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**Session I: Disruptive innovation in Latin America and the Caribbean:
Competition enforcement challenges and advocacy opportunities**

-- Contribution from Mexico --

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The attached document from Mexico (IFT) is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session I at its forthcoming meeting to be held on 12-13 April 2016 in Mexico.

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LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM



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14th Latin American and Caribbean Competition Forum 12-13 APRIL 2016, Mexico City, Mexico

Session I: Disruptive innovation in Latin America and the Caribbean: Competition enforcement challenges and advocacy opportunities

The disruptive impact of broadband and the decline of traditional television markets: the case of Mexico

-- CONTRIBUTION OF MEXICO (IFT)* --

1. On disruptive innovation in Latin America and the Caribbean

1.1 *What recent innovations have been introduced in your jurisdiction that have disrupted, or have the potential to disrupt, existing markets?*

1. The telecommunications and broadcasting sector in Mexico has undergone a number of technological changes and some important innovations in recent years. The digitalisation of signals, which encouraged the convergence of networks, and the growing penetration of broadband have sparked significant changes, in Mexico as in the rest of the world, in audiovisual services, more specifically in pay TV and broadcasting.

2. Today there is a very wide offering of video content that can be accessed through various media, in addition to the traditional channels offered by broadcast TV and pay TV (cable and satellite). Thanks to broadband Internet (in both its fixed and mobile forms) new business models are emerging for the transmission of content, and these are changing the way in which consumers make use of these services, generating substantial shifts in the manner, the place and the timing of consumption. An important advantage of these new models for transmitting via the Internet is that they give consumers greater

* Contribution of the Federal Telecommunications Institute (Instituto Federal de Telecomunicaciones, IFT).

flexibility to procure only the content they want. With conventional pay TV, the consumer pays for a package of channels containing a varied mix of content, much of which will not be viewed.¹

3. The development that broadband has experienced in recent years has allowed a substantial improvement in the speed of transmission and in the quality of services provided by this medium. Its growing use is having an impact on conventional markets, which are beginning to react to these new entertainment alternatives. Broadband could in this way represent, over the medium term, a disruptive element that would alter the value chain of conventional television.

1.2 How have incumbents reacted to these innovations? Have they engaged in anticompetitive conduct?

4. To comprehend the changes that are taking place as a result of innovation in audiovisual transmission services it is important to understand the chain by which TV content is delivered to the final users.

5. **The TV value chain.** From a general viewpoint, the TV value chain in Mexico can be divided into three broad segments: production, integration (or aggregation), and distribution. The production stage covers content creation and includes activities such as the generation of the concept or idea, scripting, recording etc. The main source of revenue for production companies is the sale of licenses for use of the content they produce and/or transmission rights for that content.

6. In the integration stage, the various content produced is packaged in channels. The content is integrated and shaped to suit audience characteristics, and is then programmed for each channel in light of viewers' times and patterns of consumption.

7. Lastly, the companies that comprise the distribution stage are responsible for delivering the packages or channels to the final users, as well as for invoicing users (in the case of pay TV services) and selling advertising space. The firms carrying out the distribution of the content are the operators of public telecommunications or broadcasting networks, and it is they who invest in the infrastructure and, as necessary, pay license fees for the spectrum they need for transmission. In the conventional model, these firms were divided according to the manner in which they deliver content to the user: broadcast or free-access television, and pay TV services (whether by cable or DTH (direct to home)). The revenues of the first group derive normally from the sale of advertising,² while those of pay TV companies come from the fees paid by subscribers and, to a lesser extent, from the sale of advertising space.

8. The growing penetration of fixed broadband services and the possibility of transmitting content with reasonable quality constitute a disruptive innovation in several of the value-chain segments described. This development makes it possible to offer a greater variety of services. When it comes to television content, the viewer has access to, among other services, "Video on Demand" (VoD), video playback, pause, fast-forward/rewind, reproduction of content without the need to download it locally (streaming), access to new content, purchases etc.

9. **OTT services and television.** OTT ("Over-the-Top") services involve the distribution of content via the Internet, by a provider that is independent of the company offering the Internet services. The

¹ Some international studies suggest that conventional pay TV providers have opted to increase the number of channels in order to boost the price of their packages, while consumers, for their part, use on average fewer than 20 channels. In this context, the growth of OTT ("over-the-top" services) can be explained in part by the fact that they offer customers the possibility of viewing only what they want, and paying less for it.

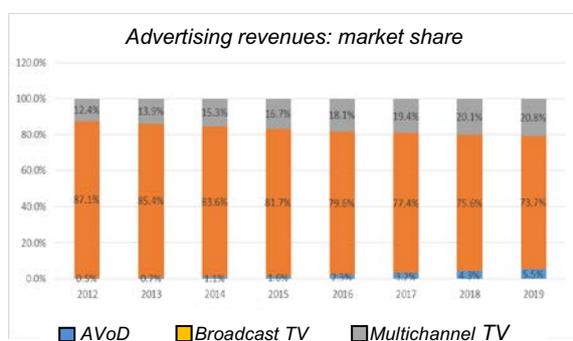
² In Mexico, TV broadcasting firms such as Televisa and Televisión Azteca are also content producers and they earn additional revenues from the sale of that content.

principle of "Web neutrality" requires that the Internet service provider must give equal treatment to all the information it transports over its network, with no preferential advantages of any kind. Thus, OTT services are beginning to compete with conventional content distribution services, which may in fact belong to the company that owns the network offering the Internet. In some cases, it is the conventional distributors themselves that develop OTT platforms in order to diversify their service portfolio and offer various distribution channels. OTT services can be classified as follows:

- Live TV. The Live TV option is a model where the content is transmitted via the Internet by streaming to the final user. The quality of transmission depends directly on the quality of the broadband connection.
- TVoD (Transactional Video on Demand or Pay Per View VoD). OTT TVoD services represent a new means of distributing video content, where viewers pay for each video file selected. It comes in two forms: EST (Electronic Sell-Through), referred to in some cases as DTO (Download to Own), which is the digital sale of a video file (films, serials, etc.) which the user can access via the Internet on an unlimited number of occasions. This option represents an alternative to the home video market. The other option, known as DTR (Download to Rent) consists of the digital rental of video content that can be accessed by the Internet for a specified period of time. There has been notable growth in the market penetration of OTT TVoD services, as can be appreciated from Figure 3.
- OTT VoD. The VoD services include AVoD (Ad-supported Video on Demand) and SVoD (Subscription Video on Demand). With the first, viewers can access video files free of charge, receiving advertising messages at various moments during programme reception. Normally, a portion of the profits obtained through advertising is earmarked for the content provider. This option is seen as an alternative means for firms to publicise themselves, and can become a complementary element to the conventional way of advertising products or services. With SVoD, viewers can access the entire menu of contents via the Internet, in return for payment of a fixed monthly fee. This alternative could represent future competition for pay TV.

10. The sale of content via the Internet offers several advantages over the conventional options (pay TV and broadcast) in terms of selling advertising space. One of those advantages is that, by definition, it allows fragmentation of the market. Another is the possibility that the company advertising via AVoD can track consumption patterns and preferences so that advertising can be targeted at a particular viewer or group of viewers. Similarly, it offers the possibility of interaction with the potential customer, who with a simple click can access direct purchase or request further information. The Internet offers advertisers an enormous range of publicity mechanisms that include showing a banner during programme reception, placing audiovisual information prior to programme reception, or sponsoring the launch of a new screening in full. Nevertheless, in Mexico advertising via broadcast TV is still the main alternative for advertisers, and OTT services represent an option for reaching viewers in a more focused and targeted way, offering interactive possibilities. (See Figures 1 and 2).

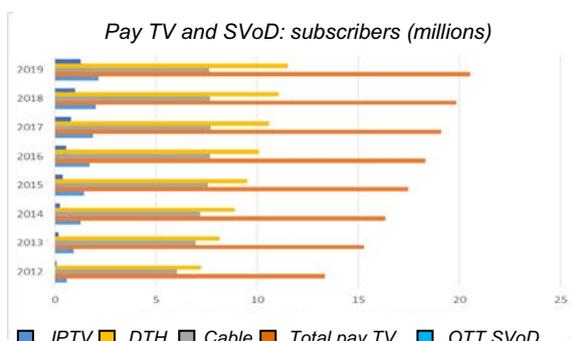
Figure 1



Note: multichannel TV includes pay TV systems (cable and DTH) as well as other digital thematic media (newspapers, magazines etc.)

Source: Ovum

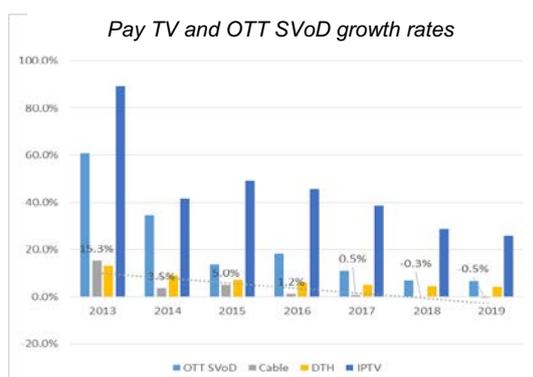
Figure 2



Source: Ovum

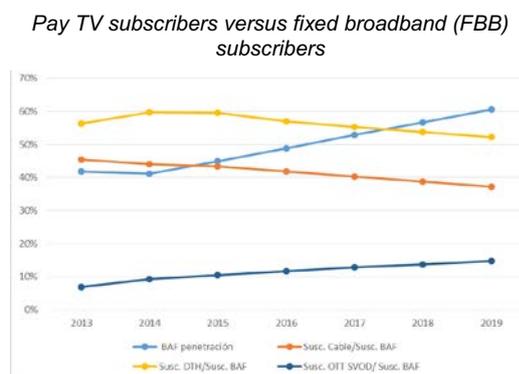
11. Figure 3 compares growth rates for the various pay TV alternatives and OTT SVoD services. With these latter services, the high growth rates apparent in 2013 and 2014 corresponded to the initial stage of service introduction: having fallen in 2015, that growth is projected to stabilise at rates higher than those estimated for the various pay TV options. It will be noted that, as of 2018, the number of cable TV subscribers is in fact projected to decline.

Figure 3



Source: Ovum

Figure 4



Source: Ovum and IFT.

12. As noted above, video content distribution services are directly related to broadband. Figure 4 compares the number of pay TV subscribers against the number of fixed broadband (FBB) subscribers, as well as subscribers to OTT SVoD and IPTV services. With the conventional pay TV alternatives, there is an inverse relationship in the growth rates for cable and DTH subscribers versus total FBB subscribers,

while in the case of OTT and IPTV subscribers the ratio is positive (the growth rate is greater). The same Figure compares the results obtained with the level of fixed broadband penetration per 100 households.

13. The technological developments described above could have an impact on the television value chain, which is in a process of reconfiguration whereby all stakeholders can seize the opportunities offered by broadband. At the present time, content producers can reach viewers directly, thus eliminating one link in the chain. Increasingly, consumers will be doing their own packaging through content selection. Advertisers are gaining access to new promotion platforms in addition to marketing their products in the conventional manner.

14. Today the conventional suppliers of broadcast and pay TV are positioning themselves on the new platforms that broadband offers. New content programmers and Internet distribution companies are also emerging. This development, while still in its early stages, could alter the market structure, although at the time this report was prepared the Federal Telecommunications Institute (IFT) had not identified any anticompetitive behaviour related to innovation in audiovisual distribution services.

1.3 If the innovations took place in regulated industries, how did the regulator(s) respond? Are there any unique characteristics of these innovations relative to disruptive innovations occurring in, or developed in, other regions of the world?

15. In 2014 the IFT, as the regulator of telecommunications and broadcasting and the entity responsible for enforcing the Federal Economic Competition Act (LFCE) in these sectors, issued an asymmetric regulation to the Preponderant Economic Agent (PEA) in the broadcasting sector.³ That regulation, which bans the tied sale of content and prohibits discriminatory treatment, including in advertising spaces, together with the "must carry" and "must offer" obligations introduced in the constitutional reform, facilitates the inclusion of more attractive channels in the packages of competing firms, regardless of the platform they use.

16. The IFT has not applied regulation to OTTs, despite repeated demands to do so from conventional distributors of television signals. OTT services, as possible disruptive innovators, have the potential to inject dynamism into the traditional TV markets. The role of the regulator will be to ensure that conditions are propitious for the development of these alternatives, while avoiding any hasty regulation that would dampen this dynamism.

17. Mexico has one characteristic that distinguishes it from other countries: the former telephone service monopoly, Telmex, is prohibited by its license from distributing TV signals, and this has kept it out of the game in distributing content via conventional platforms.

³ According to the Federal Telecommunications and Broadcasting Act (LFTyR), an economic agent is preponderant if it holds a share of more than 50% in the telecommunications sector or in the broadcasting sector, and is therefore subject to additional regulation. See article 28 as well as transitional articles 4, 8-I i III and 9 of the Mexican Constitution, article 15 (XXI to XXIII), title XII of the LFTyR on Asymmetric Regulation and Preponderance, which includes articles 262 to 277, as well as articles 119-121; 131, 133, 138, 158, 166, 206 and 208 of said regulation.

2. On market definition issues in innovation-driven markets

2.1 *Has your authority encountered challenges with respect to market definition in an innovation-driven market, including (i) rapidly evolving or disappearing boundaries between markets, or (ii) highly customized products?*

18. The growing penetration of fixed and mobile broadband services means that new audiovisual applications are now within the potential reach of a majority of the population. In the third quarter of 2015⁴ there were 14.3 million fixed broadband and 57.5 million mobile broadband subscribers. The penetration rate for these services in Mexico last year was 44 per 100 households and 48 per 100 inhabitants, respectively.

19. This growing teledensity has gone hand in hand with an improvement in the quality of Internet services that users receive. In 2015, 9% of users had fibre optic links and 71% had link speeds of between 10 and 100 Mbps. These technological improvements, and the growing penetration of services, offer greater access to new video applications and services, the disruptive effect of which has just begun to make itself felt in Mexico.

20. In September 2015 the IFT adopted a rule for determining the existence of an economic agent with substantial market power⁵ (*agente económico con poder sustancial de mercado*, AE-PSM) in the pay TV market. When substantial market power is found to exist, the IFT will impose ex ante regulation to protect the healthy development of competition in the market.⁶

21. As part of the investigation and research conducted in the process of determining the AE-PSM, it was important to consider technological changes and the possible disruptive impact of video transmissions via the Internet. The IFT examined the possibility of substitution between OTT services and pay TV. This analysis evaluated OTT subscription services such as Claro TV and Netflix; free services funded through advertising such as YouTube and Crackle; and those received as a complement to a pay TV subscription, such as Dish Online, Total Play Donde Sea and others. It also considered the possibility of acquiring channels, shows and news directly.

22. The IFT Plenary concluded that **at the present time** OTT services do not exert sufficient pressure in terms of competition to pay TV, considering that: (i) they are focused primarily on offering a catalogue of audiovisual programmes which has mostly already been premiered through other platforms; (ii) in contrast to pay TV, they do not offer linear programming in particular and they do not own high ratings channels like pay TV players do; and (iii) they are dependent on the Internet connection capacity (in Mexico speeds are still low). The IFT also recognised that a significant number of pay TV subscribers have no Internet connection. On this point, the 2014 National Survey of Household Incomes and

⁴ Unless otherwise specified, the source of the data included in this note is the IFT, Statistical Report, Third-Quarter.

See http://www.ift.org.mx/sites/default/files/contenidogeneral/estadisticas/informetrimestral3q2015version_habilitada_paralectordepantallav4.pdf.

⁵ The determination of an AE-PSM is made on the basis of the LFCE and the conventional tools of analysis in this area, in contrast to the concept of "preponderance", which depends solely on market share.

⁶ See: <http://www.ift.org.mx/sites/default/files/conocenos/pleno/sesiones/acuerdoliga/dofpiftext03091594.pdf>.

Also of interest is the determination of the existence of an AE-PSM in 2014.

See: <http://www.ift.org.mx/sites/default/files/conocenos/pleno/sesiones/acuerdoliga/dofpiftext300915114.pdf>

Expenditures found that 46.8% of households with pay TV services have no Internet connection.⁷ From the foregoing, it may be concluded that OTT services and other transmissions via the Internet do not yet represent sufficient competitive pressure vis-à-vis pay TV.⁸

23. The rapid penetration of broadband services suggests however that, over the medium term, OTT services and other video transmissions by the Internet will have a disruptive effect on the choice of entertainment services in Mexican households.

2.2 *Has your authority seen the emergence of online platforms being used to justify mergers of "bricks and mortar" retailers (the "but Amazon" defence)? How did it respond?*

24. The IFT has not encountered any such cases in the course of its regulatory work.

3. *On two-sided markets: has your authority adapted traditional market assessment tools to consider two-sided markets?*

25. The IFT has used two-sided market analysis in certain cases. We may note the investigations conducted to *determine the substantial market power of GTV*, in various geographic areas. The last of those investigations was resolved in August 2015, and is referred to in section 2.

26. In this case, it was considered that pay TV platforms can constitute multi-sided markets. On one hand, they offer audiovisual services to final users against a monthly fee. On the other hand, they sell space to transmit publicity materials for advertisers or merchants wishing to reach subscribers with their products and services. In pay television, market groups or sides are not able to negotiate among themselves, and consequently it is impossible for them to use side payments to sidestep the price allocation determined by the platform: this difference is significant for determining the total volume of services sold via the platform.

27. Pay television also presents other characteristics inherent in two-sided markets: the existence of indirect externalities between groups, i.e. the value that the consumer in one group places on the service or product of the platform increases as the number of consumers in the other group rises. Thus, advertisers will want to place their messages on the pay TV platform, as it has more subscribers.

28. In Mexico, the Federal Telecommunications and Broadcasting Act (LFTyR) and the Pay Television Service Regulation restrict advertising time to six minutes per hour in the case of pay TV. This timeslot may belong to the content programmer, depending on negotiations between it and the distributor. The IFT estimated that, on average, around four of the six minutes belong to the programmer. Moreover, the operator must announce its packages and programmes in the few minutes available to it, and consequently the revenues it earns from advertising are very limited. Accordingly, the IFT focused its analysis on that side of the market relating to TV service to the final user, and it therefore applied the traditional tools of competition analysis.

29. Another case involving two-sided markets analysed by the IFT was the complaint filed by Telmex, Dish and others against GTV, Televisa and Televisión Azteca, alleging various "relative

⁷ Another aspect considered by the IFT Plenary is the price of the services, which in some forms such as VoD is considerably higher than the price of watching a film on pay TV.

⁸ Another relevant aspect has to do with the legal competence of the IFT to regulate so-called "apps" and OTTs, given that these are not telecommunication or broadcasting services covered by the LFTyR.

monopolistic” practices.⁹ This case was launched in 2011 before the former Federal Competition Commission (CFC), and was subsequently transferred to the IFT and resolved in August 2014. The plaintiff claimed that GTV and Televisión Azteca¹⁰ were refusing to sell advertising space on broadcast television, pay TV and other communications media and were also tying the sale of broadcast TV signals for transmission over restricted TV with a national geographic dimension.

30. There were found to be two relevant markets, each of them affected by a different practice: the market for the sale of advertising space in broadcast TV signals, the geographic scope of which is national; and the market for the wholesaling of broadcast TV signals, which are retransmitted over pay TV systems, of national geographic scope.

31. The IFT held that the sale of advertising space in broadcast TV signals is a two-sided market, where two agents interact through a platform. On one side of the market are the advertisers, who seek to promote their services via the channels with the greatest audience. On the other side of the market are the consumers, who access the platform in search of content. For consumers, advertising represents a negative externality as they access the platform in search of specific content, and not of advertising.

32. Although the existence of two-sided markets is mentioned throughout the study, the analysis was conducted with the traditional competition tool contained in the LFCE, on the grounds that the practices indicated affected only one side of the market (the wholesale side).

33. The IFT found that the evidence was inadequate for determining that the object or effect of GTV's conduct had been to displace other competitors unfairly in the markets or substantially to prevent entry to those markets.

31. *If so, has this approach led to different decisions than would have been made by considering each side of the market separately?*

34. In the two cases indicated above, the existence of two-sided markets was recognised and noted. However, as mentioned, that analysis was conducted within the framework established by the relevant legislation, which allows consideration of one or several relevant markets, in addition to the analysis of related markets. If the analysis of two-sided markets had not been included, the provisions of the law would not have been fully applied.

3.2 *If so, has this approach led to different decisions than would have been made by considering each side of the market separately?*

35. As to the *determination of the existence of an AE-PSM in the pay TV market*, subsequent studies on the other side of the market – advertising – will have to be evaluated by the IFT under a specific framework relating to two-sided markets.

36. In the case of *Telmex versus GTV*, one member of the IFT panel commented thus: "I must note that the investigation process did not include any related markets that might have offered further elements,

⁹ See the public version of the decision on case E-IFT/UC/DGIPM/PMR/0001/2013 at the following link: <http://www.ift.org.mx/sites/default/files/conocenos/pleno/sesiones/acuerdodoliga/versionpublicapiftest150814195.pdf>

¹⁰ The complaints filed against Televisión Azteca for “relative monopolistic” practices were dismissed on the grounds that it clearly had no substantial market power.

with other concepts of damage. For example, in the market for production and marketing of restricted TV signals, which was not analysed, further evidence of damage to consumers might have been found".¹¹

4. Has your authority adapted traditional market assessment tools to consider two-sided markets?

37. The IFT has been operating for 30 months now, during which time it took part in drafting the LFTyR, and issued a number of guidelines of general application in regulated sectors. It has issued rulings on preponderance¹² and its regulation, both in telecommunications and in broadcasting, and it has addressed several cases of non-compliance in the area of interconnection, among many others. During this time only a few cases have arisen that have required the analysis of two-sided markets, and the cases in which this feature was the determining factor in the decision are even rarer. Nevertheless, in the decisions where this perspective has been applied, the IFT has conducted the analysis within the framework established by law, using the possibility of defining various relevant markets and related markets for the same matter. In the near future, suitable criteria could be established for analysing these markets. For the time being, it is deemed important that persons involved in the examination and study as well as the resolution of cases should be aware of the existence of these markets, their implications and characteristics, as well as the limitations that may arise from the application of traditional competition analysis tools.

4.1 *How can competition authorities identify disruptive innovations at an early stage in order to encourage engagement with regulators and monitor potential incumbent anticompetitive behaviour?*

38. The IFT is the regulatory agency for telecommunications and broadcasting and, following the regulatory reform of telecommunications, it is also the body responsible for enforcing the LFCE in the indicated sectors. The comprehensive purview of the IFT gives it a complete picture of the activities and the impacts of the various regulatory provisions, and this facilitates incorporation of pro-competitive criteria in the regulations it issues and in its actions. As the competition regulator and agency, it engages in competition advocacy efforts in favour of society in general, in co-operation with other international bodies, and within the agency itself. In the latter case, it seeks to ensure that the areas responsible for defining regulations always seek the opinion and criteria of the areas specialised in competition, and vice versa. Communication among the different areas of the IFT is important in this context.

39. The IFT works closely with the industry through working groups and committees, and it also conducts open and transparent public consultation. This enables it to refine its acts and provisions, identifying the risks as well as the opportunities inherent in technological development and innovation. Furthermore, the IFT makes sure that its staff have access to timely and accurate information on international cases that are most relevant in markets where the pace of innovation is strong. Experience in other countries can provide warnings and useful lessons to the persons responsible for examining, assessing and regulating the different cases and services.

40. The IFT's close relationship with experts from academia and international agencies allows it to anticipate market developments to some extent, as well as to understand those practices that have yielded the best results in other countries. Ex ante regulatory solutions could be useful for minimising practices that are harmful to free competition, recognising that at the present time cases involving ex post resolution of anticompetitive practices under the LFCE can run on for at least five years, including the investigation stage – the procedure takes the form of a judicial inquiry that guarantees a hearing for the defendants and, as appropriate, litigation before specialised tribunals. Nevertheless, the reform of the Constitution, the

¹¹ See: <http://www.ift.org.mx/sites/default/files/conocenos/pleno/sesiones/extraordinaria/xviii-sesion-extraordinaria-del-pleno-15-de-agosto-de-2014/versionpublicaestenografica18aext150814.pdf>.

¹² See footnote 2.

LFCE and the LFTR to the effect that the courts cannot suspend the resolutions or findings of the IFT while proceedings are under way has in practice mitigated the adverse effects of their prolongation.

4.2 *Other than through market studies and providing comment to regulators through formal processes, are there any opportunities for competition authorities to foster engagement between regulators and disruptors?*

41. As the regulator, the IFT maintains ongoing dialogue with various stakeholders in the industry, both traditional operators and new entrants, either individually or collectively, within the framework of the existing rules of contact for these meetings.

42. In addition, the IFT interacts frequently with other regulators in various regions of the world, as well as with agencies such as the ITU, where it is able to exchange information and experience with other authorities on the most recent developments, including the evolution of markets and the introduction of innovative proposals.

4.3 *Given the unique characteristics of innovations identified in (1) (if any), how should competition advocacy efforts be tailored to Latin American and Caribbean markets?*

43. In the face of a disruptive factor, the IFT favours the free play of competition and it prefers to delay the introduction of regulatory measures. The idea here is to avoid distorting markets or biasing the use of technologies that could yield benefits for final consumers. In the context of rapid technological change and in the presence of a disruptive factor, the IFT considers it important to make timely use of the precautionary tools provided by the LFCE.

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