



THE DIGITAL MERGER (A)

In May 2002, Canal Satélite Digital and Vía Digital, the only two platforms offering satellite pay-TV in Spain, in both cases since 1997, officially announced their merger. This appeared to signal the start of a new episode in the “digital soap opera” that had begun when the Spanish government promoted the launch of a second digital platform to compete with the incumbent operator. The battle between the two digital platforms had flared up even before they started broadcasting and had raged on throughout the first five years of their existence. And yet, considering the current state of pay-TV in Spain, and in Europe as a whole, it was quite possible that this episode would be the last.

The digital war

In an audiovisual industry gathering held in late May 1996, the various television stations operating in Spain declared the need for alliances between operators to facilitate the introduction of digital television. The Government was in favour of this proposal and the Secretary of State for Communication stressed the need to create “a single platform to launch digital television in Spain, broadcasting beyond Spain to Latin America and Spanish-speaking audiences in the United States”.¹ Two of the companies attending the gathering believed that they had what it took to create such a platform. And a third company had the financial muscle to make it work.

The first project was headed by state-owned broadcaster RTVE. RTVE started talks with Televisa, the Mexican communications group that controlled around 85% of broadcast

¹ “Miguel Angel Rodríguez defiende una plataforma única de televisión digital” (“Miguel Angel Rodríguez favours single digital TV platform”), *El País*, August 20, 1996.

Professor Jordi Gual and Sandra Jódar, Research Assistant, prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. November 2003. Rev. 2/04

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television in Mexico, as well as with various international groups and the other Spanish TV stations. Its plan was to launch up to 50 thematic satellite channels during 1997, offering coverage of all Spanish-speaking countries. The second project was promoted by Sogecable, owner of Canal+ España, which had been broadcasting a small selection of thematic satellite channels for some time already. Sogecable announced the launch of its digital platform on a trial basis for the end of 1996. From January 1997 users would be offered 20 thematic channels, with a further 20 being added the following year. To achieve this Sogecable was relying on the subscriber base and experience of Canal Satélite, the company that grouped together its offering of 5 thematic satellite channels, and of an analogue pay-TV channel that had almost one and a half million subscribers. The third contestant was Telefónica, the incumbent telephone operator, which had a monopoly in Spain and was in the process of being privatized. Telefónica had declared its intention of venturing into satellite television, since regulations prevented it from developing the cable business. Because it did not have any specific plans for a digital platform in terms of content, Telefónica's first moves were on the technology front. It signed a deal with the Kirch group of Germany that gave it exclusive rights to sell Kirch's decoder in Spain. The only other decoder available in the Spanish market at that time was the one used by Sogecable for its Canal Satélite broadcasts.

Of the three projects, that of RTVE soon won Government backing. In view of RTVE's delicate financial situation, Telefónica decided to join the project and take over the leadership. Thus, ten days after the Sogecable announcement, Telefónica announced plans to launch its own platform in March 1997. However, whereas the Telefónica platform aimed to expand its shareholder base to include all of the television operators in Spain, as well as other companies, and immediately started negotiations to that end, the Sogecable platform already had an established body of shareholders and quickly concentrated on acquiring content. One week before the Sogecable platform (Canal Satélite Digital, CSD) was due to start regular broadcasting, Telefónica set up its own platform (Vía Digital), initially with the backing of RTVE, a few regional broadcasters, Antena 3 (one of the private stations), and foreign partners.

That was when what might be called the "digital war" began in earnest. On December 24, 1996, Antena 3, Sogecable and TV3 (the Catalan regional public broadcaster) reached an agreement whereby they would share their rights to televise Spanish League matches through Audiovisual Sport (AVS), a company set up specifically for that purpose. Under this same agreement Antena 3 and its subsidiary Gestora de Medios Audiovisuales (GMA) –through which it owned television rights to 27 clubs– became shareholders of CSD, while both Antena 3 and TV3 ceased to be shareholders of Vía Digital. After the agreement, CSD purchased exclusive rights to televise live football matches on a pay-per-view basis. In practice, this agreement meant that Vía Digital was effectively locked out of televised football, and so lost the content generally considered to be one of pay-TV's main selling points in the eyes of subscribers. One day after CSD started broadcasting, the Spanish government passed the "Satellite Law"², regulating the use of decoders. Under the new law, all decoders had to be approved by the Government before they could be used. This put Sogecable in an awkward position, as it had already acquired the decoders it planned to use. Basically, the law called upon the two platforms to agree on a single type of decoder using open standards, and if no such agreement was forthcoming imposed the Telefónica decoder³.

² Royal Decree Law 1/1997 and Law 17/1997, May 3, on Digital Television.

³ The European Commission disagreed with the Spanish regulations, which were supposed to be a transposition of the EU directive into Spanish law. Brussels argued that the directive merely stated that the decoders had to use open standards, but at no time did it require that there be no more than one type. In June 2003 the Spanish High Court ordered the Government to pay damages to CSD on the grounds that the provisions of the "Satellite Law" breached Community law and had caused harm to CSD in the form of a delay in the recruitment of 180,644 subscribers and the loss of a further 26,193.

In July 1997 the Government also won parliamentary approval for the “Football Law”⁴, which stipulated that one match per day had to be reserved for free-to-air broadcasters, who would have first choice. The law gave the various parties interested in offering pay-per-view football one year to agree on broadcasting rights⁵. To make up for Vía Digital’s lack of content –CSD had pushed ahead with its content acquisition policy by signing exclusive deals with the North American majors⁶– and increase its bargaining power in the bidding for soccer rights, Telefónica decided to acquire a controlling stake in Antena 3 and GMA, thus effectively gaining control of 40% of AVS. However, Telefónica’s acquisition of Antena 3 raised issues of cross-shareholdings in regulated industries and Sogecable lodged an appeal with the competition authorities in Brussels, alleging abuse of a dominant position. As a cautionary measure, the European Commission decided to block the takeover of Antena 3 and the sale of AVS’s rights to Vía Digital, both of which were on the agenda of the upcoming board of directors meetings of the two companies. Despite the warnings, Telefónica succeeded in preventing AVS from operating normally as a rights management company, with the result that pay-per-view soccer broadcasts were brought to a halt. All of this took place in mid-September 1997, when CSD had been broadcasting since January and had 125,000 subscribers, while Vía Digital had started broadcasting eight months later with a much more limited content offering. The battle over soccer rights ended in November 1997, when Sogecable and Telefónica reached an agreement that allowed pay-per-view to resume during the 1997-1998 season, but this time through both platforms.

The next episode of the saga began at the end of June 1998, when the European competition authority ratified the soccer rights agreements that AVS had been set up to manage and recognized CSD’s exclusive pay-TV rights, though limited to a three-year period⁷. Perhaps daunted by the prospect of another soccer rights free-for-all, this time with CSD backed by Brussels, at the end of July the two platforms announced a merger plan. The plan was viewed favourably by the political parties in general and by the Spanish competition authority (TDC), which saw it as an opportunity to reduce the cost of content acquisition and make savings that could be passed on to consumers in the form of lower prices. For its part, Brussels would give its approval provided the platform was a system open to other competitors and the decoder was fully compatible. The two companies came to the merger in very unequal circumstances: CSD with more than 500,000 subscribers and exclusive agreements that were valued highly by the market; Vía Digital with 300,000 subscribers and a much lower potential value. Following disagreements over the valuation of the two companies and the resulting ownership structure, the merger plan was eventually dropped in October. And so the struggle for content, particularly football, resumed.

In March 1999, Vía Digital signed a deal with Universal Studios and decided to increase the number of channels and cut its prices. At the same time, the public television station RTVE sold its broadcasting rights to the Champions League and withdrew from the shareholder group. Prior to this, in June 1999, CSD and Vía Digital had come to an agreement under which CSD would share the pay-TV rights to Spanish League matches and Vía Digital would share the rights to the Champions League, starting the following season. These changes enhanced the attractiveness of Vía Digital’s offering to such an extent that

⁴ Law 21/1997 regulating live and recorded broadcasts of sporting competitions and events.

⁵ The content of the law proved highly controversial, as it appeared to prohibit the sale of exclusive rights in pay-per-view, and there was no guarantee that it would not be applied retroactively.

⁶ The big movie production studios, such as Time Warner, Universal, Paramount Pictures or Disney.

⁷ The competition authorities pointed out that exclusive agreements are common practice in the industry and that the important thing is that the agreement be reached in an environment of free competition, which the Commission considered had been the case in this instance.