of space segment, and to enter into competition with a growing number of competitors in commercial fields, would require a fundamental transformation of their Operating Agreements."* Restructuring of the ISOs took the form of privatisation. At the same time, Low Earth Orbiting Satellite systems and similar systems such as Iridium and ICO entered the market for space segment capacity. See "Market restructuring, alliances, mergers" - Satellite Communications - 6th Satel Conseil Symposium - Communications Satellites and Market Realities" by Dr Herbert Ungerer, 8/9/98, Paris.

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4.6.4 Attack From Mobile Operators

It is interesting to consider the extent to which the core strength of TOs in the operation of infrastructure and the provision of telecommunications services was affected by the introduction of competition from the mobile operators' side. It is submitted that, gradually, competition from such operators will be disassociated from competition in the provision of telephony services; it will be seen to pervade in the field of multimedia, or TV-interactive, services as well.⁸⁰

Initially, the Commission became concerned about two practices. First, some Member States had maintained exclusive rights for the provision of mobile telephony granted to the national telecommunications organisations, which already enjoyed a dominant position in creating the terrestrial networks. Secondly, other Member States restricted or disallowed the self-provision of infrastructure or the use of third party infrastructure, whilst they obliged mobile operators to use the leased line capacity of TOs for both internal network connections and for the routing of long distance portions of calls.

It was anticipated that in the former case, the investment decisions taken by the TOs, which enjoyed exclusivity, would be to prioritise fixed network technologies whereas new entrants would have the incentive to exploit mobile and personal technology, indirectly competing with fixed services, in particular as regards the local loop.

In the latter case, it was thought that, considering that the charges for leased line rental represented a substantial proportion of the mobile operators' cost base, TOs were enabled to have a considerable influence on the commercial viability and cost structure of mobile operators. Moreover, bearing in mind that the effectiveness of pan-European roaming for GSM relied on the widespread availability of addressed

⁸⁰ See Part [III] of this thesis.

⁸¹ But note that at the moment cable TV networks are the ones can really be competitive in this field: *"all other options such as wireless and satellite are still unable to reach the same interactive multi-media capabilities"* ; see Dr H. Ungerer, "Infrastructure, Telephony And Competition: Developing Cable Networks Into Full-Scale Multi-media Networks – Deregulation Features", The Second World CATV Strategies Summit, 3/2/1999, speech available at Internet address <http://www.europa.eu.int>.

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signalling systems, a technology which was not as yet universally offered by the TOs throughout the Community, the above mentioned restrictions on infrastructure was slowing down the development of mobile services. The Commission pointed out that *"to the extent that the competitive provision of mobile services is prevented because the telecommunications organisation is unable to meet the mobile operator's demand for infrastructure or will only do so on the basis of tariffs which are not oriented towards the costs of the leased line capacity concerned, these restrictions inevitably favour the Telecommunication Operator's offering of fixed voice services"*.⁸²

To remedy the situation in the former case, the European Commission directed the Member States to establish a licensing procedure within a reasonable time and in any case by 1 January 1998.⁸³ It specified that Member States should give preference to the use of Pan-European standards in the area, such as GSM, DCS 1800, DECT and ERMES, in order to allow development and cross-border provision of mobile and personal communications services.⁸⁴ Of great significance is the explicit direction of the Commission that, in adopting a licensing system in the context of the liberalisation of the market, *Member States should take due account of the requirement to promote investments by new entrants in these areas*.⁸⁵

In the latter case, it required Member States to lift the restrictions and grant, if requested, to the relevant mobile operators access to the necessary scarce resources to set up their own infrastructure including radio frequencies,⁸⁶ on a non-discriminatory basis.⁸⁷ Special and exclusive rights in respect of the establishment of cross-border

⁸² see para. 16, Preamble to Directive 96/2/EC

⁸³ see Article 2(1), Directive 96/2/EC It highlighted that DECT was expected to provide an alternative to the existing local loop access to the public switched telephone network. Thus Member States were directed to establish a licensing procedure within a reasonable time-frame. The Commission explicitly stated that Member States should abstain from granting the TOs or any associated organisation a license for this mobile service.⁸³

⁸⁴ see para. 7 of Preamble to Directive 96/2/EC (n.47, ante.)

⁸⁵ see para. 8, Preamble to Directive 96/2/EC. Thus the Commission explained that where a Member State would grant or had already granted DCS 1800 licenses, the granting of new or supplementary licenses for existing GSM or DCS 1800 operators should take place only under conditions ensuring effective competition. In particular, it directed that operators of GSM systems already present on the territory of a Member State should not be given priority to the granting of DCS 1800 licenses, if it could be shown that this would eliminate effective competition in particular by the extension of a dominant position.

⁸⁶ see para. 15, Preamble to Directive 96/2/EC

⁸⁷ see Article 3 Directive 96/2/EC inserting new Article 3c to Directive 90/388/EEC.

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infrastructure for voice telephony would remain unaffected by this Directive.

*Hence the risk for incumbent TOs of potential competition from investors in mobile and personal communications technology and thereafter in mobile telephony with the consequence of inflicting their main competence in fixed telephony services. The DT/FT/ENEL alliance reflects an attempt to preempt such competition even outside the TOs' national market or else evidences the move towards convergence of mobile and fixed telephony.*⁸⁸

4.6.5 Attack On TOs' Major Strength: Voice Telephony

Albeit this Part of the thesis is interested mostly in identifying the avenues for potential competition with TOs, mainly as regards the provision of multi-media services, the author considers it necessary to refer to the opening up of "voice telephony" to competition in order to consider how the attack on the most traditional strength of TOs may have affected their strategic thinking. It was explained in the above sub-sections that the opening up of the market for infrastructure provision to competition was justified on the ground that new services, for which the TOs did not necessarily have the capacity, had to be developed. For TOs, this was not particularly problematic; it was still not difficult for them to exert their power / influence from one segment of infrastructure provision onto another or to deny access to their network which was essential for other infrastructures to run. On the other hand, introducing competition even in the area of services with which TOs were predominantly engaged could constitute a turning point. Especially because alternative infrastructure operators, which, so far, were single-point competitors, could now turn into multi-point competitors.

"Voice telephony" was defined as "the commercial provision for the public of the direct transport and switching of speech in real-time between public switched

⁸⁸ See Part [III] of the thesis.

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network termination points, enabling any user to use equipment connected to such a network termination point in order to communicate with another termination point".⁸⁹

The abolition of exclusive and special rights over the provision of voice telephony was envisaged to allow the current TOs from one Member State to directly provide their service in other Member States.⁹⁰ Simultaneously, the EU telecommunications market opened to the US and the foreign telecommunications industry. To facilitate the advent of a competitive environment rather than the strengthening of a dominant position by the TOs in their home market, it was directed that new entrants should be granted free choice as regards the infrastructure required for the provision of their services. It was explicitly warned that *"reserving to one undertaking which markets telecommunications services the task of supplying the indispensable raw material, i.e. the transmission capacity, to all its competitors would be tantamount to conferring upon it the power to determine at will where and when services can be offered by its competitors, at what cost, and to monitor their clients and the traffic generated by competitors, placing that undertaking in a position where it would be induced to abuse its dominant position".⁹¹* As a result, the Commission directed that Member States allow voice telephony providers to use their own and / or any alternative infrastructure of their choice.⁹²

Hence the presence of multipoint competitors in related industry segments.

4.6.6 Attack From Internet Technology

In the meantime, due to the development of specific software it became possible to code, compress and transmit voice communications in such a way that it was viable to send them via the Internet to other Internet subscribers using the same or interoperable software and via gateways to standard telephones. This technological development has created the challenge of whether a new service, namely *"Internet*

⁸⁹ Commission Directive 96/19/EC of 13 March 1996, published in OJ L 074, 22/03/96 P.0013

⁹⁰ This should take effect as from 1 January 1998. With the exception of Greece, all EU Member States have by now fully liberalised their telecommunications sector.

⁹¹ see para.7, Preamble to Directive 96/19/EC

⁹² see Article 2, Directive 96/19/EC.

$$- \frac{1}{\sqrt{\pi}} \int_0^x \frac{f(t)}{(x-t)^{1/2}} dt$$

Figure 1. The effect of the concentration of the *Agrobacterium* suspension on the transformation efficiency of *Agrobacterium* strains.

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telephony" need be recognised; whether such a service has already been dealt with under the head of voice telephony which is now liberalised; and, whether such service should be regulated in the same framework as that applied to traditional provision of voice telephony. The European Commission detected the above development and it issued a Notice⁹³ dealing with the questions identified above. The Notice considered situations where users are connected to the Internet via public switched (fixed) network termination points in order to communicate.⁹⁴

With this focus, three distinct categories of voice communications making use of the Internet were identified by the Commission, from the user's standpoint: first, *computer to computer voice services* - voice communications transmitted via the Internet between the PC of one user and the PC of another, both users having modems, compatible software, loudspeakers and microphones to communicate; secondly, *computer to phone voice services* - voice communications transmitted via the Internet between a PC of one user (with modem, software, loudspeaker and microphone) and another user using a traditional telephone connected to the public switched network (PSTN); thirdly, *phone to phone voice services* - voice communications transmitted via the Internet, but between users who both are using telephones connected to the PSTN, i.e. part of the communication is transmitted via packet means using Internet protocols instead of fully via the national and international PSTNs.

Pursuant to the definition of '*voice telephony*' in Directive 90/388/EEC, voice communications on the Internet could only be considered as voice telephony, if each of the following criteria were met: (a) the communications are the subject of a commercial offer - i.e. the transport of voice is provided as a separate commercial activity with the intention of making a profit; (b) they are for the public; (c) they are from and to PSTNs; and, (d) they involve the direct transport and switching of speech

⁹³ on the "Status Of Voice Communications On Internet Under Community Law And, IN Particular, Under Directive 90/388/EEC", published in OJ No. C 6 of 10/1/98, at p.4

⁹⁴ The Notice does not consider the situations where the Internet is only used to dial up a call-back operator in order to set up a telephone call via the Public Switched Network (PSTN). Note, however, that if the call-back operator also provides, in addition to switching, direct transport of speech on own or leased infrastructure, then it will fall within the category of Voice Telephony providers: see footnote (2) to the Notice, ante.

in real time. In conclusion, the Commission emphasized that, for the time being the Internet voice services could not be considered as 'voice telephony', and therefore *they should be taken to have fallen within the liberalised regime even before the deadline set for the implementation of full competition*. It warned that the situation must be kept under review in the light of technological and market developments. *In addition, it clarified that applications which allow, for example, stored data (such as Web Pages, e-mails or voice mails) to be retrieved in spoken form are considered to be new multimedia services, notwithstanding the voice element within the overall service.*

Thus, in principle, the risk of potential competition imposed by Internet technology on TOs could be dated back to 1990. However, it is only recently that TOs have deployed their strategies in apprehension of that risk. The Telia/Telenor/Schibsted alliance is an example.⁹⁵ This is not to say that they were late in any sense. It rather points out that they could afford that because of their control over the public telecommunications network on which Internet access is based.

4.7 Access Control: The Strategic Challenge

The most important ring of the value-chain for the purposes of understanding the incentives for concluding SAs in the telecommunications sector – especially in the post-liberalisation era - is the “access control” ring.

Set-top box, CA, API, EPG	Local Loop ADSL modem
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What creates a *strategic challenge* in this context is the existence of a *regulatory asymmetry*:⁹⁶ access rules have been set only for telecommunications networks, such as the interconnection and open network rules;⁹⁷ on the other hand, no

⁹⁵ See Part [III].

⁹⁶ This asymmetry was detected by the Green Paper on Convergence, ante., p.17.

⁹⁷ Reference to these rules was made in Section 4.6. “Interconnection” basically ensures that users can contact any other user and service providers can contact those users on fair, non-discriminatory and proportionate terms.

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access rules have been prescribed for the infrastructure used for broadcasting activities and albeit a framework of access rules exists for conditional access systems in relation to digital television, it does not apply to all types of digital services; further, even though the principles are broadly similar, the competition rules that are designed for access to the telecommunications networks are not the same for conditional access systems.⁹⁸

The author wishes to clarify that it is not within the scope of this thesis to discuss about whether the rules that are currently applicable to telecommunications and digital television conditional access infrastructures should be applied universally in the sectors affected by convergence in relation to every type of access channel. *Rather, it is within the interests of the thesis to stress that such regulatory asymmetry constitutes a strategic challenge and a potential driver for alliances between those controlling any of those access channels.*

On the one hand, where market players control the access to the customers either through ownership of the local loop or through control of conditional access technologies, *they are able to discriminate in favour of their own services*; on the other hand, where the controlling player is required by law to grant access either to the local loop or to a conditional access system, that player will negotiate the terms of access as a matter for commercial agreement between market actors – regulation does not go as far as to stipulate the terms of such agreements – *and thus it has the chance to make its competitors aware of, and exert upon them, its stronger bargaining power.* Hence, it is strategically attractive to extend one's control over as many types of access channels as possible.

The reader should be able to discern the underlying strategic interest in concluding more and more interrelationships with those who control access channels outside one's industry, as the technological convergence brings distinct industries closer and closer. To this end, the author will proceed on with demonstrating which are the access channels of significance for the purposes of delivering convergence-

⁹⁸ This point is made out by J. T. Lang, "Media, Multimedia And European Community Antitrust Law", ante., p.439, footnote 110.

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driven services to consumers; and, simultaneously, which are the market players who control them.

4.7.1 Access To The Local loop

Liberalisation of the telecommunications sector led to the emergence of a distinct market, namely the market for access to facilities which are necessary for the provision of the liberalised services.⁹⁹ In this sense, access can relate to a number of situations, including the availability of leased lines enabling a service provider to build up its own network, or interconnection to the public switched telecommunications network: *physical access*. In addition, a service provider may need access to other facilities in order to make end-users aware of its services: for example, access to directory information.

This brings us back to the question "*has liberalisation been an effective attack on incumbent TOs' strengths?*". Where an industry emerges from a long period of strict regulation, it is likely that certain firms will inherit some of the advantages which arise out of special or exclusive rights granted previously. Thus it is not surprising that the incumbent TOs "*control access to infrastructure on which competitors may have to rely, if they are to enter the market without undue handicap.*"¹⁰⁰ The problem is that the incumbent TOs may be tempted to resist providing access to such infrastructure to third-party providers or other network operators, particularly in areas where the proposed service will be in competition with the service provided by the TO itself. The question arises whether the access provider should be obliged to contract with the service provider in order to allow the latter to operate on a new service. What is the legal position on this?

⁹⁹ See para. 45 of the Commission Notice on the application of Competition Rules to Access Agreements, 1998 OJ (C 265) 002.

¹⁰⁰ EC Commission, 21st Report On Competition Policy

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In principle, incumbent TOs should provide access to a new service provider where there are no commercially feasible alternatives to the access being requested.¹⁰¹ The access to the facility in question must be “*essential*” for companies to compete on that market.¹⁰² It will not be essential merely because the position of the company requesting access would be more advantageous, if access were granted; refusal of access must lead to the proposed activities being either impossible or seriously and unavoidably uneconomic.¹⁰³

Considering that law can go as far as that point, the Commission acknowledged that in relation to the market of access, the Incumbent TOs will remain dominant for some time after liberalisation has taken place. Even where restrictions are lifted, competition in downstream markets will continue to depend upon the pricing and conditions of access to upstream network services that will only gradually reflect true competitive market forces.¹⁰⁴ Besides, the incumbent TOs are enabled to *sustain* their dominance as long as they are not required to *divest* their interests in alternative infrastructure and as long as they are not required to *unbundle* the local loop;¹⁰⁵ both of these regulatory gaps allow them to retain a firm bottleneck control on competition in the local loop.¹⁰⁶

¹⁰¹ The principle was derived from the transport field mainly. The Commission relied also on the precedents of the ECJ in, inter alia, the following cases: Case 6 and 7/73 *Commercial Solvents v Commission* [1974] ECR 223; Case 311/84, *Telemarketing* [1985] ECR 3261; Case C-260/89, *Elliniki Radiophonia Tileorassi* [1991] ECR I-2925.

¹⁰² For a very insightful presentation of the “essential facilities” doctrine, please refer to T. Cowen (1995), “The Essential Facilities Doctrine In EC Competition Law: Towards A ‘Matrix Infrastructure’.”, *International Antitrust Law & Policy*, Fordham Corporate Law Institute.

¹⁰³ See para. 91, Commission Notice On The Application Of The Competition Rules To Access Agreements In The Telecommunications Sector – Framework, Relevant Markets And Principles, 1998, OJ (C 265) 002-028.

¹⁰⁴ See para. 89 *ibid.*

¹⁰⁵ Indeed, some Member States granted to the same TO the right to establish both cable TV and telecommunications networks, thereby putting that TO in a situation where it had no incentive to attract users to the network best suited to the provision of the relevant service, as long as it had spare capacity on the other network. On the contrary, it had an interest in overcharging for use of the cable infrastructure for the provision of services other than voice telephony, in order to increase the traffic on their telecommunications networks (see para. 18, Preamble to Directive 95/51/EC). In a recent review concerning the joint provision of telecommunications and cable TV networks by a single operator, the Commission announced its intention to issue an amending directive requiring the legal separation of the cable television companies from telecommunications companies. (see CABLE REVIEW, Commission Communication published in O.J. C 71, 7/3/1998, p.4)

¹⁰⁶ Dr Herbert Ungerer pleads this himself in his speech of 14th June 1999 on “Local Loop Unbundling” at London Business School; available at Internet address <http://www.europa.eu.int/comm/dg04/speech>. In conclusion, even though, by August 1998, a total of 526 network operators had been licensed to offer network services (192, national; 256, international; rest, local network services), the figures do not

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Unbundling the local loop entails the separate provision of access to the switch and to the copper wire: this allows alternative operators to use only the copper wire of the incumbent, to invest in their own switching equipment and thus bypass the switching infrastructure of the incumbent.¹⁰⁷ Thus unbundling would allow competitors to invest in infrastructure which would upgrade the narrowband copper telecommunications network to broadband capability.¹⁰⁸ At present only some Member States allow local loop unbundling, under specific conditions.¹⁰⁹ In Germany, it is compulsory to grant competitors access to the local loop but the National Regulatory Authority ("NRA") has not taken any final decision on the prices for the provision of customer access lines: interested parties identify this as a serious barrier to competition in the local loop. In Denmark legislation for unbundling the local loop came into force as from 1 July 1998. In the Netherlands, if competitors are unable to reach an agreement with KPN Telecom to obtain unbundled access, a decision may be requested from the telecommunications authority ("OPTA"). In Finland unbundling of the local loop was enforced legally in 1997 and competition has evolved well. In Sweden, the PTS is currently considering unbundled access to the local loop. In the United Kingdom, OFTEL has historically not mandated local loop unbundling for basic telephony because it was not viewed as helpful to network competition and also because there has been no demand for it in relation to such services. Nevertheless, it has launched a consultation on local loop unbundling in relation to the market for higher bandwidth services.

For the purposes of this thesis, it is interesting to note that the asymmetric pattern of regulation in the European Union provides the dominant TO in a Member State which directs unbundling of the local loop with the ability to form a SA with a TO which is dominant in a Member State where the local loop is still bundled, to the effect that the former TO is able to cross-subsidise its operations in the former State

necessarily reflect any diminution in the market share or market power of the incumbent TOs. The data on market impact from liberalisation is given by Annex 1 to the 4th Report on The Implementation Of The Telecommunications Regulatory Package, COM (1998) 594 final, 25/11/98.

¹⁰⁷ Kevin Coates, 1998, "Competing For The Internet", published at the Internet address <http://www.europa.eu.int/comm/DGIV/speech/eight/en/sp980xx.htm> at p.5 of 10.

¹⁰⁸ Ibid.

¹⁰⁹ The following data was given in Annex 5 to the 4th Report on The Implementation Of The Telecommunications Regulatory Package, COM (1998) 594 final, 25/11/98.

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through the monopolistic profits in the latter State. The same pattern was witnessed in relation to national markets still insulated from voice telephony competition and markets where full-competition had already taken place such as the U.K. and Scandinavia. T. J. Ramsey concludes that this should not only be seen as a strategic challenge for the TOs in the former States to conclude alliances with TOs in the latter States, but also as an issue for the Directorate-General for Competition ("DGIV") of the European Commission: whether to subject strategic alliances ahead of the 1998 deadline for Full Competition to its rules in order to prevent the individual anti-competitive practices of incumbent TOs.¹¹⁰

4.7.2 Set-top box

In the case of digital pay-TV services, digital distribution requires, on the user's side, either a set-top box along an analogue TV receiver or a fully integrated digital TV set. From a technical point of view, a set-top box is nothing more than a computer system with the main purpose of decoding digital into analogue signals. It is equipped with a conditional access system ("CA"), which prevents unauthorised signals from corrupting the decoder population and rendering it unaddressable. A CA system is the technical means by which content and service providers can recoup their investment either through subscriptions or charges for individual consumption.¹¹¹ An electronic programme guide ("EPG") and application programme interface ("API") allowing the supply of interactive services are normally also required. EPGs represent the electronic "zappers" of the future, guiding viewers through a myriad of digital television programmes and channels.¹¹² In other words, the EPG is a navigation system which lists channels and services and via which viewers are able to tune to different data signals, and thus to change channels or services. In contrast to browsers, EPGs are linked to the *information* accessed via them. *Thus, exclusive arrangements*

¹¹⁰ See (1995) "The EU Commission's Use Of The Competition Rules In The Field Of Telecommunications: A Delicate Balancing Act", International Antitrust Law & Policy, Fordham Corporate Law Institute p.561

¹¹¹ There are several conditional access systems available in Europe including SECA, Nabravis, Mediaguard, Videocrypt, Irdeto and Viaccess. See further, J. T. Lang in "Media, Multimedia And European Antitrust Law", ante. at p. 441

¹¹² See Green Paper on Convergence, ante., p.24

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tying EPGs to particular services constitutes the unilateral firm practice of bundling. The Application Programming Interface ("API") is a set of software in the consumer's home terminal, resembling the operating system of a PC. It is used to manage interactive applications, including EPGs, carried by the terminal, and to provide a specified interface for the development of applications by third parties. There are a number of different APIs used in set-top boxes in Europe. The combined use of proprietary APIs together with EPGs and conditional access may also constitute the unilateral firm conduct of bundling in so far as there is no particular technical reason for tying them together.

The question "*can television decoding systems be essential facilities to which competitors are entitled to have access*" has been raised many times in Europe, but not directly in any complaint to the European Commission. It is up to the National Competition Authorities to rule upon it. The starting point of the proponents for an "essential facilities" treatment of these systems is that to establish a system for decoding pay-television signals requires a huge investment, and the company doing it has to persuade a large number of households to buy or to rent such relatively expensive equipment. Once this is done, it becomes uneconomic, or at least too risky, for any second company in the Member State to launch a competing system, and anyway the first one has an unbeatable first mover advantage. The counter-argument runs like this: a competitive advantage is not the same as an essential facility. The condition for recognising an essential facility rests on whether a normal reasonably efficient competitor following an appropriate strategy could be expected to provide an alternative facility or system itself. The mere fact that start-up losses are likely, the capital costs are large and the return on capital is delayed, is not in itself enough to create a duty to give access. In principle, if a reasonable owner of the facility who had no interest in any downstream operation would have a substantial interest, acting rationally, to refuse access, the owner is entitled to do so.

Eventually, the "Advanced Television Standards" Directive set out a regulatory framework for conditional access to digital television services, based on a requirement for those operating such systems to offer broadcasters technical services on a fair, reasonable and non-discriminatory basis. However, if one addresses itself to

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the question "*who might be interested in obtaining access?*", he / she discovers that in the television market there is, in addition to broadcasters, another distinct group, namely cable TV network operators who might be interested in access to such technical infrastructure. Hence the Advanced Television Services Directive creates a regulatory asymmetry by giving rights only to *digital broadcasters*:¹¹³ this does not include *analogue broadcasters*;¹¹⁴ nor does it include *cable TV companies*, on the ground that the latter should not be regarded as broadcasters because they merely transmit programs they receive or obtain from outside their cable networks.¹¹⁵ Indeed, how different are these two categories? A broadcaster transmitting an encoded programme must arrange somehow for households to have decoders to see its programmes. It thus needs access only to a suitably programmed decoder. A cable TV company, needs also access to programmes, and so it must have access specifically to the decoder of the broadcaster of those programmes.

It should be inferred from these facts that a cable-TV operator who wishes to enter the market for pay-TV has a strong strategic interest in allying with a broadcaster. Further, considering that a digital broadcaster has one competitive advantage as regards the set-top box technology, but still needs to build on all the other capabilities that an analogue pay-TV broadcaster would already have, it is not surprising that cable-TV companies ally with analogue pay-TV broadcasters in order to create jointly the technical infrastructure for digital pay-TV and to offer jointly digital pay-TV services.

Another regulatory asymmetry, which has been created by the Advanced Television Standards Directive resides in the fact that it does not guarantee access to CA systems for the provision of *interactive services*, which albeit they are not television services as such, they may still have an important impact on the profitability

¹¹³ Article 4 of European Parliament And Council Directive No. 95/47 on the Use Of Standards For The Transmission Of Television Signals ("The Advanced Television Services Directive"), 1995 OJ (L281) 051 directs: "*Member States shall take all the necessary measures to ensure that the operators of conditional access services, irrespective of the means of transmission, who produce and market access services to digital television services offer to all broadcasters, on a fair, reasonable and non-discriminatory basis, technical services enabling the broadcasters' digitally-transmitted services to be received by viewers authorised by means of decoders administered by the service operators, and comply with Community competition law, in particular if a dominant position appears.*"

¹¹⁴ See J. T. Lang, ante. p.390.

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of cable companies and other carriers of television services in the near future.¹¹⁶ *This asymmetry constitutes another strategic challenge for alliances.*

Even more interesting is the fact that the Directive applies only to CA systems: not to other similar kinds of facilities such as the API, the EPG, or the verifier system.¹¹⁷ It thereby creates a strategic interest for digital broadcasters in *bundling* CAs with proprietary APIs and EPGs. If they do so, they can get the benefits of both worlds. On the one hand, they have the first mover advantage entailed by being the first to exploit the technology for CA systems; they can sustain that advantage because of, first, the high investment cost that becomes a disincentive for competitors, and secondly, the access rules which recognise the first mover's right to refuse to provide access to the EPG and API. On the other hand, considering that EPGs are linked to the information accessed via them, they enjoy the benefit of exploiting any other advantage they have in relation to access to content. *From this last point, it can be inferred that there is a strategic interest in bundling the components of a set-top-box and in allying with content producers or with market players who are in an advantageous position in respect with access to content.*

4.7.3 ADSL modem and Navigation Systems

The provision of Internet services has created a distinct market for Internet access. Essentially, enjoying Internet services requires having a dial-up account with an "Internet Access Provider ("IAP").¹¹⁸ This means that the user's computer is connected via a modem (normally, a credit-card like piece of hardware inserted into the computer) giving access to the Internet through the standard telephone network.¹¹⁹ *Hence the same principles apply here as with access to the standard telephone*

¹¹⁵ *ibid.*

¹¹⁶ *ibid.*

¹¹⁷ *ibid.*

¹¹⁸ Dial-up Internet access consists essentially of the supply to subscribers of an Internet address, provision of the relevant software to enable messages to be sent and received in the correct electronic format used for Internet traffic, and connectivity, i.e. access to all other networks which together make up the Internet. See Case No. IV/JV.1 – Telia / Telenor / Schibsted, para 17.

¹¹⁹ Alternatively, the end-user may have access to the Internet by means of a dedicated private line (dedicated access).

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network by any other service providers. Perhaps, more interesting is the fact that technology for that network is constantly improving in response to the Internet Service Providers' demand by new entrants for faster access to the local loop.¹²⁰ Their objective is to introduce xDSL technologies which multiply by 100 the capacity of a twisted copper pair traditionally used in the local loop. The demand for fast access is also a major driver of backbone investments, potentially stimulating the wide-scale deployment of ATM switching.

Once the user has accessed the Internet, he faces the need to receive as much content as is possible. Browsers (e.g. Netscape, Microsoft Explorer) and search engines (e.g. Altavista, Yahoo), both known as navigation systems, are tools for exploring Internet web pages. Browsers do their job not on the user's personal computer, which is linked to the network, but instead on a "host" computer. It is these host computers that are the true nerve centres of Internet access. Competition between browsers is thus fierce. Browsers give the user a selection of search engines. These are enormous compilations of information which is constantly updated. Access to search engines is free as search engines rely on advertising revenue to display or flash pre-paid advertisements on the user's screen. Browsers and Search Engines are inherently independent: that is to say, they are able to explore the Internet web pages without tying themselves to particular sources of information or to any particular operating software or hardware. *If, therefore, browsers are packaged together with other software or as an integral part of other software, this constitutes purely the unilateral firm conduct known as bundling.*¹²¹

So the asymmetry in this context is that whereas there is free access to search engines and browsers, Internet access is not free as far as it involves the telecommunications network. The principles which were described in sub-section

¹²⁰ for instance, Integrated Service Digital Network (ISDN) and Asynchronous Digital Subscriber Line (ADSL).

¹²¹ It is important to remember that, the user's computer needs to run an operating system or software which is capable to organise the information accessed and / or retrieved and to respond to other computers communicating with it. Providing the software for computers has grown into a huge market: examples of competing operating systems are Microsoft's DOS (Disc Operating System), Microsoft's windows and Unix. IBM's OS/2 Warp did not manage to prevail over Microsoft's programs.

3.7.1 above still apply. *Hence, the strategic challenge for TOs to conclude alliances which bring them in the field of Internet-related services.*

4.7.4 Access To Content

Expansions in the means of delivery brought about by improvements in technology and by convergence may shift the bottleneck from carriage and delivery to content. Shortages of content could inhibit new market entry and with it competition and innovation.¹²² Consider the Internet: it is a global information exchange vehicle. Content providers are the key players on the Internet as far as the ordinary user is concerned.¹²³ Content can be real-time or downloadable. Real-time content is data that can be assessed, as if it were communicated at the same time as the user who is assessing it. A "discussion" taking place between Internet users takes place in real time because it is occurring as the users access the Internet. It is this type of content, which creates the major problems as it demands constant provision of data while the discussion continues. Then consider pay-TV: its success depends on the availability of a programme portfolio big enough to make it easy to create a variety of different specialised packages of programmes targeted at particular groups.¹²⁴

It is very interesting to note that there is no regulation in relation to access to content. As a general rule, arrangements between content providers, rights' owners and content carriers are a matter for commercial agreement. Exclusive agreements between content providers and content carriers may limit consumer choice by excluding access to content provided by competitors, especially until there is effective competition in the provision of delivery channels to the user.¹²⁵ Thus possession of rights to key content such as major sporting events, may give market players particular commercial power.¹²⁶ *Hence the strategic challenge for concluding alliances not necessarily with content providers but rather with any other market player well*

¹²² See Green Paper On Convergence, ante., p.15.

¹²³ see P. Ruttle, ante. held in his article at p.189.

¹²⁴ This is confirmed by the Commission's decision in the MSG case.

¹²⁵ *ibid.*, at p. 25.

¹²⁶ This Thesis does not intend to go into any depth on issues related to rights to televising sports events, televising the catalogue of a film studio and the issues related to the protection of such rights. For a very good analysis of this, please refer to J. T. Lang (1997) pp. 377-448.

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positioned as regards content access. That is to say, TOs need not integrate vertically with Content Providers; they can ally with broadcasters either at the level of infrastructure operation or at the level of service provision, so that they can defend competition at those levels and, simultaneously, cure their weakness at the content provision level through sharing the broadcasters' strengths in content access .

4.8 Concluding Remarks: PART [II]

- In Part [I] the author concluded that competition is no longer about positioning: it is for manoeuvring whilst sustaining a leading position. The author submitted that many SAs are founded with this intent. A test was suggested for the purposes of identifying whether the parents' intent is indeed defensive. This requires to identify, first, the potential avenues for manoeuvring: hence, the emerging value-chain specific to the telecommunications sector was identified (Section 4.4). The ability to manoeuvre depends on the actual and potential competitors' position: hence the playing field, reflecting the sector-specific value-chain, was identified (Section 4.5). It became apparent that there is multipoint competition in the sector: this necessitates that competitor analysis must encompass each competitor's entire portfolio of business units:¹²⁷ hence the pattern adopted for depicting the playing field. Sustaining a leading position while manoeuvring is a function of the existing capabilities or strengths. Of particular interest to this thesis is to detect the TOs' intents when concluding alliances, and therefore their strengths in each and every business unit or industry segment are analysed in detail (Section 4.6). The reader was addressed to the strength that is specific to incumbent TOs (Section 4.7.1).
- Further, the author concluded in Part [I] that there are certain factors which ought to reinforce the finding of a defensive strategic intent.

(a) the possibility that the parents may be aided with exercising bundling by means of the SA: hence Section 4.7.1 referred to bundling of the local loop,

¹²⁷ This was the conclusion in Section 2.4.

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Section 4.7.2 revealed the potential for bundling the components of a set-top box and Section 4.7.3 referred to the potential for bundling Internet search engines with other software of the user's terminal. Normally these are unilateral firm practices which can however be implemented for the joint profit of the parents within the SA.

- (b) The possibility that the parents may be aided with exercising the practice of cross-subsidisation by means of the SA: hence, Section 4.7.1 highlighted the potential for such a practice in the light of asymmetry in the implementation of liberalisation in the Member States of the European Union in two respects: before the 1st March 1998, in the context of voice-telephony competition; since the 1st March 1998, in the context of local loop unbundling.
- (c) The possibility that the SA will give the parents technological leadership, which will be sustainable and will entail first-mover advantages: hence, Section 4.7.2 analysed the situation in relation to the development of technical infrastructure for digital pay-TV and the principles governing access to it by competitors.
- (d) The fact that the SA brings together a firm which operates in a highly regulated industry with a firm operating in a non-regulated industry: this theme ran through Section 4.7.

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PART [III]
INSTRUMENTS OF EC COMPETITION LAW
FOR THE CONTROL OF SAs

5.1 Introduction

This Part will examine the legal instruments available within the array of European Competition law, which could be applied for the purposes of assessing cases of SAs. It need be stated that since a distinct concept of SAs has not been recognised by European Competition Law so far, the legal instruments which appear to be most relevant are those applicable to joint ventures. Of most interest in the context of SAs are the legal instruments applicable to *full-function* joint ventures (“FFJV”), since it is more likely than not that the allies will choose this institutional form for their alliance in order to render it stable and durable enough.¹²⁸ The notion of FFJV is employed by the EC Commission to confer the meaning of a distinct legal entity set up to perform all the functions of an autonomous economic entity on a lasting basis.¹²⁹ European Competition rules in relation to FFJVs have changed over the years. Merely an outline of their evolution suffices for the purposes of this thesis.

Until the 1st March 1998, a FFJV was presumed to be a concentration falling within the ambit of Article 3(1)(b) of the EC Merger Regulation (“ECMR”) Council Regulation 4064/89 of 21 December 1989. This presumption could be rebutted by the EC Commission, if it could prove that the creation of a FFJV, had as its “object”, or entailed as an “effect”, *“the co-ordination of the competitive behaviour amongst the undertakings which remained independent”*¹³⁰, (hereinafter, “the behavioural

¹²⁸ This point is deducted from Section I of the thesis.

¹²⁹ See Commission Notice On The Concept Of Full-Function Joint Ventures Under Council Regulation (EEC) No. 4064/89 On The Control Of Concentrations Between Undertakings, 1998 OJ C 66. Para. 12 explains that, to that effect, the JV must have a management dedicated to its day-to-day operations and access to sufficient resources including finance, staff, and assets (tangible and intangible).

¹³⁰ I.e. amongst the parents of the JV or between the JV and its parents

aspect").¹³¹ A finding of such a behavioural aspect was taken to affect the very essence of the JV: even if it were set up to perform all the functions of an autonomous economic entity on a lasting basis, it would not be classified as a *concentrative* FFJV; it would be held to be equivalent to a cooperative arrangement between independent undertakings, and therefore it would altogether be assessed under Article 81 (ex Article 85) of the EC Treaty. Many differences in relation to the procedural rules being applicable were entailed by such classification.¹³² For the purposes of this thesis, however, it is more interesting to note the difference in the substantive test which would apply following that classification.

If it were classified as a *cooperative* FFJV, its effects would be assessed pursuant to Article 81(1) EC.¹³³ Hence, the European Commission would look into whether "*the object or effect of the joint venture is to restrict appreciably competition between the undertakings concerned and, in turn, to affect trade between Member States*". If the SA were classified as a *concentrative* FFJV, its effects would be assessed pursuant to Article 2(2),(3) EC Merger Regulation ("ECMR"); hence the test would be whether "*the concentration creates or strengthens a dominant position which significantly impedes competition in the Common market*".

The underlying rationale for this distinction between concentrative and cooperative FFJVs, over and above the distinction between FFJVs and partial-function JVs, was repeatedly challenged.¹³⁴ The ECMR was eventually amended pursuant to Council Regulation 1310/97 of 7 July 1997. Since the 1st March 1998, the European Commission distinguishes merely between full-function and partial-function joint ventures. The approach it adopts is as follows. Upon finding that a FFJV has been created, the ECMR 'dominance test' is applied to assess the effects resulting from the fact that such a joint venture brings about a change in the structure of the undertakings concerned, that is to say the parents. If it is found that such a FFJV

¹³¹ See Article 3(2) of the ECMR.

¹³² For a very detailed analysis of these differences, please see F. E. Gonzalez-Diaz, 1999, "Joint Ventures Under EC Competition Law: The New Boundaries", not yet published.

¹³³ The same test would apply to a *partial-function* joint venture.

¹³⁴ Inter alia, by: Barry Hawk, "Joint Ventures Under EEC Law", Fordham International Law Journal, 1991, Vol. 15, p. 303; Pathak, "The EC Commission's Approach To Joint Ventures: A Policy Of

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presents the behavioural aspect which was analysed above, only that behavioural aspect will be assessed under Article 81 EC. This is expressly dictated by Article 2(4) ECMR as amended.

The author welcomes the elimination of the distinction between cooperative and concentrative FFJVs. It constitutes a meritorious change in so far as it appears to appreciate that the behavioural aspect of a FFJV does not reduce the ability of such a JV to bring about a significant degree of economic integration, and therefore qualify as a concentration.¹³⁵

Having said that, the author wishes to review the European Commission's decisions in the MSG, the NSD, the BiB cases and the Telia/Telenor/Schibsted, the FT/DT/ENEL and the NC/Canal+/CDPQ/ BankAmerica cases.¹³⁶ The review aspires at revealing whether we can safely rely upon the existing methodology of the Commission for the purposes of assessing cases of SAs. In particular, the following issue is addressed: the extent to which the model for detecting the strategic intent of the parents that was suggested in Part [I] of the thesis and discussed further in Part [II], has been, already, either explicitly or implicitly employed by the European Commission. The author is of the opinion that it is worth exploring this question against the fact that Karel Van Miert, former Competition Commissioner, proclaimed that the Commission, in examining alliances, *does embark* upon detecting whether the underlying strategy of the alliance is a defensive one.¹³⁷

In the concluding remarks to Part [I] it was clarified that the alliances which should raise serious concerns (and thus demand an insight into the strategic intents and the plausible strategies for their achievement) are those concluded between

Contradictions", [1991] 5 ECLR, p.171; Barry Hawk, "A Bright Line Shareholding Test To End The Nightmare Under The EEC Merger Regulation", [1993] CMLR 30.

¹³⁵ Gonzalez-Diaz, ante. at p. testifies this himself.

¹³⁶ All the decisions which have been chosen for the purposes of this review relate to cases of SAs set up in the telecommunications sector. The author hopes that such choice enables the reader to build on the points made in Part [I] and put in context in Part [II].

¹³⁷ "In principle, we take a positive attitude towards new vertical and horizontal partnerships and ventures, so long as we can be convinced of the real synergies and benefits which should form the underlying logic for these moves. If, on the other hand it looks more like a defensive strategy to sew up markets and shut out competitors, then the competition rules must be used without hesitation to block

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leading firms. Hence, the review examines the extent to which the ECMR test of “dominance”, which is based on “market power”, looks into all the strengths of the parents, in all of their portfolio activities: this was a central component of the model for identifying the strategic intent.

Besides, in Part [I] the reader was invited to address itself to the instrumental role that a SA can play for the advancement of its parents’ defensive strategic intent. If the reader is prepared to accept that the behavioural aspect of a FFJV actually reflects the instrumental role a SA can play for its leading parents, is it not wrong to dismiss the risk that the co-ordination of the firms’ competitive behaviour is intended to *create or strengthen a dominant position*? The author suggests that we reconsider whether “it is good enough to assess the behavioural aspect separately, under Article 81, rather than as a factor to be taken into consideration when applying the ECMR “dominance” test on the structural effects brought about by the creation of the FFJV”.¹³⁸ If the reader objects to applying a structure-oriented test to mere behavioural patterns, then he / she is invited to consider whether Article 82 (ex Article 86) of the EC Treaty ought to be the second-best alternative, and thus to assess whether the co-ordination of competitive behaviour is equivalent to *abuse* of the parents’ dominant positions.

Frequently, a JV agreement stipulates by way of an ancillary restraint that the parents will not compete any more in the activity for which they set up the alliance. Therefore when the Commission is confronted with the task of assessing a subsequent alliance between them, it finds that there cannot be any co-ordination of their behaviour in their activities outside the scope of this subsequent alliance since they are, by virtue of the ancillary restraint in the previous alliance, not competing anyway.

the agreement”. see “Mapping the new open telecommunications marketplace”, by Karel Van Miert, IIC Telecommunications Forum, Brussels, 7/7/97.

¹³⁸ The author challenges the EC Commission and the EC Council for failing to take a chance which was open to them when the ECMR was amended. In F. E. Gonzalez-Diaz’s own words, “(t)he immediate consequence of this modification of concentrative joint venture would normally have been to subject all full-function joint ventures not only to the procedures of the Merger Regulation but also, and most importantly, to the dominance test. However, neither the Commission nor the Council wanted to go down this route. In order to prevent the exclusive application of the dominance test to full-function joint ventures, the Commission thus proposed to insert a new paragraph 4 to Article 2 of the Merger Regulation...” (Gonzalez-Diaz, 1999).

This brings the author to the ultimate issue: the extent to which we should take the “non-competition” between the parents (ancillary restraint) as a factor adding to the market power of the parents. The author submits that we ought to detect when the market power of a market player increases by way of its participation in a network of alliances which exclude or prevent competition from its potential competitors.

5.2 Full-Function Joint Ventures & Strategic Intent

5.2.1 Creating Or Strengthening A Dominant Position

Article 2(1) ECMR provides that “*concentrations shall be appraised with a view to establishing whether or not they are compatible with the common market*”. Article 2 (3) ECMR provides that 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.

The innovative point about the ECMR in the European legal order resided in the fact that it does not only prohibit the *strengthening* of a dominant position, but also the *creation* of a dominant position. This feature is very useful in so far as it entitles us to look into the position of the JV – as a distinct full-function entity – and evaluate whether it will enjoy a dominant position itself, and further, we are entitled to see whether the setting up of the JV will create a dominant position for its parents or strengthen their pre-existing dominance. *Thus, in principle, the ECMR aides us with assessing whether the strategic alliance is an instrument for its parents.* Nevertheless, it remains a matter of debate whether we can control *joint* dominance or at least whether the ECMR is the proper legal instrument for controlling the creation or strengthening of *joint* dominance of the parents or the parents and the JV.¹³⁹ Having noted that, it is outside the scope of the thesis to indulge into that debate.

¹³⁹ See the ECJ decision on this issue: Cases C-68/94 and C-30/95 France v Commission [1998] 4 CMLR 829 on appeal from the EC Commission Decision in Case IV/M.308 Kali and Salz/MdK/Treuhand [1994] OJ (L186) 38. The ECJ, adopting a teleological approach, held that the issue of joint dominance does fall within the ambit of the ECMR.

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“Dominance” is a *structural* concept and refers specifically to market power in the market investigated.¹⁴⁰ Thus the Commission will consider ‘dominance’, only after having defined the relevant product and geographic markets.¹⁴¹ The classic definition of dominance was enunciated by the European Court Of Justice (“ECJ”) in the United Brands case: “*a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers*”.¹⁴² Thus dominance is bound to encompass both features specific to the structure of the relevant market and the behavioural feature of the “economic strength” or “market power” of the firm in question.

In Europe, “market power” is generally defined as “the ability to raise prices above long run marginal cost without significant loss in demand” or else, in less definite terms, as “*power over price and other components of bargains*”.¹⁴³ In the United States, the classic definition of market power refers to the ability of a firm or group of firms to raise prices profitably by reducing their own output.¹⁴⁴ The economic theory underlying the need to control market power is reflected in that

¹⁴⁰ Peter Crowther, (1996) “Product Market Definition In EC Competition Law: The Compatibility Of Legal And Economic Approaches, JBL, p.177

¹⁴¹ See European Commission Notice On The Definition Of Relevant Market, 1997 OJ (C 372) 03. A relevant product market is taken to comprise “all those products and/or services which are regarded as interchangeable with, or substitutable for, the product in question by the consumer by reason of the products’ characteristics, their prices and their intended use”.¹⁴¹ Interchangeability is assessed in terms of product characteristics, price and intended use. Substitutability is assessed as a function both of demand and supply conditions. Geographical market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because of conditions are appreciably different in those areas (Case 85/76 Hoffman-La Roche v Commission [1979] ECR p.461). Homogeneity of conditions is interpreted predominantly in terms of trade barriers, consumer habits, transport costs and, a factor which recurs in the cases that will be reviewed hereinafter, linguistic differences. Further, conditions must be homogeneous enough for the economic power of the undertaking concerned to be able to be evaluated (See Case 27/76 United Brands Co. v Commission [1978] ECR 207). It is submitted that the identification of the relevant market for the purposes of assessing dominance should reflect the markets in which the parents to the alliance are active, if possible reflecting their entire portfolio.

¹⁴² Case 27/76 United Brands Continental BV v Commission [1978] ECR 207; [1978] 1 CMLR 429, para. 38. The concept of ‘dominance’ had been employed already within the gulf of EC Competition law when the ECMR was first adopted. Thus, Richard Whish, ante., at p.717 stated that “*case-law under Article 86 is clearly of importance as to the meaning of the term “dominant position”*”.

¹⁴³ Valentine Korah, 1997, An Introductory Guide To EC Competition Law And Practice, (Oxford: Hart Publishing) p.8

¹⁴⁴ Posner R., 1976, Antitrust Law: An Economic Perspective, p.8.

definition. It is a fundamental premise of a Perfect Competition market that the quantity produced is exactly as much as the consumers are prepared to consume and thus the price equals marginal cost. In such a market the firm is a price taker. Allocation of resources is optimal. On the other hand, when a firm acquires market power, it becomes a price maker. It has the possibility to raise prices and restrict output, arranging production in a way that maximises its profits. As a result, some consumers who are prepared to pay more, will buy the product at a higher price, while others will not buy it at all. Unsatisfied customers represent a loss in consumer welfare. That loss is the economic cost of market power.¹⁴⁵

Progressively, there grows a school of thought in the United States which argues that the focus of the “classical” market power enquiry is too narrow. According to that school, we should go on to assess the “exclusionary” market power: “*the ability to exclude competition through cost-raising strategies*” because “*some firms that are unable to raise price solely by reducing their own output may nevertheless acquire or exercise market power by raising the costs or reducing the output of their competitors*”.¹⁴⁶ The author contends that this perception of the concept of market power is more appropriate in the context of assessing the market power of strategic allies. Indeed, the defensive strategies that were described in Part [I], are mainly aimed at sustaining one’s leading position by increasing the costs of potential competitors to the extent that it is no longer attractive for them to enter the market or to reposition, thereby excluding any potential competition.

Besides, the author suggests that the two definitions of the market power need not be read as if they are mutually exclusive but rather as complementary: that would resolve the ambiguity problem with the classic definition of ‘dominance’ which R. Whish has detected. He highlighted that the definition contains two elements – the ability to prevent competition and the ability to behave independently – without explaining precisely how these two ideas relate to each other: “*Does the Court mean*

¹⁴⁵ Schereer & Ross, 1990, “Industrial Market Structure And Economic Performance”, Houghton Mifflin, ch.2.

¹⁴⁶ An adherent to this school of thought is Thomas G. Krattenmaker & Steven C. Salop, 1986, “Anti-competitive Exclusion: Raising Rivals’ Costs To Achieve Power Over Price”, 96 Yale L.J. 209.

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*that they are cumulative, that is to say, that both must be proved? Or, is one idea parasitic upon the other, in which case which is the parasite?"*¹⁴⁷

Furthermore, the author argues that the "exclusionary" capacity of market power is even more consistent with the notion of dominance that the ECMR seeks to prohibit. Albeit it is agreed that, as Frank L. Fine¹⁴⁸ points out, "*the ECJ's definition of dominance does not suggest that dominance shall entail the actual elimination of competition; on the contrary the Court suggested that dominance does not preclude a lively competitive struggle*", it has been clarified already by Giuliano Amato¹⁴⁹ that it is Article 82 (ex Article 86) EC Treaty which punishes that type of dominance. The remedy of a prohibition of a concentration pursuant to the ECMR was sought to address the difference between a dominant firm, which faces some competition, notwithstanding that it may be weak and a dominant firm, which enjoys an exclusive position (i.e. it does not face any competition at all any more, or it is not likely to face any competition in the reasonably foreseeable future because of contractual aggregation). In brief, it is foreclosure of the market that the ECMR prevents.

The author submits that the factors, which the European Commission appeared to consider when measuring the relevant undertakings' market power, so far reflected the classical definition of market power. This thesis aims at revealing which other elements may be worth considering in the light of "exclusionary" market power.

The starting point for the assessment of market power has naturally been the market share of the undertakings concerned in the relevant market. Large market shares may evidence themselves a dominant position, provided they exist for some time.¹⁵⁰ For example, a market share of 50% will be taken to be very large and, in the absence of exceptional circumstances, it will in itself indicate dominance.¹⁵¹ If a firm enjoys a market share in the range of 40-45%, normally, additional factors will need

¹⁴⁷ See ante. at p. 260.

¹⁴⁸ (1994), *Mergers And Joint Ventures In Europe: The Law And Policy Of The EEC*, p.206.

¹⁴⁹ At p. 78

¹⁵⁰ Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, [1979] 3 CMLR 211

¹⁵¹ Case C-62/86 *AKZO Chemie BV v Commission*, Judgment of 3/7/1991.

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be taken into account before concluding that it is dominant.¹⁵² Subject to the same proviso, dominance cannot be ruled out even where the market share in issue lies within the range of 20-40%.¹⁵³ The 15th Recital of the Preamble to the ECMR, albeit not having legal force, suggests that, if the *combined* market share of the undertakings concerned after the operation, in the common market or a substantial part of it, is less than 25%, it will be a *factor* toward finding that the concentration is compatible with the common market; market power (and, in turn, dominance) will not be an issue. However, market shares cannot be the decisive factor since *ex hypothesi* they cannot indicate the competitive pressure exerted by firms not yet operating on the market but with the capacity to enter it.¹⁵⁴

Which other factors have been taken to determine market power? ‘*Barriers to entry*’ were considered to be the most obvious factor on the ground that a firm with a large market share will be in a much better position to earn monopoly profits, if it knows that, in doing so, it will not attract new competition. There has been a great debate over what should be included within the term “barrier to entry”. One school of thought perceives many purported barriers to entry as entirely natural, being related to efficiency. They argue that a true barrier to entry is a cost to new entrants which was not applicable to the existing market operators when they entered the market.¹⁵⁵ This narrow definition concentrates on the perceived ability of the market to rectify any inefficiencies without intervention from law. Thus they classify as barriers only legal provisions that restrict entry to the market. On the other hand, there is the school of thought which regards the barriers to entry much more broadly so as to comprise any factor which would tend to discourage firms from entering the market. Accordingly, a ‘barrier to entry’ is “any cost, which is higher for a new firm than for firms already in the industry”.¹⁵⁶

The ECJ and the Commission have not attempted to lay down a general definition of the term. Nevertheless, they appeared to include within its ambit

¹⁵² Michelin Case, published in OJ [1981] (L 353) 33.

¹⁵³ EC Commission, 10th Report on Competition Policy, point 50.

¹⁵⁴ R. Whish, *ante.* at p. 263.

¹⁵⁵ See R. Bork (1993) *The Antitrust Paradox: A Policy At War With Itself* (Oxford: Maxwell Macmillan).

Year	Population	Area	Population	Area
1900	1,000,000	1,000,000	1,000,000	1,000,000
1910	1,500,000	1,500,000	1,500,000	1,500,000
1920	2,000,000	2,000,000	2,000,000	2,000,000
1930	2,500,000	2,500,000	2,500,000	2,500,000
1940	3,000,000	3,000,000	3,000,000	3,000,000
1950	3,500,000	3,500,000	3,500,000	3,500,000
1960	4,000,000	4,000,000	4,000,000	4,000,000
1970	4,500,000	4,500,000	4,500,000	4,500,000
1980	5,000,000	5,000,000	5,000,000	5,000,000
1990	5,500,000	5,500,000	5,500,000	5,500,000
2000	6,000,000	6,000,000	6,000,000	6,000,000
2010	6,500,000	6,500,000	6,500,000	6,500,000
2020	7,000,000	7,000,000	7,000,000	7,000,000
2030	7,500,000	7,500,000	7,500,000	7,500,000
2040	8,000,000	8,000,000	8,000,000	8,000,000
2050	8,500,000	8,500,000	8,500,000	8,500,000
2060	9,000,000	9,000,000	9,000,000	9,000,000
2070	9,500,000	9,500,000	9,500,000	9,500,000
2080	10,000,000	10,000,000	10,000,000	10,000,000
2090	10,500,000	10,500,000	10,500,000	10,500,000
2100	11,000,000	11,000,000	11,000,000	11,000,000

exclusive rights granted to a firm either by way of national legislation¹⁵⁷ or governmental regulation or even by intellectual property rights.¹⁵⁸ This is non-controversial as it complies even with the narrow view of barriers. Access to capital was also accepted to be a potential factor.¹⁵⁹ Economies of scale might also indicate dominance.¹⁶⁰ Product differentiation is a barrier to entry which was first recognised by the economists. The underlying idea is that due to advertising or brand loyalty, consumers may perceive homogeneous goods as being different, and consequently it is more difficult for a new entrant to present its products as interchangeable, thereby competing with the existing players.¹⁶¹

More interesting is the fact that evidence of superiority of a firm in technology can be adduced toward proving dominance.¹⁶² The relevance of possession of existing and potential access to future technology has also been acknowledged.¹⁶³ Recognising technological advantage as a barrier to entry suggests that the ECJ and the Commission are prepared to adhere to the broader view of barriers. The same conclusion can be drawn from the fact that vertical integration and well developed distribution systems have been regarded as evidence of dominance. An undertaking is vertically integrated, if it controls upstream and downstream production facilities. The argument runs that integration allows an undertaking a much higher level of control over the way in which a product reaches the market. This provides the undertaking with commercial stability that constitutes a significant advantage over its competitors.

Regardless of the fact that the ECJ and the Commission have been ready to take a broad view of barriers to entry, it can still be claimed that such stance was justified on the ground that the firms could rely on those barriers in order to restrict their output and still raise their prices without sacrificing profits. The only occasion on which the ECJ looked into the “exclusionary” conduct of a firm and held that even

¹⁵⁶ Stigler (1968) *The Organisation of Industry*, (Chicago: Chicago UP), p.67.

¹⁵⁷ Case 22/78 Hugin v Commission [1979] ECR 1869, [1979] 3 CMLR 345.

¹⁵⁸ Tetra Pak I (BTG License) 1988OJ (L 272) 27, [1988] 4 CMLR 881.

¹⁵⁹ See Continental Can case, ante.

¹⁶⁰ Case T-6/89 BPB and British Gypsum v Commission [1993] ECR II-389; [1993] 5 CMLR 32.

¹⁶¹ See United Brands case, ante., Hoffmann La Roche case, ante. Michelin case ante.

¹⁶² Ibid.

¹⁶³ See Case 85/76 Hoffman-La Roche, ante.

that could qualify as a barrier to entry has been in the AKZO case.¹⁶⁴ The conduct in question was ‘predatory pricing’ exercised in order to eliminate competitors. The reasoning of the ECJ could be depicted as follows: “if an undertaking has a history of reacting to new entrants with exclusionary conduct, it will discourage potential entrants from attempting entry. (T)hey will be well aware of the likely response of that undertaking”.¹⁶⁵

The author submits that on the basis of ‘exclusionary’ market power, we should extend the ambit of barriers to entry to include competitive advantages which result from “*competitor interrelationships*”. The latter have been defined and described in Section 2.4: they essentially refer to the multi-point presence of firms in different segments of an industry or in the same business unit of distinct industries. In simple words, they refer to *links* between firms. The reason for suggesting that they be considered as a barrier to entry derives from the fact that many SAs are formed with the defensive intent of combining interrelationships (links) so that potential competitors will only enter, if they are able to ally with other players, and thereby possess comparably strong interrelationships. Thus firms nowadays appreciate the power derived from such interrelationships. In fact, at intervals, the author highlighted that competitor interrelationships can nowadays play the same role as vertical integration: for instance, when it comes to controlling access to content (Section 4.7.4), TOs will be tempted to ally with broadcasters in knowledge of the fact that they have strong interrelationships with content producers; they need not ally with the content producers themselves.

5.2.1. Case No IV/M.469 - MSG; OJ L 364/1, 31/12/94

The MSG decision is very important for the purposes of this thesis for the reasons that follow. First, the proposed joint venture was set up to operate in a market which did not already exist, a *future market*, namely the market for technical and administrative services required for the operation of digital pay-TV. Indeed, the parents relied on the premise that “*as a consequence of the introduction of digital*

¹⁶⁴ Case C-62/86 AKZO Chemie BV v Commission [1991] ECR I-3359; [1993] 5 CMLR 215.

¹⁶⁵ See Rodger & MacCulloch, ante. At p.90.

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*television over the next few years, the joint venture's downstream market for pay-TV services will grow rapidly and other suppliers will enter the market, so it may be assumed that a market will develop for the services offered by MSG, which will reach a substantial size in the foreseeable future".*¹⁶⁶ Secondly, it flowed from the aforesaid that the *market share* of the parents in the relevant services market was not available as an indicator of their market power and hence as an indicator going toward proving whether the joint venture would create or strengthen a dominant position in its market. Instead, the Commission enunciated that the parents' *competitive advantages in related but distinct markets / industries* would be the appropriate indicator of the parents' market power. Hence the strength or weakness, the leadership or followership, of the partners in related business units or industry segments was taken into account. Thirdly, it was accepted, albeit not expressly, that *convergence* is what makes the advantages of a company dominant in one market, relevant to the assessment of its plans in the other. Technological convergence is what makes two markets related enough for market power in one to be used in the other or in intermediate or in related markets.¹⁶⁷ Fourthly, the Commission revealed that some links, interrelationships amongst competitors in neighbouring markets may prevent potential competition in the relevant market. Hence the Commission appeared to accept that the overall portfolio of each and every partner ought to be examined across the portfolio of potential competitors. Fifthly, by taking a firm stance that each partner to MSG had a business interest to enter independently on the market which was the target of MSG, the Commission managed to bring to the surface the underlying strategic intents of the partners.

The business object of the alliance

The object of the MSG alliance was the provision of the necessary technical infrastructure for the supply of mainly pay-TV and other communication services, including conditional access and subscriber customer management.

¹⁶⁶ Para. 10 of Commission decision

¹⁶⁷ J. T. Lang, ante. At p.403. He makes this comment in relation to several convergence-driven mergers, including the MSG case.

The parents' business

The alliance was concluded between Bertelsmann AG ("Bertelsmann"), Deutsche Bundespost Telekom ("DT"), and Taurus Beteiligungs GmbH, a holding company belonging to the Kirch Group ("Kirch"). Bertelsmann's core business was book and magazine publishing, book clubs, printing, music publishing and sound recording; hence an electronic publisher. Kirch's portfolio included, predominantly, the supply of feature films and television programming; a content creator and software developer. The core to DT's portfolio was the provision of telecommunications services and the necessary technical infrastructure; clearly a TO. All entities were active primarily in the geographic market of Germany.

Relevant market

The Commission found that pay-TV was a relevant market for the purposes of the assessment of MSG's impact on its parents' position. For the same purposes, the Commission held the operation of the Cable TV network to be a relevant market. In fact, the MSG agreement provided that DT would be in charge of the digitisation of the cable TV network in the hyperband area, that is an innovation market.

a. Alliance set up between to pre-empt potential competition in a new market

The European Commission found that MSG would be the *first* supplier of technical and administrative services for pay-TV in Germany. In the near future, it would also be the *only* supplier and thus have a monopoly. The Commission clarified that "*although a monopoly in a future market that is only just beginning to develop should not necessarily be regarded as a dominant position within the meaning of Article 2(3) of the Merger Regulation, the assumption that no market dominance exists presupposes in such a case that the future market in question remains open to future competition and that the monopoly is consequently only temporary*".¹⁶⁸ On the

¹⁶⁸ para.55 of the Commission Decision.

facts, one could expect that the market for the services to be offered by MSG would be sealed off by the establishment of MSG who, therefore, would be expected to acquire a long-term monopoly and, needless to say, enjoy a dominant position.

For the purposes of this thesis, it is not as important to consider the parents' intent in so far as it provided for the success of the alliance, but rather in so far as it aimed at pre-empting any competition between the parents in a new market that both would like to enter.

On its way to the conclusion that MSG would enjoy a dominant position, the Commission identified the most likely *potential competitors* in the provision of these services. From the experience in other countries, it inferred that *pay-TV suppliers* and *cable network operators* were the most likely potential competitors. Not surprisingly, the only pay-TV supplier at the time was Premiere, the analogue pay-TV operator controlled by Bertelsmann, Kirch and Canal Plus. The Commission identified a strong business interest for Bertelsmann / Kirch to expand into setting up the technical infrastructure for digital pay TV due to the additional programme possibilities that digital television makes available precisely for pay-TV.¹⁶⁹ Besides, the Commission identified a strong business interest for DT to enter the pay-TV market and the future market of interactive higher-value services: the possibility would open up for DT to pursue a more strongly use-oriented policy in the broadband cable service area rather than a purely connection-related payments and charges policy.¹⁷⁰

Detecting the strong business interests of the parties separately, the Commission expressed the opinion that, even if they were not involved in MSG, they would *independently* enter the market for the provision of a digitised infrastructure for the operation of pay-TV and also the market for the services necessary to its operation. The Commission rejected the argument that the risk of investing in digital infrastructure could only be assumed if shared with another, on the basis of the previous experience with the introduction of the mobile telephone system, GSM, in Germany. In that case, an infrastructure covering as much of the country as possible

¹⁶⁹ Para. 57 of Commission decision.

¹⁷⁰ Para. 59 of Commission Decision.

had to be set up; yet, it proved possible for two competing mobile telephony operators to undertake the task, and thus it was ensured that mobile telephony users could choose between two competing systems, that operated by DT and another operated by a private consortium. Further in this respect, the Commission revealed a contradiction in the parties submission: if MSG's investment risk was so high that Bertelsmann / Kirch and DT would each be unable to take on the risk on their own, how could they argue that other competitors would consider it economically feasible to enter the market, once MSG was successfully established on it?¹⁷¹

Moreover, it is in the interests of this thesis to consider who else could be a potential competitor and why did DT not pick it up as a partner instead of Bertelsmann, Kirch. In fact, the parties informed the Commission that Selco Servicegesellschaft fuer elektronische Kommunikation mbH ("Selco") was at the time known to be interested in offering the MSG-type services. Selco's business was confined to the marketing of foreign-language programmes in Germany. If it embarked upon providing the MSG-type services, it would thus have to operate in a niche market with *a limited subscriber base*. Thus it could not be a particularly attractive ally.

An additional factor which is important to note is that there was already a *link* between Kirch and Selco. Selco constituted a joint venture between the private television broadcaster PRO7 (50,1% of shares) and News Corporation Ltd (49,9% of shares), which belonged to the Murdoch Group. However, 47,7% of the shares in PRO7 were held by Mr Thomas Kirch, the son of the owner of the Kirch Group. In consequence, PRO7 used to purchase to a large extent programme software from Kirch for use in its programmes. Thus, DT could get the best of both worlds by allying with Bertelsmann, Kirch considering that, first, they were realistically the most significant potential competitors and, secondly, they were already well interrelated with the rest of potential competitors, thereby reducing any appreciable risk from effective competition.

b. Alliance Set Up To Extend Parents' Market Power To Another Market

¹⁷¹ Para. 66 of Commission Decision.

It is worth paying attention to the competitive advantages that Bertelsmann/Kirch enjoyed in the analogue pay-TV market in Germany, which were likely to be extended to the market for digital pay-TV and which rendered them the most credible players in the latter market.

(i) Subscriber base

Bertelsmann / Kirch already had a subscriber base which they could also use in future digital pay-TV.¹⁷² This was material in the sense that the risk of investment in a digital infrastructure was significantly reduced, if the service provider could build on a subscriber base of analogue pay-TV customers. The requirement of a subscriber base is an inherent feature to pay-TV since there is a trade relationship only between the programme supplier and the viewer as subscriber, in contrast with TV funded by commercial advertising and public television financed partly through fees and partly through advertising where the trade relationship is only between the programme supplier and the advertising industry.¹⁷³

(ii) Preferential access to programme software

Kirch was the leading German supplier of feature films and entertainment programmes for television. It had at its disposal a stock of about 15 000 movies of all types and 50 000 hours of television programmes. It also had extensive production activities in the area of movies and television. Secondly, Kirch controlled, jointly with Axel-Springer-Verlag, ISPR, which was the leading agency for sports broadcast rights. Similarly, Bertelsmann had access to attractive sports rights and film production activities through UEFA. Thirdly, both undertakings had holdings in free-access commercial television broadcasters: in particular, Kirch had a share of some 80% of television advertising revenue in Germany through its holdings in RTL, SAT 1, PRO 7,

¹⁷² Para. 62 of Commission decision.

¹⁷³ Para. 32 of Commission Decision.

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RTL 2, VOX, Deutsches Sportfernsehen and Kabelkanal. Thereby, Kirch had the ability to bid for, and acquire, film rights or sports rights at higher prices than other competitors.¹⁷⁴

(iii) Preferential access to potential distribution channels

Bertelsmann is the leading book operator in Germany with, at that time, six million book club members and experience in the customer management of 22 million book club members worldwide. It was argued that this fact would add to the security of the customer base of MSG. Arguably, such book clubs constituted a potential distribution channel of pay-TV programmes. Yet Bertelsmann made assurances that it was not interested in steering the buying power of book club clients from the current club products towards other products, in recognition of the fact that this did not fit the culture budget of such customers.

The Commission addressed the question whether Bertelsmann / Kirch would extend their dominant position in analogue pay-TV to digital pay-TV.

The Commission appeared to be much concerned by their advantage as to preferential access to software. It explained that, because of that advantage, Bertelsmann and Kirch could put together different *program packages*, tailored to the requirements of specific target groups, which they would be able to offer at an attractive subscription price. This ability would be enhanced by the digitisation of pay-TV infrastructure. *“Experience in other countries where pay-TV is at a more advanced stage reveals that the bringing together of individual programmes to form programme packages is a key factor in achieving success on the pay-TV market. Pay-TV suppliers occupying a less important position on the market may be forced to include their programmes in the leading pay-TV supplier’s packages, thus giving it control over its competitors.”*¹⁷⁵

¹⁷⁴ Para. 77 of Commission Decision.

¹⁷⁵ Para. 78 of Commission Decision.

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c. Alliance Set Up to Defend a Parent's Position In the Innovation Market

DT had a broadband cable network with over 13 million connected households, that is more than 90% of all cabled households in Germany (a total of 14 million cable connections). The cable network was thus particularly important in Germany compared to satellite TV (the other basic means for transmitting pay-TV) which could only be received by seven million households. The Commission, relying on these figures, emphasized that it made sense to provide services relating to pay-TV, only if they related to pay-TV programmes that were also transmitted by cable; it would be unwise to provide satellite pay-TV related services except in case of special market segments such as that served by Selco. As a result, it could be inferred that any pay-TV provider was dependent on the use of the cable network of DT.

On the facts, the question arose whether and how DT's position in the cable TV network, could be strengthened by the MSG alliance. The JV agreement provided that DT would be in charge of the digitisation of the cable TV network in the hyperband area. According to the information provided by the parties, digitisation of DT's cable network would take place in 1995. It was expected that 15 channels would become available for the transmission of digital programme signals in the hyperband range of 300-450 MHz on DT's broadband cable network. On each channel a total of four to 10 digital programmes was to become available. The Commission concluded that *"DT would determine the gradual expansion of the transmission channels for digital TV and could thus control the development of transmission capacity for digital TV"*.¹⁷⁶

Aware of that consequence, the Commission managed to discern the strategic intent of DT in concluding this alliance. It intended to foreclose innovative use of the cable TV network *before* the cable TV network would be opened up to competition by means of the Community liberalisation scheme. It thus sought to safeguard its dominant position in anticipation of liberalisation in infrastructure provision. In this respect, the alliance with Bertelsmann and Kirch was defensive because it prevented them from being available as potential partners for other future cable TV network

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operators.¹⁷⁷ In other words, DT sought technology leadership in order to enjoy first-mover advantages and interrelationships with competitors that future competitors would not be able to match.

It is interesting to consider why did Bertelsmann/Kirch not wait until other cable TV network operators would enter the market rather than rush into allying with DT? DT was well interrelated in the field of network operation! Not long before the MSG alliance, DT acquired a 16,6% holding in SES, the main European satellite operator, which reaches 6 million households in Germany via the Astra satellites. It thereby became the second largest shareholder in SES and collaborated with it “*in order to ensure compatibility between the satellite network and the cable network in the digital television area*”. This was important considering that satellite transmission could already be carried out in either analogue or digital form. Moreover, DT gained the ability to influence, albeit not to control, the allocation of satellite channels using the Astra satellites.

Besides, at the time of concluding MSG, DT was the holder of the monopoly for the fixed telephone network. Such network was particularly important in relation to *interactive digital television*, which being different from pay-TV in general, posed a commercial risk to broadcasters dealing with pay-TV only. The fixed telephone network was important because it could provide the return channel required for interacting. The use of the mobile phone network as a return channel, though technically possible, did not appear to be an appropriate alternative in economic terms at least for private households, at the time. Bearing in mind that even the broadband cable network could not for technical reasons be used at the time as a return channel, DT's telephone network or its glass fibre network was all the more important as the only channel currently available for interactive television.

¹⁷⁶ Para. 61 of Commission decision.

¹⁷⁷ Para. 92 of Commission decision.

d. Alliance Set Up to Give Its Parents Sustainable First-Mover Advantages

Finally, the Commission discerned the strategic intent of Bertelsmann / Kirch as being to achieve first mover advantages on digital pay-TV market in the form of influencing the relative prominence given to competing channels in terms of channel allocation, electronic programme guides and slots on smart cards, as well as other informational advantages. They sought to achieve the defensive objective of ensuring that MSG's terms and conditions and price structure were arranged in a disadvantageous way to their competitors' programmes so that the choice left for future pay-TV competitors would be either to accept MSG's conditions or to stay out of the pay-TV market.¹⁷⁸ It seems that they were confident about achieving it, on the basis of the so-called "tipping effect": the fact that customers are most likely to be attracted by players who have already achieved a market share substantially greater than their competitors.¹⁷⁹ Surveys of enterprises confirmed that potential competitors took this message and indeed intended to withdraw their plans on future pay-TV supply in the digital area.¹⁸⁰

The reaction was realistic considering the nature and cost of the technical infrastructure in question. At the time, a digital decoder was expected to cost between DM 1 000 and DM 1 500. Facing this, it was anticipated that digital pay-decoders would be leased to, rather than bought by, viewers. The Commission dismissed the argument that, if MSG were to install a decoder base using a common interface, potential competitors would no longer need to invest in their own decoder base, and thereby surmount the technological barrier to entry on the market. The Commission detected a strategic move that was open to MSG to take: it could impose on viewers, by means of a term in the decoder lease agreement, the requirement that they should not use the decoder with modules of other pay-TV or service providers without the consent of MSG. Such a restriction would deny MSG's competitors free and unconditional access to the installed decoder base in spite of a common interface.¹⁸¹

¹⁷⁸ Para. 82 of Commission Decision.

¹⁷⁹ See J. T. Lang, ante, at p. 401.

¹⁸⁰ Para. 101 of Commission Decision.

¹⁸¹ Para. 69 of Commission Decision.

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The Commission concluded that the MSG alliance would achieve a dominant position in the upstream market for administration and technical services that would enable the parents to create or strengthen a dominant position in the downstream market for digital pay-TV services in which they would be active.

B. Case No IV/M.490 – NSD;¹⁸² 1995 OJ (L 53) 20

NSD is a very important case. NSD would be in the business of providing transponder capacity and the transmission and distribution of satellite TV channels to the Nordic market (Denmark, Sweden, Norway and Finland). It was set up with the aim to establish an attractive satellite position for transmission of TV signals to the Nordic countries. NSD would distribute satellite TV channels to direct-to-home users and to cable TV networks through the parents' distribution companies Viasat and Telenor CTV and through the parents' cable TV operators. Besides, NSD would create an integrated infrastructure for the distribution of satellite TV and other related services. Basically individual TV households would only need one decoder box irrespective of whether they received signals from cable TV networks or via a satellite dish antenna.

In rebutting the parties argument that the operation would lead to technical and economic progress, the Commission clarified that the problem resided not in the integrated character of the proposed infrastructure but rather in the vertical integration of the parents, which was not necessary for such infrastructure to be created. Further, the Commission held that in reality NSD would lead to reallocation of the already available transponder capacity to broadcasters in a way which favoured the interests of the parties whereas it would not add any capacity. The author is more interested in throwing light on the concept of potential competition and market power in a similar fashion to that adopted for the MSG case.

¹⁸² OJ (L 53) 20



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Transmission of a channel via satellite

The reader is introduced briefly to the process whereby a channel may be transmitted via satellite. It requires that TV signals be sent to an up-link station. Up-link is the process of sending a TV signal from an earth station to a satellite. From the up-link station the TV signals are sent to the satellite that transmits them. Satellites used for TV are placed in a geostationary orbit position and are therefore able to maintain a constant beam on a given territory. Each satellite contains several *transponders* that are elements on a satellite used to receive and transmit TV signals.

The TV signals are received by satellite dishes on the ground. The receivers can be either direct-to-home households with smaller dishes, or cable TV operators with one or more much larger dishes or SMATV operators. The latter consist in entities receiving the TV signals using a satellite master antenna and retransmitting the signal within a smaller network. They will rarely contract directly with the broadcasters, but will normally be customers of local cable operators.

The diagram which follows has been drawn to give the reader a clearer insight into NSD's parents' position.

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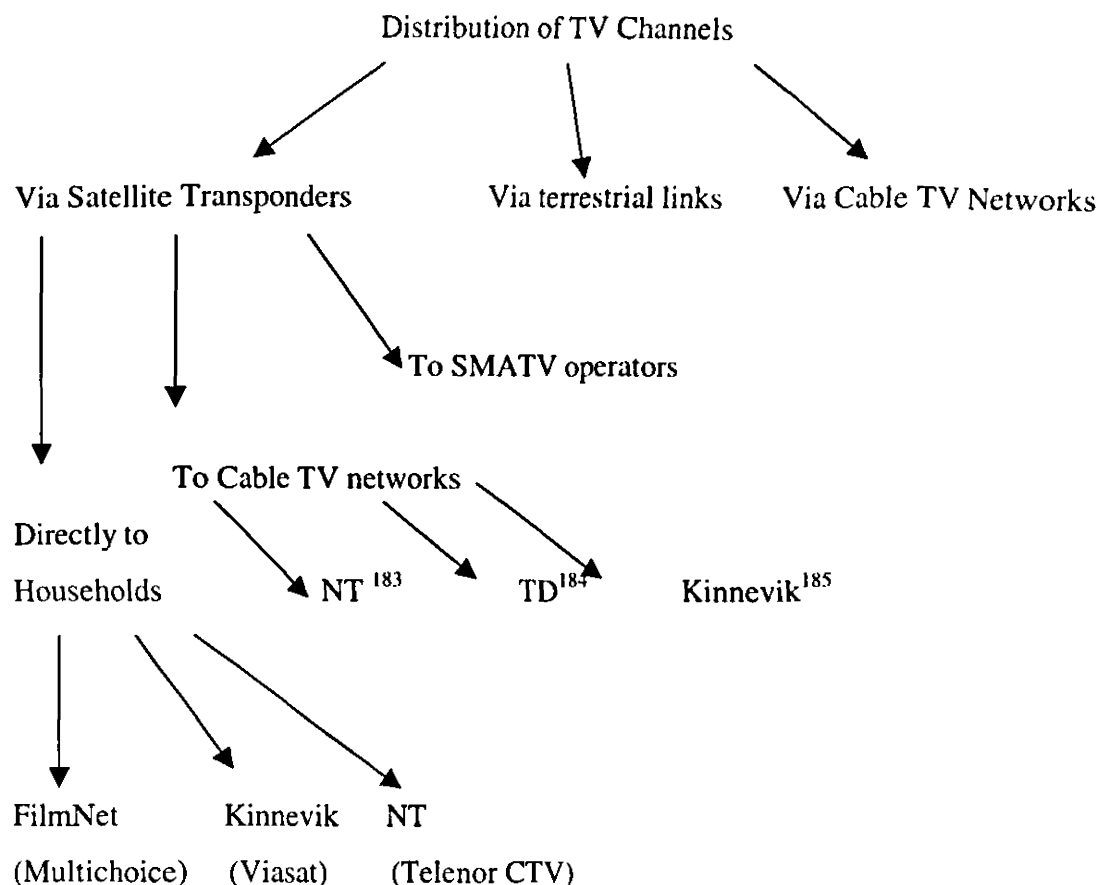
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¹⁸³ NT is a Norwegian company controlled by Telenor AS. The latter is the principal provider of telephone services in Norway. Further, it owns and/or leases transponder capacity from the satellites Thor, Intelsat and TV-Sat, situated at 1 degree West. NT owns, through a subsidiary, a large cable network in Norway. NT provides television distribution services to the direct-to-home market in Norway, Sweden and Finland and in Denmark through another subsidiary, namely Telenor CTV.

¹⁸⁴ TD is the Danish TO. It has the exclusive right to provide public voice telephony services and other related services in Denmark as well as to install and operate the Danish public telecommunications network. TD owns a national broadband distribution network called the Hybrid Network, which is currently used for the transmission of radio and television signals to local distribution networks. TD's cable subsidiaries distribute TV channels to its own and other local networks.

¹⁸⁵ Kinnevik is a private Swedish group of companies with activities mainly in forestry, farming, packaging materials. As regards television, media and telecommunications, Kinnevik owns companies which are active in satellite television broadcasting and pay-TV channels, in distribution of satellite television (the Viasat companies), conditional access systems and radio broadcasting. Further, Kinnevik has a 23% shareholding in the commercial television channel TV4 and a 37,4% shareholding in Kablevision AB, a cable TV operator in Sweden.

a. Intent To Control The Allocation Of Transponder capacity (a scarce resource) And Hence The Distribution Of TV Channels Via Satellite.

At the time there were five satellites in the position 1° W and 5° E.

Satellite:	Thor	Intelsat	TV-Sat	Sirius	Tele-X
Transponders:	five	ten	five	five	five
	↓	↓	↓	↓	↓
	Telenor	Telenor	Telenor	Kinnevik	Kinnevik
	owns &	reserved	leased it	& TD	& TD
	operates it	all 10	from DT	leased 4	leased 2

Thus NSD and its parents would control directly or indirectly a large majority of the capacity available for the Nordic region. Out of a total of 30 transponders, NSD would immediately lease 19.

The parties claimed that Astra and to a lesser extent Eutelsat were *actual competitors* to the Nordic satellites since direct-to-home households in the southern part of Scandinavia could receive signals from some of their transponders, and in fact 50 transponders were currently used for channels aimed at the Nordic households.

The Commission defeated their argument mainly on the ground that the satellites, which NSD would control, were aimed at Nordic viewers only whereas all channels on Astra and Eutelsat were in foreign languages and aimed at other non-Nordic countries; the fact that some of those channels, such as Eurosport and MTV, might be of interest to Nordic viewers did not render Astra and Eutelsat actual competitors to NSD's satellites. In any event, all the transponder capacity on Astra

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and Eutelsat was occupied whilst the market was currently characterised by a rise in demand and a shortage of supply.

The author places emphasis on the arguments substantiated by the Commission to dismiss any realistic possibility for significant competition from Astra or Eutelsat. *In setting out its arguments, the author seeks to indicate the strategic relevance of having Kinnevik as an ally, and also, the extent to which the Commission brings to the surface strategic aspects of Kinnevik's market power.*

(1) NSD's link to Kinnevik (as broadcaster)

NSD would offer a package of 15 to 30 programmes including the TV3 channels of Kinnevik. According to the parties TV3 could be watched by about 50% of all households in Sweden, Norway and Denmark. The Commission went on to stress that four out of five Nordic transponders on Astra were already leased by Kinnevik and used for its channel TV3. Drawing from the parties' admission that most dishes in the area (70% of which were currently directed to Astra) would be turned towards the Nordic satellites as soon as TV3 would move to them from Astra, the Commission attached emphasis to Kinnevik channels' "*pulling power*"¹⁸⁶ and concluded that there would be no real competition from Astra.

The "*pulling power*" of Kinnevik's TV3 explains why NT and TD chose to ally with Kinnevik rather than any other broadcaster. Cable TV operators indicated that 70% of their viewers watched regularly TV3, and therefore it was the most important channel for them to carry on their cable network, apart from the national terrestrially distributed channels. The viewers' preference for TV3 could be also evidenced by the fact that they incurred a cable TV subscription fee to be able to watch it, whereas for any terrestrially distributed channel they would avoid that cost.

(2) NSD's link to Kinnevik (as distributor of satellite TV channels)

In the Nordic area, most direct-to-home distributors sell the channels in packages (a bouquet of channels) of which some contain up to 25 channels of all types. There were currently three major distributors in the Nordic region: Multichoice, owned by FilmNet; Kinnevik, through its subsidiaries; and, NT, through its subsidiaries.

The NSD agreement which provided that a broadcaster transmitting from Astra or Eutelsat would be excluded from NSD's packages. This would put broadcasters other than those transmitting their channels through NSD's satellites in a very disadvantaged position. Two options would be open to those broadcasters: either to develop new packages competitive enough with those of NSD (but this would essentially mean competitive with Kinnevik's TV3) and this was very unlikely; or, to get onto FilmNet's package which could not be an attractive choice for a broadcaster once NSD would be set up.

The author draws the reader's attention to this aspect of the alliance. It is the prime example of an alliance which intends, or at least will unavoidably have the effect, to block the channel access for a parent's competitors. *It is even more interesting to consider why it would not be an attractive option for such competitors to go through other channels.* The author seeks to explain this by relying on the Commission's observation that Kinnevik had appeared to exercise "exclusionary" conduct in the past against FilmNet, a competitor of Kinnevik in the market of distribution of pay-TV channels to households. In 1993, Kablevision, in which Kinnevik owned 37,4% of the shares, stopped distributing FilmNet's pay-TV channels until the national competition authority had to intervene. Hence, the Commission emphasized that Kablevision's potential competitors will have to take into account, before taking any action, Kinnevik's influence over the strategies of its subsidiaries. *The author applauds the Commission for being eager to go into incidents of the parents' "exclusionary" market power.*

¹⁸⁶ Para. 88.

The parties put forward another argument, namely that *potential competition* would rise in the future in the market for transponder capacity because of the expected net increase in transponders.¹⁸⁷ Their major argument was that the introduction of digital technology would increase the capacity of a satellite by 5 to 10 times. *It is interesting to consider how the Commission defeated this argument and at the same time spelled out the defensive strategy of the parents.* Digitalisation on a commercial basis would take place within the next one or two years. The Commission explained that since NSD would control the transponder capacity of the Nordic satellites, it was not evident why digitalisation would make it more attractive for a potential new supplier of transponder capacity to supply transponder capacity directed towards the Nordic area. Eventually, any increase in transponder capacity would be absorbed by NSD.

b. Intent to control access to TV channels by cable TV operators in favour of its parents.

Besides, it is interesting to consider the third argument the Commission put forward to dismiss the likelihood for competition from Astra and Eutelsat in so far as it reveals the strategic significance for Kinnevik of allying with TD and NT and of the timing for such alliance. NT and DT controlled about 20-30% of approximately 5 million households connected to cable TV networks and SMATV networks in the Nordic countries. The Commission concluded that a broadcaster transmitting from Astra or Eutelsat should anticipate the possibility of exclusion from a larger part of Nordic viewers connected to cable networks in the digital environment since NSD would effectively be able to control a much larger part of cable TV network in the

¹⁸⁷ In addition, this increase was attributed to the following factors: (1) Astra had plans to launch a *new satellite* in 1995, which would increase its transponder capacity from 64 to 82, and another satellite in 1996, which would increase Astra's capacity to 102 transponders. Eutelsat had similar plans. The Commission did not take this argument easily as it highlighted that it would only be after 3 to 4 years that such additional transponders could become available. (2) *New parties* could be expected to launch and operate new satellites. The Commission responded to this argument by stating that it usually takes 5 years from the decision to build a new satellite until the satellite can begin transmitting. (3) Potential competitors could buy or lease an operative satellite in the second-hand market for operative satellites. Indeed, satellites situated between 1° W and 5° E at the time were second-hand. The Commission denied that it would be economically rational for a new company to enter the market for transponder capacity to the Nordic area by using second-hand satellites in the light of NSD's "Hot Bird" with all its competitive programming advantages transmitting 15 to 30 TV channels of which several are not accessible but by NSD.

Nordic region due to its role as a gate-keeper to the Nordic cable TV networks.¹⁸⁸ That function is described hereinafter. The market for access to, and operation of, cable TV networks is described in some more detail to show the position that TD enjoyed.¹⁸⁹ It must be stated that the number of cable TV connections was expected to grow slowly in the coming years, since most of the areas where it was *economically sensible* to lay cables have by now been cabled.

In Denmark, the largest cable TV network was owned and operated by a subsidiary of TD, namely TD Kabel TV and supplied approximately 50% of all households connected to cable TV and SMATV. The second largest operator was Stofa AS, which is controlled by Telia, the Swedish TO. It had not been possible to enter the Danish cable TV market with full-scale operations as TD had a legal monopoly on the ownership of the commercial cable TV infrastructure and the transmission of TV signals by cable across municipal borders. According to the liberalisation scheme laid down by the Danish Parliament, by 1st July 1995 cable operators other than TD would have been allowed to own cable network infrastructure but, until 1st January 1998, they would have been excluded from offering cross-municipal-border transmission of signals in their own infrastructure; they would merely get the right to make use of TD's infrastructure on a leased-line basis.

The Commission held that this feature of the Danish liberalisation scheme entailed the following advantages for TD and disadvantages for its competitors: (a) TD's competitors were denied *the economies of scale* from which TD currently benefited; (b) TD was put in a position where it would obtain *knowledge about the strategic considerations of their competitors*, since all offers made by the competitors

¹⁸⁸ That role was analysed by the Commission in para. 131 of its decision and will be analysed hereinafter.

¹⁸⁹ Therefore, only the situation in Denmark is material. The situation in Norway: Telenor Avidi, owned by NT, was the largest cable TV operator with about 30% of all connections, but the second largest operator enjoyed a 22% market share and the third largest a 20%. Hence, the Commission accepted the Norwegian Competition Authority's conviction that direct competition between cable TV operators was to a large extent possible, since about two-thirds of all connected households have the possibility of choosing an alternative cable TV supplier. Furthermore, the Norwegian TV market was expected to grow by 2-3% per year. The situation in Sweden: the Cable Act was adopted in 1992 and removed all legal barriers to entry. Svenska Kabel-TV AB, which is owned by Telia AB, is the dominant operator with approximately 50% of all connections. The second largest cable operator is Kablevision AB with 18% of all connections. Two smaller cable operators (each with around 9% of all connections) entered the market.

of TD would necessarily involve a contractual relationship with TD regarding the use of TD's infrastructure, in contrast with TD itself, which could make an offer without being forced to negotiate the terms for using another's company infrastructure. The Commission concluded that although the legal situation was expected to change, the heavy investment needed to build up a cable network, together with the dominant position already held by TD, made entry by competitors unlikely.

Of most interest is to consider how the creation of NSD would affect TD's dominant position. The Commission noted that due to the dominant position of NSD on the transponder market, cable TV operators would have to negotiate with NSD to obtain a TV channel rather than directly with broadcasters, as was the practice at the time. (This was reinforced by the fact that NSD would obtain exclusivity for some channels and thus even independent *broadcasters* will have to negotiate directly with it.) *"The establishment of NSD will therefore lead to an important change in the negotiating position of cable TV operators".*¹⁹⁰ Further, it revealed that, albeit in principle they could get programmes from Astra or other satellites not controlled by NSD and in such a case they would negotiate directly with broadcasters, only non-Nordic language channels would be available on Astra or other satellites. The Commission held also that NSD would be *in a position to price-discriminate or impose terms on independent cable operators in favour of the cable operators owned by the parents* or in favour of its direct-to-home operations.¹⁹¹

Therefore, NSD would strengthen TD's dominance.

c. *Intent to control broadcasters' access to cable TV networks: the "gate-keeper" function.*

The reader need be introduced to the technical Infrastructure for satellite Pay-TV and the specific infrastructure that NSD would build up.

¹⁹⁰ Para.126 of Commission decision.

¹⁹¹ Para.128, *ibid.* And even if there was no discrimination, NSD would still be able to exploit its position on the cable TV markets due to its dominant position on the transponder market.

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In the Nordic area, all channels broadcast by satellite are encrypted in contrast to other parts of Europe. When encryption takes place, a datastream is inserted along with the TV signal for use by the conditional access system. To receive encrypted TV signals a consumer needs a decoder. If an *open* encryption system is used, a personal smart card is made available to the viewer which is inserted into the decoder to scan through the datastream that comes along with the TV signal to find out if its identity is present. If it does find it, then the TV signal is decrypted and passes onto the TV set. From the consumer's standpoint, an open system means that decoders are available from many sources and that the consumer can, with the same decoder, receive TV signals in different open systems simply by changing the smart card. In contrast to the rest of Europe, in the Nordic region open encryption systems are used.¹⁹²

It was the intention of NSD's parents to implement a joint Nordic encryption system and a joint Nordic head-end. NSD would control the system and the head-end. It planned to offer transparent transmission. Such a service would be economically attractive to many cable TV operators, since they could eliminate an encoding and decoding system in each head-end and thereby reduce technology. Some independent cable TV operators had hundreds of head-ends or more and need a decoder for each channel in each head-end, with current technology. Considering the economic benefits for cable households and the fact that subscribers connected to the cable networks would not notice any difference, if NSD provided transparent transmission, it would be difficult for a small cable TV operator to refuse such a solution.

The Commission concluded that it should be foreseen that by controlling such a system, NSD would be in a position to strengthen its function as a gate-keeper for broadcasters wishing to get access to the Nordic cable networks. It would be very difficult for a broadcaster without access to NSD's system for encryption to get access to cable networks, should such a system be developed.¹⁹³ Thus, Kinnevik's position would be strengthened.

¹⁹² Where a *closed* encryption system is used, it is necessary for the consumer to purchase or hire a special decoder to receive TV signals encrypted in this way. In turn, it means that the households have to buy or rent an additional decoder, if they want to receive TV signals which are encrypted in another system.

¹⁹³ Para. 131, *ibid.*

5.2.2 Co-ordination Of Parents' Competitive Behaviour

So far, the Commission has been considering issues of conduct related to the multi-point presence of competitors separately from issues of market power. In particular, an issue which has caused concern consisted in the likelihood that the parents would co-ordinate their competitive behaviour in case they retained significant economic activities in markets which are upstream, downstream or neighbouring but closely related to the market wherein the JV is set up.¹⁹⁴ Naturally, such likelihood of co-ordination should be anticipated to be greater the more linked the parents are: that is the more interrelationships they enjoy in common. Rather than employing the very framework of the ECMR for the control of such likelihood, traditional perception of competition law directed that Article 81 (ex Article 85) EC Treaty be adopted, on the ground that co-ordination of behaviour is a "behavioural issue", and therefore outside the ambit of the "structure" oriented ECMR.

Before proceeding with the analysis of the Article 81 framework, the author wishes to submit that the limitation of this approach can be revealed by the already delivered decisions of the Commission. In none but one of the cases that are hereinafter reviewed did the Commission reach the conclusion that the creation of the JV was intended to, or would in effect, lead to co-ordination of the parents' behaviour: this does not question the appraisal it carried out; rather, in the author's opinion, it indicates that the prevailing objective of the parents in setting up the JV is formulated in terms of their position in the market and is targeted at reinforcing that position rather than to co-ordinate the way they conduct business. In the one and only case where the Commission identified a risk of co-ordination, co-ordination was over *access to the market for content*.

Article 2(4) ECMR reads as follows: "to the extent that the creation of a joint venture constituting a concentration pursuant to Article 3 has as its object or effect the co-ordination of the competitive behaviour of the undertakings that remain

independent, such co-ordination shall be appraised in accordance with the criteria of Article 85(1) and (3) of the Treaty, with a view to establishing whether or not the operation is compatible with the common market". Incompatibility with the common market will be upheld, if "the co-ordination, which is the direct consequence of the creation of the joint venture affords the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products or services in question".¹⁹⁵

By definition, a FFJV is an undertaking which remains independent from its parents. Therefore, the above reference to '*undertakings that remain independent*' shall be taken to include each of the parents and the FFJV itself. The Commission defines candidate markets for co-ordination as those on which the JV and *at least two* parent companies are active, or markets which are upstream or downstream to that of the JV and where at least two parents retain significant activities, or closely related neighbouring markets where at least two parent companies remain active.¹⁹⁶ The EC Commission Notice On The Distinction Between Concentrative And Cooperative Joint Ventures ("hereinafter, the 1994 Notice")¹⁹⁷ clarifies that the co-ordination of the competitive behaviour *between the parent companies and the JV* is relevant only in so far as it is *an instrument* for producing or reinforcing the co-ordination *between the parent companies*.¹⁹⁸ The 1994 Notice goes on to explain that the Commission will be concerned about co-ordination *between the parent companies* in relation to *prices, markets, output or innovation*.¹⁹⁹

¹⁹⁴ Article 2(4) ECMR as amended, subparagraph 2(a).

¹⁹⁵ Article 2(4) ECMR as amended, subparagraph 2(b).

¹⁹⁶ See para. 29 Commission Decision in Case No. IV/JV.1 – Telia / Telenor / Schibsted.

¹⁹⁷ 1994 OJ (C 385) 001 of 31/12/1994. The Notice has not been superseded as regards the notion of "*co-ordination*" of competitive behaviour that the Commission investigates.

¹⁹⁸ See para. 17 Hawk & Huser (post., at p.43), commending on the 1994 Notice, said that the co-ordination of the competitive behaviour between the parent companies and the JV would in any event indicate that the JV would merely be a 'single-function' entity. This reasoning is followed in the Commission Notice on the concept of FFJVs: paragraph 14 dictates that *'the strong presence of the parent companies in upstream or downstream markets is a factor to be taken into consideration in assessing the full-function character of a JV'*. However, F. E. Gonzalez-Diaz ("JVs: The New Boundaries") underlines that *"it was never argued that Article 85(1) did not apply at all and, in any event, reference was always made to co-ordination between companies remaining independent, thus leaving the door open to the possibility of taking into account this type of spillover effect under certain circumstances. The practical result was the same since the Commission never applied Article 85(1) simultaneously to these effects even if the possibility was there"*.

¹⁹⁹ See para. 17.

It then suggests various scenarios which may raise concerns about the likelihood of co-ordination. Amongst others, the following are noted:

- (a) *“Where two or more parent companies have a significant activity in a neighbouring market and this neighbouring market is of significant economic importance compared with that of the JV, the collaboration of the parent companies within the JV may lead to the co-ordination of the parent companies’ competitive behaviour on this neighbouring market.”*²⁰⁰

In this context, a neighbouring market is a separate but closely related market to that of the JV, both markets having common characteristics including technology, customers or competitors.²⁰¹ However, it should be clarified that a ‘neighbouring market’ need not be in a different geographic market. Indeed, the scenario described above, appears in the 1994 Notice under the heading 3.1 on “Product Market” rather than under the heading 3.2 on “Geographic Market”. Hawk & Huser suggest that “the concept of ‘neighbouring market’ may include complementary or ‘full line’ product markets exhibiting a high degree of structural linkage with the JV’s specific product lines”.²⁰² “A separate ‘technology’ or ‘innovation’ market probably also falls within this concept”.²⁰³ Nevertheless, the NC / Canal+ / CDPQ / BankAmerica case, which will be discussed hereinafter, has been described as a “co-ordination in a neighbouring market” case, probably because it literally raised that concern in a geographically neighbouring market.

- (b) *“Where the parent companies or the joint venture specialise in segments of an overall product market, unless these segments are of minor importance in view of the main activities of the parent*

²⁰⁰ See para. 18, sub-para. 7 of the 1994 Notice.

²⁰¹ Ibid.

²⁰² (1996) *European Community Merger Control: A practitioner’s Guide* (Kluwer Law International) p.58

²⁰³ Ibid.; at footnote 208 they explain that in Case No. IV/M.269 Shell/Montecatini of 3/6/1994, O.J. (L 322) 48 the Commission described the ‘technology’ market as ‘upstream’ but applied the ‘neighbouring’ spillover market analysis.

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companies or of the joint venture respectively or there are objective reasons for the parent companies to retain the activities outside the JV, for instance because of the technology involved. In the latter case each of the parent companies retains a genuine interest in their specific segments. The existence of the JV does not normally of itself justify the assumption that they would co-ordinate their behaviour with regard to these activities.”

The NSD case presents an aspect falling within this scenario. The Commission found that there was competition between NT and TD (i.e. between two of the parents) in the market for TV up-linking services to the satellite. Both parents currently provided those services from their respective countries, but the insignificance of that market in economic terms was taken to show clearly that the operation had neither the object nor the effect of co-ordinating the activities of the parent companies with respect to services outside the field of the NSD alliance. The TELIA / TELENOR / SCHIBSTED case is also relevant in the context of this scenario and will be discussed in some more detail.

- (c) *“Where a network of cooperative links already exists between the parent companies in the JV’s market, the main object or effect of the JV is to add a further link and thereby strengthen already existing co-ordination of competitive behaviour”.*

This paragraph goes deeper into the concept of “two or more parents remaining active in the JV’s market” by interpreting it to include situations where two or more parents participate not necessarily as sole companies but also as participants in pre-existing JVs operating in the JV’s market. Pursuant to Article 2(4) ECMR, we should be able to extend the “JV’s market” to “markets which are upstream, downstream or neighbouring but closely related to the JV market”. Cases which appear to be relevant under this scenario include the MSG case and the FT/DT/ENEL case and NC/ Canal+ /CDPQ/BankAmerica.

- (d) *“Where either of the parent companies and the JV are all in different geographic markets, the Commission will examine closely the likelihood of co-ordination between the parents. In doing so, it will consider the interaction between markets, and foreseeable developments in the emergence of wider geographic markets, particularly in the light of the market integration process in the Community”.*²⁰⁴

The Commission was in fact faced with this scenario in the FT /DT / ENEL case, which will be discussed hereinafter.

The Commission has not as yet issued guidelines on the application of Article 2(4), albeit it does intend to do so in the future.²⁰⁵ Pending the issue of such guidelines, the author will attempt to reveal the approach taken by the Commission in its already delivered case-law. For obvious reasons the decisions are discussed according to the chronological order of their delivery.

5.2.2.1 CASE NO. IV/JV.1 – TELIA/TELENOR/SCHIBSTED, decision delivered on 27 May 1998.²⁰⁶

The business object of the alliance

The JV company (“NewCol”) would take over the assets and activities of Telia InfoMedia and Scandinavia On-Line AB (SOL). It would be active in two markets: first, the Internet gateway services; and, secondly, the web site production for third parties and related programming. “Internet gateway services” essentially mean that through the gateway, consumers and businesses can have access to a range of services presently offered by SOL and InfoMedia, such as financial information, games,

²⁰⁴ See para. 19, sub-para. 1 of the 1994 Notice. And see: *“The same applies where one of the parent companies and the JV are in the same geographic market, while the other parent companies are all in different geographic markets.”*

²⁰⁵ See footnote 3 of EC Commission Notice On The Concept Of Full-Function Joint Ventures, 1998 OJ (C 066).

²⁰⁶ Available in the CELEX database document no. 398J0001

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business information, shopping, travel, ticket sales, etc. NewCol would produce its services in the Swedish language.

The parents' business

Telia AB is wholly owned by the Swedish State and is the main TO in Sweden, providing a broad range of telecommunications services both in Sweden and abroad, including enhanced services through its shareholding in Unisource. It is also an Internet service provider ("ISP"). Internet services in the Swedish language are provided by Telia InfoMedia Interactive AB.

Telenor AS is the main Norwegian TO. Its subsidiary Telenor Nextel AS offers a number of Internet related services. It is a 33% shareholder in Telenordia (together with BT, TeleDanmark), which provides telecommunications services in the Swedish market. Telenordia's subsidiary Algonet is an ISP on the Swedish market.

The Schibsted Norwegian group, is involved in a range of media-related activities such as newspapers, television, films and multimedia. Its subsidiary, Schibsted Multimedia AS, has a number of Internet related activities, including the provision of content, in Sweden via Scandinavia On-Line AB, which is jointly owned by Telenor AS. Schibsted also has a stake in Aftonbladet, a newspaper in Sweden, which also has an Internet edition.

In this case the Commission found that no concerns were raised about the creation or strengthening of a dominant position, and therefore it proceeded with examining whether there was a risk of co-ordination of competitive behaviour.²⁰⁷

Relevant Markets For Co-ordination of Competitive Behaviour

Concerning the market for the provision of advertising over the Internet, it found that only Schibsted Multimedia AS remained active on it after the creation of the JV. Therefore it excluded it from the candidate markets for co-ordination.

Concerning the market for subscriber content provision over the Internet, it found that none of the parent companies would remain active on the same product market as the JV following the operation. Telenor Nextel AS and Schibsted Multimedia AS were active on it through Scandinavia OnLine AB (common subsidiary) but transferred all their activities to this JV. Therefore it excluded this market from the candidates for co-ordination.

However, the Commission found the market for the *production of web sites* to be a relevant product market for co-ordination. The geographic market was confined to Sweden or Swedish-speaking territories. Two of the parent companies remained active on it: namely, Telia through its subsidiary Telia Promontor AB, and Telenor Nextel, through Bonnier Telenor Foretagsinfo AB. (InfoMedia, which was also active in this market, would be contributed to the JV.)

²⁰⁷ The Commission distinguished three markets as relevant for the purposes of applying the dominance test: first, content provision; secondly, advertising on the Internet; thirdly, the production of web sites. Eventually, the Commission accepted that since content provision would be offered for free than on a paid-for basis, it could be brought within the market for Internet advertising.²⁰⁷ The Commission identified a fourth market, namely the provision of access to the Internet to end users, in respect with which it held that "*(t)he NewCol itself is not present on this dial up Internet access market, but two of its parents (Telia and Telenor) are, and it is clearly closely related to NewCol's markets. It is accordingly not a relevant market for the assessment of dominance, but it is considered further from the viewpoint of co-ordination*". As regards the relevant geographic market, the Commission found that it was national in scope on a linguistic basis. Applying the dominance test to the operation in the context of Internet advertising, the Commission concluded that such market is a rapidly growing market with many actors, and therefore the parents' market shares would not create or strengthen a dominant position.²⁰⁷ Applying the test in the context of web site production, the Commission reached the same conclusion.²⁰⁷ Hence the structural effects of the creation of the JV were declared compatible with the common market.

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Similarly, the Commission found the *dial-up Internet access market* to be a candidate market for co-ordination. Access to the Internet is a necessary prerequisite for the use of any Internet service. The dial-up Internet access market must therefore be considered as a market upstream to the JV's market and, consequently, as a market closely related to the JV's. Both Telia and Telenordia (Algonet) provided dial up Internet access to users. The relevant geographic market was confined to Sweden.

Assessment of Co-ordination

The parties submitted that co-ordination of the competitive behaviour between the parent companies was not the *object* of the creation of the JV. In turn, the Commission held that "*in the absence of clear indications to prove that such an object is pursued, an intended co-ordination of the parent companies' behaviour cannot be established*".²⁰⁸

Thus the Commission proceeded on with examining whether the creation of the JV would have the *effect* of co-ordinating the parents' competitive behaviour. It explained that "*this question has to be examined separately for the web site production market and for the dial up Internet access market*".²⁰⁹

(a) The combined market share of the parent companies *on the web site production market* in Sweden would not exceed 5%. Nor would the JV's market share exceed 5%. It could therefore be inferred that, even if the parties were to co-ordinate their activities, any restriction of competition would not be '*appreciable*'.²¹⁰ It flowed from this conclusion that it was "*not necessary to establish a causal link between the creation of the JV and the behaviour of the parent companies outside the JV on this closely related market*".²¹¹

²⁰⁸ See para. 38 of the Commission's decision.

²⁰⁹ Ibid.

²¹⁰ See para. 40, *ibid.*

²¹¹ Para. 41, *ibid.*

(b) The *dial up Internet access market* is characterised by a high rate of growth (approximately 30%). This is due to the fact that there are relatively low barriers to entry: the costs of starting a small ISP providing a dial up service are low and small companies can and do provide dial up Internet access. Entry is possible both from local start-up ISPs and global ISPs entering the Swedish market. In addition, as the market is very price sensitive, in particular given the low switching costs, this would prevent higher prices through co-ordination from being sustained: any increase in prices would result in the parties quickly losing market share to rival companies as new subscribers opted for lower offerings. Telia has 25-40% of the market. Telenordia has 10-25% of the market. However, if the market share of Telenordia were to be attributed to Telenor (the holding company), their total market share would be 35-65%. The largest service provider offering dial-up Internet access market is Tele2, a telecommunications company which is a member of the Kinnevik Group, a leading Nordic media company: it has 40-50% of the market. Having said out these figures, the Commission concluded that *“(m)arket shares are of limited significance on this growing market. In any case, the combined market share of Telia and Telenordia has fallen by between 15% and 20% of the total market over the last nine months”*.²¹² In brief, the Commission held that *“the market structure is not conducive to co-ordination of competitive behaviour”*.²¹³

Most interestingly, the Commission went on to consider the ‘likelihood’ of co-ordination. It stated that “the relative size of the markets for Internet advertising, content and web site production (the markets of the JV) compared with that of dial-up Internet access is relevant to the likelihood of co-ordination”.²¹⁴ Looking into this matter, it concluded that the dial-up Internet access market is substantially larger than the other markets mentioned above (the proportion of revenues from Internet access to other services was 93% to 7%), and therefore “the likelihood of co-ordination is reduced further”.²¹⁵ *The author attaches emphasis to this statement. It is meritorious in so far as the Commission appears to take into consideration the economic relevance of JV for its parents. But the author wishes to highlight that the above*

²¹² Para. 43, *ibid.*

²¹³ Para. 44, *ibid.*

²¹⁴ Para. 45, *ibid.*

²¹⁵ *ibid.*

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finding should also go toward confirming that the strategic relevance of the JV for its parents resides not in its effect on their behaviour but rather on their position vis-à-vis potential competitors.

5.2.2.2 CASE NO. IV/JV.2 – ENEL / FT / DT, decision delivered on 22 June 1998²¹⁶

The business object of the alliance

The alliance, Wind Telecomunicazioni Spa (“Wind”), was concluded in order to provide a full range of telecommunications services, combining mobile and fixed line, in Italy in competition with the incumbent TO, namely Telecom Italia, and other new market entrants.

The parents’ business

FT is the main TO in France, providing a full range of services including analogue and GSM mobile services. DT is the main TO in Germany providing the same range of services. FT and DT do not have any direct telecommunications activities in Italy but they do operate in Italy through GlobalOne, a JV they had set up together with Sprint Corporation for the provision of advanced services to corporate users.

ENEL is the principal provider of electricity in Italy, both to domestic and industrial users. ENEL already owns and operates a telecommunications network along its electricity grid which it has been using still now for its own telecommunications needs.

²¹⁶ Available in the CELEX database, doc. No.398J002

The JV Agreement

The proposed operation consisted of the Shareholders' Agreement, a Pooling Agreement between FT and DT, a Backbone Lease Agreement between ENEL and Wind, and a General Agreement for the Provision of Services. In the latter, the parties agreed that ENEL would outsource its telecommunications needs on an exclusive basis to Wind and that Wind would be appointed as the exclusive distributor of GlobalOne's services in Italy.

Relevant Market For Co-ordination Of Competitive Behaviour

After having leased its telecommunications network to Wind, ENEL could no longer be regarded as a competitor on any markets. Thus the Commission stated that only the relationship between FT and DT demanded analysis. It noted that neither FT nor DT were active in the market for domestic and international voice and data telecommunications services in Italy. It held that in view of the substantial investments in Wind which the parties have already made or will have to make, it is unlikely that they would enter these markets on their own in the future. *"This is reflected by their agreement not to compete with each other on these markets".*²¹⁷ It then went on to identify the market for such services in France and Germany, where the FT and DT are in fact active, as markets closely related to that of the JV, and therefore falling within the ambit of Article 2(4).

Assessment Of Co-ordination

The Commission stated that both FT and DT are dominant in their national markets for domestic and international voice and data communications. FT and DT could be considered as (at least) potential competitors on the German and French markets, respectively. However, FT has not so far expanded its operations to Germany to any important degree since it sold its shares in Info AG in the context of the Atlas/GlobalOne transaction. Neither has DT entered the French markets to any noticeable degree. The Commission stated that this was their deliberate choice against

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the fact that there were possibilities for competing with each other in their respective home markets because of liberalisation in the sector. *“The lack of competition on their respective markets in the past therefore appears to stem from a deliberate choice on the part of these companies. It is not possible to claim with the requisite degree of certainty that such lack of competition (if it were to continue in the future) would be the result of the creation of Wind”.*²¹⁸

Besides, the Commission acknowledged that both FT and DT would in the future be able to route their traffic through the network of Wind, and thereby they might be given certain advantages over their competitors. However, there was no indication that this would result in a co-ordination of the competitive behaviour of these two companies.²¹⁹ It concluded that there was no likelihood that the operation of the JV would lead to co-ordination of the competitive behaviour of the parties, and therefore it was not necessary to establish a causal link between the creation of the JV and the behaviour of the parent companies outside the market of the JV.

The author underlines that this case, too, goes toward demonstrating that the strategic relevance of the JV for its parents lied not in facilitating co-ordination of their behaviour but rather in strengthening the position of the parents in their core markets and strengthening their interrelationships with competitors in peripheral markets where they met again.

The Commission's line of reasoning appeared to be as follows: “no potential for competition exists” means that “potential competition cannot be eliminated”. It is the same thing as saying “You cannot steal something that does not exist”. The question should be, though, “why does it not exist?”. Obviously, “because of previously prescribed non-competition”. Is it fine to let it go then? We should pose the following question: is the lack of causal link more important for competition law than the addition of another non-competition instance? “Want this facilitate firms to interweave a network of SAs?” The author submits that we should rule upon such

²¹⁷ para.31 of Commission Decision

²¹⁸ *ibid.*, para.37.

²¹⁹ *ibid.*, para. 38.

cases more carefully, considering that it may be the strategic intent of the parents to actually create such a network in apprehension of multipoint competition.

Apparently, in the FT/DT/ENEL case the Commission adopted the same methodology as regards how to establish a causal link as it had done in Case No IV/M.469 – MSG. Bertelsmann and Kirch, two of the three parents to the MSG alliance, had been already *linked* by way of sharing control, together with Canal Plus, in another joint venture, namely Premiere, which was established in order to operate analogue pay-TV and provide the services required for its operation. In particular, the partners to Premiere undertook (*“as a specific measure embodying their company – law obligations in the joint venture”*) not to participate in any other German-language pay-TV service for the duration of their joint venture, without the agreement of the other partners. By way of the Premiere alliance, they both added to their portfolio a core strength in service provision as pay-TV broadcasters. The Commission originally accepted that the co-operation of Bertelsmann with Kirch, which resulted from the Premiere alliance did not necessarily implicate either that additional co-ordination of their competitive behaviour was intended or that, in effect, would be caused, by their participation in MSG.²²⁰ Rather, any future cooperation in the supply of pay-TV programmes would still be accruing from the “non-competition” clause in the Premiere agreement. There would be no causal link with MSG.

However, the following point is remarkable. The Commission came back to this issue, highlighting the importance of the clause in the context of the assessment of dominance. It explained that non-competition between Kirch and Bertelsmann is *“perhaps less important in the case of analogue television, since, given the shortage of available transmission channels, the possibility of new pay-TV programmes is in any event limited. However, with the increase in transmission capacities following digitalisation, both Bertelsmann and Kirch will have the possibility of supplying a much larger range of programmes on the market. Against this background, the competition ban acts as a restriction of competition to a much greater extent than previously.”*²²¹

²²⁰ Para. 14 of Commission Decision.

²²¹ Para. 80 of Commission Decision.

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In other words, the Commission appeared to accept that dominance resides in the ability of a firm to prevent competition (as a result of which it can act independently of its competitors); bearing this in mind, it detected the strategic intent of Bertelsmann and Kirch as being to defend the potential for competition between them that would be brought about by increase in capacity induced by digitalisation. The author finds it interesting that since the MSG case was decided under the ECMR before its amendment, and thus altogether under the dominance test, it is a case which evidences that we can place the right weight on the non-competition between the parents, if we read it in the light of the strategic intent underlying the creation of the JV rather than in the context of the causal link with the co-ordination of competitive behaviour of the parents.

5.2.2.3 CASE NO. IV/M.1327 – NC/CANAL+/CDPQ/BANK AMERICA,
decision delivered on 3 December 1998.²²²

The business of the alliance

NCH,²²³ an already existing entity, would continue to operate on a long term basis in cable television services. Its cable networks would be used to provide high-speed cable modem-access to the Internet and perhaps data and voice telephony services. It was expected that, if this transaction were approved, NCH would also have the resources to expand the scope of its activities in telephony provision.

²²² Available in the CELEX database, doc. No. 398M1327.

²²³ The proposed operation consisted in the acquisition of joint control over NCH by Canal +, CDPQ and BankAmerica. At the time the operation was proposed, Canal+ owned 99.9% of the share capital of NCH. The proposed transaction was therefore, in essence, an increase in NCH's capital. In fact, BankAmerica and CDPQ entered the transaction through an acquisition vehicle, namely "Exante". The resulting shareholdings were as follows: Canal+ 63%; Exante 37%. An interesting point in the light of this thesis is that control over NCH on the part of Exante was justified on the ground that they would be in a position to veto rights, such as the Annual Budget and the Business Plan, which determine the strategic behaviour of NCH. It is already recognised that control over strategy constitutes an ingredient for establishing "concentration". (para. 8 of Commission Decision).

The parents' business

Canal + is a French company that, with its affiliates, is active mainly in pay television broadcasting, the distribution of television services by cable and satellite and the production and distribution of programming.

Canal+ owns jointly (with Prisa+) Sogecable: the latter operates in terrestrial/analogue pay-TV and in digital satellite pay-TV (Canal Satellite Digital).

BankAmerica forms part of the corporate group of BankAmerica Corporation which provides diverse financial products and services to individuals, businesses, government agencies and financial institutions throughout the world.

CDPQ is a wholly owned subsidiary of Caisse de dépôt et placement du Québec (henceforth « Caisse de dépôt »). The latter is a portfolio management company which invests the funds entrusted to it by Quebec public pension and insurance plans as well as various public bodies. The activity of CDPQ is to invest in companies operating in all areas related to communications, including audio-visual production, wireless technology, multimedia, publishing and media.

The BankAmerica and CDPQ's groups have controlling interests in Cableuropa, a company which started providing cable pay-TV services in Valencia in September 1998 and has been granted licences to operate in Sevilla, Mallorca and other Spanish regions.

NCH's sole asset is 99.9% of the shares of NC NumeriCable ("NumeriCable"), previously known as Compagnie Generale de Videocommunication), a French societe en nom collectif. NumeriCable operates cable television networks in France through controlled subsidiaries.

The Commission found that no concerns were raised about the creation or strengthening of a dominant position, and therefore it proceeded with examining whether there was a risk of co-ordination.²²⁴

Relevant Market For Co-ordination Of Competitive Behaviour

The Commission identified the pay-TV market in Spain as a relevant market.²²⁵ This was based on Article 2(4) second sub-paragraph of the ECMR as amended, which provides that in the assessment of co-ordination attention shall be paid to whether the parent companies retain to a significant extent activities in *a neighbouring market closely related* to the market of the joint venture.

The Commission noted the following: first, Cableuropa (a “child” of BankAmerica and CDPQ”), via the operation of cable networks, would be a *future* significant competitor to Sogecable (a “child” of Canal+) which enjoyed a very strong market position in the Spanish pay-TV market; and secondly, CableEuropa was a buyer of pay-TV rights from Sogecable (i.e. Cableuropa was *vertically related* with Sogecable). Since Cableuropa was under the joint control of BankAmerica and CDPQ and Sogecable was under the joint control of Prisa and Canal+, it was concluded that the parents of NCH did retain activities in Spain, a neighbouring market, and to a significant extent.

Assessment Of Co-ordination

Thus, the Commission decided to proceed with the assessment of whether *the link created* by the notified operation, i.e. the setting up of NCH as a joint venture,

²²⁴ The Commission defined the *relevant market* for the purpose of assessing the creation or strengthening of a dominant position as being the pay-TV market in France or in French speaking territories in Europe (because NCH is mainly active in cable television distribution in France, whereas it is only experimenting to enter in the field of Internet access and telecommunications services. See para. 14 of the decision). It then found that the concentration would not have any negative effect on competition in the relevant product market: (a) there were competitors of approximately equal market shares on the market, such as France Telecom Cable (20-30%), Lyonnaise Communications (20-30%) and ANOC (15-25%) – NCH itself also had (20-30%). These figures were based on subscriptions. Hence, the Commission concluded that the concentration would only give the NCH an improved financial position.

would have an impact on competition in the Spanish pay-TV market and / or in the Spanish market for the wholesale supply of films and sports channels for retail pay-TV.

Eventually, the Commission found that there was not enough evidence to support the conclusion that the acquisition of joint-control in NCH had the *object* of co-ordinating the competitive behaviour of Sogecable and Cableuropa. But it did not decline to say that it might have the *effect* of co-ordinating their competitive behaviour. The methodology it adopted in looking into this issue was the following:

- (a) It examined the *current structure* of the pay-TV market and of the market for the wholesale supply of films and sports channels for retail pay-TV in Spain;
- (b) It then assessed whether there was a risk of *horizontal* co-ordination between Sogecable and Cableuropa as a result of the operation;
- (c) It went on to assess whether there was a risk of *vertical* co-ordination between them as a result of the operation.

On point (a), the Commission concluded that the current structure of the relevant markets in Spain was characterised by a very strong market position of one of its players, namely Sogecable, and a highly concentrated market with *links* among all market players in a number of joint ventures!

- (i) Sogecable had by far the largest number of subscribers for *terrestrial / analogue* pay-TV (1-2 million) and for *digital satellite* pay-TV (100,000 – 1m.) vis-à-vis Telefonica with 100,000 – 500,000 subscribers for *digital satellite* pay-TV and Retevision, which was just a new entrant in the sense that it was licensed to operate in *cable* pay-TV in the near future and thus it did not possess any market share, yet. It is repeated that Cableuropa could be the most significant future competitor of Sogecable as a *cable* pay-TV operator. Apart from that, Telefonica was licensed, and therefore was expect to enter the market, for the operation of *cable* pay-TV.

²²⁵ See para. 15 of Commission Decision.

- (ii) Besides, Sogecable and its subsidiaries had control of the most important premium pay-TV contents, necessary to operate in the pay-TV market, stemming from exclusive contracts with most of the Hollywood major studios such as Paramount, Universal, Sony/Columbia, Warner, Fox. It further had control over the most important pay-per view football rights in Spain via Canal Satellite Digital and Audiovisual Sport.
- (iii) Both Telefonica and Sogecable have shareholdings in Audiovisual Sport, which has *the power to exploit* the football rights for the Spanish Premier League; the exclusive rights' holder, however, remains Canal Satellite Digital (subsidiary of Sogecable!).
- (iv) Cableuropa and Retevision jointly control CTC in Catalonia.

On point (b), the Commission concluded that the possibility of horizontal co-ordination between Sogecable and Cableuropa should be excluded.

- (i) Cableuropa was a new entrant in the Spanish pay-TV market, and therefore it needed to get as many subscribers as possible in its start up phase; this fact alone should render unlikely any co-ordination with Sogecable *on prices*.
- (ii) Cableuropa offered an unbundled package of services (internet, telephony, pay-TV) whereas Sogecable offered solely pay-TV services; this fact should render more unlikely a possible horizontal co-ordination of their competitive behaviour.

On point (c) – risk of vertical co-ordination - the Commission noted that “Cableuropa’s parents are now, and will continue in the future, co-financing the

cable interests of Canal+ in France via their JV, namely NC. The success of NC's cable businesses is very important to Canal+ because of new revenues from voice, Internet, etc.".²²⁶ "Consequently", said the Commission, "*Cableuropa would have a very significant and real power to retaliate against Canal+ in France, if it was not given favourable conditions in the access to the audio-visual rights that it needs in order to develop its pay-TV activities in Spain*".²²⁷ Credibly enough, the Commission felt justified to conclude that "*as a result of the NC deal*" both companies have a strong incentive to co-ordinate their competitive behaviour at least with regard to the "*access to Sogecable's content*".²²⁸

The Commission added force to its findings by revealing that, indeed, some days after the NC deal was signed, Sogecable and Cableuropa reached a content distribution agreement, which, albeit on a non-exclusive basis, was only reached by Cableuropa.²²⁹ The parties invited the Commission to recall that Prisa is joint owner, together with Canal+, of Sogecable in Spain and that it would be against the interests of that partner, if Sogecable were to discriminate in favour of Cableuropa only. Remarkably, the Commission did not see any value in that argument. Instead, it said "*aloud*" that *Sogecable's policy and strategy with regard to the chain of operation of audio-visual rights (production, management, distribution) is substantially determined by Canal+ France for the whole Canal+ group [...] The competitive strategy of Sogecable has always followed the policy of the Canal+ Group, as illustrated by the launching of Canal Satellite Digital in Spain following Canal Satellite in France*".²³⁰

In brief, in the above case, the only risk of co-ordination that the Commission recognised consisted in a discrimination policy vis-à-vis other market players in their *access to Sogecable's content*. Consequently, the underlying incentive for such co-ordination must have been the strengthening of links with the stronger of potential competitors and the foreclosure of all others from the market.

²²⁶ Para.33 of Commission Decision.

²²⁷ Ibid.

²²⁸ The emphasis is added by the author of the thesis.

²²⁹ Para. 34 of Commission Decision.

²³⁰ Para. 36 of Commission decision.

The author wishes to make the following remark. When assessing “dominance” under the ECMR in this case, the Commission found that “*there are no affected markets within the meaning of Form CO*”²³¹ on the ground that two of NCH’s parents (BankAmerica and CDPQ) were not operating in the pay-TV market (the relevant product market) in France or in other French speaking countries. It found that therefore, there was no horizontal overlap or any vertical link created between the parties (Canal+ and BankAmerica/CDPQ) as a result of the transaction.

Affected markets consist of *relevant product markets* where, two or more of the parties to the concentration are engaged in business activities *in the same product market* and where the concentration will lead to a combined market share of 15% or more: that is markets which do, and will, present horizontal relationships between the parties to the concentration. In addition, affected markets include *relevant product markets* where one or more of the parties to the concentration are engaged in business activities in a product market, which is upstream or downstream of the product market in which any other party to the concentration is engaged and any of their *individual* or *combined* market shares is 25% or more, regardless of whether there is or is not any existing supplier/customer relationship between the parties to the concentration: that is markets which do, and will, present vertical relationships.²³²

We just saw that on assessing the likelihood for co-ordination of their competitive behaviour, the Commission revealed that, BancAmerica and CDPQ were indirectly – that is to say, through their shareholdings in Cableuropa – involved in that very product market, but in a different geographic market. Considering that the only difference regarded the geographic market, which in itself does not appear as a criterion in the guidelines of Form CO as to what constitutes an affected market, was it not wrong to decide that there were no affected markets, in the first place? Did the Commission not admit itself that BankAmerica and CDPQ were indeed involved in the relevant product market, through their holdings in Cableuropa, by actually going

²³¹ See para. 16.

²³² The concept of ‘affected markets’ is defined in Section 6 of Form CO, published in OJ L 061 of 2/3/1998.

on to apply Article 2(4) ECMR as amended on the resulting relationship between Sogecable and Cableuropa? Was it not already decided by the Commission in Case IV/M.709 – Telefonica/Sociedad/Canal+/Cablevision of 19th July 1996 - that Sogecable in fact raised serious doubts about its dominant position in the Spanish pay-TV market? Intrigued by the Commission's finding under Article 2(4), the author queries into whether there is scope for interpreting the concept of "affected markets" – which is relevant at the stage of applying the Article 2(1),(2) ECMR test – as broadly as actually is demanded by Article 2(4) ECMR as amended. This query is intended to be food for thought for the reader: due to the word limit of this thesis, it will not be analysed any further; but, in the author's opinion, such interpretation would be more effective with controlling the parents' strategic intent, which underlies the creation of the JV.

5.2.3 *Non-Competition Between The Parents*

The author has deduced from the above cases that reconsideration of the way we assess non-competition clauses may be necessary in the context of SAs. The legality of ancillary restraints has been approached in different ways by different academics. On the one hand, an ancillary restraint is described as "*any clause or restriction in an agreement that is not appreciable and that is considered to fall outside Article 81 EC Treaty*".²³³ On the other hand, ancillary restraints are said to comprise simply one category of restrictive agreements, amongst others, that do not fall within Article 81 EC. They are "*a collection of terms considered 'objectively necessary' for the performance of certain contracts that do not fall within the 'commercial risk' reasoning*".²³⁴ While 'commercial risk' clauses usually necessitate an economic analysis of the market to determine whether they are permissible, ancillary restraints do not require – at least in European Competition Law – a full economic analysis of the market. This is the case, notwithstanding the fact that they must still satisfy the proportionality test; that is to say, they must not go beyond what

²³³ V. Korah, 1994, EC Competition Law, (5th ed.) pp 148-9.

²³⁴ R. Whish, ante. At pp.210-1.

is necessary for the transaction to occur.²³⁵ However, the explanation which has prevailed is that ancillary restraints are such restrictions as are necessary for the full preservation or full transfer of value in certain types of transactions.²³⁶ Gonzalez-Diaz²³⁷ points out that *“the European Commission articulated a version of the ancillary restraints doctrine according to which the legality of some restrictions may depend exclusively on their connection to the main transaction and not on their independent impact on competition”*.

As regards ancillary restraints attached to joint venture agreements - in particular non-competition clauses – guidance on how the Commission had been evaluating them until the 1st March 1998 can be derived from the Notice it issued back in 1990.²³⁸ Non-competition clauses were considered directly related and necessary to the implementation of the concentration in so far as they expressed the reality of the lasting withdrawal of the parents from the market assigned to the JV, and therefore their disappearance as actual or potential competitors of the new entity. It should be recalled that that was the crucial criterion for holding that a JV constituted a concentration. A proposal has already been made for the amendment of the Notice to take into account the redefinition of the “FFJV” concept and this should be taken to reflect the Commission’s approach since the 1st March 1998.²³⁹ It appears that the above ground for justifying non-competition clauses disappeared in line with the amendments to the concept of FFJV. The proposed principles for their evaluation suggest that non-competition clauses may be necessary to reflect the need to protect the parents’ interests in the JV from competitive acts facilitated by privileged access to know-how and goodwill transferred or developed by the JV. The proposed Notice goes on to stipulate that, if the JV is set up to enter a new market, reference will be made to the products, services and territories in which it is called to operate under the JV agreement. The presumption will be that a parent’s interest in the JV does not need to be protected from competition from the other parent in markets other than those in

²³⁵ See Gonzalez-Diaz, 1995, “Some Reflections On The Notion Of Ancillary Restraints Under EC Competition Law”, *International Antitrust Law & Policy*, Fordham Corporate Law Institute, p.329.

²³⁶ *ibid.*, at p.328.

²³⁷ *ibid.*, p.334, referring to the Commission’s decision in *Reuters / BASF*, 1976 OJ (L 254) 40.

²³⁸ 1990 OJ (C 203) 05.

²³⁹ Available at the internet address <http://www.europa.eu.int/comm/dg04/> as a working document under the heading Mergers / Legislation.

which the JV will be active at its outset. Any departure from this principle will have to be justified by the notifying parents.

Indeed the above mentioned principles of evaluation of non-competition clauses do not seem to depart from the long established doctrine with respect to ancillary restraints which suggests that "*their legality depends exclusively on their connection to the main transaction and not on their independent impact on competition*"²⁴⁰. In all of the preceding cases the Commission declined to apply Article 81 EC Treaty to the ancillary restraints on the ground that they were necessary for the transaction, and consequently did not restrict competition. In the light of the remarks made in Section 5.2.4, should we not assess whether inserting such clauses may enhance the 'foreclosure of actual/potential competition' effect of a network of alliances?

It should be recalled that under Article 81 EC analysis, where an agreement does not have the object of restricting competition, it is still necessary to consider its effects. Barry J. Rodger & Angus MacCulloch say that when the effect of an agreement is considered it is important to examine the market in its economic context.²⁴¹ They cite a passage from the ECJ decision in *Brasserie de Haecht v Wilkin*: "*it would be pointless to consider an agreement, decision or concerted practice by reason of its effect, if those effects were to be taken distinct from the market in which they were seen to operate*".²⁴² Most importantly, the ECJ recognised that the effect of a *single* agreement may be negligible, but if that agreement constitutes one amongst a *network* of agreements, it is the effect of the network that need to be examined.²⁴³ Furthermore, it appears from the ECJ's reasoning in the *Delimitis* case that not only account need be taken of the effects of the agreements on the existing market but also of its potential effects on the *development* of the market. In particular, the court emphasized the imminent risk of foreclosure of the market through a network of agreements and identified a number of factors to look into when assessing the effect. First, the possibilities for a new competitor to penetrate the

²⁴⁰ Gonzalez-Diaz, ante. Footnote 202.

²⁴¹ Ante., at p.141.

²⁴² Case 23/67 [1967] ECR 407; [1968] CMLR 26, at para. 40.

²⁴³ See Case C-234/89 *Delimitis v Henniger Brau* [1991] ECR I-935; [1992] 5 CMLR 210.

bundle of contracts by acquisition of an established operator or the establishment of new outlets; secondly, the conditions of competition on the market, including the level of product saturation and customer loyalty. The Court clarified that we need to look into the extent to which an agreement contributes towards the effect carried by the rest of the agreements in the network. If its effect is insignificant, it will not fall within the Article 81 EC prohibition. The author thus suggests that there is room for examining ancillary restraints pursuant to Article 81 EC. Further, the principles which the Court has already developed appear to strike the necessary balance, and therefore the parties to a FFJV, which enter a non-competition agreement ought not to fear that it will be unduly stroke out thereby jeopardising the value of their transaction.

5.3 *Partial-Function JVs & Strategic Intent*

At this stage, the author wishes to illustrate a point which was made in Section 1.5 of the thesis, namely that the strategic intent of a SA is not necessarily reflected in the institutional form that the parents choose for it. The intent of the parents may still be the strengthening of their dominant position in the market by precluding potential competition, even if the alliance is not set up as a FFJV, and thus cannot be tested under the ECMR 'dominance' test. The JV agreement is assessed under Article 81 EC, instead. In the author's view, the case presented hereinafter is a vivid example of an agreement concluded to strengthen the "exclusionary" market power of the undertakings concerned. Article 81 EC appears to be a lax legal instrument in such a case, in so far as it gives the parties the benefit of invoking the exemption under Article 81(3) EC Treaty in the name of "promoting technical and economic progress".

5.3.1 Case No IV/36.539 – BiB, decision delivered on 21/10/98²⁴⁴

The business object of the alliance

The ultimate business object of BiB was to provide *digital interactive TV services* to consumers in the UK and Ireland.²⁴⁵ The BiB services would include home banking, home shopping, down-loading of games, learning-on-line, entertainment and leisure, sports, motor world. Any form of entertainment where viewing itself is the primary form of entertainment for the viewer, without the possibility of interactivity, such as video-on-demand entertainment services were excluded from its scope.

Basically, the BiB service would consist in allowing *content providers* to offer their goods and services directly to digital TV viewers *and* to complete transactions with such viewers. The service would combine both “*broadcast content*”, content broadcast *via digital satellite*, and “*on-line content*”, content delivered via a standard domestic telephone line. In addition, the partners of BiB intended to enter into negotiations with a view to making the BiB service available alongside the digital broadcast entertainment services, which were transmitted on *digital terrestrial* and *digital cable* in the UK.

The primary object of BiB was to set up the *technical infrastructure* necessary for the provision of the above mentioned services. In particular, the BiB infrastructure was intended to allow both digital broadcast data signals and digital on-line data signals to be decoded by authorised viewers for display on the current generation of analogue television sets and future sets and to allow those viewers to interact in a safe environment. BiB would provide its infrastructure both to digital TV broadcasters and to providers of digital interactive services.

The BiB company was held not be an autonomous economic entity because it would not perform all the functions of such an entity; instead, it would rely on its

²⁴⁴ OJ C 322/6,

parents for a substantial part of its activities.²⁴⁶ Therefore, the Commission's decision was delivered on the basis of Article 81 (ex Article 85) of the EC Treaty. Pursuant to Article 81(3) EC, BiB was granted an individual exemption taking effect as from the date that certain conditions would be fulfilled.

The parents' business activities

BiB's parent companies would be (1) BT Holdings Limited, (2) British Sky Broadcasting Limited ("BskyB"), (3) Midland Bank plc ("Midland") and (4) Matsushita Electric Europe (Headquarters) Ltd ("Matsushita"). Of most interest is to consider the activities of the first two parents.²⁴⁷

(1) BT Holdings Limited is a wholly-owned subsidiary of BT. After the liberalisation in the telecommunications sector in the UK, BT was licensed to run certain telecommunications services in the UK and to provide the technical infrastructure for such services. It remained dominant on the market.

(2) BskyB's core business activity is the broadcasting of *analogue* pay-TV services delivered by the Astra satellites for direct-to-home and cable reception in the UK and Ireland. BskyB intended to expand its activities as a broadcaster by launching a *digital* pay-TV service during 1998. As an analogue pay-TV broadcaster, BskyB operated both at the retail and at the wholesale level. At the retail level, it supplied wholly-owned BskyB channels, channels in which it had an interest and third party channels *to subscribers* in the UK and Ireland. At the wholesale level, it supplied its own channels and a small number of third party channels *to operators* who supply packages of channels to viewers via other systems.

²⁴⁵ See para. 2.2.1 of Commission Decision: Digital TV interactive services are internet-like, on-line services, delivered via television screens. They include retailing, information services, game playing, 'walled garden' internet access and adding interactivity to broadcast entertainment services.

²⁴⁶ Para. 2.1 of the Decision.

²⁴⁷ For the reader's information, a description of the other parents is noted here. Midland is a public limited company authorised to carry on banking business by the Bank Of England. It belongs to the HSBC group of companies which provides a full range of banking and financial services. Matsushita is a wholly-owned subsidiary of Matsushita Electric Co. Ltd (MEI). MEI's portfolio includes the designing, development and manufacture of electronic and electrical products and associated software and information technology for home, industrial and commercial uses. The MEI group operates in other EU Member States.

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It is important to know that BSkyB has been a wholly-owned subsidiary of British Broadcasting Group plc. The latter was formed by a merger between Sky Television Limited – then a subsidiary of News Corporation – and its then competitor British Satellite Broadcasting Limited. The BSkyB group brings together the following wholly-owned subsidiaries:

- (i) Sky Subscribers Services Ltd (“SSSL”), which provides analogue conditional access and subscriber management services to BskyB;
- (ii) Satellite Encryption Services Ltd (“SESL”), which provides analogue conditional access and subscriber management services to third party satellite direct-to-home pay-TV broadcasters using Astra transponders;
- (iii) and Sky In-Home Services Limited (“SIHSL”), which is involved in the sale and installation of satellite dishes.

SSSL would perform both its current role and the role of SESL in respect of *digital* conditional access services.

BiB’s reliance on its parents²⁴⁸

(a) BskyB Group

- (i) BiB would sub-lease digital satellite transponder capacity from BskyB, albeit not exclusively; it could sub-lease it from third parties, too.
- (ii) SSSL would provide BiB with conditional access services (“CA”) and access control services (“AC”). The latter is the on-line equivalent to conditional access for broadcast services.
- (iii) Thus, BiB’s digital interactive set-top box would embed BskyB’s proprietary CA and AC systems; since the Set-top box would not contain a common interface, it would, therefore be tied to BskyB’s CA and AC. *But the BiB set-top-box would include a digital satellite demodulator and would have*

²⁴⁸ Midland would provide BiB with a transaction management system (“TMS”), that is a mechanism for authorising and undertaking financial transactions through the digital pay-TV platform. The TMS would interface with a merchant acquiring system, that is the processing of credit and debit card payments from retailers and from other vendors of goods and services. Midland would provide the TMS on a ten-year exclusive basis.

interface ports, whereto digital cable, digital terrestrial and broadband telecommunications network (i.e. all transmission systems) side cars could be attached.

- (iv) BskyB would agree with Open TV that the latter would enhance its application programming interface ("AIP") and thereafter to supply it to BiB. In effect, the enhanced API would allow BiB's set-top box, in which it would be inserted, to decode high quality still and moving pictures broadcast via satellite and improve the quality of sound.
 - (v) BiB would use BskyB's Electronic Programme Guide ("EPG"). It was intended that for the first ten years from the launch of the BiB service, BskyB would only supply its EPG to BiB.
- (b) BT
- (i) The transmission to the up-link site and up-link of broadcast content to the satellite would be provided by BT.
 - (ii) BT entered into an agreement with Oracle with the effect that the latter would provide BiB with enhanced software for the broadcast server.
 - (iii) BT would supply BiB with "access to the on-line system", that is with a network of access points throughout the UK, for three years.

Co-ordination of JV's competitive behaviour with its parents' behaviour

Basically, BiB would co-ordinate its competitive behaviour with BskyB only:

- (i) The marketing services agreement of BiB with consumers would stipulate that purchase of a BiB subsidised set-top box would be conditional on the purchaser subscribing to BskyB's digital pay-TV service for the minimum contract term of 12 months;
 - (ii) BskyB agreed, in the JV agreement, to use reasonable endeavours to ensure that all programmes broadcast on BskyB's analogue satellite service be broadcast simultaneously on BskyB's digital satellite service;
 - (iii) The parties to the JVA agreed that for so long as BiB would be subsidising set top boxes, they would only promote digital set top boxes which would
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be capable of receiving BiB services, subject to a proviso, that BskyB might promote any other set top box where the purpose of such promotion related to the use of such boxes in homes which already had a BiB subsidised set top box.

(iv) Moreover, the JVA required that certain advertising of the BiB be integrated with BskyB's advertising.

Assessment Of The Effects Of BiB

The European Commission identified the following relevant markets: (a) the market for digital interactive TV services; (b) the market for retail pay-TV; (c) the market for technical and administrative services for digital interactive TV services and retail pay-TV; (d) the markets for the wholesale supply of films and sports channels for retail pay-TV; (d) the market for local loop infrastructure.

The Commission found that certain features of the notified agreements were incompatible with Articles 81, 82 (ex-Articles 85, 86) EC Treaty and imposed an obligation on the parties to amend the notified JVA and the agreements corollary to it, in order to be able to claim the benefit of an individual exemption. It explained that the amendments were required in order *"to ensure that the impact of the transaction on the structure of the various markets would not be such as to prevent competition emerging or developing"*.²⁴⁹ Where it considered it necessary, the Commission imposed a condition that the amendments be in a specified form.

In particular, the Commission was concerned that BT's participation in BiB might lead to a reduced incentive in the short to medium term to invest in the local loop infrastructure in which BT was dominant. This might have a consequential effect on the supply of services which make use of that infrastructure. The Commission said that, if upon review of BT's participation in BiB in the short to medium term, it appeared that competition was restrained, *"BT might be required to choose between its continued participation in the BiB joint venture, and the provision of unbundled access to its local loop infrastructure"*.²⁵⁰ Eventually, BT agreed to divest its existing

²⁴⁹ See para. 5.1 of Commission decision.

²⁵⁰ See para. 5.3.5 of Commission Decision

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broadband cable interests in Milton Keynes and Westminster and also BT committed not to extend its broadband cable interests in the UK.²⁵¹

Further, the Commission required the deletion of the term obliging purchasers of BiB subsidised set-top boxes to subscribe to BskyB's pay-TV bundle.²⁵² This practice would have constituted *bundling* in the interests of BskyB and against the interests of the consumers. Thus the condition was necessary to ensure that BskyB's dominance on the retail pay-TV market is not *affected* by its participation in BiB.

Following the same reasoning the Commission put a condition on BskyB, at the wholesale level of its activities, that it would offer to distribute its film and sports channels either including or excluding (clean feed) interactive applications at the choice of the purchaser on a non-discriminatory basis.²⁵³ The Commission's aim was to prevent BskyB from *bundling interactivity* at the wholesale supply level *with its programming* to the detriment of both competitors to BiB on its digital interactive services, and its own competitors on the retail pay-TV level.

Another potential anti-competitive behaviour of BskyB which the Commission attacked was the exercise of its veto rights – by virtue of the JVA – against any proposal to subsidise other set-top boxes. The Commission explained that since the companies requesting BiB to subsidise other set-top boxes would in practice be competitors of BskyB on its core market, *“the condition was intended to address BskyB's conflict of interest in its decisions as a BiB shareholder and its interests as a retail pay-TV operator”*.²⁵⁴

The author submits that this case raises a question as to whether Article 82 EC Treaty should be attributed a more important role in cases of strategic alliances, since it is a more appropriate legal instrument for controlling exclusionary market power. The conditions the Commission imposed seem to support the author's opinion. Article 82 EC is directed at the activities of a powerful single firm which is subject to weak

²⁵¹ See Condition 6 attached to the Decision.

²⁵² See Condition 2 attached to the Decision.

²⁵³ See Condition 5 attached to the Decision.

²⁵⁴ See Para 5.3.4.3 of the Decision and Condition 7.

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competition. An undertaking in a dominant position may use its market power to, inter alia, perpetuate its position or to extend its position into another market. Thus, Article 82 prohibits the '*abuse*' of a dominant position. Article 82 had been used in the past to control mergers. The ECJ held that it is an abuse for a dominant undertaking to strengthen its position in a market by merging with a competitor.²⁵⁵ Arguably the same should apply in the case of a joint venture in so far as the JV agreement would bring about an abuse of the parents pre-existing dominant position.

²⁵⁵ Case 6/72 Continental Can v Commission [1973] ECR 215; [1978] 1 CMLR 199.

CONCLUSION

- ***On The Model For Identifying The Strategic Intent***

The decisions of the European Commission appear to confirm the appropriateness of the model, which was suggested in the concluding remarks to Part [I] for the purpose of *detecting the strategic intent* of the parents of an alliance. The model was actually confirmed irrespective of the institutional form, which the allies have chosen. The BiB alliance sustained the same defensive strategic intent as the MSG alliance, notwithstanding the fact that the former was set up as a partial-function JV whereas the latter as a full-function JV. At the same time, the author believes that the insight into the characteristics of the telecommunications sector, which was given in Part [II], has indeed made the strategic reasoning behind who allies with whom much clearer. This suggests that to detect the strategic intent, one needs to be well aware of the structure of the market from the economists' standpoint and moreover of the legal and regulatory framework within which that industry functions. It is out of legal and/or regulatory asymmetries that firms found the opportunities to deploy their defensive strategies.

The author feels obliged to pay much credit to the Commission's decision-making in so far as it appears to take into account the players' strategic practices. In the MSG case, the Commission managed to disclose the strategic intent underlying the setting up of the JV by, for instance, looking into the business interest of DT. If the latter entered the pay-TV market and the future market of interactive higher-value services independently, the possibility would open up for DT to pursue a more use-oriented policy in the broadband cable service area rather than a purely connection-related payments and charges policy, which would render it more profitable. So, it was not a case where but for the JV, it would not have entered the market. The strategic intent was therefore to eliminate a potential competitor in that market. Further, in the same case, the Commission identified the parents' strategic

intent as being to achieve technological leadership in the digital pay-TV market, which could, however, only be secured by raising the investment costs of potential competitors. To confirm that such intent was plausible, the Commission pointed to a strategic move, which was open to MSG to take: it could impose on viewers, by means of a term in the decoder lease agreement, the requirement that they should not use the decoder with modules of other pay-TV or service providers without the consent of MSG, in spite of a common interface in the decoder. In the Canal+/BankAmerica/CDPO case, it said “aloud” that Sogecable’s policy and strategy with regard to the chain of operation of audio-visual rights (production, management, distribution) was substantially determined by Canal+ France, its parent. “[...] The competitive strategy of Sogecable has always followed the policy of the Canal+ Group, as illustrated by the launching of Canal Satellite Digital in Spain following Canal Satellite in France”. Hence, the Commission appeared to raise the veil from subsidiary companies and hold that it is the parents’ strategies that prevail over the affairs of their subsidiaries. It thus opened the way to detecting the strategic intent of the parents even in markets which are neighbouring to that of the JV, if in such neighbouring markets they have subsidiaries which may implement, or benefit from, such strategic intent.

- ***On The Way We Assess Dominance***

Why is it so important to detect whether the strategic intent is anti-competitive or defensive? Does it not suffice that the effects of the JV are themselves anti-competitive or defensive? One may reasonably come up with such a question. In fact, the ECMR “dominance test” does not comprise the criterion of “is it the parents’ intent to create or strengthen a dominant position?”. Only Article 2(4) ECMR requires that we examine whether “the creation of the JV has either as its *object* or the effect of co-ordinating the competitive behaviour of the parents”. Why then the author considers it useful to detect the strategic intent of the parents?

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The answer lies in the Introduction to this thesis. It was therein said that there is an increasing interest in bringing within the gulf of European Competition law the strategic behaviour of the parents. The author of this thesis has therefore sought to demonstrate that detecting the strategic intent of the parents enables us to gain a wider perspective on how the firms themselves perceive ways of creating or strengthening or extending their dominance. In turn, the author suggests that this should aid us with defining dominance in a more comprehensive way. As industries converge, the notion of dominance demands that we take into account competitive advantages which accrue from more than one industry. And the author has suggested that the game about dominance today is a game about surviving and winning over multi-point competitors. It is for this reason that the author invited the reader to focus its attention on identifying whether the strategic intent underlying the setting up of a JV relates to the strengthening of links between multi-point competitors. In particular where the strengthening of links takes the form of adding to a network of alliances (JVs) so that a potential entrant can only consider seriously entering the market if it can find an available ally; otherwise the costs of entry for such a potential competitor are significantly high.

In the same context, the author suggested that “exclusionary market conduct” should be taken into account to a greater extent when assessing dominance. Thus the author applauded the Commission’s decision in the NSD case for taking into account that back in 1993, Kablevision, in which Kinnevik owned 37,4% of the shares, stopped distributing FilmNet’s pay-TV channels until the national competition authority had to intervene. Hence, the Commission emphasized that Kablevision’s potential competitors will have to take into account, before taking any action, Kinnevik’s influence over the strategies of its subsidiaries. It is particularly important to control such type of “exclusionary market conduct” as it can be promoted by participation in a network of alliances.

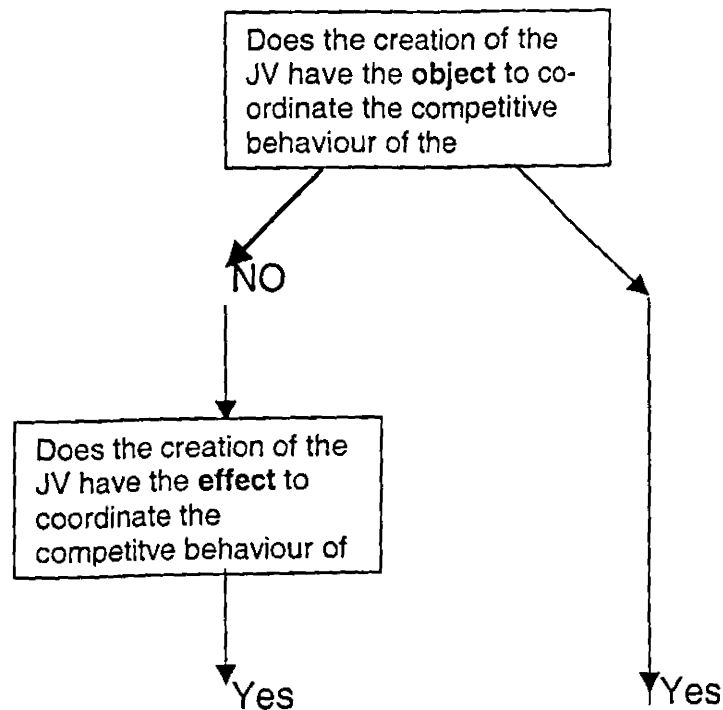
- ***On The Way We Assess Co-ordination Of Competitive Behaviour***

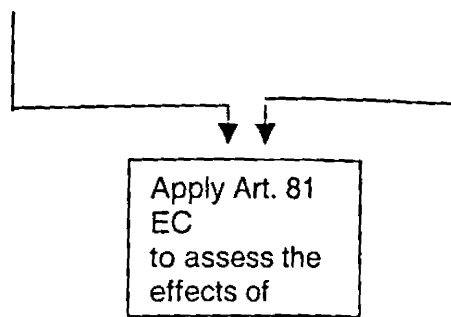
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The author submits that since Article 2(4) ECMR itself allows us to consider whether it is the “object” of the creation of a JV to co-ordinate the competitive behaviour of the parents, strategic intent has a role to play. Before explaining at which point and how, the author wishes to summarise by way of the following two diagrams how the European Commission has been assessing the issue of co-ordination of the competitive behaviour of the parents. The diagrams present the test, which the Commission has been applying.

EC COMMISSION PRACTICE
ON ARTICLE 2(4) ECMR as amended
A. IS IT NECESSARY TO APPLY ARTICLE 81 EC?





B. HOW TO APPLY ARTICLE 81 EC ?

1. Is it **likely** that the parent companies will co-ordinate their behaviour?
 - (a) Would it constitute **economically rational behaviour** for the parents to co-ordinate their behaviour?
(Is the **structure of the market**, where this co-ordination could take place, **conducive** to co-ordination?)
 - (b) What is the **relative size of the JV market(s)** to the parents' market(s) ? A : The larger the latter compared to the former, the smaller the likelihood of co-ordination.)

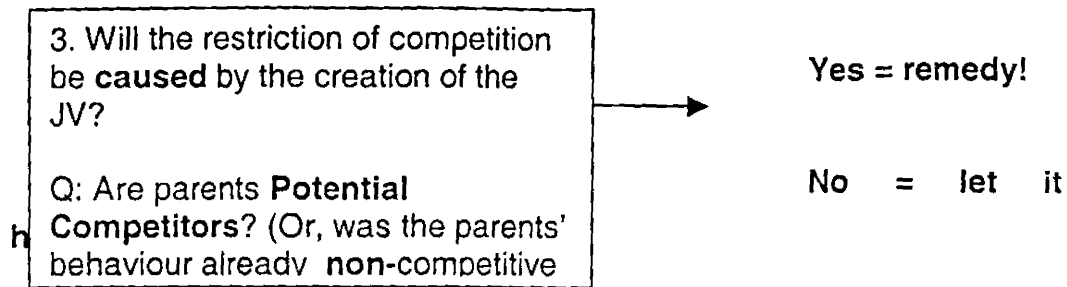
Continue = Yes, likely!

Not likely = Stop!

2. Would such coordination lead to an **appreciable** restriction of competition?
(See: Combined Market Share!)

Continue! = Yes

No = Stop!



« **Object Or Effect** »

- As it appears from the first diagram, « object » ought to be considered first. However, in all of the cases that appeared before it so far, the Commission decided that there was not enough evidence to support the conclusion that co-ordination of the competitive behaviour was intended. Therefore, it would proceed to the assessment of the « effect ». Thus the second diagram presents the test for the appraisal of whether it is the « effect » of the JV that the parents will co-ordinate their behaviour.

Likelihood Of Co-ordination

- In the Abstract of this thesis, F. E. Gonzalez-Diaz proclaims that Article 2(4) ECMR as amended shows that the adoption of the amending Merger Regulation constitutes a new and welcome point of departure for a more *economically driven* analysis. The author of this thesis warns that a point of departure has only been made, if what is *economically rational* for a firm to do is taken to include what is *strategically rational* for a firm to do.

1. How does Gonzalez-Diaz interpret « economic rationality » ?
Commenting upon the Telia/Telenor/Schibsted case, he explains:¹
« *The Commission has thus recognised that despite the relatively high combined market shares of the parent companies and the JV (between 45 and 60% according to some estimates), the characteristics of the market (in particular low entry barriers, high growth and high elasticity of demand) were such that co-ordination of the competitive behaviour of the parents would not be profitable and consequently would be unlikely.* » On the facts, the Commission found that *raising prices* and sustaining them through co-ordination would not be profitable because of the structural characteristics of the industry. Apparently, « economic rationality » is interpreted in terms of « how conducive the structure of the market is to sustaining profitability which is caused by co-ordination ». If the structure of the market is not conducive, then it will not be economically rational to co-ordinate.

2. According to Gonzalez-Diaz, how does the Commission demonstrate its move towards a more economically rational analysis ? « *Indeed, rather than presuming that, given their combined market share, the parent companies were likely to co-ordinate their competitive behaviour and then examining whether this co-ordination would have an appreciable effect on competition, as it has done in several cases in the past, the Commission has opted for assessing whether co-ordination would constitute economically rational behaviour at all. Having considered under the circumstances that this was not the case, there was no need to examine causality or appreciability.*² »

¹ (1999), at p.41

² *ibid.*

3. The author admits that the Commission practice is meritorious in so far as it begins with an interest in *seeking to prove* the likelihood for certain behaviour occurring in real terms rather than *presuming* that it will occur and, especially, in so far as heavy reliance on market shares is avoided. At the same time the author emphasizes that the way economic rationality is interpreted may be flawed to the extent that the Commission solely looks into the structure of the industry. In fact, even when it comes down to co-ordination in relation to prices or output, the structure of the market need not be such as to facilitate collusion for the firms to find it rational to co-ordinate. On this point the author relies on Reynolds & Snapps.³ They show that in markets where entry is difficult (*this remains a condition*), partial ownership arrangements, including small joint ventures, link the fortunes of actual or potential competitors, producing a positive correlation among their profits. They explain that such arrangements arise *not* out of increased opportunities for collusion, but rather out of the *linking of profits*, which gives each firm an incentive to compete less vigorously and adopt behaviour more conducive to joint maximisation than would otherwise be the case. In fact, increases in ownership interests may produce lower market outputs because such links 'internalise' a competitive 'externality' – namely, the benefits each firm generates for rivals as a result of unilateral output restrictions. Reynolds & Snapp cite as an example that if 5 Cournot competitors had 10% equity interests in each other, equilibrium market output would be 10% less than that which would occur without any partial ownership.
4. Indeed, the author has identified the parties' *strategic* interest in co-ordinating their behaviour not necessarily with an interest in co-ordinating their prices or the amount of their output but rather in co-ordinating their interrelationships, that is to say the links to competitors in other industry segments or industries that they possess. The underlying incentive for co-

³ (1986) "The Competitive Effects Of Partial Equity Interests And Joint Ventures", *Int. Journal Of Industrial Organisation* Vol.4, p. 141.

ordination may thus be the enjoyment of a better position as regards access to such an industry segment or market. This was illustrated by the NC/Canal+/BankAmerica/CDPO case.⁴ This suggests that the structure of the market need not necessarily be such as to facilitate collusion for the parties to find it economically rational to co-ordinate. *Instead, the author suggests that we should be assessing such likelihood in the light of the strategic intent of the parents as regards the creation of JV.* If they intend to create or strengthen a dominant position, then we should look into whether co-ordination will pretty much take the character of increasing interrelationships (and thereby, e.g. ensuring better conditions for access to another's market) at the cost of potential competitors. In fact, although not reproduced in the text of Article 2(4) of the amended ECMR, Recital 5 of the Regulation has taken on board the Commission's proposal to consider that, if any effects of the creation of the JV are primarily structural, Article 85(1) does not as a general rule apply.

5. Further, the author is of the view that we should not be dismissing the likelihood of co-ordination between the parents too easily on the ground that the JV's market is of small size compared to the size of the rest of the parents' markets.⁵ In particular, if the size of the JV market is small, but, at the same time, such market is new, the latter characteristic ought to be more important. If we accept that the strategic intent behind the creation of the JV is to increase or strengthen interrelationships, then adding little by little the *meeting points* for co-operation than competition, enhances the *linking of profits* of the joint venturers, which as Reynolds & Snapp indicate above, is the floor for co-ordination.

⁴ Section 5.2.2.3, pp.113-120.

⁵ The Commission adopted this approach in 14 cases to date, including: Case JV.1 Telia/Telenor/Schibsted of 27/05/1998, Case JV.2 ENEL/FT/DT of 22/06/1998, Case JV.3

- With regard to Article 2(4), the focus of the analysis is the co-ordination between the parent companies exclusively, and not the co-ordination of the competitive behaviour of the parent companies and third parties.⁶ This is contrasted with the wider ambit of the dominance test under Article 2(3) ECMR which goes on to examine whether the setting up of the JV would create or strengthen a dominant position for the parents or for the parents *and* third parties.
- This difference in the ambit of the tests is reflected in the calculation of the « combined market share » which is made for the purposes of deciding whether co-ordination will lead to an « appreciable » restriction of competition. Normally, the inclusion of the market share of another JV concluded by the parents and third parties will not be included in the combined market share for the purposes of Article 2(4). However, in the Telia/Telenor/Schibsted case, the Commission added to the market share of Telenor, the market share of Telenordia, a JV of Telenor, BT and TeleDenmark. Gonzalez-Diaz argued that although such practice is fully acceptable for the purposes of Article 2(3) ECMR, it should not be adopted for the purposes of Article 2(4) ECMR..⁷ In this author's opinion, the Commission may have felt the need to account for the presence of the parents in a network of JVs. This is a central issue in the context of appraising the effects of strategic alliances. It is doubted, however, whether it is good practice to account for them when we assess appreciability and to ignore them when we assess likelihood or causality.

BT/AirTouch/Grupo Acciona/AirTel of 08/07/1998, Case JV.5 Cegetel/Canal+/AOL/Bertelsmann of 04/08/1998, JV.6 Ericsson/Nokia/Psion of 11/08/98.

⁶ Gonzalez-Diaz (1999), p.40.

⁷ *ibid.* p.41, footnote 91.

Causality

- The author has identified an aspect of the Commission's methodology, which is problematic for the assessment of SAs whose strategic intent is to increase or strengthen interrelationships. The said aspect is that if any co-ordination of the parents' competitive behaviour is found to be likely but such likelihood can be attributed to an earlier JV that the parents concluded between them and a third party, and in particular by virtue of a non-competition clause in that earlier JV agreement, then the Commission is ready to hold that there will be no causal link between the JV in issue and the likely co-ordination. In this way, non-competition situations increase in parallel with a network of alliances which expands. The author has expressed her concern in the light of Case ENEL/FT/DT and even more the MSG case.

Causality/Co-ordination/Market Power

- In Section 5.3 the author has gone on to suggest which is the proper way we should be assessing ancillary restraints in the form of non-competition clauses. It has been argued that rather than examining their link with co-ordination of competitive behaviour we should be examining their link with the development of the market and hence with any increase in the foreclosure effect of the parents' market power. Indeed, the author wishes to raise the following questions: (a) Will the parties be able to exercise collective market power, if they stop competing against each other and do not compete against the venture? Are the parties ready to contend that they will compete against each other and the venture through membership in other collaborations? Even if they contend so, will they have the ability and the incentive to join competing networks?

Can't we extend the dominance test to all the effects of the JV?

The question then remains: how should we control the co-ordination of competitive behaviour of the undertakings under European Competition law? In the

author's opinion, it ought to suffice to apply the ECMR dominance test to all the effects of the JV, as it is more likely than not that any co-ordination of the competitive behaviour ("the behavioural aspect") will be intended to reinforce the position of the parents in the market ("the structural aspect"). What we had better do is to reconsider the definition of the relevant market, in the light of convergence, to cover for the markets where co-ordination is likely. This will, in fact, be more consistent with the way companies perceive their competitors, their potential competitors. Notwithstanding the specific industry in question, *important* potential competitors are the ones who have important interrelationships with market players at different levels of the value chain and thus in upstream, downstream and neighbouring markets. Why is this suggestion made at all? Because rather than adopting two filtering procedures which are narrow enough for the facts to fall outside them, a single filter which is deeper in ambit may capture the cases which do raise concerns in the light of multi-point competition and the firms' strategies in response to that.

R. Whish has pointed out that *"an important question is whether Article 2(3) contains one test or two when considering if a merger is incompatible with the common market"*.⁸ It could be argued that the second idea (*"significantly impeding effective competition"*) is merely a description of the consequences of the first (*"creation or strengthening of a dominant position"*) in which case it adds little.⁹ An alternative view is that the Commission has to satisfy both parts of Article 2(3), if it is to block the concentration in question: in this case the second test will provide a *de minimis* exception. *"Also it could be that reference to impeding effective competition means that the Commission would take a dynamic view of the market and consider whether harm to competition is likely to be transitory or permanent: it should act only in the latter situation"*.¹⁰ R. Whish concludes that *"it is likely that the Commission will interpret Article 2(3) in a flexible way*

⁸ "Competition Law", 1993, 3rd ed., Butterworths, London, at p.718

⁹ *ibid.*

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so that it will provide it with a margin of discretion for use in appropriate cases".¹¹ Considering the wording of Article 2(3) ECMR, the author contends that there is room for considering the behavioural aspect in order to determine whether effective competition would be impeded.

Otherwise, Article 82 EC Treaty might be a more appropriate tool to control the behavioural aspect. The existing list of practices, which have been recognised to fall within the ambit of Article 82 EC, includes a category within which we could assess the "behavioural aspect" of a FFJV: namely, the category of "limiting production or technology development" – Article 82(1)(b) EC. The suggested test could therefore be: "would the co-ordination of the parents' competitive behaviour limit production or technology development and thereby be equivalent to abusing the parents dominant position?" Arguably, applying Article 82 EC will carry the advantage of capturing the situation where non-competition between the parents inside the market of the JV and in the markets of other JVs in which they are involved leads to an abuse of the dominance of the parents of the JV in issue cumulatively - collectively with their allies here and there. In principle, once we introduced Article 81 EC into the "ex-ante control" system of the ECMR, we should not face the question of whether it is legitimate to introduce Article 82 EC – a classically "post-facto control" tool – in the same system!

¹⁰ *ibid.*

¹¹ *ibid.*

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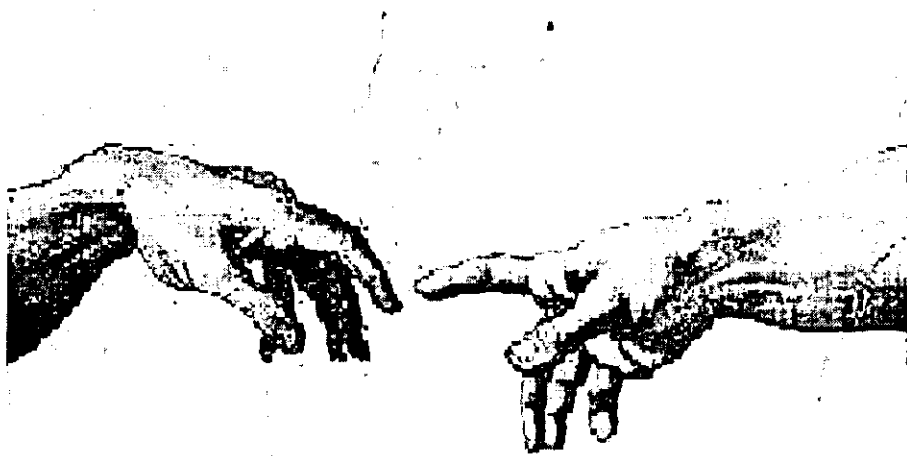
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1. The first part of the document is a list of names and addresses of the members of the committee.

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