

Text of ITV's RPA Proposal

Rules for the Protection of Advertisers (RPA)

ITV obligations under RPA

- ITV would be under an obligation (as under CRR) to make a separate stand alone offer on ITV1
- ITV would be subject to an obligation to offer ITV1 airtime on "Fair and Reasonable" (F&R) terms to all advertisers/agencies (both new and existing).
- ITV would be required to publish a set of Transparency Rules for Advertisers ("TRA") which would:
 - (a) contain specific measures to address CC concerns regarding ITV's ability to extract higher spend commitments as a result of ITV1's ability to deliver mass audiences
 - (b) set out the factors and processes to be taken into account by ITV in making a F&R offer on ITV1
- ITV would be required to report annually to Ofcom on the detail of its compliance with the TRA. The report would provide sufficient information to allow Ofcom to ensure that any areas of residual concern that the CC identifies can be appropriately monitored.
- ITV would not be able to change the TRA without Ofcom's consent.

Transparency Rules for Advertisers (TRA)

Measures to address concerns regarding ITV's ability to require higher spend commitments as a result of ITV1's ability to deliver mass audiences

- ITV would commit to a "price control" on ITV1 airtime that limits its ability to require higher spend commitments from advertisers/agencies. This would encompass the following measures:
 - ITV would not require advertisers/agencies to give a higher SOB commitment on ITV1 unless ITV1 SOCI has increased ie advertisers/agencies would have the protection of a SOB ceiling in negotiations with ITV1.

- ITV would commit to maintaining weighted average contracted discounts at not less than their current levels across ITV1 airtime as a whole.
- ITV would be required to ensure that any offer involving a change in a customer's discount for ITV1 airtime would reflect prevailing market conditions for similar advertisers/agencies with similar contractual terms and would be determined in a non-discriminatory manner.
- ITV would commit to maintain access to ITV1 specials at their current levels and at current prices as specified in each advertiser/agency's current protected contracts, subject to content rights.

Factors to be taken into account by ITV in making a F&R offer on ITV1

- ITV would be obliged to take account of the following factors when making an F&R offer on ITV1:
 - The terms of the current contract of the agency/advertiser for ITV1 airtime;
 - Changes in a range of metrics (such as SOCI, SOCV and VOCI) that reflect changes in ITV1's ability to deliver advertiser needs over the preceding year;
 - Volume of spend by the agency/advertiser;
 - The need to avoid contractual commitments that would lead to ITV1 being over-traded;
 - General economic and regulatory factors that would be expected to lead to a change in demand for TV advertising as a whole;
 - Changes in the underlying audience measurement system.
- Other factors that ITV would take into account when relevant to the circumstances of a particular advertiser/agency would include:
 - The expected performance of ITV's upcoming programme schedule;
 - Changes in ITV's investment in specific content that is likely to lead to changes in ITV1's ability to deliver audiences targeted to the particular advertiser/agency's needs;

- Changes in demand against different advertiser categories;
- Changes in supply or demand against particular demographics;
- Changes in the advertiser's/agency's expenditure profile eg by day-part, day of week or seasonality;
- Demand for unique or non-standard terms and conditions;
- The extent to which demand for specific terms and conditions impact on ITV's ability to optimise its inventory.

Processes to be taken into account by ITV in making a F&R offer on ITV1

- ITV would write to all advertisers/agencies that have annual deals 10 weeks before their current contract ends in order to seek confirmation whether or not they intend to purchase ITV1 airtime in the upcoming year.
- ITV would provide all advertisers/agencies who have annual deals, and who had indicated an intention to purchase ITV1 airtime in the upcoming year, with an indicative offer for airtime on ITV1 in line with the TRA 8 weeks before their current contract ends.
- ITV would provide all advertisers to whom it had provided an indicative offer with a formal offer for airtime on ITV1 in line with the TRA before their current contract ends.

Internal monitoring of compliance

- ITV would establish new internal arrangements for ensuring compliance with RPA. These arrangements would include the following:
 - The adoption of an appropriate Code of Conduct for all personnel involved in the sale of ITV1 airtime
 - The development of specific training and guidance for personnel involved in the sale of ITV1 airtime to ensure compliance with the Code of Conduct
 - A review of employee conditions and incentives to ensure that they are appropriately aligned with compliance with ITV's commitments under RPA

- The establishment of new internal monitoring procedures to ensure compliance with ITV's commitments under RPA

Adjudication

- In the event of a dispute as to whether ITV's offer is F&R, the dispute would be referred to Ofcom under arrangements modelled on Ofcom's existing dispute resolution processes under the Communications Act (including associated sanctions)¹.

Calculating the weighted average contracted discount

Under the RPA scheme ITV will be required to maintain weighted average contracted discounts at no less than their current level across the market. ITV will calculate its current weighted average contracted discount level and this will provide the aggregated contracted discount obligation that ITV will be required to deliver in the following year. The contracted discount obligation figure will be weighted by demographic spend on a one year lagged basis (similar to CRR) to ensure it reflects actual demand across advertisers/agencies for different demographics. This will also ensure there is a clear target for ITV each year ahead of the deal season for negotiations.

The contracted discount obligation figure will be rebased each year to ensure it continues to reflect the effective discount available in the market in 2009 even if actual demand by demographic changes over time.

Overall, the steps involved in the RPA weighting calculation are similar to those currently carried out by ITV under CRR (applied in this case to discounts rather than to SOB), though the RPA weighting process is less complex as it is not carried out on an advertiser by advertiser basis and uses less weighting factors than CRR (ie the RPA does not require

¹Or such other dispute resolution process as may be agreed in the course of this review by the CC, Ofcom and ITV.

weighting by regions or day-parts). Below, ITV sets out the step by step calculations involved in this process.

The first part of the RPA process is to calculate the weighted average contracted discount that is currently delivered (The Year 0 weighted average contracted discount). Using the indicative data from Figure 1 (which ITV provided for illustrative purposes and does not reflect actual contractual data or discounts), this is calculated as follows:

The first step is to calculate the actual contracted *value* delivered by advertiser by demographic. This is calculated by taking the actual spend by advertiser by demographic and applying the contracted discount. For example if Advertiser A spends £4000 on Adults at a 15% discount then Advertiser A realises £4706 of value. This is calculated as: $£4000/(85/100)$.

This is carried out for each advertiser for each demographic.

The actual spend by advertiser by demographic is then summed, and the actual contracted value delivered by advertiser by demographic is also summed. This provides the total actual spend by demographic and the total actual contracted value delivered by demographic.

The total actual spend by demographic is then summed which gives the total actual spend against all demographics. The total actual contracted value delivered by demographic is also then summed which gives the total actual contracted value delivered against all demographics.

The overall weighted average contracted discount is then calculated based on these two numbers. Again, from the data in Figure 1 the total actual spend against all demographics is £81,200 and the total actual contracted value delivered against all demographics is £88,877 then the total weighted average contracted discount is 8.6.

This is calculated as: $100 - ((81,200/88,877)*100)$.

Therefore, based on the Figure 1 data, the weighted average contracted discount that ITV would be required to deliver in Year 1 would be at least 8.6%. Therefore, in negotiations for

Year 1 ITV would be required to ensure that it delivers a weighted average contracted discount of at least 8.6 % to the market on the basis that the same relative audience volume demand in Year 1 is maintained as at Year 0 ie in negotiations for Year 1 ITV must ensure that its weighted average contracted discount obligation is achieved at year end for Year 1 if the same relative audience volume demand were to be maintained throughout Year 1 as in Year 0. This ensures that ITV can continue to meet its weighted average contracted discount obligation even if demand for demographics change year on year. It also ensures that ITV has reasonable certainty as to what its required weighted average contracted discount obligation is likely to be ahead of the deal season minimising the need for a reconciliation mechanism.

Using the same steps set out above for Year 0, the weighted average contracted discount obligation would be recalibrated annually based on actual spend to take account of variations in advertisers'/agencies' spend patterns from year to year. Annual rebasing of the weighted average contracted discount obligation ensures that it continues to reflect actual demand over time, thereby avoiding rigidities creeping in over time as demand changes and ensuring that the mismatch of supply and demand that resulted under CRR does not materialise under the RPA.

Figure 1: Calculating the Year 0 weighted average contracted discount

Year 0		Adults	16-34s	Adults ABC1	Total spend
Agency A	Discount	-15.0	-3.0	-5.0	
	Volume of spend	£ 4,000	£ 9,400	£ 23,000	£ 36,400
Agency B	Discount	-11.0	-9.0	-8.0	
	Volume of spend	£ 7,500	£ 2,000	£ 13,900	£ 23,400
Agency C	Discount	-15.0	-10.0	-11.0	
	Volume of spend	£ 10,000	£ 3,000	£ 8,400	£ 21,400
Total spend by audience		£ 21,500	£ 14,400	£ 45,300	£ 81,200
% of total revenue		26%	18%	56%	
Total weighted average discount		-8.6			

Effect of introducing an ITV1+1 service

1. In this appendix we discuss the effect on ITV1's SOCI and revenue of introducing an ITV1+1 service. We received evidence on the potential size of the revenue effect of introducing ITV1+1 from ITV and a number of broadcasters. This evidence focused on two main issues:
 - (a) the effect on a parent channel's SOCI and revenue of launching a +1 channel;
 - and
 - (b) the potential effect on ITV1's SOCI and revenue of launching ITV1+1.

(a) Effect on a parent channel's SOCI and revenue of launching a +1 channel

2. We were provided with evidence from broadcasters of the effect of launching different +1 channels. In each case, the evidence provided was intended to show the effect of launching a +1 channel in terms of:
 - (a) the reduction in impacts on the parent channel (cannibalization); and
 - (b) the additional impacts on the +1 channel (incremental impacts/net uplift).
3. Third parties analysed in a variety of different ways the effect of introducing a +1 channel—by looking at the change in impacts on the parent channel and +1 channel combined after one month, after three months and after one year; and by looking at the share of impacts between the parent channel and the +1 channel. From the analysis, it was clear that, whilst it is relatively straightforward to understand the amount of impacts delivered on each new +1 channel, it is very difficult to isolate the amount of cannibalization from the parent channel, and the incremental impacts attributable to the launch of the +1 channel. In particular, a number of factors make it difficult to assess accurately the extent of cannibalization or to draw any broad

conclusions in relation to launching ITV1+1 from the SOCI changes experienced by any particular parent channel and +1 channel:

- (a) The lack of a relevant control group to understand the cannibalization effect on the parent channel. For most +1 channels it is difficult to understand the impact on the parent channel because it is not possible to control for other factors that affect the change in SOCI on the parent channel over the period since the launch of the +1 channel.
- (b) The effect of different programming schedules and other factors such as the weather. These make monthly comparisons pre- and post-launch of a +1 channel unreliable because they may not reflect 'core' changes in SOCI and may be affected by other temporary or unusual factors.
- (c) Differences in the effect on different platforms (digital terrestrial television (DTT), digital cable and satellite) carrying the channel. These differences are caused by different relative positions of the new +1 channel to the parent channel in the electronic programme guide (EPG) (eg an EPG position closer to the main channel can help increase viewing on the +1 channel); different levels of usage of personal video recorders (PVRs) and video on demand (VOD) for viewers on different platforms (eg increased usage of PVR and VOD among satellite viewers can lead to a smaller increase in viewing of a +1 channel); and different viewing behaviour within demographics on different platforms (eg other channels that appeal to the same demographics and are being launched on a particular platform at the same time).
- (d) The increase in digital penetration over time affecting the different levels of take-up of particular +1 channels, and in particular exogenous events leading to jumps in digital penetration (eg the football World Cup).

4. Given these factors, it is most appropriate to look across the full range of +1 channels to see the effects of cannibalization and incremental impacts. [REDACTED]¹

[REDACTED]

5. [REDACTED]

[REDACTED]

6. [REDACTED]:

(a) [REDACTED]

(b) [REDACTED]²

(c) [REDACTED]

(d) The range of the size of these effects from –1 to 66 per cent highlighted the sensitivities of the effect of a +1 channel to the factors set out in paragraph 3.

(b) The potential effect on ITV1's SOCI and revenue of launching ITV1+1

7. ITV said that there was considerable uncertainty regarding the effect on ITV1's SOCI and revenue of launching an ITV1+1 service. In its internal assessment of launching a new ITV1+1 service, ITV assumed that there would be cannibalization by the ITV1+1 service of [REDACTED] per cent of ITV1's SOCI with a net uplift of [REDACTED] per cent in SOCI of ITV1 and ITV1+1 combined.
8. Taking into account the evidence on the effect of other +1 channel launches, third parties provided estimates of the likely effect of launching an ITV1+1 service. Table 1 shows that cannibalization estimates were consistently at 5 per cent of SOCI and the net uplift in SOCI ranged from 4 to 10 per cent. In all cases, third parties noted that the effects were difficult to predict given the issues highlighted in paragraph 3.

¹[REDACTED]
²[REDACTED]

TABLE 1 Summary of third party views on the effect of ITV1+1 on ITV1's SOCI

	[£]	[£]	[£]	[£]	[£]	[£]	[£]*	[£]
	<i>per cent</i>							
Cannibalization from ITV1	-5	-4	N/A	N/A	N/A	-5	N/A	N/A
Total impacts on ITV1+1	<u>15</u>	<u>9</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>10</u>	<u>N/A</u>	<u>N/A</u>
Net effect (incremental impacts) (%)	10	5	8	8	4.2-8	5	At least 5	10

Source: Third party analysis.

* [£] analysis was based on share of viewing rather than SOCI.

Notes:

1. Figures in the table are expressed in terms of percentage change in ITV1's SOCI.
2. N/A means the party only provided the net effect.

9. ITV and third parties each used these estimates to assess the impact of launching ITV1+1 on their own businesses:

(a) ITV used the estimates to evaluate the effect of launching ITV1+1 on ITV's

profitability (after taking into account the costs of launching ITV1+1, [£]). ITV estimated that the net impact on its EBITDA would be up to £[£] million a year.

(b) Third parties tended to use the estimates to evaluate the net revenue impact on other broadcasters resulting from the net uplift in ITV1's SOCI. The net revenue effect calculated was the revenue that ITV would be able to take from competitors as a result of launching ITV1+1. Third parties' estimates of the net revenue effect ranged from £17 million to £93.5 million depending on the assumptions used.

Costs to ITV of the CRR Undertakings

Introduction

1. In this appendix we assess the costs to ITV of the CRR Undertakings in their current form. This assessment is based on a quantitative assessment conducted by OC&C on behalf of ITV. This appendix supports our assessment of costs of a varied CRR set out in Section 7 of the report.
2. The OC&C report conducted a 'top-down' and 'bottom-up' approach to assessing the costs to ITV of CRR.

Top-down approach

ITV's views

3. In the top-down approach, OC&C estimated that the current total cost to ITV of CRR is in the range £[x]–£[x] million a year in 2008/09, giving a mid-point estimate of £[x] million.
4. The top-down approach was based on a comparison of ITV's performance over the period 2003 to 2009 with that of Channel 4. OC&C focused on ITV1's and Channel 4's ratio of programme expenditure to its share of NAR,¹ indexing both ratios to 2003 in order to show the relative performance of Channel 4 and ITV1 in terms of 'programming efficiency'. OC&C considered it reasonable to assume that at least some part of the apparent decline in ITV1's 'programming efficiency' was due to CRR, but noted that part of the decline may be the result of programming decisions taken in the past. It attributed between [x] and [x] per cent of the gap between

¹OC&C referred to this as 'SOB'.

Channel 4 and ITV1 to 'dynamic efficiency gains which would have been available to ITV had it not been operating under CRR'.

Our views

5. We considered that the top-down approach adopted by OC&C suffered from measurement problems and produced results which were open to more than one explanation:

(a) The metric used by OC&C measured ITV1's performance relative to Channel 4.

However, if Channel 4 gained share of NAR at the expense of other broadcasters except ITV1 (where 'other broadcasters' includes other channels in the ITV family), ITV1's position might appear worse even if its ratio of programme expenditure to share of NAR remained the same or improved. We did not therefore consider this to be an appropriate measure of ITV1's 'programming efficiency'.

(b) Even if it were accepted that the metric used by OC&C is, in some respects, a measure of ITV1's 'programming efficiency', in our view Channel 4 may have been more efficient than ITV in its programming decisions during this period for reasons entirely unrelated to CRR. In particular, the apparent decline in ITV1's 'programming efficiency' may be partly as a result of the fact that Channel 4 has pursued different strategies to target different demographics. There are also a wide range of factors that have influenced the strategies of both ITV and Channel 4 since CRR was implemented.

Bottom-up approach

6. In the bottom-up approach, OC&C identified specific costs to ITV of CRR totalling between £[redacted] million and £[redacted] million a year in 2008/09 (giving a mid-range estimate of £[redacted] million). OC&C stated that each of these costs were directly and wholly attributable to 'dynamic inefficiencies' resulting from CRR. In addition, OC&C noted

that there were £[redacted] million a year of administrative costs created by CRR. These costs are summarized in Table 1.

TABLE 1 Summary table of OC&C estimates of costs to ITV of CRR

<i>Cost to ITV of CRR</i>	<i>Cost estimate by OC&C £m</i>
A. Costs of the ARM in creating incentives to:	
(i) Focus on daytime rather than peak-time impacts	[redacted]
(ii) Align programming investment with high viewing months rather than NAR	[redacted]
(iii) Focus on volume of impacts rather than profile	N/A
(iv) Reduce levels of new higher-risk programming investment in favour of ageing programme formats*	N/A
(v) Increased number of soap operas instead of greater variety of programmes	N/A
(vi) Not invest in ITV1+1 or ITV1 HD	[redacted]
B. Cost of protected contracts in creating deal debt and requiring ITV to [redacted] for [redacted] rights to address this deal debt	[redacted]
C. Operational constraints of CRR	[redacted]
D. Regulatory risk and uncertainty introduced by CRR	N/A
E. Administrative costs of CRR to ITV including the costs of the Office of the Adjudicator and internal compliance costs	[redacted]
Total	[redacted]

Source: OC&C analysis.

*OC&C estimated a cost of £[redacted] million for this unintended effect but did not use it in their total estimate.
 Note: N/A means costs were not able to be quantified. Figures may not sum due to rounding.

7. We consider each of these costs in turn.

Costs of the ARM

ITV's views

8. ITV submitted that the formulation of CRR had distorted its incentives to deliver what advertisers and audiences wanted. In particular, the ARM was based on SOCI, which meant that ITV was incentivized to maximize ITV1's SOCI. ITV submitted that this led to outcomes that were inconsistent with the demands of advertisers and audiences. ITV submitted that prior to CRR being introduced, Carlton and Granada negotiated with media buyers across a range of factors: reach and frequency, quality of programming, ability to deliver viewers in key demographics, average programme viewings and other qualitative terms (for example, position in break).
9. The ARM focuses solely on changes in ITV1's SOCI, weighted by demographic. Under the ARM, for each percentage point fall in SOCI there is a proportionate fall in

SOB commitment. CRR therefore rewards ITV for maximizing volumes of commercial impacts on ITV1 so as to maintain SOCI and prevent decreases in the SOB commitment of individual media buyers. ITV argued that the consequence of the ARM not capturing reach and other quality parameters was that, to prevent reductions in SOB commitment, ITV was indifferent between reach and frequency on ITV1, focusing only on maintaining SOCI.

10. ITV submitted that there were six main effects of the incentive to maximize SOCI:
 - (a) to focus on daytime rather than peak-time impacts;
 - (b) to align programming investment with high viewing months rather than NAR;
 - (c) to focus on volume of impacts rather than profile;
 - (d) to reduce the level of new higher-risk programming investment in favour of ageing programme formats;
 - (e) to increase the number of soap operas instead of greater variety of programmes;
and
 - (f) not to invest in ITV1+1 and/or ITV1 HD.

11. On each cost, we present in turn ITV's (and OC&C's) views and our views.

To focus on daytime rather than peak-time impacts

- *ITV's views*

12. ITV stated that the ARM created an incentive to invest in daytime rather than peak time because SOCI treated all impacts at all times and on all channels as equal. Consequently ITV submitted that it was incentivized to maximize impacts on ITV1 wherever it could gain incremental viewers for least cost and irrespective of daypart. ITV argued that, because peak-time programmes were more expensive to produce²

²OC&C noted that ITV1's anchor daytime programming—*Jeremy Kyle* and *Loose Women*—all delivered impacts at a cost of less than £[§] per thousand impacts versus more than £[§] for many of ITV1's high-profile peak-time programmes (eg *Britain's Got Talent*, *Kingdom*, *Dancing on Ice*).

and faced greater competition than daytime TV,³ it was more expensive and harder to attract incremental viewers during peak time. ITV had therefore focused on increasing ITV1 impacts in the daytime rather than peak time. ITV told us that, although increasing impacts, this was inconsistent with what advertisers wanted because they wanted ITV to maximize its delivery of ITV1's peak-time impacts, not daytime impacts.

13. ITV submitted that between 2003 and 2007/08, ITV1's share of programming expenditure spent on daytime programming increased from [%] per cent in 2003 to [%] per cent in 2007 and [%] per cent in 2008. However, despite the incentive to maximize ITV1's SOCI, ITV nevertheless adopted a '2100 strategy' for ITV1 (investing in its 9pm peak-time programming) from September 2007. ITV submitted that this was a recognition that the long-term success of ITV1 was dependent on delivering a diverse range of quality programming in peak time but noted that, as this strategy did not seek to maximize SOCI, it might lead to a reduction in revenue under CRR.
14. OC&C estimated this cost by comparing the proportion of ITV1's programming expenditure spent on daytime and peak time in 2007 and 2008 with the proportion in 2003. OC&C assumed that ITV would realign programme expenditure to the 2003 proportions between daytime and peak time. It then used the relative cost effectiveness of selected peak-time and daytime programmes and the relative value placed by a major advertiser ([%]) on peak-time impacts over daytime impacts to calculate the potential improvement in returns from reallocating programming expenditure to peak time from daytime. This generated a range of £[%]-£[%] million a year, depending on whether 2008 or 2007 was used as the comparator year.

³OC&C noted that many multi-channel broadcasters did not start broadcasting until late afternoon. For example, only 54 per cent of commercial channels within Sky's entertainment genre provide a full 24-hour schedule.

- *Our views*

15. We considered first the reliability of the cost estimates calculated by OC&C:
- (a) First, there seemed no basis for concluding that 2003 was the 'right' level to which to compare the proportion of programming expenditure between daytime and peak-time programming. Although this was the pre-merger level, it is unclear what would have happened to programming expenditure absent CRR given that peak-time programming has become more competitive than daytime programming. In particular, the trend among other broadcasters over the same period was not examined by OC&C. We therefore considered that the estimate was most likely to be an overestimate of this effect, to the extent that it existed.
- (b) Second, the 'upper bound' estimate of this cost (£[redacted] million) was based on a comparison between 2003 and 2007 daytime expenditure, despite a decline in daytime expenditure since 2007. This suggested that it is not appropriate to use this as a comparator as effects other than CRR are likely to be included in the 2007 figures. To the extent that these figures could be used, we considered that the 2008 comparator was more appropriate with an 'upper bound' estimate based on an average over the five years. This reduced the size of the 'upper bound' estimate by about £[redacted]-£[redacted] million.
16. We next considered the extent to which this cost to ITV could be attributed to CRR. Our views on the extent to which the ARM determined ITV's strategy are set out in paragraphs 7.12 to 7.14 of the report.

To align programming investment with high viewing months rather than net advertising revenue

- *ITV's views*

17. OC&C submitted that, absent the need to maximize SOCI, it would be commercially rational for ITV to seek to align monthly programming expenditure on ITV1 to

advertiser demand (as measured by the proportion of total NAR that is spent by advertisers in a given month). However, ITV [X].

18. OC&C assumed that ITV would be able to close the gap in this inefficient spending by [X] per cent, enabling it to reappropriate programming expenditure from low-yielding months to higher-yielding months. OC&C further assumed that this reallocation would enable ITV to increase the returns on its marginal programming expenditure by up to [X]. These assumptions generated an estimate of the cost to ITV of CRR in this respect of between £[X] million and £[X] million a year.
19. Based on the variance in ITV1's NAR between 2001 and 2008, OC&C noted that it would expect a natural mismatch between programming expenditure and NAR of [X] per cent. ITV did not provide any evidence of the pattern pre-CRR and OC&C argued that it was not relevant because of the underlying changes in relevant market dynamics since that period.
 - *Our views*
20. It was not clear that this cost could be directly attributed to CRR. In particular, we would expect some misalignment between programme expenditure and NAR. No comparisons were provided pre-CRR. We acknowledged OC&C's estimate regarding the natural mismatch between programming expenditure and NAR of [X] per cent, but this estimate did not capture the extent to which out-turn programme expenditure does not match planned programme expenditure, and so there is a further margin of error to take into account. In addition, we would expect this outcome given ITV's stated strategy between 2003 and 2007 (see paragraphs 7.12 to 7.14 of the report) and we noted that other strategic factors are likely to have had a strong bearing on programming decisions, and hence the pattern of programme expenditure during the year.

To focus on volume of impacts rather than profile

- *ITV's views*

21. ITV stated that the ARM created an incentive for it to be risk averse in its programming choices. ITV told us that, because media buyers' SOB commitment fell in line with SOCI, it had become more risk averse in its programming decisions. In addition, ITV told us that, as the ARM was weighted by revenue for each demographic, it focused attention on the largest demographics. ITV is therefore less incentivized to reach less popular demographics. ITV submitted that, because of these two factors, it had focused on ITV1 programmes that guaranteed a high volume of impacts in the required demographics.
22. ITV submitted that, absent CRR, it might commission or schedule a programme even if it did not maximize SOCI. Examples included programming to attract new viewers and extend reach (eg new movies); high-quality or 'event' status programming, which had a 'halo effect' (positive association) on brands in advertisements (eg *The Brits*); and programming targeted at a demographic valued by certain advertisers but potentially not delivered effectively elsewhere in ITV1's schedule.
23. OC&C noted that, absent the ARM, commercially rational behaviour would have ITV commissioning programming aligned to advertiser demand for programmes which deliver targeted, high-quality audiences. However, ITV has instead been incentivized to invest in programming which delivers high volumes regardless of audience profile and the long-term impact on the ITV brand. OC&C was not able to quantify this effect but identified an example of this issue when *Lost in Austen* was not recommissioned due to a poor total audience volume performance despite achieving high critical acclaim and a strong ABC1 audience profile.

- *Our views*

24. We do not consider that there is clear evidence linking this cost to CRR. ITV1's approach of focusing on volumes rather than profile is a function of the short-term strategy it adopted between 2003 and 2007 (see paragraph 7.12 of the report). This strategy was not necessarily implied by the ARM for the reasons given in paragraph 7.13 of the report. ITV has continued to invest in event programming since CRR, even before it changed its strategy in September 2007—notably programmes such as *Britain's Got Talent*, *X Factor* and *Champions' League*. Further, we would expect there to be some programmes that have a higher profile but deliver lower volumes of impacts. If advertisers truly value impacts on these programmes then we would expect ITV to benefit from continuing to produce them because the premium it can charge on its impacts will increase. In addition, we would expect that continued production of programmes that advertisers want would mean they would not necessarily reduce their demand in line with the ARM.

To reduce the level of new higher-risk programming investment in favour of ageing programme formats

- *ITV's views*

25. ITV cited the following evidence to illustrate that it has reduced levels of new higher-risk programming investment in favour of ageing programme formats:
- (a) *Recommissioning series that have performed well rather than taking a risk on a new series.* In a marketing presentation entitled *Event Entertainment programming*, ITV submitted that there were [X] times as many series in 2006 and 2007 as in 2003. ITV calculated that [X] per cent of its impacts on ITV1 now came from only [X] series.
- (b) *Giving recommissioned series extended runs rather than taking a risk on a new series.* For example, *Ant & Dec's Saturday Night Takeaway* was 66 per cent longer in 2005 compared with 2004 and *Bad Girls* was 80 per cent longer in 2005 compared with 2004.

26. OC&C noted that, without the disincentive from the ARM, it would be expected that ITV would be more willing to invest in new programming hours. OC&C estimated that the relative performance of new versus established dramas at 9pm was a revenue loss of £[~~8~~] million. However, OC&C did not include this estimate in its overall assessment of the cost to ITV of CRR.

- *Our views*

27. We noted that between 2002 and 2003 ITV's investment in new programming on ITV1 fell—it is not therefore clear whether the pattern of greater recommissioning of programmes was a continuing trend from prior to the implementation of CRR. We also noted that despite ITV's comments regarding a focus on volume and not profile it has continued to commission new programmes since 2003, including some that have been less successful (such as *Echo Beach/Moving Wallpaper*, *Rock Rivals* and *The Palace*) and some that have been successful (for example, *Doc Martin*, *Footballers' Wives*, *Lewis*, *Primeval*, and *Kingdom*). These programmes have all been commissioned with particular motives in mind, but in our view CRR is only one factor influencing these decisions. Any strategy of reducing new programming expenditure was not necessarily implied by the ARM for the reasons given in paragraph 7.13 of the report. Indeed, we noted that the change in strategy in September 2007 included a commitment to focus on new commissioned content with CRR in place (see paragraph 7.12 of the report.

To increase the number of soap operas instead of greater variety of programmes

- *ITV's views*

28. ITV submitted that it had increased programming of soaps in order to maximize SOCI. For example, *Emmerdale* had an extra episode introduced in January 2004. ITV submitted that occasional additional episodes of *Coronation Street* and *The Bill* had also been screened since 2004 with a view to ITV1's SOCI. ITV added that these

additional episodes, although increasing SOCI, were damaging the programme brands because they increased frequency rather than reach.

- *Our views*

29. We noted that an additional episode of *Coronation Street* was introduced pre-CRR in 2002. In our view, this aspect of ITV's strategy cannot therefore be directly attributed to CRR.

Not to invest in ITV1+1 and/or ITV1 HD

- *ITV's views*

30. ITV submitted that the definition of ITV1 had reduced the incentive for ITV to invest in other methods of delivery of ITV1 (ITV1+1 and ITV1 HD): impacts delivered through other methods would not count as part of the ARM and so could potentially mean ITV1 would lose impacts to any new ITV digital channels (especially as programmes are likely to be the same and advertisements identical) and hence would lose media buyers' SOB commitment in line with the reduction in ITV1's SOCI. The existence of CRR might therefore mean that ITV makes less revenue than it otherwise would do by introducing these channels. ITV submitted that other commercial channels introducing HD or +1 channels did not suffer from an overall reduction in their SOCI (even if some parent channel impacts were taken by the +1 channel), whereas ITV1's SOCI would fall if it lost impacts to ITV1+1 or ITV1 HD and, under CRR, this would entitle ITV1's customers to an automatic reduction in the level of their SOB commitments in their next year's contracts for ITV1 airtime.⁴
31. OC&C estimated the cost of this effect in relation to ITV1+1 to be a lost profit impact on ITV of £[redacted] million. This figure was derived from a net SOCI increase of [redacted] per cent from the introduction of ITV1+1 and cost estimates of £[redacted] million a year.

⁴ITV submitted that a similar argument applied to its other digital channels but not to the same extent because these channels were targeted at different audiences and so there was less cannibalization of ITV1 impacts.

- *Our views*

32. We agree with ITV that this cost can be directly attributed to CRR. We discuss our views on this effect in detail in Section 4 of this report.

Costs of protected contracts

ITV's views

33. 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. The negotiation would ensure an annual recalibration of the supply of impacts with the demand for impacts.
34. Under CRR, media agencies are entitled to fall back on their 2002/03 contracts in all negotiations. These historic 'protected' contracts remain in place even when agencies negotiate new contracts (unless an agency nominates the new contract as a 'protected' contract⁵). This means that ITV1 has to be in a position to meet these historic contractual commitments, even though they may not actually be required to do so. ITV submitted that, even if all contracts were renegotiated, this meant that it could not optimize its inventory in response to changes in demand.
35. ITV submitted that demand for demographics had changed year on year since CRR was introduced with shifts towards upmarket and younger target audiences. ITV submitted evidence of significant changes in impacts since 2002 across its six major demographics. Despite these changes in demand, ITV told us that it had been unable to renegotiate contracts with media buyers because umbrella contracts had allowed them to manage demand changes from advertising clients without needing to renegotiate with ITV. ITV said that it had not foreseen this when it proposed the CRR remedy in 2003. ITV also told us that media buyers had tended to favour not

⁵See the Undertakings, Clause 10e.

negotiating their contracts and retaining their historic protected contracts. ITV said that this was because the certainty provided by the CRR regime meant that media buyers obtained automatically (ie without negotiation) substantial, unanticipated benefits from CRR—and these benefits disincentivized media buyers from engaging in the time and cost involved in meaningful negotiations with ITV.

36. ITV told us that, although the big media agencies typically entered into some form of annual negotiation and generally reprotected their new contract, this tended to [REDACTED].⁶
37. ITV told us that this inability to negotiate led to significant deal debt problems of about £[REDACTED] million in 2006. This deal debt disappeared the following year. ITV submitted that this was largely due to (a) improved performance in impacts in 2006 and 2007, especially Formula 1 coverage with the arrival of Lewis Hamilton, Liverpool in the UEFA Champions League final and England in the Rugby World Cup final, and (b) some major customers [REDACTED].
38. OC&C noted that concerns about deal debt had led ITV to spend [REDACTED] on certain programming [REDACTED]. In particular, it pointed to the extent to which ITV had [REDACTED] for [REDACTED] rights [REDACTED]. It submitted that this had enabled ITV to avoid building up deal debt.
39. OC&C estimated that ITV [REDACTED] by £[REDACTED] million for the rights to [REDACTED]. This estimate was based on an ITV board paper on the case for [REDACTED] acquisition which included a line item of £[REDACTED] million defined as '[REDACTED]'. OC&C noted that this line item therefore directly influenced the price of £[REDACTED] million which ITV ultimately paid for the rights to [REDACTED]. ITV told us that acquisition of these rights was important for [REDACTED] but that the evidence from the board paper clearly demonstrated that ITV's willingness to pay for these rights would have been substantially less were it not also forced to consider

⁶At present, historic protected contracts account for £[REDACTED] million of revenues ([REDACTED] per cent).

removal of deal debt. Absent CRR, ITV would not have had specifically to acquire rights for the purpose of clearing deal debt and its maximum willingness to pay for [X] would have been £[X] million lower.

40. In addition, OC&C noted that the effect (of [X] per cent of the value of [X] rights being attributable to [X] caused by CRR) was likely to apply equally across the full range of ITV1's other [X] rights. OC&C submitted that it conservatively applied only [X] per cent of this effect (ie only [X] per cent of the value) to other [X] rights, generating an additional annual cost to ITV of £[X] million.
41. In total, OC&C calculated that the effect of [X] for [X] rights was between £[X] million and £[X] million a year in 2008/09.

Third parties' views

42. In relation to incentives for media buyers to negotiate, the OFT's advice noted that a number of third parties suggested that CRR might be inhibiting dynamism in the media buyer market. These third parties argued that to depart from their existing protected contract—for example, to change their channel profile, target audiences, trading parameters and so on—necessitated renegotiation which was a potentially protracted process. They also argued that if a media buyer involved the Office of the Adjudicator to decide on fair and reasonable terms, it risked reprisals from ITV. They said that the status quo therefore represented a safe option and was the path of least resistance.⁷
43. The OFT also noted the mixed views on the extent of contract negotiations. Some media buyers considered that the CRR remedy had increased the complexity of contract negotiations, with agreements becoming increasingly legalistic where every

⁷OFT advice, paragraph 6.21.

aspect of the deal was covered. However, one third party said that it was easy to negotiate minor changes to contracts, and another believed that there were similar levels of changes to ITV's contracts as for other channels.⁸

44. In relation to the impact of any lack of contract negotiations, the OFT's advice noted that third parties did not believe that CRR was preventing ITV from honouring its contracts. Many third parties pointed out that deal debt had been eroded even with CRR in place. One suggested that the deal debt was caused by giving away more discount to dissuade media buyers from reducing their expenditure commitments to the full extent provided by the ARM. Another suggested that it was due to lack of audience supply. Some suggested that ITV had made use of its digital channels to deliver on deals and that this was mutually acceptable.⁹

Our views

45. We considered first the reliability of the cost estimates calculated by OC&C. No evidence was submitted to support the extent to which ITV had [redacted] for other [redacted] rights, which accounted for £[redacted] million of the 'upper bound' estimate of costs. We did not therefore find that there was any basis on which to include this cost estimate, and this reduced the upper bound estimate of costs to £[redacted] million.
46. We next considered the extent to which this cost to ITV could be attributed to CRR. We have set out our views in paragraph 7.15 of the report on the extent to which protected contracts may, in principle, have created costs for ITV.
47. We also examined OC&C's approach to quantifying this cost of CRR, which focused on the extent to which ITV had [redacted] for [redacted] rights, notably the [redacted]. We noted that ITV paid £[redacted] million for the rights to [redacted]. We do not know what the next highest bid was

⁸OFT advice, paragraphs 6.23 & 6.24.

⁹OFT advice, paragraph 6.37.

but the board paper shows that the highest bid scenario put forward to ITV's board was £[redacted] million. It is therefore far from clear that the final bid, [redacted], can be directly and wholly attributed to CRR. In particular, we noted that evidence from the board papers suggested that acquisition of these rights was at least as important for [redacted] as it was for removal of deal debt:¹⁰ [redacted].

Operational constraints

ITV's views

48. ITV submitted that CRR had acted as an operational straitjacket through clause 10(h), which restricts ITV from making changes to the CASS.

49. OC&C noted that, although it had not conducted a full operational review of ITV, one example of the effect of CRR restricting commercially rational changes [redacted]. OC&C estimated that such changes could generate cost savings to ITV of between £[redacted] million and £[redacted] million a year.

Our views

50. We have set out our views on this cost in paragraphs 7.18 to 7.20 of the report.

Regulatory risks and uncertainty

ITV's views

51. OC&C noted that CRR introduced regulatory costs on ITV by creating regulatory risk in operational decisions. In particular, OC&C noted that regulators (the OFT and the Office of the Adjudicator) had the ability to overturn or delay ITV's decisions. OC&C presented an example of ITV's decision in 2007 to [redacted]. OC&C noted that this decision [redacted]. OC&C submitted that the regulatory uncertainty could have cost ITV

¹⁰Deal 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 ratings to match the ratings 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.

£[x]–£[x] million lost profit a year, although it did not include this figure in its estimate of the costs of CRR.

Our views

52. We have set out our views on this cost in paragraph 7.21 of the report.

Administrative costs

ITV's views

53. OC&C estimated that CRR cost ITV about £[x] million a year in direct administrative costs and potentially up to £[x] million once contingency costs are included. These static costs comprise:

- (a) internal costs—legal team, CRR compliance team, senior management and sales operation team: £[x];
- (b) Office of the Adjudicator: £[x]; and
- (c) contingency that ITV is required to set aside by Ofcom against overspend by the Office of the Adjudicator: £[x].

Our views

54. We have set out our views on this cost in paragraph 7.22 of the report.