

REVIEW OF ITV CONTRACT RIGHTS RENEWAL UNDERTAKINGS

Provisional decision on remedy variations

Published: 19 January 2010

The Competition Commission has excluded from this published version of the provisional decision information which the Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure of information). The omissions are indicated by [✂].

Contents

	<i>Page</i>
1. Summary.....	2
Variations that we propose not to pursue	3
Variations that we intend to implement.....	5
Proportionality	5
Provisional conclusion on remedy variations	5
2. Introduction	6
Background.....	6
Process since the Provisional Decision	8
Structure of the provisional decision on remedy variations	9
3. Variations that we propose not to pursue	9
Variations to address ITV1's advantage in delivering large audiences	10
Variations to remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms	10
Variations to address any incentives for ITV to focus primarily on maximizing ITV1's SOCI.....	11
Variations to address any difficulties for ITV in reacting to changing demand.....	12
Summary on variations that we propose not to pursue	12
4. Variations that we intend to implement.....	12
The definition of ITV1	12
Third parties' views.....	13
ITV's views	15
Our assessment	16
5. ITV's proposed Rules for the Protection of Advertisers.....	20
ITV's rationale for its RPA proposal.....	21
Key features of ITV's RPA proposal	21
Third parties' views of the RPA	24
Overview	24
The 'price control'	24
Adjudication.....	26
Our assessment of ITV's RPA proposal	27
(a) The ability of ITV to demand a higher SOB commitment for any given level of discount.....	27
(b) Price discrimination	31
(c) Changes to the airtime sales system	32
Summary of our views on ITV's RPA proposal	32
6. Summary of our provisional views on variations to CRR	33
7. The proportionality of the CRR Undertakings as varied	34
Costs to ITV of CRR.....	35
ITV's views on the costs to ITV of CRR	35
Third parties' views on the costs to ITV of CRR.....	36
Our assessment of the costs to ITV of CRR	37
Proportionality of CRR as varied	42
Detriment.....	43
Assessment of proportionality of variations to CRR	45
8. Our provisional conclusion	45
9. Next steps	46

Appendices

- A: Text of ITV's RPA Proposal
- B: Effect of introducing an ITV1+1 service
- C: Costs to ITV of the CRR Undertakings

1. **Summary**

- 1.1 This report is our provisional decision on variations to the [undertakings](#) which were given by Carlton Communications Plc (Carlton) and Granada plc (Granada) at the time of their merger to form ITV plc (ITV) in 2003. The undertakings include the contract rights renewal (CRR) remedy which was put in place to address concerns that the merger would lead to adverse effects in the sale of TV advertising airtime.
- 1.2 Following a request from ITV, the Office of Fair Trading (OFT), with assistance from the Office of Communications (Ofcom), reviewed that part of the undertakings which comprise the CRR remedy (the CRR Undertakings) and, in May 2009, it advised the Competition Commission (CC) to consider varying the CRR Undertakings. The OFT drew attention to new ways of delivering ITV1's programming and a decline in ITV1's market position, but noted its continuing strength in the supply of mass audiences for advertisers.
- 1.3 In our provisional decision as to changes of circumstance (the Provisional Decision) published on 15 September 2009, we set out our assessment of the changes of circumstance since the CC completed its [report](#) on the merger in October 2003 (the 2003 report). We provisionally decided that circumstances had not sufficiently changed since the 2003 report to warrant releasing ITV from the CRR Undertakings but that there may be a case for variations to the CRR Undertakings.
- 1.4 In the [Notice of possible variations](#) (the Notice) which accompanied the Provisional Decision we set out possible variations to the CRR Undertakings and invited views on them. We received a number of responses to the Notice and a [summary](#) of these has been published on our website.

1.5 We have reviewed responses to the Notice and held meetings with various parties, including ITV, to explore their views. Our assessment has included a review of a remedy proposal made by ITV although ITV contended that the appropriate outcome to our review is the abolition of the CRR Undertakings in their entirety. We provided a range of parties with a description of ITV's proposal and invited their views.

Variations that we propose not to pursue

1.6 We have provisionally decided not to pursue possible variations to:

- (a) address ITV1's advantage in delivering large audiences;
- (b) remove elements of the CRR Undertakings while maintaining an obligation on ITV to offer ITV1 airtime on fair and reasonable terms;
- (c) address incentives for ITV to focus primarily on maximizing ITV1's share of commercial impacts (SOCl); and
- (d) address difficulties for ITV in reacting to changing demand.

1.7 The responses that we received in relation to these possible variations supported our views, expressed in the Notice, that they were not likely to be either practicable or effective in addressing the adverse effects of the merger.

1.8 We considered carefully the proposal put to us by ITV. This proposal, entitled Rules for Protection of Advertisers (RPA), would lift the requirements of paragraphs 5 to 18 of the CRR Undertakings and replace them with a form of 'price control' and an obligation on ITV to offer ITV1 airtime on 'fair and reasonable' terms.

1.9 We see merit in ITV and media buyers (advertisers acting on their own behalf and media agencies acting on behalf of advertisers) being able to negotiate flexibly, but we do not consider that the RPA proposal put forward by ITV would be able to

remedy effectively the adverse effects arising from the merger. We identified five main issues with the RPA proposal:

- (a) Media buyers would lose protection over the relationship between their share of broadcast (SOB) commitment and ITV1's SOCI. The RPA would not prevent ITV from insisting on either a disproportionately higher SOB commitment in the event that ITV1's SOCI increased or substantially the same SOB commitment in the event that ITV1's SOCI fell.
- (b) The proposal to regulate weighted average discounts could only be policed after the event and as it applies in aggregate it would not be capable of dispute by an individual media buyer. In our view, given this requirement, no individual media buyer would in practice be able to use the adjudication process to challenge effectively the discounts it had been offered.
- (c) The non-discrimination requirements of RPA have little practical application given the wide range of factors ITV would be allowed to take into account in making offers to media buyers for ITV1 airtime.
- (d) If the fair and reasonable obligations in RPA were still to provide appropriate safeguards for media buyers, there would need to be extensive guidance as to how compliance would be assured and on what basis adjudication would be conducted, including the weighting that would be applied to various factors in determining a 'fair and reasonable' outcome. We found that such guidance could not be adequately developed given the wide range of contractual terms involved in TV advertising airtime negotiations and the differences between each media buyer's contractual terms with ITV1.
- (e) We found that the proposed variations to the adjudication process put forward by ITV were not satisfactory. The scope of disputes that the adjudicator would be permitted to review would in practice be narrower than under CRR and the grounds for evaluating ITV's offers for ITV1 airtime would be limited only to compliance with each individual element of RPA.

Variations that we intend to implement

- 1.10 In the Provisional Decision we recognized that CRR has deterred ITV from launching new ways of delivering ITV1, such as ITV1 time-shifted by an hour (ITV1+1) and ITV1 in high definition (ITV1 HD). We find it appropriate to vary the definition of ITV1 in the CRR Undertakings to include ITV1+1 and ITV1 HD.
- 1.11 We noted the possible effect of such a variation on ITV1's SOCI and its share of net advertising revenue (NAR), potentially at the expense of other broadcasters' share of NAR. However, we found that such effects are part of the normal competitive process and would not arise from the enhanced market power created by the merger.
- 1.12 In our view, changing the definition of ITV1 to include ITV1+1 and ITV1 HD would not lessen the effectiveness of the CRR remedy in addressing the adverse effects of the merger.

Proportionality

- 1.13 We assessed the costs to ITV of the CRR remedy—once the proposed variation to the definition of ITV1 has been taken into account—and found that many factors have played a part in determining ITV's strategy in relation to ITV1 programming decisions and acquisition of rights for ITV1. We provisionally concluded that the extent of costs that could be directly attributed to a varied CRR was likely to be significantly lower than the level of detriment caused by the merger. We therefore provisionally concluded that CRR with our proposed variation is proportionate to the detriment that would have arisen in the absence of CRR.

Provisional conclusion on remedy variations

- 1.14 We provisionally concluded that we should vary the CRR Undertakings to:

- (a) redefine ITV1 to include ITV1+1 and ITV1 HD impacts, should such services be launched;
- (b) require that, in order for the impacts to be counted towards ITV1's SOCI in CRR, ITV1+1 and ITV1 HD services be exact replicas of ITV1 except for some allowance for regional differences between the two services to be arrived at as a result of negotiations between ITV and media buyers; and
- (c) allow these changes to take effect once revised undertakings have been accepted. Impacts counted in that year's SOCI would feed into the audience ratchet mechanism (ARM) calculation of CRR in the following year.

2. Introduction

Background

- 2.1 Following the CC's 2003 report on their merger to form ITV, [undertakings](#) were given by Carlton and Granada and accepted by the Secretary of State for Trade and Industry under section 88(2) of the Fair Trading Act 1973 (the Undertakings).¹ The Undertakings set out the CRR remedy in relation to the sale of commercial advertising airtime on the 'Regional Channel 3 Services'² (ie ITV1).³
- 2.2 In October 2006, ITV asked the OFT to conduct a review of the CRR Undertakings, which relate specifically to clauses 5 to 11 and Annex 1, which cover the sale of commercial airtime; clauses 12 to 18 and Annexes 2 and 3, which cover adjudication; and clauses 23 to 25, which deal with interpretation. In January 2008, the OFT, with assistance from Ofcom, started its review.

¹The full text of the Undertakings can be found at [Appendix A](#) of the Provisional Decision.

²'Regional Channel 3 Services' is as defined in the [Broadcasting Act 1990, section 14\(6\)](#).

³In 2003, the ITV1 channel was known as ITV. We have used ITV1 throughout this report when referring to the ITV1 channel.

- 2.3 On 29 May 2009, in exercise of its powers under Schedule 24, paragraph 16, of the Enterprise Act 2002, the OFT gave its advice to the CC.⁴ The OFT recommended that, if the CRR Undertakings were retained in any form, the definition of ITV1 in the Undertakings should include all methods of delivering the ITV1 programme schedule. The OFT also recommended that we give further consideration to ‘whether the decline in ITV1’s market position means that the remedy can be varied to provide effective protection against the remaining detrimental effects of the merger arising from ITV1’s strength in mass audience programming, but impose fewer costs and distortions than the remedy in its current form’.⁵
- 2.4 On 15 September 2009, we set out our assessment of the changes of circumstance since the 2003 report in the Provisional Decision.⁶ We provisionally decided that circumstances had not sufficiently changed since the 2003 report to warrant releasing ITV from the CRR Undertakings. However, we considered that there may be a case for some variation to the CRR Undertakings to address the following changes of circumstance:
- (a) the decline in the market position of ITV1;
 - (b) unintended incentives for ITV created by the ARM to focus primarily on maximizing ITV1’s SOCI;
 - (c) the unintended incentives for ITV created by the definition of ITV1 in the Undertakings; and
 - (d) difficulties for ITV in reacting to changing demand.⁷
- 2.5 At the same time as we published the Provisional Decision we invited submissions on the possible variations to the CRR Undertakings that we had set out in the Notice.⁸

⁴www.of.gov.uk/shared_of/register_of_orders_and_undertaki/CRR-review/exec-sum.pdf.

⁵OFT advice, paragraph 2.3.

⁶Review of ITV contract rights renewal undertakings—Provisional decision as to changes of circumstance, 15 September 2009.

⁷See paragraph 8.2 of the Provisional Decision.

Process since the Provisional Decision

- 2.6 We received responses both to the Provisional Decision and to the Notice from ITV and third parties (agencies, advertisers, broadcasters, trade associations, the Office of the Adjudicator and Ofcom).
- 2.7 ITV provided a detailed response to the Provisional Decision. We will address this, as well as other responses, in our final report. In summary, ITV submitted that the changes of circumstance since 2003 have been sufficient to justify the abolition of CRR and that there was no need for protection to be afforded to media buyers.⁹
- 2.8 Despite this view, ITV gave us a brief outline of certain ideas which it said it had been considering in the light of the concerns expressed in the Provisional Decision and which it developed and refined into a proposal which it made to the CC. We provided a range of third parties with a description of ITV's proposal and invited their views. These views are summarized in paragraphs 5.8 to 5.15. ITV subsequently provided a response to the Notice, which we published on our website on 22 December 2009, alongside a summary of other responses to the Notice.
- 2.9 We reviewed the responses to the Notice and held meetings with various parties to explore their views further, including holding a hearing with ITV. We also put further questions to ITV and third parties and undertook additional analysis, including an examination of the possible effects of the launch by ITV of an ITV1+1 or an ITV1 HD service.
- 2.10 Our assessment in this document is based on the changes of circumstance identified in the Provisional Decision. If our provisional conclusions as to the changes of

⁸See www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/notice_possible_variations.pdf.

⁹As in the Provisional Decision, we use the term 'media buyers' to include both media agencies acting on behalf of advertisers and advertisers acting on their own behalf. We only use 'advertisers' and 'media agencies' where we are specifically referring to such parties.

circumstance since the 2003 report were to change, this could affect our provisional conclusions as to variations, as we have presented them in this report.

Structure of the provisional decision on remedy variations

2.11 In this report we set out our provisional decision on remedy variations. The remainder of the document is structured as follows:

- Section 3: those variations on which we invited comments in the Notice but which, following responses to the Notice, we do not propose to pursue.
- Section 4: those variations on which we invited comments in the Notice and which we intend to implement, including the proposed redefinition of ITV1.
- Section 5: ITV's RPA proposal.
- Section 6: summary of our views on the effectiveness of the proposed variations.
- Section 7: the proportionality of the CRR Undertakings based on our proposed variations.
- Section 8: our provisional conclusion.
- Section 9: next steps.

3. Variations that we propose not to pursue

3.1 In this section we set out the variations to the CRR Undertakings that, on the basis of the responses that we received to our Notice and further analysis, we propose not to pursue. These are variations to:

- (a) address ITV1's advantage in delivering large audiences;
- (b) remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms;
- (c) address incentives for ITV to focus primarily on maximizing ITV1's SOCI; and
- (d) address difficulties for ITV in reacting to changing demand.

Variations to address ITV1's advantage in delivering large audiences

3.2 We considered varying the CRR Undertakings to regulate only sales of airtime within large audience programmes or programmes shown during peak time as a proxy for large audience programmes. Such variations could potentially take into account the decline in ITV1's SOCI and the ability of certain types of campaign to be run effectively without making use of ITV1's ability to attract large audiences. In the Notice, we said that this variation would be complex to implement and presented risks of unintended effects.¹⁰

3.3 There was little support for this variation.¹¹ Virtually all the responses to the Notice indicated that this variation would be difficult to design and implement, would create a more complex set of rules, and would be uncertain in terms of its effects. ITV submitted that the CC's concerns regarding the complexities of separating the sale of ITV1 airtime into regulated and unregulated parts were well founded. It added that such a variation would require ITV to change its current airtime trading model to avoid being severely curtailed in its ability to optimize its inventory on ITV1.

Variations to remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms

3.4 We invited views on a variation that would remove the entitlement of advertisers to renew existing contract rights but would retain the requirement that ITV should offer airtime on ITV1 on 'fair and reasonable' terms. We said that, in our view, this variation had a number of significant drawbacks. These included the difficulty of establishing and applying consistently a 'fair and reasonable' test in relation to the

¹⁰Notice, paragraph 9.

¹¹For a fuller summary of third party views on the possible variations in this section, see our website.

pricing of TV airtime and the resulting likely increase in the number of disputes. We said that, for these reasons, we were not minded to pursue this variation.¹²

3.5 Almost all parties agreed that this variation would be impractical, citing, for instance, the negotiating power that ITV had and the likely increase in disputes arising from the imprecision of any requirements to offer ITV1 airtime on terms which were ‘fair and reasonable’.

3.6 ITV submitted its RPA proposal. This was based upon an obligation on ITV to offer ITV1 airtime on ‘fair and reasonable’ terms, but was supplemented by a number of other components, including a form of ‘price control.’ We discuss this proposal separately, in [Section 5](#), because its scope extends beyond the variation regarding fair and reasonable terms that we set out in the Notice.

Variations to address incentives for ITV to focus primarily on maximizing ITV1’s SOCI

3.7 We considered variations that could address incentives for ITV to focus primarily on maximizing ITV1’s SOCI, for example by using an alternative measure of ITV1’s market position or by changing the relationship between ITV1’s SOCI and media buyers’ SOB commitments in the ARM. In the Notice, we suggested that alternative measures or relationships could introduce fresh, unintended consequences and may create specification problems relative to SOCI.¹³

3.8 ITV agreed with our concerns over such possible variations. Most third parties also saw no reason to adopt a different measure. Introducing a new measure would, it was put to us, create confusion and opportunities for misunderstanding. There was little support for changing the 1:1 relationship between ITV1’s SOCI and media

¹²Notice, paragraph 13.

¹³Notice, paragraph 21. These included a lack of reliable measurement, the need to define a specific time of day or set of programmes and the fact that only one aspect of coverage would be captured.

buyers' SOB commitments, nor was there a consensus as to how an alternative relationship should be defined.

Variations to address difficulties for ITV in reacting to changing demand

3.9 In the Notice, we invited views on any variations that could introduce more flexibility into the negotiations between ITV and media buyers whilst ensuring that the CRR Undertakings continued to address the adverse effects of the merger. We received no proposals from third parties. ITV submitted that, apart from the adoption of a 'fair and reasonable regime' (see ITV's RPA proposal in [Section 5](#)), it was not aware of a variation to CRR that would be likely to deliver greater flexibility in negotiations and an acceptable outcome to such negotiations.

Summary on variations that we propose not to pursue

3.10 The responses to the Notice on the variations to the CRR Undertakings set out in paragraph 3.1 supported our views, expressed in the Notice, that these variations were not likely to be either practicable or effective in addressing the adverse effects of the merger. We therefore propose not to pursue these variations any further.

4. Variations that we intend to implement

The definition of ITV1

4.1 In the Notice, we explained that the current definition of ITV1 in the Undertakings relates to the Regional Channel 3 Services licence and not to ITV1's programme schedule. It does not therefore encompass other ways of delivering the ITV1 programme schedule—including an ITV1 HD or ITV1+1 service.¹⁴ As a result, we found that ITV is deterred from launching alternative ways of delivering ITV1 as impacts generated by these services would not be counted towards ITV1's SOCI, and indeed

¹⁴Impacts on ITV1 broadcast on satellite and cable platforms are not, technically, counted in CRR but have, in practice, been considered in this way to date. See [OFT Advice](#), paragraph 6.6.

could reduce it. We said that we were minded to vary the CRR Undertakings to count impacts delivered by such services towards ITV1's SOCI and invited views.

- 4.2 In this section, we set out the responses to the Notice on this variation from third parties and ITV. We then set out our assessment of the proposed variation.

Third parties' views

- 4.3 The majority of the responses we received supported the proposed variation. However, views differed between media buyers on the one hand, which generally tended not to object to the variation, and the smaller broadcasters and their sales houses, which generally expressed concern that the variation would cause ITV1's SOCI, and thus, potentially, its share of NAR, to increase at the expense of other broadcasters.

- 4.4 Third parties raised a number of specific concerns in relation to this proposed variation:

(a) *Content of ITV1+1 and ITV1 HD.* The majority of third parties commented that the variation should be based on a requirement that ITV1+1 and ITV1 HD services are exact replicas¹⁵ of ITV1 with identical programming and advertisements.

Some particular concerns were expressed in relation to this:

- (i) Some broadcasters expressed concern that ITV would not be able to offer an exact replica of ITV1 because there would be difficulties in providing the regional services presently offered by ITV1.
- (ii) One broadcaster ([redacted]) told us that an ITV1+1 channel (and possibly an ITV1 HD service) would not be subject to Ofcom's code of scheduling TV advertising (COSTA) rules and so would be able to broadcast more advertising minutage.

¹⁵We use 'exact replica' to refer to a 'simulcast' of ITV1 in the case of ITV1 HD, and a 'staggercast' delayed by 1 hour in the case of ITV1+1. We note that in practice there may be circumstances when it may not be feasible for advertisements on an ITV1+1 channel to be identical to ITV1, eg advertisements for a lottery being shown after the lottery has taken place. Such circumstances would need to be taken into account.

(iii) Another broadcaster (Sky) said that there would need to be a change to the recording and attribution of viewing for ITV1+1 and ITV1 HD. It said that safeguards were necessary to ensure that such viewing was in the first instance correctly recorded by the Broadcasters' Audience Research Board (BARB) in the appropriate region of viewing and then correctly attributed to ITV1's SOCI under the ARM.

(b) *Value of impacts on ITV1+1 and ITV1 HD.* One broadcaster ([REDACTED]) submitted that including ITV1+1 and/or ITV1 HD within CRR would have the effect of forcing media buyers to buy ITV1+1 and/or ITV1 HD as part of their CRR protected contracts with ITV, whether or not they wanted to do so. A media agency ([REDACTED]) questioned whether ITV1+1 and ITV1 HD impacts should be traded at the same price as ITV1. Its view was that impacts delivered by these channels should contribute to the ARM by a factor of 0.5 and their pricing set at a maximum of 50 per cent of that of ITV1 (similar, it said, to the relative price of ITV1 to ITV's digital channels such as ITV2). [REDACTED]

(c) *Speed of implementation.* Some third parties submitted that any variation to the definition of ITV1 in the CRR Undertakings should be phased in. One broadcaster ([REDACTED]) proposed a transitional period before impacts from any new channels were included in ITV1's SOCI so as to allow the market to gauge their impact on the distribution of viewing and of commercial impacts. Another broadcaster (Sky) submitted that ITV should only be entitled to monetize additional inventory in the year following its actual delivery (eg in 2011, if launched at the start of 2010), and a media agency ([REDACTED]) submitted that the impacts delivered by ITV1+1 and ITV1 HD should only be included in ITV1's SOCI after one year of transmission.

(d) *Effect of launch.* A number of broadcasters were concerned that the potential for ITV to count impacts on the ITV1+1 service towards ITV1's SOCI would mean a slower decline in ITV1's SOCI, and consequently its share of NAR, with less revenue becoming available to other broadcasters as a result. These other

broadcasters provided estimates of the likely effect on ITV1's SOCI of launching an ITV1+1 service. These estimates were based on those broadcasters' own experience of launching a +1 service and in particular the extent to which viewers of the +1 service were watching it instead of the 'parent' service (so-called cannibalization). This evidence is set out in detail in Appendix B.

ITV's views

4.5 ITV said that, were CRR to be abolished, the definition of ITV1 would cease to be an issue. If, however, CRR were to remain, the definition of ITV1 should be amended to include ITV1+1 and ITV1 HD, as proposed by the CC. It told us that, had these variants of ITV1 existed in 2003, the definition of ITV1 in the Undertakings would have covered them at the time.

4.6 ITV addressed the specific concerns expressed by third parties:

(a) Content of ITV1+1 and ITV1 HD:

(i) ITV told us that, [REDACTED].¹⁶ ITV estimated that, based on ITV1+1 covering [REDACTED] as opposed to the existing 15 regional opt-outs on ITV1, [REDACTED] per cent of ITV1's NAR would come from sales regions that would not be replicated under the ITV1+1 service.¹⁷

(ii) In relation to ITV1 HD, ITV stated that [REDACTED]. ITV recognized that a similar regional issue existed in relation to ITV1 HD as to ITV1+1 [REDACTED].

(b) Value of impacts on ITV1+1 and ITV1 HD. ITV told us that it currently sold its ITV2+1 channel on a consolidated basis with ITV2 (ie ITV2 and ITV2+1 are sold as ITV2) [REDACTED].

(c) Speed of implementation. ITV told us that there was a natural phasing in of any new channel because it would slowly increase its SOCI over time.

¹⁶At present there are 15 regional licences across the ITV network, which can be further broken down into 26 micro-regions.

¹⁷This excludes the regions owned by SMG and Ulster, over which ITV plc has no control.

(d) Effect of launch:

- (i) ITV said that there was considerable uncertainty regarding the effect on ITV1's SOCI and revenue of launching an ITV1+1 service. ITV provided board papers supporting the case for an ITV1+1 service. These board papers estimated that launching ITV1+1 would lead to a net increase in impacts of [X] per cent: an increase of [X] per cent derived from the total number of viewers watching ITV1+1 offset by a decrease of [X] per cent from viewers transferring from ITV1 to ITV1+1. As noted in Appendix B, ITV estimated that the deterrence from launching ITV1+1 cost ITV £[X] million profit per year.
- (ii) ITV told us that, while an ITV1+1 channel might be expected to have a cannibalistic effect, it might also expand ITV1 viewing (and hence ITV1's SOCI) overall. However, ITV added that an ITV1 HD channel would directly cannibalize the ITV1 channel and there was no evidence to suggest that there would be any expansionary effect. Hence over time one would expect that, absent a variation to CRR, the reduction on ITV1's SOCI and revenue caused by ITV1 HD would be greater than that caused by ITV1+1.

Our assessment

4.7 In the Provisional Decision, we recognized that CRR has deterred ITV from launching new ways of delivering ITV1 such as ITV1+1 and ITV1 HD. A variation of the definition of ITV1 in the Undertakings would address the distorting effect without reducing the effectiveness of the CRR remedy. In the remainder of this section, we set out our assessment of each of the issues raised by third parties in paragraph 4.4.

(a) Content of ITV1+1 and ITV1 HD

4.8 This variation relates only to ITV1+1 and ITV1 HD: any other alternative ITV1 service (eg ITV player) is outside the scope of this variation.

- 4.9 If impacts on ITV1+1 and ITV1 HD services are to be counted towards ITV1 in the ARM calculation, we consider that they should be an exact replica of ITV1 subject to the qualification in subparagraph 4.10(a). Programmes available on ITV1 in standard definition only should be shown on ITV1 HD to ensure an exact replica of ITV1.
- 4.10 We did not find that any of the specific issues raised by third parties regarding the content of ITV1+1 and ITV1 HD materially undermined the rationale for this variation:
- (a) We noted that the extent of lost regional capability of an ITV1+1 service is likely to account for less than [X] per cent of ITV1's NAR. We would expect ITV to offer the same regionality on ITV1+1 and ITV1 if it were commercially attractive. If ITV wanted to realize cost savings by reducing the regional advertising opportunities that it offered, it would have to renegotiate the contractual terms for media buyers that currently have access to such regions. Such negotiations would, consistent with the CRR Undertakings, be subject to ITV's obligation to offer ITV1 airtime on fair and reasonable terms, and media buyers' entitlement to renew their existing contract rights if equally or more attractive terms are not made available. We consider that the same argument applies to ITV1 HD.
- (b) We consider that any ambiguity as to whether or not advertising minutage could be varied on ITV1+1 and ITV1 HD would be avoided through a requirement that impacts on those services may count towards ITV1's SOCI only if advertisements on them are exact replicas, subject to the qualification in (a) above .
- (c) We understand from BARB that the measurement issues raised by third parties are not of concern and the systems can be put in place with sufficient lead time to record, measure and attribute the impacts of ITV1+1 and ITV1 HD services appropriately.¹⁸

¹⁸We understand from BARB that, subject to its current understanding of ITV's requirements and with sufficient lead time, it expects to be able to implement the procedures necessary to record, measure and attribute the impacts of an ITV1+1 and/or ITV1 HD service.

(b) Value of impacts on ITV1+1 and ITV1 HD

- 4.11 If the services are to be exact replicas, we consider it most likely that impacts on ITV1+1 and ITV1 HD would be sold on a consolidated basis with ITV1. This approach has been adopted by other sales houses, including [redacted]. We did not find there to be any basis for reducing the weight attributed to ITV1+1 and ITV1 HD impacts in ITV1's SOCI: any basis would be arbitrary and its effect would be uncertain. Moreover, most media buyers appeared content for ITV1+1 and ITV1 HD impacts to be sold on a consolidated basis with ITV1 impacts and priced at the same level.

(c) Speed of implementation

- 4.12 In our view, there would be a natural phasing in of the effects of ITV1+1 and ITV1 HD services on ITV1's SOCI because of the way in which the ARM calculation works. For example, if ITV1+1 or ITV1 HD were introduced on 1 April 2010, the impacts would count towards ITV1's SOCI for the final three quarters of 2010, and would be included on this basis in the ARM calculation for SOB commitment purposes in the 2011 deal year. We therefore find that there is no need for additional phasing requirements.

(d) Effect of launch

- 4.13 If ITV1's SOCI increases following the launch of ITV1+1 or ITV1 HD, some broadcasters will, obviously, lose SOCI.¹⁹ This seems to us to be a normal part of the competitive process. Moreover, not all broadcasters would lose SOCI and we would expect that those broadcasters competing with an ITV1+1 and ITV1 HD service would respond competitively to retain their SOCI.

¹⁹We recognize that the introduction of an ITV1 HD service is likely to lead to significantly less incremental impact than the introduction of an ITV1+1 service given that the programmes on ITV1 HD would be shown at the same time as on ITV1. The main effect would therefore be the cannibalization effect.

4.14 If ITV1's SOCI were to increase, it is not clear that media buyers would necessarily increase their SOB commitment or increase it to the same extent. If, under a varied CRR, ITV1's SOCI increased as a result of ITV1+1 and ITV1 HD impacts being counted towards ITV1, this would allow ITV to propose that media buyers, if they wished to retain their present discounts, increase their SOB commitments up to the level indicated by the ARM, though subject to the maximum SOB commitment in protected contracts.²⁰ However, in the event that a media buyer declined to increase its SOB commitment, this would be likely to lead to negotiation between ITV and the media buyer over the appropriate level of discounts to be applied in such circumstances, and so the precise effect on a media buyer's SOB commitment to ITV1 (and thus other broadcasters' share of NAR) is uncertain.

Summary of our views on changing the definition of ITV1

4.15 In the Provisional Decision we recognized that CRR has deterred ITV from launching alternative ways of delivering ITV1 such as ITV1+1 and ITV1 HD. We find it appropriate to vary the definition of ITV1 in the CRR Undertakings. As set out in paragraph 4.6, this variation in relation to ITV1+1 alone is estimated to be worth £[~~8~~] million of profit per year to ITV. The lost profit in relation to ITV1 HD is also likely to be significant.

4.16 We noted the possible effect of the proposed variation on ITV1's SOCI and its share of NAR, potentially at the expense of other broadcasters' share of NAR. However, we consider that such effects are part of the normal competitive process and would not arise from the enhanced market power created by the merger.

4.17 For the reasons set out in paragraphs 4.8 to 4.14, we do not find that any of the issues raised by third parties lead us to conclude that this variation would lessen the

²⁰The 'base year' level: see Annex 1 to the [Undertakings](#).

effectiveness of the CRR remedy in addressing the adverse effects of the merger.

We therefore provisionally conclude that the CRR Undertakings be varied in order to:

- (a) redefine ITV1 to include ITV1+1 and ITV1 HD impacts, should such services be launched;
- (b) require that, in order for the impacts to be counted towards ITV1's SOCI in CRR, ITV1+1 and ITV1 HD services be exact replicas of ITV1 except for some allowance for regional differences between the two services to be arrived at as a result of negotiations between ITV and media buyers; and
- (c) allow these changes to take effect once revised undertakings have been accepted. Impacts counted in that year's SOCI would feed into the ARM calculation of CRR in the following year (for example, if ITV1+1 or ITV1 HD were introduced on 1 April 2010, the impacts would count towards ITV1's SOCI for the final three quarters of 2010, and would be included on this basis in the ARM calculation for SOB commitment purposes in the 2011 deal year).

5. **ITV's proposed Rules for the Protection of Advertisers**

- 5.1 ITV submitted its RPA proposal which we reproduce in Appendix A. As well as the RPA proposal itself, its submission explained how the RPA was intended to operate in detail and how it differed from CRR. We draw on both this explanation and the RPA in our analysis here.
- 5.2 The RPA was put to us as, effectively, an alternative to the remedy variations that we discussed in the Notice. We note that ITV is proposing that both the RPA and the redefinition of ITV1 be adopted by way of a variation to the Undertakings. In practice, ITV is proposing that RPA would introduce a new regime for the protection of advertisers which would replace the CRR Undertakings in their entirety.

ITV's rationale for its RPA proposal

5.3 ITV told us that the proposition underlying its RPA proposal is that RPA is a more proportionate remedy than CRR as it would fully address the specific concerns identified in the Provisional Decision, but does so in a manner that imposes substantially less distortion (and hence costs) on ITV's business. Although RPA does not deliver advertisers the same ex-ante protection as they were afforded under CRR, ITV believed that such certainty was no longer warranted in light of the changes of circumstance in the market in which ITV1 operated and, in particular, the increased substitutability of ITV1 airtime. Moreover, ITV believed that this ex-ante certainty has itself led to significant distortions in media buyer's behaviour creating market rigidity which RPA would eliminate. Instead, under the RPA, ITV said that negotiations would take place between ITV and media buyers in a flexible and dynamic environment.

5.4 ITV told us that material restrictions on ITV's flexibility in these negotiations would nevertheless be imposed as a result of the constraints contained within the RPA. In particular, ITV said that RPA requires that ITV meets specific contractual and pricing obligations that have been designed to address the concerns identified in the Provisional Decision. These obligations would ensure that ITV's terms and conditions for ITV1 airtime were fair and reasonable. ITV told us that any residual doubts as to whether such arrangements would, in practice, lead to mutually satisfactory outcomes would be addressed through a revised dispute mechanism.

Key features of ITV's RPA proposal

5.5 ITV's RPA proposal would replace paragraphs 5 to 18 of the Undertakings in their entirety. This would include paragraph 10(h) which obliges ITV not to change the Current Airtime Sales System (CASS) in a way that would materially alter the basis on which airtime sales are made without the consent of the OFT. ITV considered that

it was unnecessary to have a specific undertaking that ITV must continue to trade on the basis of SOB commitments or station average pricing so as to ensure that it did not attempt to circumvent the RPA by changing the trading mechanism. This was because ITV would need to retain these trading parameters in order to comply with agreed SOB commitments. ITV also stated that maintenance of paragraph 10(h) of the Undertakings would not be acceptable to it given the broad-ranging and constraining nature of this requirement.

5.6 The definition of ITV1 implied by paragraph 11 of the Undertakings would also be replaced by a new definition. In addition, ITV said that, since RPA would replace all aspects of CRR, the provisions of the CRR Undertakings regarding the rights of advertisers which change agencies or merge with other advertisers and the rights of agencies that merge with other agencies would also be replaced.

5.7 Under the RPA proposal:

(a) ITV would be obliged to make a separate stand-alone offer for ITV1 airtime on 'fair and reasonable' terms to all customers.²¹

(b) ITV would commit to a form of 'price control' for ITV1 to address the CC's concerns regarding ITV1's ability to require higher SOB commitments as a result of ITV1's advantage in delivering mass audiences. This would operate in two main ways:

(i) by constraining ITV's ability to make offers that would require media buyers to increase their SOB commitments in respect of ITV1 unless ITV1's SOCI had increased; and

(ii) by maintaining the overall weighted average contracted discount levels on ITV1 at not less than their current levels. ITV said that, as the discount

²¹ITV said that, although it considered such an obligation to be unnecessary in light of Ofcom's conditional selling rules, it was willing to offer this obligation in order to avoid the need to consider the effectiveness of Ofcom's rules.

element of the price control related to aggregate levels of discount, whether ITV met its weighted average contracted discount obligation overall was a matter of general compliance with the RPA rather than a matter for dispute on an individual agency or advertiser basis. ITV proposed that its obligations relating to aggregate discounts could be validated, ex post, by an appropriate body such as Ofcom or an independent auditor appointed by Ofcom.

- (c) The 'price control' would be supplemented by additional measures that would provide further guidance and protection to media buyers when negotiating contracts for ITV1 airtime. These would include:
- (i) a commitment that any change in a media buyer's discount terms for ITV1 airtime would be determined in a non-discriminatory manner. ITV explained that this obligation would apply only to changes of discount and that, as differential pricing had existed across contracts since before 2003, pricing differences would continue to exist. Specifically, it said that 'ITV would be required to ensure that any changes to discount reflect prevailing market conditions for similar advertisers with similar contract terms'.
 - (ii) a commitment by ITV to maintain media buyers' existing access to ITV1 specials on current terms;
 - (iii) a commitment by ITV to take account of a published list of objective factors when making an offer for ITV1 airtime;²²
 - (iv) the adoption by ITV of new arrangements to ensure compliance with these revised undertakings; and
 - (v) the adoption of a new dispute resolution process. This would be overseen, if not undertaken, by Ofcom rather than the Office of the Adjudicator. ITV told us that Ofcom would consider whether ITV had complied with each individual element of the RPA (for example, making a stand-alone offer for ITV1 or not requiring an increase in SOB in the event that ITV1's SOCI had not

²²ITV would be under an obligation to publish these which it refers to as the 'Transparency Rules for Advertisers' (TRA).

increased) in order to determine whether ITV's offer for ITV1 airtime was fair and reasonable. ITV told us that the dispute mechanism proposed under RPA differed from CRR in that RPA replaced the current subjective system (based on one individual's 'view' of the market) with a clear set of objective parameters to be considered.

Third parties' views of the RPA

Overview

5.8 The general view of the third parties to whom we spoke was that ITV's proposals would lessen the protection offered to media buyers compared with CRR, offer greater scope to ITV to increase ITV1's share of NAR, and be difficult to monitor and to adjudicate in the event of disputes. Ofcom, having discussed the RPA proposal with ITV, noted some positive aspects of the RPA, including the potential for greater long-run flexibility, which would allow undertakings based on RPA to evolve with changes in market conditions. In addition, it told us that the remedy, if workable, would provide stronger incentives for full annual negotiations compared with what happened under CRR—where media buyers may simply accept the change in SOB commitment defined by the ARM or only negotiate over that portion of SOB commitment released by the ARM. However, Ofcom also identified a number of shortcomings of the RPA proposal, which we have set out in paragraphs 5.14 and 5.15.

The 'price control'

5.9 All third parties to whom we spoke noted that, under the RPA SOB commitment/SOCI proposals (see paragraph 5.7(b)), media buyers would, in the event that ITV1's SOCI fell, lose their entitlement to reduce their SOB commitment in proportion to the fall in ITV1's SOCI whilst retaining their discounts. Any such reduction in SOB commitment, and the discount allowable against it, would need to be negotiated. Third

parties also suggested that the criteria proposed by ITV for use in such negotiations would tend to favour ITV, rather than the media buyer. It was put to us that, in those circumstances, some media agencies could face a significant fall in their ITV1 discounts, potentially sufficient to risk making them uncompetitive compared with other media agencies. This would be especially noticeable where media agencies had umbrella contracts²³ or deals based on SOB commitments. Media agencies with line-by-line contracts²⁴ would be less at risk were they to switch expenditure away from ITV1.

- 5.10 We asked third parties if the relationship between media buyers' SOB commitments and discounts could be defined, but none could identify a non-arbitrary, transparent and reasonable way of doing so. They said that media buyers' contracts contained many terms besides discount entitlements and SOB commitment that would also need to be considered when assessing the reasonableness of discounts offered in response to a media buyer's proposed SOB commitment.
- 5.11 More generally, most third parties said that the loosely-defined nature of the factors proposed for the assessment of the fairness and reasonableness of any ITV offer for ITV1 airtime and the absence of any indication as to the relative weight to be attached to them was such as to undermine the effectiveness of the RPA. The lack of precision regarding the rights of media buyers, compared with CRR, would either result in a plethora of complaints to the adjudicator or, because of the fear of retribution, media buyers would not bring complaints against ITV in the first place. One third party, however, suggested that the adjudicator could, at least to an extent,

²³Umbrella contracts are contracts between a sales house and a media agency that encompasses the media agency's expected portfolio of advertising clients. These umbrella contracts can, however, include provisions for specific advertising clients for whom terms are negotiated on a 'line-by-line' basis.

²⁴In line-by-line contracts, advertisers, or media agencies on advertisers' behalf, agree their own specific terms. Some media agencies offer line-by-line contracts to all their advertising clients.

rely upon previously agreed terms between ITV and media buyers as a benchmark for assessing the reasonableness of ITV offers for the sale of ITV1 airtime.

- 5.12 On the proposal to maintain the overall weighted average contracted discount levels at not less than their current levels, third parties told us that the allocation of discount between media buyers would not be transparent to individual media buyers. Even if an independent auditor were employed to verify ITV's compliance with the requirements on aggregate discount levels, such a control could only be implemented after the event. Further, they said that monitoring compliance would be extremely difficult, given the complexity both of the deals and the underlying data, and may thus present opportunities for circumvention. It was suggested, for example, that ITV could increase ITV1's revenue whilst maintaining aggregate discounts by selling some ITV1 airtime against narrower, higher-yielding demographics.

Adjudication

- 5.13 We asked third parties to comment on ITV's proposals for the adjudication process. Parties acknowledged that the adjudicator's role was a difficult one which needed to combine independence, up-to-date knowledge of the airtime trading market and judgement. Some third parties did not think that Ofcom would necessarily have the detailed knowledge of the airtime trading market needed to perform this role.
- 5.14 Ofcom told us that, although ITV had suggested that Ofcom's role in the disputes process could be modelled on the one it currently had under [section 185 of the Communications Act 2003](#), these powers were specifically related to the telecommunications sector and at present did not apply to broadcasting.
- 5.15 On the process of adjudication, Ofcom's concern was that there would be no clear way of understanding exactly how an offer for ITV1 airtime had been derived. Without

more explanation about the weighting of different factors taken into account by ITV when making an offer (see paragraph 5.7(c)(iii)), there would be little scope for an adjudicator to consider weighting in the adjudication process. Ofcom was concerned that ITV would be simply required to 'take account' of the various factors in the RPA without providing any additional information about the weighting of different factors or if and how they affected ITV's offer.

Our assessment of ITV's RPA proposal

5.16 In its 2003 report, the CC identified three adverse effects arising from the merger:

- (a) that the merged entity could insist on terms that were generally less attractive to advertisers and media buyers: this might include demanding a higher SOB commitment for a given level of discount;
- (b) that it might enhance the ability of the merged entity to engage in price discrimination; and/or
- (c) the merged entity might change the system under which TV airtime was sold to its advantage.

CRR was put in place to remedy these adverse effects. We noted in the Provisional Decision that all three adverse effects remain a concern. We consider the ability of ITV's RPA proposal to address each of these adverse effects in paragraphs 5.17 to 5.33. We consider in particular whether the lower level of protection for media buyers that the RPA would represent is appropriate in view of the changes of circumstance that we identified in the Provisional Decision.

(a) The ability of ITV to demand a higher SOB commitment for any given level of discount

5.17 We considered three scenarios regarding a change in ITV1's SOCI and the possible impact of the 'price control' in the RPA in each case:

- (a) ITV1's SOCI increases and ITV seeks an increase in SOB commitment from a media buyer;

(b) ITV1's SOCI decreases and a media buyer seeks a proportionate reduction in SOB commitment; or

(c) ITV1's SOCI decreases and a media buyer seeks a more than proportionate reduction in SOB commitment.

5.18 Under the first scenario, ITV would be entitled to propose an increase in SOB commitment from a media buyer, but it was not clear to us how large an increase would be considered fair and reasonable. Under CRR, through the ARM, an increase in ITV1's SOCI would entitle ITV to seek a commensurate increase in SOB commitment from a media buyer.²⁵ No guidelines as to what constitutes a 'fair and reasonable' relationship between media buyers' SOB commitments and SOCI are envisaged under RPA. ITV may therefore propose an increase in SOB commitment of more than the growth in ITV1's SOCI. Further, it was not clear what would happen if, in the event that ITV1's SOCI increased, a media buyer declined to increase its SOB commitment. Were ITV, in response, to propose a discount reduction and were the media buyer to consider this excessive, it was not clear what practical recourse would be available to the media buyer. As noted in paragraph 5.7(b)(ii), ITV's RPA proposal indicates that whether or not ITV meets its weighted average discount obligation overall is not a matter for dispute on an individual agency or advertiser basis, but is rather one of general compliance with the RPA Undertakings.

5.19 Similar considerations arise under the second scenario. While ITV has suggested that in these circumstances the adjudicator would be able to refer back to precedent, linking reductions in ITV1's SOCI to commensurate reductions in a media buyer's SOB commitment, we do not believe this would always be the case. Under the RPA proposals, previous ITV1 airtime agreements would not necessarily be relevant because the criteria for judging whether terms were fair and reasonable would be

²⁵Subject to the upper limit represented by the media buyer's original, 'Base Year', SOB commitment.

wider than under CRR: ITV1's SOCI, for example, would be only one of several performance measures that would be relevant to negotiations. ITV might therefore contend that it was fair and reasonable to require a media buyer's SOB commitment to remain the same, despite a fall in ITV1's SOCI, on the grounds that, for example, its volume of commercial impacts (VOCI) had increased or performance in the next deal year would be improved as a result of a significant rights purchase. Within the RPA, no guidance would be available to indicate the relative weight that might be attached to these different factors.

- 5.20 Under the third scenario, in which a media buyer seeks a reduction in SOB commitment greater than the decline in ITV1's SOCI, the adjudicator would have even fewer cases to rely upon as precedent.
- 5.21 In our view, ITV's proposals have the merit of introducing some flexibility into the negotiation process. However, we have concerns that, in the absence of clear guidelines as to what constitutes a 'fair and reasonable' relationship between media buyers' SOB commitments and discounts, ITV would have the incentive and the ability to insist on terms less attractive to media buyers.
- 5.22 We have sought views, including from ITV, as to whether these concerns could be addressed through, for example, tighter specification of what would constitute a 'fair and reasonable' relationship between media buyers' SOB commitments and discounts. We explored a number of approaches, including the possibility of modelling the existing relationship between media buyers' SOB commitments and discounts and also the possibility of introducing a degree of equivalence between agency 'buy-in' and 'buy-out' deals.²⁶ However, we noted from the 2003 report²⁷ that there was no

²⁶'Buy-in' deals are where an agency will propose increasing its SOB commitment in exchange for a greater discount. 'Buy-out' deals cover the opposite case: an agency wishing to sacrifice some discount in exchange for reducing its SOB commitment.

²⁷[Appendix 5.2](#), 2003 report.

clear or consistent relationship between media buyers' SOB commitments and discounts, and we found that applying buy-in terms to buy-out proposals would not be practicable.

5.23 However, our view is that even if some agreed relationship between SOB commitments and discounts could be established, this would not take account of the many other contractual terms between media buyers and ITV which influence negotiations over discounts, for example an advertiser's access rights to particular programme breaks. Under CRR, existing contractual rights can be retained, thus excluding them from negotiations over discounts. Under RPA, ITV could propose varying, for example, the 'quality' terms in a media buyer's contract if that media buyer were not willing to concede on terms relating to SOB commitment and discount.

5.24 On balance, it is our view that the RPA proposals would not be effective in preventing ITV from insisting on terms that were generally less attractive to media buyers, including demanding a higher SOB commitment for a given level of discount. In our view, the RPA would also not prevent ITV from demanding either a disproportionately higher SOB commitment in the event that ITV1's SOCI increased or substantially the same SOB commitment in the event that ITV1's SOCI fell.

Changes to the adjudication process

5.25 We now consider whether the revised adjudication process proposed by ITV under the RPA arrangements (see paragraph 5.7(c)(v)) would mitigate our concerns over the practicability of basing the remedy on 'fair and reasonable' terms.

5.26 In the absence of a defined relationship between changes in ITV1's SOCI and a media buyer's SOB commitment or the relationship between changes in SOB commitments and discounts, RPA implies a greater reliance on the adjudication process

to resolve disputes as to whether any particular contractual term may be deemed 'fair and reasonable' than is the case at present.

5.27 In our view, ITV's proposed adjudication process represents a lessening of the oversight which has been in place under CRR. Despite ITV's offer of disclosure of its aggregate discount calculations to an independent third party such as Ofcom, this would only be reviewable after the event. In addition, we share Ofcom's concern that ITV would simply be required to take account of the various factors in the RPA without providing any additional information about how different factors affect ITV's offer. These proposed variations to the adjudication procedure would represent a significant weakening of the current regime and we find that they therefore do not adequately address the first of the adverse effects identified in the 2003 report.

(b) Price discrimination

5.28 The second adverse effect identified in the 2003 report was that the merger may enhance ITV's ability to engage in price discrimination. We therefore consider the degree to which ITV's RPA proposal addresses this.

5.29 We interpret the non-discrimination provisions in ITV's RPA proposal, as set out in paragraph 5.7(c)(i), to mean that it is the intention of these provisions that existing contractual terms that reflect pre-merger price differentials and may appear 'discriminatory' may be retained. If ITV were to make an offer that would require a change in a media buyer's discount, however, that offer would have to be in line with other relevant and similar terms in place elsewhere.

5.30 In our view, the non-discrimination requirements of RPA have little practical application given the wide range of factors ITV would be allowed to take into account in making offers to media buyers for ITV1 airtime.

(c) Changes to the airtime sales system

- 5.31 The third adverse effect identified by the CC in the 2003 report was that ITV would be able to change the system under which TV advertising airtime was sold to its advantage.
- 5.32 As set out in paragraph 5.5, ITV's proposed arrangements would replace clauses 5 to 18 of the Undertakings in their entirety. This would include removing paragraph 10(h) which obliges ITV not to change the CASS 'in a way that materially alters the basis on and the way in which they offer Commercial Airtime for sale'.²⁸
- 5.33 We found it difficult, however, to see how ITV could be sure of complying with undertakings varied on the basis of RPA if it were to move away from using the existing trading metrics. We therefore thought it unlikely that, under RPA, ITV would change the system under which airtime is sold.

Summary of our views on ITV's RPA proposal

- 5.34 We see merit in ITV and media buyers being able to negotiate flexibly, but we do not consider that the RPA proposal put forward by ITV would be able to remedy effectively the adverse effects arising from the merger. We identified five main issues with the RPA proposal:

- (a) Media buyers would lose protection over the relationship between their SOB commitment and ITV1's SOCI. The RPA would not prevent ITV from insisting on either a disproportionately higher SOB commitment in the event that ITV1's SOCI increased or substantially the same SOB commitment in the event that ITV1's SOCI fell.
- (b) The proposal to regulate weighted average discounts could only be policed after the event and as it applies in aggregate it would not be capable of dispute by an

²⁸Paragraph 10 (h) of the Undertakings.

individual media buyer. In our view, given this requirement, no individual media buyer would, in practice, be able to use the adjudication process to challenge effectively the discounts it had been offered.

(c) The non-discrimination requirements of RPA have little practical application given the wide range of factors ITV would be allowed to take into account in making offers to media buyers for ITV1 airtime.

(d) If the fair and reasonable obligations in RPA were still to provide appropriate safeguards for media buyers, there would need to be extensive guidance as to how compliance would be assured and on what basis adjudication would be conducted, including the weighting that would be applied to various factors in determining a 'fair and reasonable' outcome. We found that such guidance could not be adequately developed given the wide range of contractual terms involved in TV advertising airtime negotiations and the differences between each media buyer's contractual terms with ITV1.

(e) We found that the proposed variations to the adjudication process put forward by ITV were not satisfactory. The scope of disputes that the adjudicator would be permitted to review would in practice be narrower than under CRR and the grounds for evaluating ITV's offers for ITV1 airtime would be limited only to compliance with each individual element of RPA.

6. **Summary of our provisional views on variations to CRR**

6.1 We consider that CRR has been an effective remedy in addressing the adverse effects identified in the 2003 report. This is supported by third party evidence submitted during our review. However, we identified in the Provisional Decision that there may be ways in which the CRR Undertakings could be varied to take into account certain changes of circumstance whilst retaining their effectiveness.

6.2 For the reasons given in paragraph 3.10, we do not consider that variations to:

- (a) address ITV1's advantage in delivering large audiences;
 - (b) remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms;
 - (c) address incentives for ITV1 to focus primarily on maximizing ITV1's SOCI; and
 - (d) address difficulties for ITV in reacting to changing demand
- would be effective remedies to the adverse effects of the merger.

6.3 For the reasons given in paragraphs 4.15 to 4.17, we consider that changing the definition of ITV1 in the Undertakings to include ITV1+1 and ITV1 HD would reflect the changes of circumstance and would not reduce the current effectiveness of the CRR remedy in addressing the adverse effects of the merger.

6.4 For the reasons given in paragraph 5.34, we do not consider that ITV's RPA proposal would be an effective remedy to the adverse effects of the merger.

7. **The proportionality of the CRR Undertakings as varied**

7.1 In the previous section we identified the redefinition of ITV1 as the only practical variation to the CRR Undertakings that would not undermine the effectiveness of the CRR remedy, the underlying principles of which we regard as continuing to be necessary to address the adverse effects of the merger. In this section, we consider whether retaining the CRR Undertakings with the proposed variation would be proportionate to the size of the adverse effects that would have arisen from the merger in the absence of CRR (the detriment). We first set out ITV's views on the costs to ITV of CRR in its current form followed by our assessment of those costs as they relate to CRR with the proposed variation. We then consider the proportionality of the CRR Undertakings as varied in relation to the detriment.

Costs to ITV of CRR

ITV's views on the costs to ITV of CRR

7.2 Following the publication of the Provisional Decision, ITV submitted a quantitative assessment by consultants OC&C of the costs to ITV of CRR in its current form. The OC&C report estimated the costs to ITV of CRR using both a 'top-down' approach and a 'bottom-up' approach:²⁹

(a) The top-down approach estimated that the current total cost to ITV of CRR was in the range £[redacted]–£[redacted] million in 2008/09, giving a mid-point estimate of £[redacted] million.

(b) The bottom-up approach identified costs³⁰ to ITV of CRR of between £[redacted] million and £[redacted] million in 2008/09 (giving a mid-range estimate of £[redacted] million) which OC&C said were directly and wholly attributable to 'dynamic inefficiencies' resulting from CRR in its current form. ITV and OC&C identified costs to ITV in relation to:³¹

(i) *Costs of the ARM in creating distorted incentives for ITV (£[redacted]–£[redacted] million), of which £[redacted] million related to the cost of not investing in ITV1+1 and ITV1 HD services (discussed in Section 4).* ITV submitted that, because the ARM was based on SOCI, ITV was incentivized to maximize ITV1's SOCI. ITV submitted that this had led to outcomes that were inconsistent with the demands of advertisers and audiences.

(ii) *Cost of protected contracts in creating deal debt (£[redacted]–£[redacted] million).* ITV submitted that, absent CRR, it would negotiate new contracts during the deal season so as to match the expected supply of TV airtime (based on expected schedule performance) to advertisers' demand.

²⁹The 'top-down' approach was based on a comparison of ITV1's performance over the period 2003 to 2009 with that of Channel 4. The 'bottom-up' approach estimated specific costs to ITV of CRR.

³⁰We use the term 'costs' in the same way as ITV: the term 'costs' includes both costs incurred by ITV and, in many cases, revenue forgone by ITV.

³¹Figures may not sum to the total of £[redacted]–£[redacted] million due to rounding.

(iii) *Operational constraints arising from CRR (£[redacted]–£[redacted] million)*. ITV submitted that CRR had acted as an operational straitjacket through clause 10(h) of the CRR Undertakings, which restricted ITV from making changes to the CASS.

(iv) *Regulatory risk and uncertainty introduced by CRR (not quantifiable)*. OC&C noted that CRR introduced regulatory costs to ITV by creating regulatory risk in operational decisions. In particular, OC&C noted that the OFT and the Office of the Adjudicator had the ability to overturn or delay ITV's decisions. It cited a delay in relation to ITV's decision to [redacted].

7.3 In addition, OC&C estimated administrative costs of CRR (such as the costs of the Office of the Adjudicator and ITV's compliance costs) to ITV of £[redacted] million a year.

7.4 These costs are described in more detail in Appendix C.³²

7.5 ITV submitted that CRR had a material negative impact on ITV's business and that, in particular, the 'dynamic inefficiencies' resulting directly from CRR were significant and amounted to at least £[redacted] million in 2008/09. It also expected the size of these costs to increase year on year. When considered alongside ITV1's total profit in 2008 (£[redacted]), ITV said that CRR was not a proportionate remedy and should not be maintained.

Third parties' views on the costs to ITV of CRR

7.6 As noted in the Provisional Decision, third parties did not raise any significant unintended effects of the CRR Undertakings.

³²Most of the costs identified in the OC&C assessment had previously been identified by ITV and we evaluated these costs in Section 7 of the [Provisional Decision](#) in our discussion of 'unintended effects'. However, the misalignment of programming investment with NAR, the operational constraints of CRR, and regulatory risk and uncertainty had not previously been explicitly identified by ITV as unintended effects.

Our assessment of the costs to ITV of CRR

- 7.7 Given the quantitative analysis of costs by OC&C, we have set out in Appendix C a further assessment of the costs to ITV of the CRR Undertakings. ITV submitted OC&C's analysis to demonstrate that CRR should not be retained. However, we have used OC&C's bottom-up analysis to consider the costs that might be incurred by ITV following our proposed variation to CRR.
- 7.8 In this section, we set out our overall views on the bottom-up approach. We do not discuss the top-down approach further here, since in our view it does not provide a reliable basis on which to assess the costs to ITV of CRR. In particular, the approach fails to capture the wide range of factors that have influenced the strategies of ITV1 and Channel 4 between 2003 and 2008/09.³³
- 7.9 Our proposed variation addresses the £[redacted] million cost to ITV of not investing in ITV1+1 and ITV1 HD services (see paragraph 4.15). As a result, this cost would not be incurred in the future. In this section, we have therefore only considered the remaining costs identified by ITV—a range of £[redacted]–£[redacted] million.³⁴
- 7.10 We first assessed the reliability of each cost estimate provided by OC&C. We found that the upper bound of the range of estimates provided by OC&C regarding the cost to ITV of focusing on daytime impacts and the cost of protected contracts were likely to be overstated by a total of at least £[redacted] million (see Appendix C, paragraphs 15 and 45). This reduced the upper bound of alleged costs of CRR as varied from £[redacted] million to £[redacted] million in 2008/09, leading to a revised range of £[redacted]–£[redacted] million.

³³See Appendix C for further discussion of the top-down approach.

³⁴Comprising costs (i) to (iv) in paragraph 7.2(b) and the £[redacted] million administrative costs in paragraph 7.3 but excluding the £[redacted] million attributable to not investing in ITV1+1 and ITV1 HD.

7.11 In paragraphs 7.12 to 7.22, we set out our view on the extent to which each cost could be directly attributed to CRR and which would continue under CRR as varied in the manner we propose.³⁵ We have not attempted to estimate the precise percentage of each cost that could be directly attributable to a varied CRR. However, in paragraphs 7.32 and 7.33, we assess what proportion of these costs, taken together, would need to be attributed to a varied CRR in order for such costs to be higher than the estimated detriment that would have arisen from the merger in the absence of CRR.

Costs of the ARM

7.12 We considered the extent to which CRR had influenced ITV's strategy for ITV1. We noted that between 2003 and 2007, ITV adopted a strategy of maximizing ITV1's short-term SOCI. In our view, this strategy was adopted for a wide range of reasons, of which CRR was one contributing factor. In September 2007, ITV changed this strategy, moving to a content-led strategy, with a longer-term approach, despite the negative financial impact that ITV told us such a strategy would produce in light of SOCI maximizing incentives created by CRR. The new strategy focused on launching a new peak-time schedule with more 60-minute drama at 9pm, fewer repeats, more comedy and more football. It also included a focus on new commissioned content. This strategy was aimed at increasing ITV's share of 'light viewers' and ABC1 adults.³⁶ This strategic change was made with CRR in place.

7.13 We considered the extent to which the ARM creates incentives for ITV to behave in a way that is inconsistent with advertisers' demands. We noted that, although SOCI does not capture all the qualitative aspects that advertisers might value when deciding how and where to advertise their products and services, the ARM encapsulates

³⁵See Appendix C for a detailed analysis.

³⁶See, for example, investor presentations made at the time, including one on 12 September 2007.

the key driver of advertisers' demand—volume of impacts. Consequently, ITV faces a choice of programming strategies similar to other broadcasters, including decisions between whether to invest in: daytime or peak-time programmes; short-term or long-term growth strategies; profile or volume of impacts; and high-risk or low-risk programmes. Not all decisions taken by broadcasters on these choices can be expected to be successful.

- 7.14 In our judgement it is likely that, although ITV may in part have adopted its strategy between 2003 and 2007 as an initial reaction to CRR, this strategy was not determined by CRR. The decisions faced by ITV under CRR are no different from those faced by other broadcasters. We therefore find that, at most, only a small proportion of the costs of the ARM³⁷ is likely to be directly attributable to CRR.

Costs of protected contracts

- 7.15 We considered the extent to which the protected contracts of CRR have created costs for ITV by limiting negotiations between ITV and media buyers. We recognize that CRR leads to some media buyers rolling over protected contracts in order to avoid transaction costs. However, we noted that when ITV built up deal debt in 2006 it was able to [✂].³⁸ Our view is that, if media buyers choose to roll over protected contracts, it is likely that ITV has not offered terms that are as attractive as pre-merger. A key purpose of the CRR Undertakings was to prevent ITV worsening terms for ITV1 airtime from those pre-merger; ITV is not restricted by CRR from making offers to media buyers in order to negotiate away deal debt.

³⁷This relates to costs A(i) to (v) in Appendix C, Table 1, and excludes the cost of the ARM in relation to not investing in ITV1+1 and ITV1 HD.

³⁸Deal debt is a natural phenomenon in the market for TV advertising airtime. This issue is faced by all other sales houses when they are unable to deliver sufficient impacts to match the impacts sold. Most sales houses overcome deal debt through negotiation during the annual deal season. This requires the sales house to offer something in exchange for removal of the deal debt.

7.16 OC&C estimated the cost of protected contracts (cost B in Appendix C, Table 1) by examining the amount ITV had paid for [redacted] rights, notably [redacted].³⁹ We noted that evidence from the board papers which supported the bid suggested that acquisition of these rights was at least as important for [redacted] as it was for removal of deal debt (see Appendix C for a fuller discussion of this point).

7.17 Taking the factors in paragraphs 7.15 and 7.16 together, it is our view that, at most, only a small proportion of the cost of protected contracts is likely to be directly attributable to CRR.

Costs of operational constraints

7.18 The operational constraints arising from CRR (cost C in Appendix C, Table 1) resulted from the detailed requirements of the CRR Undertakings as they relate to the CASS. The CRR Undertakings oblige Carlton and Granada not to ‘change their CASS without the consent of the OFT in a way that materially alters the basis on and the way in which they offer Commercial Airtime for sale’.⁴⁰

7.19 The [Undertakings](#) contain a comprehensive definition of CASS as:
the features and processes currently used by Carlton and Granada in relation to the sale of Commercial Airtime. This includes: the use of SAP, the sale of Commercial Impacts in all regions by all demographic audiences, specific time periods, time length factors and day part definitions as currently sold by Carlton and Granada, and the current limited sale of ‘specials’ outside contracts.⁴¹

³⁹In Appendix C, we noted that there was a lack of evidence in relation to other [redacted] rights and so we excluded costs in relation to these [redacted] rights in our assessment in paragraph 7.10.

⁴⁰The Undertakings, paragraph 10(h).

⁴¹CRR Undertakings, paragraph 25.

7.20 Whilst material alterations to the terms of sale of Commercial Airtime require the OFT's consent, our view is that the definition of CASS in conjunction with the requirements of the CRR Undertakings for ITV to offer airtime on fair and reasonable terms provides sufficient flexibility for individual media buyers and ITV to renegotiate mutually satisfactory contractual terms in relation to minor changes to the airtime sales system.⁴² ITV has already completed operational changes in some areas—for example, [REDACTED]. We consider that the rationalization of micro-regions, the example of an operational cost submitted by ITV, is not prevented by the CRR Undertakings. We do not therefore believe that this cost should be directly and wholly attributed to the CRR Undertakings, although we accept that ITV may have opted not to make such changes given its interpretation of the CRR Undertakings.

Costs of regulatory risk and uncertainty

7.21 We noted that the dispute [REDACTED] did not prevent it from implementing its proposed changes. No other examples of regulatory uncertainty were submitted to us. We do not find therefore that there is sufficient evidence to support the claim that CRR led to significant costs to ITV associated with regulatory risk and uncertainty (cost D in Appendix C, Table 1).

Administrative costs

7.22 We agree that the administrative cost of CRR (cost E in Appendix C, Table 1) is a relevant cost of CRR that needs to be taken into account in assessing the proportionality of retaining the CRR Undertakings, as varied.

⁴²The contract rights roll-over provisions of CRR give protection to media buyers in the event of an unsatisfactory outcome to negotiations, and media buyers would, in any case, have recourse to the dispute procedure. Risks that ITV would circumvent CRR are addressed by the provision that such changes do not 'materially alter' the basis on which airtime sales are conducted, without the consent of the OFT.

Summary

- 7.23 As set out in paragraph 7.10, we found that OC&C's upper bound estimates were likely to be overstated by at least £[redacted] million. This reduced the range of alleged costs of CRR as varied to between £[redacted] million and £[redacted] million, prior to considering the extent to which these costs are properly attributable to CRR as varied.
- 7.24 As set out in paragraphs 7.12 to 7.22, we found that:
- (a) The administrative cost of CRR (£[redacted] million) should be directly attributed to CRR and needs to be taken into account when assessing the proportionality of CRR as varied.
 - (b) Only a small proportion, at most, of the costs relating to the ARM and protected contracts (totalling £[redacted]–£[redacted] million) are likely to be directly attributable to CRR, and the operational costs (totalling £[redacted]–£[redacted] million) identified by ITV should not be considered as directly and wholly attributed to CRR. We have therefore taken these costs into account in paragraphs 7.32 and 7.33 when we assess what proportion of these costs, taken together, would need to be attributed to a varied CRR in order for such costs to be higher than the estimated detriment that would have arisen from the merger in the absence of CRR.
 - (c) There was insufficient evidence to support the claim that CRR introduced significant costs to ITV associated with regulatory risk and uncertainty. We have therefore not taken this (unquantified) cost into account in paragraphs 7.32 and 7.33.

Proportionality of CRR as varied

- 7.25 In this section, we assess the proportionality of retaining CRR as varied, by assessing the detriment that would have arisen from the merger in the absence of CRR and weighing this up against the costs of a varied CRR.

Detriment

2003 report—views on detriment

7.26 In relation to the three adverse effects identified by the CC, the 2003 report stated that:⁴³

We expected that the overall consequence of these adverse effects would be for Carlton and Granada together to achieve a higher level of revenue than if the merger had not gone ahead. This would be most likely to be to the detriment of advertisers and the other commercial broadcasters. An increase of one percentage point in ITV's NAR would reduce the revenue available to other broadcasters by around £17 million.

7.27 The 2003 report discussed the extent of 'contestable revenue' between Carlton and Granada (in other words, the extent of revenue that could be switched between the two sales houses). It found that a media buyer could potentially switch 40 per cent of expenditure from one sales house to the other, and that at least three media buyers had recently varied their London share commitments between Carlton and Granada, with an average movement of 10 per cent of ITV London expenditure.⁴⁴ These estimates were, however, thought to be uncertain (with caveats suggesting they could be under- or overestimates). The 2003 report also noted that 'the previous CC report recorded Granada as estimating the contestable element of ITV advertising as at least £100 million, or 5.5 per cent of ITV NAR'.⁴⁵

ITV's views on detriment

7.28 ITV noted the evidence in the CC's 2003 report and submitted that 'it seems reasonable to infer that the CC was of the view that the amount of contestable revenue was

⁴³2003 report, [paragraph 2.132](#).

⁴⁴Revenue from the two London licences in 2002 was £[<]—[<] per cent of ITV's NAR.

⁴⁵2003 report, [paragraphs 5.95 to 5.98](#).

small—and was certainly less than 10% of ITV NAR and quite possibly less than 5%'. It added that 'in 2002, total ITV NAR was worth around £1.7 billion, so that 5% would have equated to around £85 million'.

Our view on detriment

- 7.29 We cannot re-conduct the competitive analysis from the 2003 report in order to quantify the detriment in more detail now. Instead, we need to consider whether the detriment identified in the 2003 report has declined due to any of the changes of circumstance we identified in the Provisional Decision.
- 7.30 The £17 million quoted in the 2003 report, representing 1 per cent of NAR in 2002, was an illustrative figure; it was not presented as an estimate of detriment. However, we find this figure to be a conservative estimate of the detriment because it does not capture the adverse effects relating to changes to the CASS and the possibility of enhanced price discrimination. In our view, a price increase of 1 per cent of NAR was also likely to be a conservative estimate of any price increase that would occur absent an effective remedy. Given the views regarding the extent of contestable revenue identified in the 2003 report, we decided that it is reasonable to assume an upper bound of detriment of 5 per cent of NAR. A range of detriment of 1 to 5 per cent of NAR equates, in 2008, to between around £11 million and £55 million.⁴⁶
- 7.31 Having examined the changes of circumstance identified in our Provisional Decision, we decided that in the absence of the CRR Undertakings the detriment arising from the merger would remain. Based on the evidence before us, we cannot foresee any significant changes of circumstance and we would therefore expect the detriment to continue.

⁴⁶Based on ITV1's NAR of around £1.1 billion in 2008. The competition concerns, although focused on London, were seen to extend across all the ITV regions. In our view, it is therefore right to focus on ITV1's total NAR and not just that in the London regions.

Assessment of proportionality of variations to CRR

7.32 In paragraph 7.23, we identified a range of alleged costs of CRR to ITV of between £[X] million and £[X] million in 2008/09. This adjusted for overestimation by OC&C but did not take into account the extent to which these costs might be attributable to a varied CRR. This compared to a range of detriment of between around £11 million and £55 million, as described in paragraph 7.30.

7.33 Taking the range of alleged costs of £[X]–£[X] million, we would need to accept that between around [X] and [X] per cent of the costs were directly attributable to CRR in order for the costs of the varied CRR to be higher than even the lower bound of the detriment. In our assessment of costs in paragraphs 7.12 to 7.22, we found that since 2003 many factors have played a part in determining ITV's strategy in relation to ITV1 programming decisions and acquisition of [X] rights. In our view, when all the relevant costs that could be attributed to a varied CRR (as set out in paragraph 7.24) are taken together, only a small proportion, at most, should be attributed to a varied CRR. In our view, this proportion would be likely to be significantly lower than even the range of [X] to [X] per cent of the costs, implying a total cost to ITV of CRR that is significantly lower than the lower bound of detriment of around £11 million. We therefore concluded that CRR with our proposed variation is proportionate to the detriment that would have arisen in the absence of CRR.

8. Our provisional conclusion

8.1 We provisionally propose to vary the CRR Undertakings as follows to take into account the cost of CRR in deterring ITV from launching ITV1+1 and ITV1 HD services:

- (a) redefine ITV1 to include ITV1+1 and ITV1 HD impacts, should such services be launched;

- (b) require that, in order for the impacts to be counted towards ITV1's SOCI in CRR, ITV1+1 and ITV1 HD be exact replicas of ITV1 except for some allowance for regional differences between the two services to be arrived at as a result of negotiations between ITV and media buyers; and
- (c) allow these changes to take effect once revised undertakings have been accepted. Impacts counted in that year's SOCI, feeding into the ARM calculation of CRR in the following year (for example, if ITV1+1 or ITV1 HD were introduced on 1 April 2010, the impacts would count towards ITV1's SOCI for the final three quarters of 2010, and would be included in the ARM calculation for SOB commitment purposes in the 2011 deal year).

9. **Next steps**

9.1 This document is issued to provide an opportunity for representations to be made in relation to our provisional decision on variations to the CRR Undertakings.

9.2 Comments are therefore invited and should be received by the CC no later than 5.00pm on 2 February 2010 and should be addressed to:

Emily Chissell
Inquiry Manager
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

or emailed to: emily.chissell@cc.gsi.gov.uk.

9.3 Before issuing its final decision in relation to the CRR Undertakings, the CC will have regard to any representations made and may modify its decision as a result of such representations.