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Determination of 3.4.2008

*Non-confidential version*

## **ANACOM'S REASONING IN REGARD TO ZON MULTIMÉDIA'S SPIN-OFF AND TO THE IMPACT ON MARKET ASSESSMENTS AND OBLIGATIONS ARISING THEREFROM**

### **A. Framework**

1. In the recent past, two events have made it necessary to review the definition and assessment of electronic communications markets, as well as the respective regulatory means of control, namely:
  - a) The structural separation between PT Multimédia (PTM, now ZON Multimédia, hereinafter referred to as ZON) and Portugal Telecom (hereinafter referred to as PT), as a result of a process known as PTM's spin-off;
  - b) The approval by the European Commission of Recommendation 2007/879/EC of 17 December, on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation (hereinafter referred to as "new recommendation")<sup>1</sup>.

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<sup>1</sup> Recommendation published on 28 December 2007.

### **A1. ZON's spin-off**

2. On 6 February 2006, the Sonae Group disclosed the decision to launch a public bid for all shares representing PT's capital, which was subject to a set of conditions.
3. Having assessed the matter, the *Autoridade da Concorrência* (Competition Authority, hereinafter referred to as AdC) decided on 22 December 2006 not to oppose to PT's and Sonascom's concentration, by way of the public bid. This decision was accompanied by the imposition of conditions and obligations aiming at ensuring compliance with commitments on the part of the notifiers. In this context, it is important to stress the choice given to Sonaecom to sell either the copper fixed network business or the cable fixed network business<sup>2</sup>.
4. In this specific scope, the AdC also imposed conditions on the acquirer, so as to ensure its independence from the Sonae Group.
5. In reply to the public bid, PT's Board of Directors, on 12 January 2007, recommended its shareholders to reject the offer made by the Sonae Group, and restated its position on 20 February that year. It presented its shareholders with a remuneration package that included the distribution of 180,6 million PTM shares to PT's shareholders, which amounted to EUR 2.0 billion or EUR 1.8 per each PT share, as a result of the former company's spin-off from the latter.
6. At PT's general meeting of shareholders on 2 March 2007, the proposal on the unblocking of PT's articles of association, which was one of the conditions of the public bid, was rejected by the majority of the votes cast. This decision extinguished the public bid launched by Sonaecom.
7. On 21 September 2007, to fulfil its commitment to shareholders, PTM<sup>3</sup> and PT communicated to the market that, in the scope of the ongoing separation process, the companies had no longer any shared directors, as there had been exchanges between members of the Board of Directors of both companies and affiliated companies.

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<sup>2</sup> As communicated by letter no. 28/2006 of the AdC, of 22 December.

<sup>3</sup> As communicated by letter issued by PTM entitled "Alteração da composição accionista dos órgãos sociais".

8. On 7 November 2007, PT informed that PTM's spin-off procedure was completed, following the "allocation to PT's shareholders of its share in that company", stating that "in accordance with the laid down spin-off procedure, shareholders were granted 0.176067 PT Multimédia shares of per each PT share they held (...) a total of 154.9 million PT Multimédia shares having been transferred to PT shareholders accounts, which corresponds to 50.1% of the share capital and voting rights in that company"<sup>4</sup>. In the same notice, PT added that "PT retained a holding of 8.3% in PT Multimédia, which corresponds to 25.7 million shares".
9. On 14 November, PTM informed the market that, as from that date, PT "had ceased to hold any direct share in PT Multimédia (...) [thus] Portugal Telecom may only claim righting votes that correspond to shares held by funds managed by Previsão, Sociedade Gestora de Fundos de Pensões, S.A. and by directors of Portugal Telecom, of less than 2% of PT Multimédia's righting votes".
10. Having announced the completion of the spin-off procedure, ICP-ANACOM was faced with the need to assess the means to adjust the regulatory framework in force. This follows not only by virtue of the procedure – briefly described above – but also from public statements made by PT representatives, letters sent by this company, and also – last but not least - the need to assess compliance of offers placed on the market, both by PT and by ZON, with obligations in force.

## **A2. Recommendation 2007/879/EC of 17 December**

11. As provided for, the European Commission published a new Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation.
12. Pursuant to paragraph 4 of article 58<sup>5</sup> and to paragraph 6 of article 59<sup>6</sup> of Law no. 5/2004, of 10 February (Electronic Communications Law – ELC), it is incumbent upon ICP-ANACOM to carry out a new market definition and assessment.

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<sup>4</sup> As communicated by letter issued by PT on 7 November 2007.

<sup>5</sup> "The market definition may be reviewed where the recommendation of the European Commission is amended or where the NRA deems that there are grounds for such a review".

<sup>6</sup> "The market analysis shall be reviewed following a new definition of the markets or where the NRA deems that there are grounds for such a review."

13. Under the new recommendation, some aspects must be stressed:
- a) “ (...) recommendation is without prejudice to market definitions, results of market analyses and regulatory obligations adopted by national regulatory authorities in accordance with Articles 15(3) and 16 of Directive 2002/21/EC prior to the date of adoption of this recommendation”.
  - b) “National regulatory authorities may identify markets that differ from those listed in (...) Recommendation” provided that such markets are “defined on the basis of competition principles laid down in the Commission Notice on the definition of relevant market for the purposes of Community competition law and be consistent with the Commission Guidelines on market analysis and the assessment of significant market power whilst satisfying the three criteria” (set out in the Recommendation<sup>7</sup>);
  - c) “The fact that (...) recommendation identifies those product and service markets in which *ex ante* regulation may be warranted does not mean that regulation is always warranted or that these markets will be subject to the imposition of regulatory obligations set out in the specific directives”;
  - d) In this context, ICP-ANACOM is currently reassessing markets, a matter which is quite complex, given the depth of the assessment, the obligation to perform several consultation procedures, as well as the emergence of new issues, concerning new technologies and new ongoing and planned market offers.

## **B. Assessment**

14. In the light of the above, two concrete and immediate assessments were deemed necessary:
- a) The extent to which ZON still integrates the PT Group, following the spin-off;

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<sup>7</sup> In this regard, the Recommendation states the following: “The first criterion is the presence of high and non-transitory barriers to entry. These may be of a structural, legal or regulatory nature. However, given the dynamic character and functioning of electronic communications markets, possibilities to overcome barriers to entry within the relevant time horizon should also be taken into consideration when carrying out a prospective analysis to identify the relevant markets for possible *ex ante* regulation. Therefore the second criterion admits only those markets whose structure does not tend towards effective competition within the relevant time horizon. The application of this criterion involves examining the state of competition behind the barriers to entry. The third criterion is that application of competition law alone would not adequately address the market failure(s) concerned”.

- b) The extent to which the spin-off will impact the different electronic communications market.

### **B1. ZON's position relatively to the PT Group**

- 15. In the scope of market assessments carried out by ICP-ANACOM<sup>8</sup>, the companies of the PT Group were deemed to hold significant market power (SMP) in 15 markets, thus having been imposed regulatory obligations<sup>9</sup>. These market assessments were based on the adoption of the company concept of competition law (article 2 of Law no. 18/2003, of 11 June), the group relationship between PT and PTM having been held to fall therein.
- 16. The spin-off procedure having been completed on 7 November 2007, the conditions on which, according to the Code of Commercial Companies<sup>10</sup>, depends the existence of affiliated companies, such as, on the one hand, companies linked by a relationship of a mere holding, reciprocal holding or of control, and on the other, companies in a group relationship (articles 481 et seq.), ceased to be met.
- 17. According to Law no. 18/2003, a group of companies may be deemed as a single company where companies “while legally independent, represent an economic unit or maintain interdependence or subordination links resulting from rights or powers listed in paragraph 1 of article 10” (cfr. paragraph 2 of article 2)<sup>11</sup>.
- 18. In this case, the situations specified in subparagraphs of paragraph 1 of article 10 of the mentioned law have not been fulfilled, and thus there are no interdependence or subordination links between PT and ZON.
- 19. Accordingly, from the perspective of the existence of a group relationship or interdependence or subordination links resulting from rights or powers listed in paragraph 1 of article 10 of the Competition Law, ZON is no longer a part of the PT Group by virtue of the spin-off, having ceased to apply the subjective assumption which made it subject to regulatory obligations imposed on that Group.

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<sup>8</sup> ICP-ANACOM has analysed 16 of the 18 markets provided for in Recommendation no. 2003/311/EC, not having yet completed the assessment of markets 15 and 17.

<sup>9</sup> Summary available at <http://www.anacom.pt/template12.jsp?categoryId=256022>.

<sup>10</sup> Republished by Decree-Law no. 76-A/2006, of 29 March.

<sup>11</sup> Emphasis added.

20. It must thus be concluded that, as a result of the spin-off, ZON may no longer be included in the list of companies subject to established regulatory obligations, as such obligations were imposed on the PT Group.
21. Without prejudice, ZON's independence must be regarded not only in a formal perspective but also in a context of company behaviour, that is, it must be considered whether, after the spin-off procedure has been completed, ZON and the companies of the PT Group have behaved as an economic unit as far as competition law is concerned.<sup>12</sup> Nevertheless, in this case and given the prior conclusion, the imposition of regulatory obligations on ZON would imply a new market assessment which effectively weighed the behaviour of companies in this perspective.
22. The method used to implement the spin-off, having PT opted to allocate its shares in PTM to its own shareholders<sup>13</sup>, determined the need to carefully assess whether ZON and PT, although formally independent, represented an economic unit for the purposes of competition law, thus being relevant in a regulatory point of view. In fact, in this case, the adoption of provisional measures, under articles 5 and 9 of the ECL could be justified, temporarily, until the completion of a market assessment procedure.
23. In this context, ICP-ANACOM requested of the AdC an opinion on the effective independence of both companies under consideration<sup>14</sup>, based on the following aspects:
  - a) ICP-ANACOM and the AdC are bound to cooperate institutionally in the performance of their tasks, and must thus appropriately articulate their work, without prejudice to the respective powers;
  - b) ICP-ANACOM must submit to a prior opinion of the AdC all "draft measures of the NRA in respect of the analysis of the market and the determination of whether or not an undertaking holds significant market power"<sup>15</sup>, which supports the mentioned need for close relations;
  - c) ICP-ANACOM has always based its market assessments on the company concept provided for in competition law, especially in Law no. 18/2003, which confers on the AdC the duty to ensure compliance with competition rules.

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<sup>12</sup> We believe that it is also in this perspective that PT, in its "Information Statement" (pg.6), mentions the need for a transitional period before PTC is able to effectively operate as an independent company and to implement its own strategy as such.

<sup>13</sup> Although there is no question of PT's freedom to decide how the spin-off procedure should have been implemented, as the spin-off was not imposed by law or regulation, less doubts would arise if a different transfer model had been chosen.

<sup>14</sup> The AdC considered that its opinion included company particulars deemed to be business secrets or internal information, and thus stated that it should be considered confidential. Later, by letter received on 19.3.2008, AdC provided ANACOM with a non-confidential version of the same opinion.

<sup>15</sup> Pursuant to article 61 of the ECL.

24. In this matter, the AdC considered that “a final decision on its [ZON's] independence for the purposes of the [Competition] Law (...), namely article 2, paragraph 2, would be premature for now.”
25. The AdC identified in particular the following evidence which seem to suggest that PT and ZON are still part of the same economic unit for the purposes of Law no. 18/2003:
  - a) “The voting record of shareholders with major holdings in both companies – PT and PTM – has been deemed adequate to approve determination of drafts submitted at the respective general meetings”;
  - b) “The shared interests of common shareholders will probably lead them to cast votes to the same effect”;
  - c) “The interdependence relationships between PT and PTM, at the level of service provision contracts, contracts of [SCI~~confidential-object of contract~~ECI], which remain in force after the spin-off completion”;
  - d) “As has already been done, it is likely that, following the spin-off, the Boards of Directors appointed by PT continue to be jointly proposed to the respective GM by [SCI~~shareholder~~ECI] and [SCI~~shareholder~~ECI], and the same situation will probably take place as regards PTM.”
26. The AdC highlights the following aspects as reasons not to consider ZON as a part of the economic unit represented by the PT Group:
  - a) “Lack of shared directors in both companies”;
  - b) “PT has transferred its share in PTM”;
  - c) “PT and PTM are independent not only in legal but also an accounting perspective.”
27. ICP-ANACOM acknowledges that, as a result of the features of the spin-off procedure, there are aspects that suggest that ZON and PT should be considered as part of the same economic unit, and other elements that point toward the opposite direction.
28. This opposing evidence makes it clear that any position taken immediately after the completion of the spin-off procedure would have been hasty.
29. The reasons that point toward the idea that ZON and PT may still be part of the same company, even after the completion of the spin-off has been announced, are linked to the existence of a group of shared shareholders in both companies – a situation that is based on the spin-off procedure itself. This fact prevents the outright rejection of the possibility that these two

companies are an economic unit for the purposes of article 2 of Law no. 18/2003. The major holdings in ZON and PT are presented in annex.

30. The grounds for considering that ZON and PT are no longer a part of the same economic unit are related to the fact that the Board of Directors of the companies do not have any shared members – although the members of the Board of Directors of each company were in the past members of the Board of Directors of the other or of affiliated companies – and to the emergence of competing offers between ZON and the PT Group.
31. Therefore, having weighted the above-mentioned aspects, ICP-ANACOM deems that a special focus should be given to the fact that a competitive behaviour is now starting to show between ZON and PT, in line with the fundamental advantage of the spin-off procedure, in a regulatory point of view. Moreover, this Authority believes that if a transitional system was applied, together with the market assessment procedure, thus making ZON subject to some or all obligations that fall currently on the PT Group, it is likely that competition would be inhibited, influencing conclusions of market assessments which must be performed. This means that one of the conditions not to consider ZON Multimédia as part of the PT Group would be prevented precisely by the fact that this company was considered a part of that Group, a vicious cycle would not be useful to the increase of competition in the electronic communications market.
32. Therefore, ICP-ANACOM deems that, as a result of the spin-off, ZON has ceased to integrate the PT Group, and as such, it is no longer subject to the regulatory obligations that follow from market assessments.
33. It should be stressed that this understanding is not a result of a market analysis, or a pre-examination relatively to the ongoing assessment, for the purposes of Chapter II of Title IV of the ECL.

## **B2. The impact of ZON's separation in electronic communications markets**

34. As referred above, in the scope of market assessments carried out by ICP-ANACOM, the companies of the PT Group were deemed to hold significant market power (SMP) in 15 markets. Given ZON's areas of action, the fact that this company has ceased to be subject to regulatory obligations imposed on the PT Group has practical implications, as far as that company is concerned, especially at the level of the wholesale broadband market (market 12)<sup>16</sup>.
35. In this market, obligations imposed on companies holding SMP are those set out in Table 1.

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<sup>16</sup> Without prejudice to the conclusions that result from the market reassessment.



**Table 1: Obligations imposed on companies holding SMP in the wholesale broadband market**

Obligations	Market for wholesale provision of broadband access, including broadband access services supported in the public switched telephone network and in the cable distribution networks
Access and use of specific network resources	<ul style="list-style-type: none"> <li>- Access to the PSTN at different locations</li> <li>- To negotiate in good faith with undertakings requesting access</li> <li>- Not to withdraw access to facilities where access has been already granted</li> </ul>
Transparency in relation to the publication of information, including reference offers	<ul style="list-style-type: none"> <li>- Publication of the broadband access reference offer ("PT ADSL Network"), clearly identifying the differences between versions and including SLAs and compensation for non-compliance</li> </ul>
Non-discrimination in relation to the provision of access and interconnection and the respective provision of information	<ul style="list-style-type: none"> <li>- Not to unduly discriminate in providing network access</li> <li>- 30-day notice to alter wholesale offers – in the case of significant alterations in wholesale offers, this time-limit is extended to two months</li> <li>- Launching of retail offers subject to the existence of equivalent wholesale offers in the "PT ADSL Network"</li> <li>- To submit information on maximum, average and minimum time-limit for deliveries, malfunction repair and degree of availability (broken down per installation type and operator)</li> </ul>
Accounting separation in respect of specific activities related to access and interconnection	<ul style="list-style-type: none"> <li>- Cost accounting system and accounting separation</li> </ul>
Price control and cost accounting	<ul style="list-style-type: none"> <li>- Cost orientation of prices (broadband access services supported in the public switched telephone network)</li> <li>- Price control ("retail-minus")</li> </ul>
Financial report	<ul style="list-style-type: none"> <li>- Making accounting records available (analytical accounting system) including data on revenues from third parties</li> </ul>

36. It is clear from the above that the obligation with a stronger impact on the issue at stake is the one concerning the "launching of retail offers subject to the existence of equivalent wholesale offers in the "PT ADSL Network", connected to the price control obligation according to the "retail-minus" rule. This obligation, which aims to avoid broadband market margin squeezes on the part of companies with SMP, entails, on a practical level, the guarantee of a minimum margin between retail and wholesale prices practised by these companies. These measures have not prevented the decrease of retail prices by companies with SMP in this market, in fact it has forced such decreases to be compatible with wholesale offers, which has led to a price decrease in both offers (retail and wholesale), with obvious advantage to competition<sup>17</sup>.

<sup>17</sup> It should be clear that obligations concerning wholesale offers in market 12 do not apply to ZON, and obligations result only from the retail-minus rule.

37. ZON's separation from the PT Group implies that retail offers it provides are no longer subject to compliance with the above-mentioned rule, and there is no impact at the level of other obligations, as ZON is not subject to wholesale offers in the scope of market 12.
38. Likewise, obligations on the PT group following the assessments of markets 1 to 6, 8 and 9<sup>18</sup> no longer apply to ZON. The impact of this fact, that concerns wholesale and retail narrowband markets (telephone services), is lower than the impact regarding obligations resulting from the assessment of market 12, as regards the inherent turnover and customer base.
39. However, as far as this company's offer dynamic is concerned, this impact must also be stressed, as ZON shall no longer be subject to comply with general obligations such as cost orientation, cost accounting systems, among others, as well as, at retail level, more specific obligations related, for example, to withdrawal periods against win-back action and to a more strict retail price regulation (retention rates in the fixed-mobile traffic, constraints when setting tariffs for off-net calls). At wholesale level, ZON is also no longer subject to the origination tariffs regulation and, as regards termination tariffs, it is subject to the regime that applies to operators not belonging to the PT Group, not being subject to obligations resulting from the RIO (including capacity-based interconnection) and SLRO.
40. However, it should be mentioned that some of the obligations which fall on the PT Group never applied to ZON, given the technological features of the offer provided by this company and the markets privileged by the company. On the other hand, no impact is produced on markets wherein ZON had no action, namely leased lines services (markets 7, 13 and 14), mobile communications (markets 15 and 16) and radio broadcasting (market 18).
41. It follows from the above that it is necessary to reassess market 12 (identified as market 5 in Recommendation 2007/897/EC) as quickly as possible, as it has been identified as including "broadband access services supported in the public switched telephone network and in the cable distribution networks", and ZON's market share in this market is significant, having contributed in the past for determining PT as SMP holder. In the framework of the assessment to be carried out, and in this context only, according to the legislative and regulatory framework in force, it will be possible to determine a new market definition, to eventually identify companies holding SMP and to impose obligations thereon. Until this

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<sup>18</sup> Market 1: Access to the public telephone network at a fixed location for residential customers; Market 2: Access to the public telephone network at a fixed location for non residential customers; Market 3: Publicly available local and/or national telephone services provided at a fixed location for residential customers; Market 4: Publicly available international telephone services at a fixed location for residential customers; Market 5: Publicly available local and/or national telephone services provided at a fixed location for non-residential customers; Market 6: Publicly available international telephone services at a fixed location for non-residential customers; Market 8: Call origination in the public telephone network at a fixed location; Market 9: Call termination in individual public telephone networks at a fixed location.

procedure is concluded, obligations currently imposed on the PT Group (which now does not include ZON) shall remain in force<sup>19</sup>. Given that the correspondent wholesale offers are replaceable, ICP-ANACOM considers that markets 12 and 11 should be assessed at the same time.

### **C. Conclusion**

42. ICP-ANACOM clarifies that, as a result of the spin-off, ZON has ceased to integrate the PT Group, and thus obligations that result from market assessments carried out in the scope of Title IV of Chapter II of the ECL, which fall upon that Group, do not apply thereto.
43. Obligations in force shall continue to apply to companies within the PT Group, under the new recommendation of the European Commission, until the respective markets are reassessed.
44. ANACOM is aware of the spin-off's relevant impact on markets 11 and 12, defined by the previous Recommendation, which the new Recommendation now calls markets 4 and 5, and is thus giving priority to the respective assessments. The Authority is preparing a document which shall launch the corresponding consultation procedure by mid May.
45. In addition, ANACOM will finalise in April the assessment of means to implement obligations which fall upon the PT Group in the scope of market 12 - within the limits defined in the obligations imposed in the scope of the referred assessment - which shall be later subject to a consultation procedure which this Authority must comply with pursuant to the ECL.

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<sup>19</sup> The new Recommendation "is without prejudice to market definitions, results of market analyses and regulatory obligations adopted by national regulatory authorities in accordance with Articles 15(3) and 16 of Directive 2002/21/EC prior to the date of adoption of this recommendation".

## ANNEX

**ZON Multimedia SA**

Shareholders	Nº of shares	%of Total
Caixa Geral de Depósitos	43.056.123	13.93%
Banco BPI, S.A.	23.929.242	7.74%
Cinveste, SGPS, S.A.	18.737.589	6.06%
Telefónica, S.A.	16.879.406	5.46%
Espírito Santo Irmãos	15.455.000	5.00%
José Berardo* Foundation	13.408.982	4.34%
Banco Espírito Santo, S.A.	12.287.294	3.97%
Joaquim Oliveira	11.637.714	3.77%
Ongoing Strategy Investments, SGPS, S.A.	9.762.452	3.16%
Cofina, SGPS, S.A.	6.883.482	2.23%
Visabeira, SGPS, S.A. Group	6.641.930	2.15%
SGC, SGPS, S.A. Group	6.182.000	2.00%
Igest - Sociedade de Gestão, SGPS, S.A.	3.985.488	1.29%
Identified Total	188.846.702	61.10%

**Portugal Telecom SA**

Shareholders	Nº of shares	%of Total
Brandes Investments Partners	98.943.217	10.50%
Telefónica	93.915.644	9.96%
Banco Espirito Santo Group	79.924.811	8.48%
Caixa Geral de Depositos Group	65.341.768	6.93%
Ongoing Strategy Investments	60.404.969	6.41%
Telmex	38.460.000	4.08%
Fidelity	23.592.185	2.50%
Barclays Group	23.216.664	2.46%
Visabeira Group	22.667.473	2.40%
Deutsche Bank	21.320.328	2.26%
Credit Suisse	21.199.067	2.25%
Identified Total	548.986.126	58.24%

Source: Information collected on the PT and ZON websites, on 27 March 2007.