

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Vertical mergers in the technology, media and telecom sector – Note by Sweden

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More documents related to this discussion can be found at

<http://www.oecd.org/daf/competition/vertical-mergers-in-the-technology-media-and-telecom-sector.htm>

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1. Introduction

1. The following contribution discusses the Swedish Competition Authority's (SCA) experience of vertical merger investigations, especially in the technology, media and telecom sector. To a large extent, the contribution follows the questions set out in the OECD invitation for submission.
2. The note firstly explains the SCA's legal framework and general principles for vertical merger investigations. The note then discusses the main theories of harm and economic methods applied by the SCA in vertical merger investigations. To illustrate the SCA's experience, the note will discuss some relevant vertical merger investigations.
3. The overall conclusion is that SCA's experience of vertical mergers that have been subject to more extensive investigation, either in phase one or phase two, is limited. However, the SCA's experience so far is that although quantitative analyses have been applied in the assessment of vertical merger investigations, qualitative analyses have played a more decisive role in those mergers assessed by the SCA. Further, the outcome of vertical mergers that raise competition concerns can be more complex to predict than horizontal mergers, since efficiencies are more common in vertical mergers.

2. Legal framework

4. The Swedish merger regulation can be found in the Swedish Competition Act (2008:579) and the SCA's Regulations on the Notification of Concentrations between Undertakings under the Swedish Competition Act (KKVFS 2010:3), which regulates which information should be provided in a merger notification (Instructions for merger notification). The Swedish rules for merger control is based on the EU Merger Regulation.
5. The SCA has not enforced any specific guidelines on the assessment of non-horizontal mergers (or horizontal mergers). When assessing mergers the SCA seeks guidance from the European Commission's relevant notices and guidelines. As regards the assessment of vertical mergers, the SCA to a large extent relies on the Commission's *Guidelines on the assessment on non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2008/C 265/07)*.

3. Competition test

6. All mergers within the SCA's jurisdiction, regardless of the nature of overlap (horizontal, vertical or conglomerate) and sector, are subject to the same regulatory framework and competition test.
7. According to the Swedish Competition Act, a merger shall be prohibited if it would significantly impede the existence or development of effective competition in the country as a whole, or a substantial part thereof and if a prohibition can be issued without significantly setting aside national security or essential supply interests.

8. The SCA Instructions defines a vertically affected market as a market where the merging parties are active on an upstream/downstream product market in relation to a product market where another party is active, and where any of the parties has a market share of 30 percent or more. Vertical mergers where the parties' market shares are below 30 percent on an upstream/downstream market are presumed unlikely to raise competition concerns. Therefore, such mergers are subject to waivers of information requirements stated in the SCA's Instructions for merger notification, and they are normally not subject to any extensive investigation.

4. Theory of harm and investigation methods

9. The SCA's overall experience is that vertical mergers are in general less likely to significantly impede effective competition, since vertical mergers do not lead to a loss of direct competition between merging firms in the same relevant market, and since they can provide substantial scope for efficiencies. Possible harm to competition arising from vertical mergers could hence be more complex to identify in relation to horizontal mergers.

10. However, there are circumstances in which vertical mergers may significantly impede effective competition, in particular where a dominant position is strengthened, essentially, since vertical merger may change the ability and incentive for the parties and their competitors in such a way that it could harm competition.

11. The SCA mainly considers two types of non-coordinated effects when assessing vertical mergers; foreclosure of input products and foreclosure of the customer market. Further, the SCA can consider non-coordinated effects arising from sharing commercially sensitive information between the vertically integrated parties. The SCA may also consider coordinated effects due to foreclosure, however to this point of time the SCA has limited experience of such assessment in vertical merger investigations. This note will only describe the SCA's experience of assessing non-coordinated vertical effects.

12. *Foreclosure of input products* means that a merger is likely to increase the costs of the downstream competitors by limiting their access to an important input. This type of foreclosure can manifest itself as poorer product offerings, reduced volume, poorer delivery terms, volume requirements and/or higher prices on input products.

13. *Foreclosure of the customer market* means that the merger is likely to foreclose the upstream competitors by increasing their costs for access to customers in the downstream market, or by limiting access to a sufficient customer base. This can in turn increase the cost of downstream competitors by making it more difficult for them to buy inputs at similar terms and prices as if the merger did not take place.

14. The SCA mainly applies an "ability-incentives-effects framework" when assessing vertical mergers.

15. For assessing the ability to input foreclosure, the SCA considers whether the merging parties produce important input for the downstream product; whether the vertically integrated firm post-merger would have a significant degree of market power in the upstream market; as well as whether, by reducing access to its own upstream products, it could negatively affect the overall availability of inputs in the downstream market. The ability is mainly examined by qualitative facts, such as interviews with customers, suppliers, competitors and analysis of the number and capacity of suppliers in the upstream market.

16. For assessing the incentives to input foreclosure, the SCA investigates how profitable such foreclosure would be, often using the so-called “vertical arithmetic” based on margins and turnover data. In this method, one assumes that the vertically merging firm will take into account how reduced sales of input to downstream competitors will affect its overall profits. The merged entity is assumed to weigh the profit loss arising in the upstream due to reduced sales of input to downstream competitors, with the gain in shorter or longer term resulting from increased downstream sales or increased consumer prices. The profitability of the foreclosure strategy depends on upstream and downstream margins, as well as how much of the foreclosed rival’s demand would divert to the merging firm’s downstream entity.

17. To investigate the merged entity’s ability to foreclose the upstream rivals in the customer market, the SCA mainly examines whether there are sufficient alternatives in the downstream market for upstream competitors to sell their products to. The starting point of this assessment is usually to collect the opinions of the upstream competitors. In general, foreclosure of the customer market can only lead to competition concerns if the vertical merger involves a company that is an important customer with a significant degree of market power in the downstream market. If, on the other hand, the SCA’s contacts with the upstream competitors shows that, even without the merged firm’s downstream entity they would still have a sufficiently large customer base, the merger is less likely to lead to competition concerns.

18. Finally, the SCA investigates the effect of a vertical merger; i.e. whether input or customer foreclosure would lead to significant impediment of effective competition. As a general principle, the SCA considers that the foreclosed companies must play a significant role in the downstream market, in order for a foreclosure strategy to be deemed to be harmful. The greater the proportion of competitors foreclosed, the greater the risk of competitive harm. Sometimes, a market player may constitute a more significant competition constraint than others despite its smaller market share. This may be the case if it is a close competitor to the merging entity, or an aggressive, price-pressing player (Maverick). The SCA also takes into account other circumstances, such as purchasing power in the downstream market, or whether the merged entity can prevent new entrants from entering the market. The SCA also takes into account efficiency gains.

19. In contrast to horizontal merger investigations, to this point of time it has not been necessary for the SCA to apply advanced quantitative methods to measure potential price increasing effects of a vertical merger. The SCA’s experience is that although vertical mergers do require quantitative analysis, e.g. when analyzing incentive for foreclosure, qualitative facts have often been more decisive for the overall assessment. Concerns from suppliers and/or customers have also played an important role for formulating potential theory of harm. It should be noted that the SCA’s experience of assessing potentially harmful vertical mergers is limited, which could possible explain why advanced economic analysis to this point of time, has not been deemed necessary.

5. Statistics

20. The SCA does not keep any specific statistics on how many notified mergers that are vertical (or conglomerate) in relation to horizontal. However, a general observation is that a vast majority of those mergers notified to the SCA, and which require some deeper investigation, is of purely horizontal nature. Notified mergers with vertical aspects often

include both vertical and horizontal aspects. Notified mergers of solely vertical nature are rare.

21. The SCA's experience of vertical mergers that have raised serious competition concerns or intervention by the SCA is limited. Consequently, the SCA's experience of extensive vertical merger investigations in the technology, media and telecom sector is also rather scarce. None of the notified mergers with vertical aspects within the media or telecom sector has been subject to prohibition by the SCA, or court ruling. However, one case in the technology sector in 2014, which was mainly horizontal but also had vertical aspects, was found by the SCA to significantly impede competition and was ultimately prohibited. This case (*Swedbank Franchise/Svensk Fastighetsförmedling*)¹ will be described in more detail below.

6. Vertical mergers in specific sectors

22. The SCA does not keep any sector-specific merger statistics, and can therefore not claim that vertical mergers are more common in some sectors than in others. Nonetheless, the SCA has not observed any drastic trend towards notified mergers within specific sectors. Although the SCA has no sector-specific statistics, the SCA has noted that a few of those vertical mergers that have been assessed in more depth by the authority has concerned the technology, media or telecom sector. Further, the SCA has observed the current international trend of vertical integration in the telecom and media sector, specifically integration between contents providers and TV-distributors. The trend is present in Sweden as well. In 2018, the telecom operator Tele2 acquired the TV-distributor Com Hem, and the incumbent telecom operator, Telia, announced its intended acquisition of the content provider Bonnier Broadcasting, a transaction notified in March 2019 and where the investigation is still ongoing. Both these transactions met the turnover thresholds for notification to the European Commission, and hence they have not been investigated by the SCA.

23. Due to the SCA's limited experience, the authority has not remarked that the assessment of anti-competitive effects in vertical mergers is more challenging in some sectors than in others. However, as far as the telecom and media sector are concerned, it could be noted that these markets in Sweden are characterized by a few substantial players. Mergers in these sectors usually bring media attention and can cause some concerns among market players. However, those concerns can sometimes be of such kind that are difficult to consider in a merger review under to the Swedish Competition Act. As regards the technology sector, it entails a wide range of products, and the SCA has not observed any notable similarities between vertical mergers in this wide sector.

6.1. Efficiencies

24. The SCA relies on guidance and practice from the Commission when assessing efficiencies in mergers. In order for the SCA to consider efficiency gains, they should benefit the consumers. Efficiencies are investigated only if the SCA foresees that a merger may harm competition. However, if the parties wish to raise efficiency claims, they should consider providing relevant information early in the investigation.

¹ Case dnr 72/2014 and case dnr 426/2014.

25. Internalization of double mark-ups is the main efficiency gain relevant to assess in vertical mergers. If the unit in the upstream market sets a price to the unit in the downstream market that exceeds its marginal cost pre-merger, the merger can lead to cost reduction for input. This reduction can lead to lowering the price charged to customers.

26. To this point of time, the SCA has not, in any depth, analyzed claimed efficiencies in vertical mergers. However, the SCA's general stand is that vertical mergers are more likely to generate more efficiencies than horizontal mergers as the vertically integrated unit can internalize the costs of the inputs or increase the quality of the products. A vertical merger can thus generate efficiencies that can lead to increased competition and, as a result, offset potential anti-competitive effects.

6.2. Remedies

27. The SCA can only impose remedies suggested and tailored by the parties. When assessing remedies, the SCA relies on the guidance and practice from the Commission, especially on the Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

28. The SCA has limited experience of remedies in vertical mergers and no experience of remedies specifically in the technology, media or telecom sector. However, as a general principle, the SCA finds divestitures of business activities, remedies granting access to key infrastructure or inputs on non-discriminatory terms, and remedies regulating long-term exclusive contracts, to be most effective in vertical mergers that lead to competition concerns.

6.3. Some relevant cases

29. This section of the note will describe the SCA's experience of some vertical merger cases in the technology, media and telecom sector.

6.3.1. Technology sector

30. As concerned the technology sector, in 2014 the SCA found that a concentration between two real estate chains (*Swedbank Franchise and Svensk Fastighetsförmedling*) with vertical aspects, would significantly impede effective competition.² The merger concerned two of the leading real estate chains, but also had vertical aspects since the parties owned 25 percent each of *Hemnet*, Sweden's largest search platform for real estate advertisements.

31. The SCA found that the merging parties would get substantial market power in the market for real estate service, as well as in the market for real estate advertising. The investigation showed that real estates mediated and promoted by the parties were important for search platforms as *Hemnet* and its competitors, since they represented a substantial part of the market. The SCA found that the merger would give incentive for the merging parties to advertise their real estate objects only on *Hemnet*. The theory of harm was that *Hemnet*'s competitors in the market for real estate search platforms would not get sufficient real estate advertisement (input) in order to challenge *Hemnet*. Without access to the full customer base, the only competitor to *Hemnet*, *Blocket*, would be impaired to compete and challenge *Hemnet*'s leading position, and it would also be a significant entry barrier to

² Case dnr 72/2014 and case dnr 426/2014.

potential competitors. The SCA filed for a motion in court to forbid the merger. The court ruled in line with the SCA's motion.

32. Another merger in the technology sector that the SCA analyzed in more depth is *Assa Abloy's* acquisition of *Swesafe AB*³ which involved manufacturing and wholesale sales of locks and fittings, and manufacturing and installation of automated doors. Assa was active in the upstream and downstream market (through *Copiax*) and Swesafe in the downstream market.

33. The SCA investigated the risk for input and customer foreclosure. The SCA also investigated the potential risk for, and competition harm arising from, sharing of commercially sensitive information between the merged entities.

34. As regards input foreclosure, the SCA investigated full and partial foreclosure. In order to investigate the risk for input foreclosure, the SCA collected data of margins and turnover in different production lines. The SCA also collected data on Assa's sales to Swesafe and to its own subsidiary (*Copiax*) in the downstream market. The SCA analysed how profits in different production lines would be affected by different foreclosure scenarios. The SCA found that incentive for input foreclosure was unlikely.

35. As regards foreclosure of customers, the SCA did not find that Swesafe was a significant customer. Further, the investigation did not show that Assa's competitors were dependent on selling products to Swesafe in order to exercise an effective competitive pressure on Assa. The SCA found that a risk for customer foreclosure was unlikely.

36. The SCA also investigated four scenarios in which sharing of sensitive commercial information between the parties could potentially harm effective competition.

37. The first scenario that was investigated was the likelihood of Swesafe using information regarding Assa's discounts to other locksmiths, in other words competitors to Swesafe, in an anticompetitive way. The SCA investigated if Swesafe's knowledge of Assa's discount would be merger specific, and whether Swesafe could use the information to foresee its competitors' pricing and adjust its offers accordingly. The investigation showed that Assa's discounts, to a large extent, were known on the market since they were based on publicly available price lists and volume discounts. Further, the investigation showed that the price was determined by other significant posts, such as material and labour costs. Hence, the SCA found that Swesafe would not get enough information to foresee its competitors' pricing.

38. The second scenario was whether Assa through Swesafe would get information about its competitors' discounts to locksmiths, and if this information would allow Assa to price less aggressively. The SCA found that Assa, through regular contacts and negotiations between locksmiths and producers, already had some information on its competitors' pricing. This fact, in combination with the fact that Swesafe's market share in the downstream market was rather moderate, lead to the conclusion that Assa would not be able to use the information on its competitors pricing to such an extent that an effective competition would significantly be impaired.

39. The third scenario was whether Assa, by receiving information on upcoming project through its project and architect services, would steer customers to Swesafe's locksmith services. The theory was that the link between Assa's and Swesafe's services

³ Case dnr 588/2010.

could lead to consumer harm. However, the SCA did not find this theory to be likely since Assa was not a substantial player in the market for project and architect services.

40. The fourth and last scenario was whether Swesafe would get access to information in certain contracts between Assa and its customers, and if Swesafe could use the information to approach and process important customer to Swesafe's competitors. The investigation showed that the handling of the agreements, and the information therein, was strictly regulated due to safety reasons. Only a few individuals in Assa had authority to handle the information.

41. The overall conclusion was that the merger would not result in significant impediment of effective competition. The merger was cleared without any conditions in phase two.

6.3.2. Telecom sector

42. In 2014, the SCA investigated *TeliaSonera's* acquisition of *Zitius*.⁴ TeliaSonera was a vertically integrated group in the telecom sector that, among other services, provided broadband services to end-users via xDSL/copper, fiber and mobile broadband, bit-stream access to wholesale customers via copper net, and communication operation service to open fibernet.⁵ Zitius was a communication operator. Although the merger mainly raised horizontal concerns, internet service providers and Tv-distributors via broadband were concerned that TeliaSonera would be able to foreclose other service providers, or apply conditions that would make it less profitable for them to operate in the networks where TeliaSonera was a communication operator.

43. The SCA's investigation showed that the ability for a communication operator to reduce the number of service providers in its network was limited, since network owners required a large number of service providers when procuring a communication operator. Regarding TeliaSonera's incentive to foreclose other service providers, the investigation showed that TeliaSonera would not have sufficiently large incentive for foreclosure. In order for the foreclosure strategy to be profitable, the lower customer penetration must be offset by the fact that a sufficient number of end customers spills over to its own vertically integrated service provider and/or that the service provider can charge higher prices to end customers. The SCA found such foreclosure would not be profitable, since a communication operator best achieved its profitability through high customer penetration at the consumer level, and because both the communication operator and the service provider segment are characterized by low margins.

44. The overall assessment showed that the merger would not result in significant impediment of effective competition. The merger was cleared without any conditions in phase two.

⁴ Case dnr 89/2014.

⁵ The communication operation service model is specific to the Swedish broadband market. A communication operator provides an open environment where multiple service providers can sign agreements with a communications operator to market their services to the end users, typically in multi-dwelling residential apartment buildings in towns and cities.

6.3.3. Media sector

45. In 2009 the SCA investigated *Tidningarnas Telegrambyrå Ab (TT)*'s acquisition of the media monitoring and analysis company, *Retriever*.⁶ TT provided media contents from news agencies, which is an upstream market in relation to the market for media monitoring and analysis. TT was owned by Sweden's largest media houses.

46. The SCA mainly investigated if the merger would lead to input foreclosure; TT's ability to foreclose *Retriever*'s competitors from news material by TT in newspapers, and the risk for TT's owners to foreclose *Retriever*'s competitors from their digital press clippings, resulting in harming *Retriever*'s competitors in the market for media monitoring and analysis.

47. The SCA's investigation showed that TT was the main news agency in Sweden and that a substantial part of the Swedish newspapers' material (input) was from TT. News material produced by TT was protected by copyright, which restricted media monitoring companies from including TT's news material in their services/products without consent. However, the reference links (to TT's news) that the media monitoring companies used in their monitoring services did not constitute such disposal of content protected by copyright. Therefore, the SCA found that TT did not have the ability to foreclose other media monitoring companies from providing their customers with links to newspapers containing TT's news material.

48. Regarding the ability for TT's owners to foreclose *Retriever*'s competitors from their digital press clippings, such foreclosure means that the newspapers would deliver their digital press clippings exclusively to *Retriever*. Since the material produced by the newspapers was protected by copyright, the media monitoring companies that wanted to provide monitoring of newspapers sources needed to enter an agreement with the newspapers. The SCA's investigations found that a foreclosure would not be a profitable strategy for the owners of TT. The investigation showed that digital press clippings from TT's owners were not necessary to provide digital monitoring services. Further, the investigation did not support that media monitoring through digital press clippings constitutes a separate relevant market, since monitoring of newspapers' web material was found to be sufficiently near substitute. The SCA found that the merger would not facilitate TT's owners to foreclose *Retriever*'s competitors from digital press clippings.

49. The SCA's overall conclusion was that the merger would not significantly impede the existence or development of effective competition and cleared the merger in phase two.

50. Post-merger, in 2014, the SCA received a complaint that *Retriever* imposed exclusivity agreements with its owners, four of the major newspaper houses in Sweden. The agreement gave *Retriever* exclusive right to purchase and resell digital versions of printed newspapers owned by these newspaper houses. The SCA initiated an investigation on whether the exclusivity-clause constituted a violation of the prohibition of anti-competitive cooperation, or violation of the prohibition of abuse of a dominant position. Shortly after the investigation started, *Retriever* announced that the exclusivity clause was removed. Three of the four newspaper houses signed an agreement with *Retriever*'s competitor, *Opoint* for delivery of digital press clippings. The SCA did not investigate the complaint any further.

⁶ Case dnr 219/2010.

7. Ex-post studies

51. The SCA has not conducted any specific ex-post study of vertical mergers that have been cleared. However, from time to time, when found to be relevant, the SCA conducts ex-post studies of mergers. The SCA's view is that the right amount of time must have elapsed before an ex-post study of a specific merger can be conducted. Possible effects of a merger can only be measured after a certain time.

52. The latest ex-post study was conducted in 2018,⁷ when the SCA accomplished a follow-up study of a number of previously cleared merger cases. The results of Telia's acquisition of Zitius, described above, was also analysed. The case raised several interesting questions about the development in the market post-merger, for example if the concerns that were raised during the merger investigation became reality. The follow-up was mainly based on interviews with various actors related to the communication operator market. In addition, the SCA analysed statistics from the National Post and Telecom Agency (PTS), in order to evaluate how the market had changed post-merger.

53. The SCA's ex-post study showed that in general, the market for communication operators had undergone a consolidation and increased vertical integration since the merger. Previously, there were a number of communication operators who were "neutral" in the sense that they were not service providers nor network owners. Today, the market consists of a few large communication operators who also work as service providers and, in some cases, also as network owners.

54. Regarding the theory of harm that Telia would foreclose other service providers in its own network (analysed in the merger review), the investigation carried out by the PTS confirmed that vertically integrated communication operators' own service provider tended to be larger in its "own" network. The SCA did not carry out a price study within the framework of this follow-up, however there was no indication that broadband prices increased as a result of Telia's acquisition of Zitius.

55. Market players that the SCA contacted affirmed that consumers was offered lower prices since the merger resulted in efficiency gains. Another positive aspect of the merger was that the quality of the communication operator services had improved, as the major players, including Telia/Zitius, are stable and reliable.

⁷ Konkursverket's konkurrens- och upphandlingstillsyn 2018 (rapport 2019:1).