

Anticipated acquisition by Arqiva Limited of certain parts of the satellite broadcast services business of British Telecommunications plc

The OFT's decision on reference under section 33(1) given on 14 February 2007. Full text of decision published 22 February 2007.

Please note that square brackets indicate figures or text which have been deleted at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Arqiva Limited (Arqiva)** is a wholly owned subsidiary of Macquarie UK Broadcast Holdings Limited which is itself owned by a consortium of investors. It supplies satellite distribution services, terrestrial transmission services, content to handheld devices, multi-operator infrastructure services and frontline communications to some of the UK emergency services.
2. **British Telecommunications plc's Satellite Broadcast Services business (BT SBS)** comprises contracts and assets related to satellite distribution services and Satnet¹ business. BT SBS' turnover from satellite distribution and up-linking services for television broadcasting to UK viewers in the financial year ending 2006 was £ [].

TRANSACTION

3. Arqiva proposes to acquire BT SBS. The OFT received a submission on 12 December 2006 and the OFT administrative deadline expired on 8 February 2007.

¹ Portable telecommunication assets.

JURISDICTION

4. As a result of this transaction, Arqiva and BT SBS will cease to be distinct. The parties overlap in the supply of satellite distribution services for television broadcast to UK viewers. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met since the merging parties' estimated combined share of supply will be more than 25 per cent. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

Product scope

5. The parties overlap in the supply to television broadcasters of full-time² satellite distribution services for television broadcasting to UK viewers on the digital satellite platform.
6. The merging parties submit that the frame of reference should include all existing digital television platforms, whether using satellites or not, such as cable TV, Digital Terrestrial Television or Internet TV. Third parties who have commented on this case have unanimously replied that other platforms are not, at present, a substitute to digital satellite distribution platforms due to substantial differences in terms of cost, coverage, penetration, regulatory obligations and technical capabilities. Thus, our assessment has focused on the distribution process on the digital satellite platform.
7. Satellite distribution services are made up of three elements: (1) up-linking (communicating from land-based teleports to a satellite transponder); (2) satellite capacity (leasing all or part of a satellite transponder and the down-linking services to home dishes); and (3) other related services (such as monitoring, archiving, terrestrial connectivity, multiplexing, encoding and encryption) which are required or enhance television broadcasting distribution.

² As opposed to Occasional Use (OU) which is not affected by this merger.

8. All three elements of the satellite distribution service can be sold under one contract (bundled services) or separately (possibly combining with self-supply of some of the elements). Up-linking is sold separately by both the parties. The OFT will not consider any further the provision of stand-alone satellite capacity nor other related services as there have been no third party concerns, the parties do not resell spare capacity or generally any of the other related services separately.
9. On the demand side the parties proposed that bundled customers could substitute a combination of unbundled services in the event of an increase in price. Third parties disagreed that this was always true. It may be the case for larger customers, as they often can self supply at least some of the service elements and have enough content to use all the satellite transponder capacity which the large broadcasters would lease. Smaller customers felt that unbundled services were not an adequate alternative, in particular as they would have to lease more satellite capacity than they would use (as there is a minimum size they can lease and this could only be fully used by sub-letting the spare capacity). The OFT has therefore concluded that large broadcasters can purchase either bundled or unbundled service elements. However, for broadcasters which require less capacity than the minimum size that satellite operators would let (a full transponder or a substantial part of it), by and large the most cost-effective alternative is to purchase bundled services from companies such as the merging parties. This suggests that competition operates differently for large and small-to-medium-sized customers. The assessment below therefore focuses on small-to-medium-sized customers for whom the option of using unbundled satellite distribution services does not provide a constraint on the parties' bundled offering.
10. The parties also argued that the bundled service constrained the price of the separately provided up-link element, such that they were in the same frame of reference. The OFT has not been provided with any evidence that a customer would switch in response to a 5 to 10 per cent price increase.
11. On the supply side, the merging parties submit that the bundled service (or up-linking alone) could be provided using teleports currently used for voice and data in response to an increase in the price of those currently used for broadcast. Third parties have unanimously replied that while the transmission equipment might be broadly similar or easily accessible, the expertise required is different. Taking a cautious view of the frame of

reference and the constraint from such providers, the use of such teleports is considered as new entry rather than within the same frame of reference.

Geographic scope

12. On the geographic scope of the frame of reference, since the footprint of the satellite transponders used by UK broadcasters extends to Western Europe the principal determining factor for both up-linking services (supplied separately) and the bundled service is whether the location of terrestrial teleports leads customers to see services provided through these teleports as a substitute for up-linking services through UK-based teleports. Third parties agree that teleports on continental Europe can uplink to Eutelsat's Eurobird 1 (which is the satellite used for all provision of bundled services bar BSKyB³) and to SES Astra's satellites⁴ (which are used for unbundled services and by BSKyB). However, many were concerned about the extra cost of circuits required to reach the continental teleport. There are a few recent examples (such as Globecast) of up-linking from continental teleports being offered separately or those offering a bundled service in the UK using a continental teleport.
13. On the face of the mixed evidence before it, the OFT has therefore taken a cautious approach and has considered the geographic scope of the frame of reference to be the UK only, but has considered continental teleports in the context of new entry.
14. The merger will therefore be assessed as to a) the supply in the UK to television broadcasters of full-time satellite distribution services for television broadcasting to UK viewers on the digital satellite platform (bundled services); b) up-linking for broadcasters in the UK.

HORIZONTAL ISSUES

Bundled services

15. There are currently four companies that provide bundled services: Arqiva, BT SBS, Globecast and British Sky Broadcasting Group (BSkyB). The merger from four to three prompted concern from a very small number of

³ British Sky Broadcasting Group.

⁴ Astra 2A, Astra 2B and Astra 2D.

customers out of those contacted that price would rise or quality decline if they could no longer threaten to switch from Arqiva to BT for bundled services and also could not switch to unbundled services.

16. A minority of third parties expressed the view that BSkyB would provide only a partial constraint on the merged entity post-merger as it is an integrated broadcaster. BSkyB provides bundled satellite distribution services (as well as some limited unbundled service elements) to some third parties whose channels are not carried as part of its Sky retail satellite TV offering. However, its focus is on its own retail television broadcast offering and its incentive to offer bundled services would differ from those of Arqiva, BT and Globecast. For example it would have little incentive to provide these services to a channel that competes with one within the 'bouquet' of television channels in its own retail broadcast offering.
17. When considering BSkyB as a constraint on the merged entity post merger, the key issue is whether Arqiva will be able to discriminate against those channel providers for which BSkyB is not an option. While Arqiva might have the ability to price-discriminate against such channels, the OFT is not aware of any evidence that this has occurred to-date. However, most contract negotiations take place on a bilateral basis, are to an extent bespoke and whether or not BSkyB would have an interest in providing bundled services to a given channel will be considered by BSkyB on a case by case basis. The fact that BSkyB has, in the last three years, only taken part in 13 out of 129 contracts that have been brought to the attention of the merging parties, and won 12 of them - all for channels which then continued to be part of BSkyB's own retail offering – might be considered to reinforce the view that BSkyB is only a partial constraint on the parties post-merger.
18. The OFT contacted a large number of customers about the merger and the vast majority who responded were not concerned. The two that did have issues however focussed on Sky not being an alternative, leaving them with a choice of two realistic competitor alternatives post-merger. While it is clear that for some television broadcasters Sky is an alternative as it has spare capacity to expand, for those for whom it is not the merger will lead to a reduction from three to two competitors.
19. The evidence suggests that Globecast will remain a competitive constraint on Arqiva post-merger for all customers, with capacity, expertise and

willingness to compete for as many contracts as possible. According to the data on contracts provided by the parties, which has been corroborated by third parties, Globecast was Arqiva's closest competitor rather than BT in the majority of cases. Arqiva and Globecast have competed vigorously with each other in nearly all cases where only two competitors have presented offers. BT was not present as a competitor in most of these cases.

20. However, for one quarter of the competitions known to the parties three competitors were present, as BT quoted as well. For these competitions Globecast will remain an active competitor post-merger and for the reasons given below there is every reason to expect new entry to occur and provide an additional constraint post-merger.

Barriers to entry and expansion

21. In considering entry or expansion, there is evidence of surplus capacity at teleports and on satellites (at transponders). The OFT considered whether technical expertise or lack of economies of scale (in other words insufficient channels from customers to lease a full satellite transponder) could represent barriers to entry in the provision of bundled services. Customers did not express concerns in terms of reliability or technical ability of potential new entrants. With regard to economies of scale the OFT notes that the number of new channels / contracts that come up each year (estimated at some 50 contracts per year) provide a significant incentive for new entrants to compete for new satellite distribution contracts with the expectation that they could achieve any necessary economies of scale. The OFT also notes that customers have expressed their willingness to switch to alternative suppliers if prices increase above the competitive level or if quality declines.
22. The merging parties submitted that SES-ASTRA and Eutelsat, the two satellite operators, are new entrants in the provision of bundled services. While third parties did not see either as having yet entered, an examination of the circumstances indicates that entry by both these businesses is feasible. Both have spare satellite capacity, with SES Astra having capacity on Eurobird, as well as the more expensive Astra satellites. Both have offered to provide up-linking services for UK customers using their teleports in Luxembourg and in Paris. One is providing satellite capacity and an uplink via its Western European teleport for a bundled service (indeed third

parties told the OFT that one bundled service provider already uses its Continental teleports for its bundled service offering in the UK). One has recently moved downstream by buying a German business providing satellite broadcasting and other related services. Both have reputation from the upstream service and would be able to use their control of spare capacity to more easily meet any scale requirements. These developments suggest that at least one of the satellite operators may be considered as a well placed potential entrant in the event of an increase in price or decline in service by the parties.

23. Also, third parties have suggested that there are companies active in the provision of standalone elements of the bundled services that have the potential to enter or expand, since they have the reputation, expertise and willingness to compete actively in the market for bundled services. In addition to the satellite providers this may include other providers of uplinking services or those currently self providing. On the basis of the evidence before the OFT, there is enough spare capacity which can be used to enter bundled services.
24. Therefore, on the information available to it, the OFT considers that there are potential competitors with both the ability and the incentive to enter should Arqiva, post merger, increase prices higher (or its service quality decline further) than absent the merger. These companies represent a credible threat of entry or expansion on the merging parties.

Up-linking

25. The providers of up-linking services to broadcasters using satellite distribution are the same as those who provide bundled services, with the addition of Siemens, which provides a standalone up-linking service to the BBC. One third party argued that the merger would lead to further concentration to two major suppliers, giving the parties increased economies of scale, which would deter entry or expansion. Customers, however, were unconcerned. They are mostly large broadcasters who considered they had countervailing buyer power. If there were any price increase or a decline in the quality of service as a result of this merger, these broadcasters consider that they could either sponsor a new entrant or start self-supplying standalone up-linking services. As noted above there are also existing overseas suppliers of up-linking beginning to offer services

to UK customers and potential entry from existing voice and data teleports. On the basis of the evidence before it, the OFT does not consider the merger raises competition concerns in respect of uplinking for broadcasters.

THIRD PARTY VIEWS

26. A large number of customers, competitors and potential entrants were contacted by the OFT. Of those who responded, almost all were unconcerned. The concerns of two on bundled services and one on up-linking are addressed above.

ASSESSMENT

27. The main area of overlap between the merging parties is the supply to broadcasters of satellite distribution services for television broadcasting to UK viewers of digital satellite television. This comprises three service elements which can be purchased under one contract (bundled services) or separately. The services are: 1) up-linking services; 2) satellite capacity; and, 3) other related services. The bundled service is considered to be the appropriate product scope of the frame of reference for the purposes of this case as the unbundled option was not an adequate alternative for smaller broadcasting customers. The parties also overlap in the provision of stand-alone (unbundled) up-linking services. A cautious view was taken of the geographic scope of the frame of reference, which was limited to the UK for the purposes of this case in respect of both the bundled service and stand-alone up-linking services.
28. In respect of bundled services, the merger removes one of four existing suppliers. For some broadcasting customers the fourth provider, BSkyB, was not an option as BSkyB is a rival in the downstream retailing of TV channels. For the majority of competitions for satellite distribution services, Globecast was Arqiva's closest competitor, rather than BT. For about a quarter of competitions, BT was considered as a competitor to Arqiva. Although the vast majority of third parties were unconcerned, two customers which saw BT as a significant competitor to Arqiva were concerned. However, Globecast will remain an active competitor post-merger, and potential competitors have the ability and the incentive to

enter should Arqiva attempt to raise price or reduce service quality by a significant amount post-merger.

29. On the basis of the evidence there is sufficient terrestrial teleport and satellite transponder capacity to make entry feasible. The incentive to do so in the event of an increase in price or decline in quality of service from the parties is significant given the current levels of profitability in the supplying of distribution satellite services. Third parties support this view and there is evidence that entry is being contemplated.
30. In relation to stand-alone up-linking services, customers felt they had countervailing buyer power in the form of sponsored entry or self provision and again there is evidence of entry from competitors located outside the UK.
31. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

32. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.