

2 Conclusions

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The reference

2.1. On 8 February 2000 the Secretary of State referred to the CC the proposed merger between Carlton and UNM. The CC was required to report by 16 May 2000.

2.2. Following the earlier announcement by Carlton and UNM of their proposals to merge referred to in paragraph 2.1 Granada announced that it was considering making an offer to acquire either Carlton or UNM. These proposals were referred to the CC on 25 February 2000 by the Secretary of State under the same powers and provisions as Carlton/UNM. The CC was required to report by 26 June 2000.

2.3. Following representations to the Secretary of State by the CC that all three merger proposals were closely interrelated, raised the same issues and should be treated as a single group of planned mergers, the Secretary of State amended the reporting date referred to in paragraph 2.1 to 16 June 2000.

The companies

2.4. Details of the history and activities of UNM, Carlton and Granada are set out in paragraphs 3.3 to 3.36, 3.37 to 3.61 and 3.62 to 3.74 for each company respectively. Details of the companies' profitability and performance are also set out respectively in paragraphs 3.22 to 3.36 (UNM); 3.45 to 3.61 (Carlton) and 3.68 to 3.74 (Granada). Table 3.1 compares the group performance for the three parties, and Table 3.2 compares their TV and media-related activities. Granada and Carlton have achieved significantly higher returns on their TV operations than UNM. UNM's need to amortize substantial goodwill on its balance sheet also affected its overall performance significantly when intangible assets were taken into consideration.

UNM

2.5. UNM is a public company listed on the London Stock Exchange, with, on 10 April 2000, a market capitalization of £4.0 billion. It operates in the media, business services and consumer publications sectors, and acquired its current shape in 1996 through a merger between United Newspapers plc and MAI plc (MAI). This combined the national and regional publishing, advertising and exhibition interests of United Newspapers with the TV (Meridian TV and Anglia Television Ltd (Anglia TV), financial services and market research interests of MAI.

2.6. Changes within the UNM group since 1996 are set out in paragraph 3.5. UNM sees itself as having become a media and information group focused upon business services, consumer publishing, and broadcasting and entertainment. It is the latter, the broadcasting and entertainment division, and particularly the TV-related interests within it, that are of prime significance in this report, although the merger with Carlton or with Granada relates to the whole group and not just to the broadcasting and entertainment division.

2.7. Details of the broadcasting and entertainment activities of UNM are to be found in paragraphs 3.14 to 3.21. The group owns Anglia TV (East of England), HTV (Wales and the West of England) and 79.9 per cent of Meridian TV (South and South-East England).¹ It owns 20 per cent of Independent Television News Limited (ITN), 26 per cent of ITV2, just under 35 per cent of Channel 5, and a one-third interest in S4C Digital Networks Limited (SDN) (an

¹Carlton holds most of the remaining interest.

operator of a multiplex on the digital terrestrial TV (DTT) platform). In addition its TV interests include the TSMS Group Limited (TSMS)—the airtime sales contractor (or ‘sales house’) which sells airtime for its own three TV licences and for independent TV companies with licences covering Scotland, Northern Ireland and the Channel Islands. It also sells airtime for S4C, the Welsh Channel 4. Programme production is not a major focus for UNM, but within individual licensees there are significant production activities.

2.8. Group profitability and performance is summarized in Table 3.3 for the four years to 31 December 1999. For the year ended 31 December 1999, UNM had turnover of £2.17 billion (1998: £2.20 billion) and an operating profit before amortization of goodwill of £316 million (1998: £349 million), which equated to a return on turnover of 15 per cent (1998: 16 per cent). Its operating profit for 1999 after amortization of goodwill was £72 million, compared with £182 million for 1998. UNM’s group balance sheets are summarized in Table 3.8 and showed at 31 December 1999 that it had net operating assets (excluding intangibles) of £193 million, or £1.95 billion if intangible assets (mostly goodwill) were included in net operating assets.

2.9. Table 3.5 summarizes the profitability of UNM’s TV and media activities for the three years to 31 December 1999. For 1999, turnover was £562 million (1998: £562 million) and operating profits, before amortization of goodwill, were £60 million (1998: £68 million), which resulted in returns on turnover of 11 per cent (1998: 12 per cent).

Carlton

2.10. Carlton is a media company which, in addition to commercial broadcasting and programme making, supplies products and services to the TV, film and video industries worldwide. Its shares are quoted on the London Stock Exchange and NASDAQ, and at 10 April 2000 had a market capitalization of £4.8 billion.

2.11. Carlton became a public listed company in 1983, and expanded from a facilities, programming, publishing and exhibition contracting company into the wider fields of TV broadcasting, programme making, audio-visual processing, consumer advertising and Internet products.

2.12. The group’s current TV-related activities are set out in paragraphs 3.41 to 3.44. It owns Carlton Television Limited (Carlton TV) (London Weekday), Central Independent Television Ltd (Central TV) (East, West and South Midlands) and Westcountry Television Ltd (Westcountry TV) (South-West England). It has interests of 25 per cent in GMTV, 20 per cent in ITN, 50 per cent interest in London News Network Limited and 38 per cent in ITV2. It owns 50 per cent (with Granada) of ONdigital plc (ONdigital), the terrestrial digital TV platform. It owns its own sales house, Carlton Sales Limited (Carlton Sales).

2.13. Carlton’s group profitability and performance is summarized in Table 3.9 for the four years to 30 September 1999. For the year ended 30 September 1999, Carlton had turnover of £1.94 billion (1997/98: £1.84 billion) and an operating profit of £270 million (1997/98: £308 million), representing a return on turnover of 14 per cent (1997/98: 17 per cent). The group’s balance sheets are summarized in Table 3.14 and showed at 30 September 1999 that it had net operating assets (excluding intangibles) of £669 million, or £815 million including intangible assets.

2.14. Table 3.11 summarizes the profitability of Carlton’s TV and media activities for the three years to 30 September 1999. For 1998/99, turnover was £859 million (1997/98: £833 million) and operating profits were £176 million (1997/98: £162 million), which resulted in returns on turnover of 20 per cent (1997/98: 19 per cent). Although Carlton made its initial application for ITV licences as a ‘publisher broadcaster’ and not a ‘producer broadcaster’ it has since developed significant programme-making capabilities.

Granada

2.15. The development of the Granada group from its founding in 1934 is set out in Chapter 3. Currently it is a listed hospitality/hotel/TV group with market capitalization of £12.4 billion on 10 April, although plans were announced on 15 May for a merger between Granada and the Compass Group including the separation of the media interests into a separate company and in due course the demerger of that company from the larger group.

2.16. Granada owns Granada Television Limited (Granada TV) (north-west England), London Weekend Television Ltd (LWT), Yorkshire Television Ltd (Yorkshire TV), Tyne Tees Television Ltd (Tyne Tees TV) which covers Yorkshire and north-east England. It also owns 50 per cent of ONdigital (with Carlton holding the remaining 50 per cent), 25 per cent in GMTV and 18 per cent in Scottish Media Group Plc (SMG). It has a 20 per cent holding in ITN as well as holdings in ITV2 (35 per cent), London News Network Limited (50 per cent), as well as a 50.5 per cent interest in Granada Sky Broadcasting Plc (a joint venture with British Sky Broadcasting Group plc (BSkyB)).

2.17. Granada is by a large margin the predominant ITV production house, and produces some 47 per cent of all production commissioned by the ITV Network Centre. The value of its production activities easily exceeds that of Carlton and UNM combined.

2.18. Granada's group profitability and performance is summarized in Table 3.15 for the four years to 30 September 1999. For the year ended 30 September 1999, Granada had turnover of £4.10 billion (1997/98: £4.03 billion) and an operating profit of £999 million (1997/98: £977 million), which represents a return on turnover of 24 per cent for both years. Granada's group balance sheets are summarized in Table 3.20 and showed at 30 September 1999 that it had net operating assets (excluding intangibles) of £4.24 billion, or £4.29 billion if intangible assets were included in net operating assets.

2.19. Table 3.17 summarizes the profitability of Granada's TV and media activities for the three years to 30 September 1999. For 1998/99, turnover was £998 million (1997/98: £942 million) and operating profits were £275 million (1997/98: £255 million), which resulted in returns on turnover of 28 per cent (1997/98: 27 per cent).

The merger situation

2.20. The three references were made by the Secretary of State in exercise of his power under sections 64, 69(2) and 75(1) of the Fair Trading Act 1973 (the 1973 Act) (see Appendix 1.1).

2.21. Under the first of the references we are required to investigate and report whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation, as defined in the 1973 Act, in that:

(a) enterprises carried on by or under the control of Carlton (a company incorporated in the UK) will cease to be distinct from enterprises carried on by or under the control of UNM; and

(b) the value of the assets which will be taken over exceeds £70 million (the assets test),

and, if events so require, whether the actual results of those arrangements are the creation of merger situation qualifying for investigation. Section 63(2) of the 1973 Act defines 'enterprise' as the activities or part of the activities of a business. Section 65 of the Act specifies the circumstances when two enterprises are to be regarded as ceasing to be distinct. One of the circumstances is where they are brought under common ownership or control.

2.22. If we find that such arrangements are in progress or contemplation, then we are further required by our first terms of reference to consider whether the creation of the merger situation may be expected to operate against the public interest.

2.23. The other two references are in similar terms to those described in paragraphs 2.20 to 2.22, but the companies mentioned are Granada and UNM in one of the references, and Granada and Carlton in the other reference. We shall identify the three references individually as: the Carlton/UNM reference; the Granada/Carlton reference; and the Granada/UNM reference.

2.24. There were three possible merger situations arising from the references made to us:

- (a) a Carlton/UNM merger;
- (b) Granada acquiring UNM; and
- (c) Granada acquiring Carlton.

2.25. Taking the first situation (Carlton/UNM), we are clear that it has been the subject of considerable preparation and have no doubt that arrangements for a merger are in progress or contemplation. Taking the two Granada acquisition proposals, we understand that there had been no consultation with either Carlton or UNM before Granada announced an intention to bid either for one or the other. Nor has there been any discussion between Granada and its targets since Granada's announcement. We were in no doubt, however, from questioning Granada on the point that it is contemplating acquiring Carlton and is also contemplating acquiring UNM, although it is not contemplating the acquisition of both.

2.26. We are, therefore, satisfied that arrangements are in progress or contemplation which may lead to any of the three mergers taking place.

2.27. Any of the three proposed mergers would involve the acquisition of assets well in excess of the £70 million threshold (see Table 3.1 for details). In answer to the second question in our terms of reference, namely whether or not any of the specified mergers has taken place, the answer is that none of them has.

2.28. We therefore find that:

- (a) arrangements are in progress or contemplation as described in the Carlton/UNM reference which, if carried into effect, will result in the creation of a merger situation qualifying for investigation;
- (b) arrangements are in progress or contemplation as described in the Granada/Carlton terms of reference which, if carried into effect, will result in the creation of a merger situation qualifying for investigation; and
- (c) arrangements are in progress or contemplation as described in the Granada/UNM terms of reference which, if carried into effect, will result in the creation of a merger situation qualifying for investigation.

We understand that the parties envisage only one of the proposed mergers going ahead. We shall accordingly consider whether the merger of any two of the parties may be expected to operate against the public interest, but shall not consider (and do not believe that we are required by our terms of reference to consider) the effect of all three companies merging.

The regulatory background to TV

2.29. TV as a whole is highly regulated and monitored, although both the nature and the extent of regulation varies as between the different platforms; for example, cable/satellite differ in some respects from terrestrial TV. The Independent Television Commission (ITC) is the main regulator. It does not consider itself to have a remit to monitor programme quality on TV services other than Channels 3, 4 and 5 (the commercial free-to-air analogue channels) but its duty to ensure fair and effective competition in the provision of TV and connected services applies to all commercial TV broadcasting services. The regulatory framework for TV broadcasting as a whole is set out in more detail in Appendix 4.2. In this investigation we have concentrated primarily on the economic regulation of Channel 3 (ITV) by the ITC. We use the term ‘economic’ to contrast with the ITC’s responsibility for a wide range of other issues related to quality of programming such as taste and decency, and diversity.

The statutory 15 per cent audience share limit

2.30. The Broadcasting Act 1990 (the 1990 Act) as amended, inter alia, by the Broadcasting Act 1996 imposes restrictions on the same person or company holding more than one TV broadcasting licence and on having interests in more than one company holding such licences. For the purposes of this report it is the restrictions as they apply to licensees within the same corporate group that are relevant.

2.31. As a consequence of the amendment made by the 1996 Act, companies in the same group can together hold two or more Channel 3 licences so long as the combined ‘audience time’ of the group is not more than 15 per cent of the ‘total audience time’. In substance, ‘total audience time’ means the audience time (‘eyeballs’) attributable to every TV service capable of being received in the British Isles.

London licences

2.32. The amended 1990 Act prevents the holder of any regional ITV licence being in the same corporate group as another company which holds a regional ITV licence for the same area. This prevents two licensees in the same corporate group together holding the two London licences. London is the only area for which more than one ITV licence has been issued.

Other restrictions on multiple holdings of licences

2.33. The amended 1990 Act sets out a regulatory framework that seeks to promote plurality in the ownership of licences for multiplexes (the basis for digital terrestrial services) and in the provision of the services themselves. As a result there are ownership restrictions, for example, on companies in the same group holding more than three multiplex TV licences. The Secretary of State has power to make an order amending the limits.

Independent Television News Limited

2.34. Section 32 of the 1990 Act, in effect, prevents any person or company having more than a 20 per cent interest in ITN.

Independent programme productions

2.35. The 1990 Act includes provisions designed to ensure that a significant proportion of ITV programmes are made by independent producers, ie not linked to broadcasters. ITV licensees must ensure that not less than 25 per cent of programme time (certain programme genres, including news, being excluded) is to be devoted to independent productions. Further details are set out in Appendix 4.2. Similar provisions apply to the BBC, and Channels 4 and 5.

The current structure of ITV and the 25 per cent NAR limit

2.36. The 1980s and 1990s saw a considerable movement towards concentration of ownership of ITV licensees, and it has been represented to us that this process is not yet complete. The ITV Network is made up of 15 regional licensees and one national licensee (GMTV). After a continuing process of concentration, ten of those regional companies are now subsidiaries of the three parties to the mergers under investigation. These parties operate alongside three licensees for ITV in Scotland—Border Television PLC (Border TV) (which also covers a small part of northern England), Grampian Television plc (Grampian TV) and Scottish Television plc (Scottish TV) (the latter two being part of SMG—and one each for Northern Ireland and the Channel Islands).

2.37. Networking arrangements have been made for ITV to operate as a nationwide system. ITV Network Limited is a company whose membership comprises the 15 regional licensees and operates under an agreement with those licensees. ITV Network commissions programmes for simultaneous broadcasting in all regions and sets the programme schedules for network programmes. The detailed arrangements are described in Appendix 4.5.

2.38. When proposals for a consolidation of ITV into three major licensee-owning groups had to be considered in 1994, a reference to this Commission was not deemed necessary in the light of non-legally-binding undertakings given to the Secretary of State that had been negotiated by the Office of Fair Trading (OFT). The key point was a non-legally-binding limitation on NAR to a maximum of 25 per cent per company. The limit could not be exceeded without the consent of the Director General of Fair Trading (DGFT). Policy statements issued by the ITC effectively imposed a similar restriction and indicated that the policy would be made mandatory if necessary by the ITC giving directions under the licences involved. NAR was defined as being the total annual advertising revenue from the supply of all terrestrial, cable and satellite TV broadcasting in the UK, net of any commission paid to advertising agencies. In this report we use the terms ‘NAR’ to cover advertising revenue generally, ‘total NAR’ to cover NAR derived from all TV broadcasting in the UK, and ‘ITV NAR’ to cover NAR derived only from ITV channels (excluding GMTV). The 25 per cent included revenue from any advertising time sold by another ITV company’s sales house on behalf of independent companies.

2.39. The OFT and ITC had embarked on a planned fifth anniversary review of the 25 per cent limit but that was suspended when the mergers were referred to the CC.

2.40. Evolution in the face particularly of the advent of new terrestrial channels (Channels 4 and 5) and of new platforms (satellite and cable) has led to a dilution of ITV’s prominence. ITV has contracted in its diversity of licensee ownership in the face of a falling share of advertising revenues to the current structure based on three major companies substantially covering England and Wales.

2.41. There has been a clear decline over the last ten years in the share of viewers attributed to ITV and a corresponding growth of Channels 4 and 5 and pay-TV. As Table 4.3 shows, the ITV share fell from 38.4 per cent in 1990 to 29.6 per cent in 1999.

The possible future position of ITV

2.42. Although predictions as to the continued relative decline of ITV vary in extent (see paragraphs 4.97 to 4.100) there is no doubt among the broadcasting community that it will continue. The advent of DTT (supported by the Government's announced intention of as early as possible a switchover from analogue) and its capacity to carry multichannel TV will intensify this process. So will the use of the Internet and the emerging new technologies described in paragraphs 4.10 to 4.13. It has been put to us that the keen competition for highly-desirable programme rights, with a need for rapid decision-taking if such rights are to be secured, has meant that even in its current slimmed-down form, the present structure of ITV, with three major companies and a number of smaller ones, denies it the speed of reaction necessary to enable ITV to compete effectively. It was not surprising therefore to learn of widely-held views within TV, its regulators, and the advertising community that within the next few years there is likely to be considerable pressure to consolidate ITV further into a single entity. In this context, we were told by the ITC that it was ready to see further concentration in ITV which resulted in there being two main sales groupings each with around 30 per cent of TV NAR but with a margin of flexibility to allow the two to compete for the airtime sales business of the smaller licensees.

2.43. This concept will no doubt be discussed in depth in the public process that is beginning with the preparation of a Broadcasting White Paper for publication later this year, and which may lead to new broadcasting legislation in the next few years. The scene is widely believed to have been set by the Secretary of State for Culture, Media and Sport, and in particular by his speech on 17 September 1999 to the Royal Television Society, in which, *inter alia*, he referred to the Government's role in removing barriers to investment and expansion, imagined a future in which broadcasting regulation was based in the first instance on competition law with a reduced set of distinctive media rules and acknowledged that at a time when the TV industry was changing a fundamental reassessment and new legislation had to be contemplated. The merger proposals we had before us reflect a new degree of urgency about that process. The pressures for further consolidation may have prompted the companies involved to consider whether the response to these external challenges could begin now, with a contraction to two major companies. It was put to us that, once the expected White Paper was published, ITV's scope for structural consolidation to meet its current problems would in practice be severely limited.

Markets

2.44. Consideration of the effects of the mergers on competition requires us to identify the relevant markets and to evaluate possible barriers to entry. There are three areas within the TV industry in which, in our view, the main impact of the mergers would be felt. They are advertising, the production of TV programmes, and the TV audience. Paragraphs 4.21 to 4.35 set out the detailed arguments for defining markets, market segments and areas of activity on which we should focus.

Advertising

2.45. On advertising we take the view—as this Commission has in earlier cases—that the differences between TV and other media are so significant that in economic terms TV

advertising should be seen as a separate market. This is not to deny that advertisers may combine the use of different media in their various campaigns. The important point is that the difference between the media means that there is a substantial degree of independence in the pricing of TV advertising with respect to other media. This view has some support from the views expressed to us by advertisers and media buyers.

2.46. Within TV advertising we recognize that there is a degree of substitutability between ITV and other channels, but we think that the advantage that ITV holds (as it is perceived by a large number of advertisers and, more particularly, those seeking mass audiences for national campaigns) allows for a degree of independence of action on the part of the sellers of ITV airtime. We therefore conclude that we should identify ITV advertising as a market segment in economic terms. While, however, we take this view of the market at the present time, we also believe that the continued growth of other channels that carry advertising airtime will in due course materially erode the advantages of ITV as an advertising medium and hence diminish the current segmentation of the market.

Programmes

2.47. Within the market for programme making the most relevant area for this inquiry is programmes made to be shown on ITV. Our main concern in this context is whether, given that all three parties involved in the mergers are to a greater or lesser extent programme makers themselves, any of the proposed mergers would limit the role of independent producers and if so whether this might affect the general level of quality of programmes shown on ITV. Our second concern is whether the mergers might impact either positively or negatively on the ability of ITV to create and commission attractive programming.

Viewers

2.48. We take a similar view on the definition of markets for TV viewers as has been taken in earlier reports of this Commission (see paragraphs 4.21 to 4.23). We identify a retail market for TV viewers that is national and extends to all channels, but we see free-to-air TV and pay-TV as segments within that overall market which, due to increasing fragmentation of the market, have important differences in terms of characteristics and behaviour. The main factor that gives rise to this view of the market is the difference in the ways in which at present viewing is paid for (ie by licence fees and advertising for free-to-air and mainly by subscriptions for pay-TV). Changes in market share between platforms would not therefore undermine this market definition (unlike the position on the advertising side). This is not of course to say that, on a wider front still, the landscape of TV may not be entirely changed—and market definitions with it—by the expected growth or convergence between TV services and Internet-related entertainment services.

Barriers to entry

Broadcasting

2.49. Barriers to entry at the platform level are high. As discussed in Appendix 4.6, the reasons vary depending on the type of platform. For terrestrial TV the reasons relate to sources of funding, regulation and spectrum availability. As regards the growing digital sector, spectrum capacity (in the form of multiplexes) has now been allocated, and there is no guarantee that the additional radio spectrum that is likely to become available will be allocated to TV. As regards the cable platform, entry by a new player seems very unlikely given that all the more densely-populated areas of the country are now subject to local monopolies in which cable systems are well developed. As for satellite, the strong position of BSkyB, including its success

in attracting viewers to its digital channels, provides a strong deterrent to a potential new entrant thinking of setting up a satellite-based operation in direct competition. In addition to the existing platform technologies there is also the prospect of using asynchronous digital subscriber line (ADSL) technology for TV, and BT in particular is pursuing this. This is, however, as yet an untested method of entry to the market.

2.50. Turning to the opportunities for launching new channels, it is clear that the much larger capacity of digital systems has increased those opportunities substantially. In principle new channels can be launched on the existing satellite platform independently of the operator, BSkyB, whereas access to digital terrestrial and cable systems is under the control of their owners. In all cases, however, platform operators/retailers will be looking for the best portfolio of channels to fit in with their broadcasting strategy, and to this extent their systems are open to new channels. We note, however, that the Zenith Media Ltd (Zenith Media) forecasts of the share of viewers of multichannel platforms envisage only a gradual increase over the next five years from around 15 per cent today to around 19 per cent in 2005. To the extent that the existing free-to-air channels are likely to retain in large measure their share of viewers, the opportunities for new channels on the multichannel platforms are more limited.

Advertising

2.51. As regards opportunities for entry in TV advertising, it is of necessity only channel providers and platform owners/retailers that can supply airtime for advertising purposes. While some carry out the selling function themselves, others, in particular the ITV companies, use the so-called 'sales houses'. But the number of opportunities for such intermediaries are limited by the fact that the commercial advantage of the seller lies in having as wide a portfolio as possible. Independent new entry at this intermediary level has been hardly practicable in the ITV context, given current rules on the way licensees can sell airtime. Given the central role of ITV in overall TV advertising the prospect of entry by other kinds of intermediary, for example brokers looking to trade airtime across all relevant TV channels, looks remote at present.

Programme production

2.52. We were told that the number of independent producers in the UK is 1,000 to 1,200 (the Producers Alliance for Cinema and Television has over 1,000 companies in its membership). This suggests that the programme production market is easy to enter. We perceived almost negligible barriers to entry in the making of smaller-scale programmes. For larger-scale production in respect of, for example, major drama, where access to substantial studio facilities is required, entry barriers are perhaps not at quite the same low level but are certainly not insuperable. A limitation on scope for independent producers also exists in that the most popular drama and light entertainment series are unlikely to be displaced easily. We do not, however, consider this as unduly hampering the opportunities for the independent sector. We also note that smaller producers are to a degree protected by the 25 per cent minimum requirement relating to independent producers (see paragraph 4.135).

The mergers

Views of the parties on the mergers

Carlton/UNM

2.53. The views of the companies are set out in some detail in Chapter 5. The merger proposal agreed by both Carlton and UNM is represented as having benefits in terms of

rationalization. The companies concerned do not believe that, were the merger to take place, there would be detriment for their advertising customers by way of increasing advertising rates beyond what would have occurred had the companies remained separate. They believe the merger is necessary to manage the continuing decline of ITV's audience and NAR shares in the face of the continuing expansion of multichannel and pay-TV.

2.54. They see value in the combination of their production arms which, if brought together, could provide a more competitive balance to Granada's current dominant position of production for the ITV Network, although after merging they would still be less than half of the size of Granada in terms of ITV Network commissions. Benefits are also perceived in bringing UNM into ONdigital (see paragraphs 3.135 and 3.140) and in the creation of a more substantial media company more capable, for example, of generating sales in international markets. The parties also felt that there would be benefit from reducing the number of separate constituency interests within ITV needing to be consulted during what might often be fast-moving negotiations in competition with other channels bidding for the rights for major sporting events or successful foreign TV series.

2.55. Although it is a third party to the Carlton/UNM merger, Granada's views on the Carlton/UNM proposals are recorded here since they are of a different nature from those of other third parties, and are closely allied to those for the proposed mergers in which they would be a main party.

2.56. Granada said that it was in favour of further consolidation of ITV at this time as a step towards the eventual emergence of a single company. However, it felt that the combination of Carlton and UNM would create an entity which would dominate ITV¹ during a period when ITV remained fragmented. It laid considerable stress on the strength of four leading licences—those held by Carlton TV, Central TV, Meridian TV and its own LWT—in terms of their coverage, and their attractiveness to advertisers as a result of their viewer profiles. It was also Granada's belief that a merged Carlton and UNM would create an imbalance between the sales houses such that an even greater share of advertising revenue would flow to southern ITV regions at the expense of northern.

2.57. It was Granada's view also that the strength of the merged company deriving from ownership of three leading licences would be reflected in the production area, where it was concerned that a growing concentration of ITV power in the South and Midlands could lead to a southward shift of performing and production talent, to the detriment of the North. That preponderance might well be accompanied by strengthened pressure for a schedule more centred on southern tastes. The latter could be to the disadvantage of the whole of ITV if the result were to cause loss of the audience which productions originating in the North had attracted.

The Granada proposals

2.58. Granada's reasons for contemplating acquisition of one or other of Carlton or UNM are set out more fully in paragraphs 3.144 to 3.148. Both UNM and Carlton were opposed to either of the Granada merger proposals being allowed to proceed. They told us that neither had seen any detailed scheme of what Granada had in mind and therefore did not feel able to discuss Granada's proposals.

2.59. UNM did, however (see paragraphs 5.143 to 5.145), urge us to give particular weight to the argument that, in considering the outcome of the Granada proposals, it was not sufficient to take into account only NAR shares. In UNM's view an overall balance should be struck which reflected the production strength of a merged company as well as its advertising revenue.

¹The merged Carlton/UNM NAR share would be 35.5 per cent of total NAR—nearly 60 per cent of ITV NAR.

It felt that a merger between Granada and one of the other two main parties would make ITV even more dependent upon Granada's programme production capacity.

Factors recognized by all main parties

2.60. All three of the main parties to this group of mergers recognized that account had to be taken of the 15 per cent audience limit in the amended 1990 Act, the prohibition on single ownership of the two London licences, and the limitation to a 20 per cent ownership in ITN. If any of the mergers went ahead, divestment would be required in order to ensure that the provisions of the Act were met. They also recognized that the mergers proposed would lead to a merged entity exceeding the current 25 per cent ceiling on NAR.

Views of third parties

2.61. These are set out in detail in Chapter 6. Representatives of the independent producers and of other producer-broadcasters were concerned that any merged company should not have a dominant share of production capability, nor the ability to control the ITV Network Centre in such a manner as to benefit their production activity through the selection of programming for the Network. Concerns were also expressed by the other terrestrial channels (Channels 4 and 5) as to the effect of a major dominant player emerging in the advertising market and the extent of distortion that could occur. Both channels were particularly concerned that the 25 per cent NAR ceiling should be retained.

2.62. Advertising industry representations were received from the Incorporated Society of British Advertisers (ISBA) and the Institute of Practitioners in Advertising (IPA). Both thought that the 1994 undertakings limiting ITV sales houses to 25 per cent of NAR had been helpful in maintaining competition in the TV advertising market. Further concentration now would not be in the public interest, as it would lead to higher rates for ITV advertising. The ISBA argued that further concentration in ITV should wait until the ITV share of NAR had fallen to around 50 per cent from its current 60 per cent. The IPA added that if a merger were permitted now then undertakings must also be imposed to safeguard competition.

2.63. Other third-party representations pointed to the possibility of adverse effects flowing from a merger involving UNM as regards its cross-media ownership interests. This is mentioned again in paragraph 2.104.

2.64. SMG was concerned to ensure that a reduction to two companies would not unduly limit their freedom of choice over who should sell their airtime.

2.65. Finally, Granada's argument that an undue concentration of the premium revenue-earning licences in the hands of a single company based in the South would exacerbate what was seen already as a 'North/South divide' was supported by a wide range of political and economic interests in the North of England.

2.66. The ITC was consulted throughout the investigation and its views are referred to, as necessary, in the body of the text.

The public interest

2.67. Three significant issues emerged as the basis for our public interest conclusions:

(a) regulation;

(b) programmes—in terms of production, commissioning and scheduling; and

(c) advertising.

The regulatory position

2.68. It was clear from our discussions with the parties and with their regulator, the ITC, that all the mergers would have the effect of breaching certain prohibitions imposed by the Broadcasting Act 1990, as amended. We distinguish between ‘prohibitions’ entrenched in primary legislation and ‘regulation’ contained in delegated legislation which can be amended without new primary legislation. The prohibitions relate to audience share, ownership of London licensees, and participation in ITN, and in respect of these we took the provisions of the legislation as given. We noted the companies’ assurances that they had recognized such aspects when formulating their proposals and had foreseen that, if approved, whatever adjustments were necessary to comply with the prohibitions would have to be made. The precise steps needed may, however, have to be shaped so as to meet any requirements imposed by the Secretary of State following this report.

2.69. It was also clear from our discussions with the parties and with their regulator, the ITC, that all the mergers would have the effect of breaching the NAR-based undertaking agreed to as a condition of the 1994 mergers round of consolidation within ITV. This undertaking is referred to in our terms as ‘regulation’.

2.70. We were told that it was debatable whether Carlton and UNM combined (but not Granada combined with either) would exceed the statutory limit on the holding of multiplex TV licences (see paragraphs 5.119, 5.196 and 5.279). This question would not arise if the Secretary of State were willing to use his delegated order-making powers to adjust the limit. However, we have not found it necessary to consider this matter further as it would make no difference to any of our findings whether a party would or would not have to divest any of their multiplex TV licensees if any of the proposed mergers went ahead.

2.71. For convenience we shall refer to the divestments that merged parties would be required to make in order to comply with the statutory prohibitions referred to in paragraph 2.68 as ‘obligatory divestments’. In analysing the effects of the proposed mergers, our approach will be to consider first what the position would be without the obligatory divestments and then to consider how our conclusion would be affected when such divestments are taken into account.

Programme production, commissioning and scheduling

2.72. We start by considering the effect of the mergers in the market for programme production.

2.73. Within the ITV sector Granada is the largest of the three parties involved in these merger proposals in terms of programme production. Chapter 4 shows that, by value, it has some 47 per cent of the original programming to the ITV Network, which is nearly three times the output of Carlton and UNM together (17.5 per cent). The merger of Carlton and UNM would therefore make little difference to the current situation. Any merger involving Granada would give Granada an increased preponderance over the remaining company in terms of market share and would strengthen its position as the largest programme provider to ITV (53.6 per cent with UNM, and 57.5 per cent with Carlton).

2.74. We considered barriers to entry to production in paragraph 2.52. Taking these comments into account, whilst we note the substantial market shares implied by the figures just

quoted and the disparities between them, we take the view that this is a competitive market. It is possible that there may be some adjustment of market shares as a result of the mergers but we do not expect to see any detriment to competition in programme making arising from any of the proposed mergers.

2.75. Concerns were raised with us in respect to the processes of commissioning and scheduling programmes for ITV. We have set out the arrangements that exist in Appendix 4.5. We felt it necessary to look more closely at the way in which the ITV Network arrangements operated in respect of the funding of programmes as well as how they were commissioned. Any of the proposed mergers would, without obligatory divestment, result in an imbalance of company size in terms of NAR. For the reasons explained in paragraph 2.76, we believe that such an imbalance could affect the size of the programming budget and have an impact on the way in which the budget was used.

2.76. The key to whether a merger is likely to be detrimental in respect of programming lies in whether or not the resulting increase in NAR share would enable its holder to establish a position of dominance in the decision-taking process for the financing, commissioning and scheduling of new programmes by the ITV Network. The operation of this is described in detail in Appendix 4.5. The arrangements provide for significant decisions, affecting either directly or indirectly the choice of programmes, such as the programme budget itself, to be subject to a vote requiring a 60 per cent majority of the Network Council on a Weighted Qualifying Revenue (WQR) basis. (WQR is closely related to ITV NAR.) Changes could be made to the 60 per cent figure by agreement between all 15 licensees, subject to the ITC's and the OFT's approval.

2.77. Without obligatory divestments, any of the mergers would result in a company with an ITV NAR share that would give it over 60 per cent of the Weighted Qualifying Votes on the ITV Council.

2.78. Beyond the position on formal voting issues there is the question of how a Network dominated by two companies of significantly uneven weight could be expected to operate in practice in its day-to-day decision-taking. It was put to us by Granada that the smaller company could find itself in a position where, with pressure on its advertising revenues, it could seek to limit the size of the ITV Network's programming budget and thereby, if successful, diminish the quality of ITV content as a whole. This would have a detrimental effect on the ability of ITV to compete for content and viewers in what we expect to become a progressively more competitive market.

2.79. A further outcome of imbalance in relative NAR could be increased temptation for the larger company to put pressure on the day-to-day decision-taking of the independent commissioning staff of the Network Centre. We are not aware that any of the staff's decisions have to date reflected pressure from one or the other of the major companies, and the independence of the Network Centre is rightly prized by its staff and by ITV as a whole.

2.80. The scheduling of programmes is another area where the ability of the larger player to influence decision-making might be enhanced. We were told that the implementation of the ITV Network strategy is a matter for the Schedule Review Group, and could thus provide an indirect means, through interference with the ITV staff's role in the detailed creation of the schedule, of affecting the impact of commissioning decisions in a way that suited the interests of the larger company.

2.81. In respect of all the programme issues discussed in paragraphs 2.75 to 2.80, and without obligatory divestment, we would be concerned by any merger which created a single company with potential for dominance within the ITV Network. That concern would be greater in the case of a dominant firm than if there were two broadly balanced companies. However, while we would regard the risks as real, we need also to give due weight to the protections built into the structure of the Network Centre to preserve its independence. Accordingly, we do not

believe that the likelihood of such detriments is high enough to justify an adverse public interest finding: taking account of the obligatory divestments, the risk would of course be further reduced.

Competition in TV advertising

2.82. We concluded in paragraph 2.46 that within the TV advertising market ITV advertising had a special position and was best seen in economic terms as a market segment. We therefore look both at TV advertising as a whole as well as at ITV advertising.

2.83. In paragraphs 4.94 to 4.109 we provide an analysis of the operation of the TV advertising market, revenue flows, and market shares by TV channel and platform. We note that, although ITV's share of total TV NAR—60.7 per cent in 1999—is expected to continue to decline in future, it could, according to Zenith Media, still be as high as 54 per cent in 2005, and ITV's current revenue of £1.9 billion a year is expected to increase further in real terms over the next five years.

2.84. As discussed in the context of market definition (see paragraphs 2.45, 2.46, and 4.21 to 4.35), we see only limited substitutability between advertising on ITV and advertising on other channels, in particular because of the needs of advertisers who seek mass audiences for national campaigns. We do not therefore accept the contentions of Carlton and UNM that BSkyB and Channels 4 and 5 provide adequate alternatives either singly or in combination. It was the advertisers' own perceptions of the special role of ITV that led them to expect that an enhancement of the market strength of the ITV sales houses would lead to higher advertising rates.

2.85. We have needed therefore to analyse the nature of competition within the ITV segment of the market. The parties told us that because of the regional monopoly element (outside London) of the licence system, competition between the sales houses was only marginal. Carlton and UNM maintained that as a result there was a very low level of competition within ITV and pointed to the low level of switching by advertisers from year to year. We accept that at the aggregate level switching is low (see paragraphs 4.107 and 4.108 and Appendix 4.3), but we do not think this provides a good indicator of the extent of competition. The fact that advertisers choose not to switch expenditure to another sales house does not show that it would not be commercially feasible to do so. As one way of approaching this, Granada gave us an estimate of what it called the 'contestable' element of ITV advertising revenue and put a value on this of at least £100 million, which would mean upwards of 5.5 per cent of ITV NAR. While such a sum may still represent only a small proportion of the £1.9 billion total, in absolute terms it is a large sum. It is also important that, while prices do vary between advertisers, they are unlikely to be set separately for the 'contestable' element, and hence the whole of the advertising spend can be affected by competition between sales houses for that element of the total.

2.86. A detailed account of the complex pricing system currently used by the ITV sales houses (and by other channels to a greater or lesser extent) for the sale of TV advertising airtime is set out in paragraphs 4.57 to 4.60, 4.110 to 4.115 and Appendix 4.3. A key element of the price mechanism used is the 'station average price' (SAP) for specific audience groups. SAP is used as a 'benchmark' price against which 'discounts' are given to determine the price for individual advertisers. These 'discounts' are broadly determined within an annual negotiation process for the year ahead (though some 20 per cent of agreements are for two or three years). The SAP (on a cost per thousand advertising impacts basis) is essentially a notional, expected price; actual prices are determined only ex-post, ie at the end of a given month. The discounts granted—virtually all advertisers get such discounts—depend on the bargaining power of the two parties and they are tied also to various 'share deal' arrangements. Each of the three ITV sales houses follows similar practices whereby many of the annual agreements with

advertisers specify discounts against SAP combined with a commitment by the advertiser to allocate to their sales houses (and often also to ITV as a whole) given proportions (or shares) of the advertiser's total TV advertising expenditure. We thought that the existence of share deals relating to 'all-ITV' spend could provide the opportunity—if airtime sellers chose—to go further than merely provide for bulk discounts, and enable the sales houses to put pressure on advertisers to increase the proportion of their total spend allocated to ITV as a whole. This could have the effect of reducing the already modest element of competition between ITV and other channels.

2.87. In the circumstances described in paragraphs 2.84 to 2.86, we conclude that there is already potential for the exercise of market power by the ITV companies in the selling of airtime and that this is not matched by the ability of customers to exert countervailing buyer power, notwithstanding the recent growth of media buying agencies able to negotiate on behalf of blocs of advertisers. These arguments are developed further in Chapter 4.

Effects of the mergers

2.88. The central question here is whether the effect of each of the proposed mergers, given their implications for changes in market shares and the reduction of three sales houses to two, would further reduce competition to such an extent as to lead to effects adverse to the public interest.

2.89. The present regulatory constraint of the 25 per cent NAR ceiling was agreed for the 1994 undertakings at a time when ITV NAR was some 75 per cent of total TV NAR. It has now fallen to around 60 per cent. This has given some headroom within the existing three-company structure. But the current limit would not accommodate the outcome of any of the proposals, since the mergers envisage that approximately 60 per cent of TV NAR would be shared between two licensee groups.

2.90. As stated in paragraph 2.39, the OFT and the ITC were already reviewing the 25 per cent limit on NAR share when the reference of the mergers caused the review to be suspended. The ITC told us that it and the OFT await our report before coming to a conclusion on these matters. Furthermore, the ITC told us that if we did not make an adverse public interest finding on a proposed merger and the merger went ahead, it would not be minded to substitute its judgement for ours by insisting upon compliance with some NAR share ceiling.

2.91. Without obligatory divestments, any of the three proposed mergers would be likely to mean the emergence of a leading sales house and a continuing imbalance between the two remaining sales houses. We believe that such an imbalance would be harmful to competition in the advertising market. The advertisers would feel a commercial pressure to reach agreement first with the larger company on advertising spend for the coming period. This would, in our view, lead to the larger of the two companies using its strong position to push up advertising prices for the regions it controls. In turn, since in general we would expect advertisers as a whole to be resistant to increasing their ITV advertising budgets, at least in the short term, this would lead to a loss of revenue to the smaller company. Quite apart from any potentially detrimental effects in terms of the Network Centre budget referred to in paragraph 2.78, we believe that this situation would mean the progressive strengthening of the larger company and that, with such increasing strength in the market, they would raise prices further.

2.92. The outcome for advertisers would be an increase in the level of ITV advertising prices, at least in the regions covered by the merged entity, and hence, given advertisers' budget constraints, a reduction overall in the effectiveness of their advertising campaigns. For some advertisers there would also be an increase in total advertising costs. The outcome would in any case be a reduced value for money for advertisers. The precise nature of this distortion in the advertising market would vary from one advertiser to another depending on their channel preferences and preferred distribution of advertising spend by region.

2.93. We have also concluded that the market strength of a sales house reflects, to a considerable extent, the particular regions for which it sells advertising. We have referred in paragraph 2.57 to Granada's view that the combination of a region's coverage and the possession of characteristics attractive to advertisers (as reflected in premium rates) differentiate four leading licences from the others. We accept that view. Together, these four licences attract the largest amount of advertising revenue, account for over 55 per cent of ITV NAR, and attract 'premium' rates.¹ The ITC agreed with us (see paragraph 6.111) that it would be preferable by far that one ITV company should not be in a strongly dominant position by virtue of the significant competitive advantage that a concentration of the leading licences would create.

2.94. In that context we take the view that the leading licences, given their combination of size, of population covered and ability to attract premium advertising rates, have a particular commercial significance. Where these licences would be distributed in an uneven way between the two sales houses, the market strength of the leading sales house and the imbalance between the two would be even greater than that indicated by company-relative NAR figures alone.

2.95. There is a second, although less significant, aspect of the importance of particular ITV regions, and this relates to those licences that are not held by the three major companies (namely the licences for Scotland, Northern Ireland, the Channel Islands, and for the Borders and the Isle of Man). All but one of these are very small in NAR terms and do not carry the same weight as the licences of the three major companies. For assessing market strength we have therefore relied on a calculation of ITV NAR excluding these small licensees.

2.96. In forming our conclusions about a balance between the ITV companies, we considered the argument put to us by Carlton and UNM that revenue from advertising and programme production should both be taken into account so as to reflect the fact that Granada's production business is greater than that of the other two combined. Although broadcasting and production have a certain relationship, a TV company does not have to carry out both types of business: Carlton and UNM were both for a time 'publisher-broadcasters' before choosing to develop their production business and become 'producer-broadcasters'. More important, the fundamental market conditions affecting the two kinds of business are different. In particular, programme production is a much more competitive market in which entry is relatively easy, as the presence in it of some 1,200 companies shows. We did not, therefore, accept the Carlton/UNM argument.

2.97. The analysis of the likely effects of the merger set out in paragraphs 2.88 to 2.96 depends on the imbalance (in terms of ITV NAR and leading licences) between the two remaining sales houses. It is not the result of a reduction in the number of sales houses from three to two. It is in fact our view that there would be no significant harm to competition if the reduction from three to two involved a fairly even balance between the remaining players. The regional monopoly element of the system would of course continue to be a constraining factor on competition but we do not think that its effect would be any greater than with three players, given the way in which the sales houses compete with each other. There would still be a strong incentive for each of the two players to compete for the marginal business. Each additional percentage point of ITV NAR won is worth about £20 million and we would expect the incremental profit on such revenue to be high. We therefore believe that two balanced sales houses would be likely to behave in a similar way in terms of competition to the three sales houses that exist at present.

North and South

2.98. It has been argued by Granada that a concentration in ownership in terms of leading licences would strengthen a perceived 'North/South divide' that existed in ITV. Our view is

¹We use 'premium' to define those regions whose share of ITV NAR is higher than their share of the ITV audience, so that their effective cost per thousand impact (CPT) rates charged to advertisers are also higher than the overall averages.

that such regional differences are better described in terms of the differential distribution of wealth-creating activity in England, given that the South as a whole is seen as more prosperous and that its demographic distribution is more attractive to some advertisers. We do not think that there is any special consideration relating to a North/South dimension arising from these merger proposals that goes beyond the issue of the relative strengths of different licence regions that we address in our competition analysis.

Merger outcomes

2.99. We considered how far there was likely to be any mitigation of the effects identified in paragraphs 2.88 to 2.96 as a result of obligatory divestments. We are not able to predict precisely what the parties to the mergers would do to meet these statutory obligations but expect that they would dispose of their interest in licensees in a way that would minimize their loss of revenue share, as well as accounting for the minimum audience share necessary to meet those obligations. For this analysis we have used the statistics summarized in Appendix 2.1. We should add that in each case we have assumed that any divested licence, whether the divestment be obligatory or otherwise, will be acquired by the non-merging party. This seems the most probable outcome given the desire expressed by each of the parties to see a consolidation within ITV.

Carlton/UNM

2.100. In this case we expect that the parties would seek to meet the 15 per cent audience share limit by reducing their interests in GMTV and Channel 5 to a point where they would no longer be required to include them in their audience share calculation. According to ITC figures, the amounts of audience share are 0.8 and 2.8 per cent respectively. When these are subtracted from the expected 18.1 per cent of the merged company, it would, at 14.5 per cent, meet the statutory obligation without the need for divestment of one of their licences. This would result in total NAR shares¹ for the merged entity and Granada of 35.5 and 19.7 per cent respectively (58.6 and 32.7 per cent of ITV NAR). There would therefore be, first, a significant imbalance in NAR shares (1.8:1) and, secondly, assuming no further divestment, the new group would retain three leading licences (Carlton TV, Central TV and Meridian TV) to Granada's one (LWT). The obligatory divestments would not on their own remove our concerns (see paragraph 2.123 as to the likely removal of the Channel 5 divestment from any ultimate restructuring).

Granada/Carlton

2.101. This combination would have an audience share of 19.6 per cent. With obligatory divestment of Carlton TV (2.7 per cent) to avoid both London licences being in common ownership, and Carlton's current GMTV holding (0.8 per cent audience share), this would be reduced to 16.1 per cent. A further divestment of a licence would achieve 15 per cent—divestment of Tyne Tees TV, for example, would, on the figures used, reduce the audience share to 14.6 per cent. Total NAR shares for the merged entity after these divestments, and for UNM if it acquired Carlton and Tyne Tees, would be 28.8 and 26.3 per cent respectively (47.8 and 43.5 per cent of ITV NAR). This would be a balance of 1.10:1. Each group would, on these assumptions, have two leading licences (merged entity: LWT and Central TV; UNM: Meridian TV and Carlton TV). This situation would not be of concern to us.

¹We have defined NAR in paragraph 2.38. In each case analysed in paragraphs 2.100 to 2.103, we have used the shares of NAR (whether all NAR or that part received by ITV, 60.7 per cent of the total in 1999) deriving only from sales on behalf of each group's own licences. We do not believe that the extra market power derived from sales on behalf of any of the smaller companies is sufficient to create distortion.

Granada/UNM

2.102. With obligatory divestment of UNM's Channel 5 holding (audience share 2.8 per cent) and Granada's in GMTV (0.8 per cent), the combined audience share of 20.7 per cent for the merged group would be reduced to 17.1 per cent. This would be insufficient to meet the 15 per cent statutory requirement. The limit could be met (14.9 per cent) by further divestment of HTV (2.2 per cent).

2.103. Again assuming divestment to the non-merged entity, total NAR shares would, for the merged group and for Carlton, respectively be 30.8 and 24.3 per cent (ITV NAR: 53.1 and 40.1 per cent), and the merged and non-merged groups would own two leading licensees each (merged entity: Meridian TV and LWT; Carlton: Carlton TV and Central TV). The NAR balance would then be 1.27:1. This would remove our concerns, although we might have thought otherwise had the imbalance been much greater. We observe in this context that the ITC told us that in its view a total NAR share of 30 per cent without representation of the smaller licences would be broadly acceptable for a single group.

Cross-media issues

2.104. In paragraph 2.63 we referred to concern over whether a media group having interests both in printed publications and TV would enjoy preferential TV advertising rates over publishers without ITV interests. A further concern was the possibility for such a media group to benefit from advance knowledge of its publishing competitors' strategies and forthcoming content as reflected in their advertising plans: this potential situation already exists with UNM. We are not aware that it has been a problem so far; we understand that undertakings exist between the companies concerned. The change due to the merger would be only one of the scale of the TV company's coverage. The continuation of these undertakings by the merged entity should, in our view, be sufficient to remove concern, and we expect that these would indeed continue with any change in ownership—either by UNM merging with Carlton or Granada. Moreover, the ITC has carried out the public interest tests required on cross-media aspects under the amended 1990 Act and has concluded that none of these mergers would be contrary to the public interest as regards cross-media issues.

Benefits

2.105. Before reaching our public interest conclusion we should consider whether there are any benefits attributable to the merger. We have considered three main possibilities. First, the parties have told us that they expect some part of the estimated annual cost savings of approximately £40 million to be invested in programme production or new media although these savings were in none of the proposals the driver for the merger. Second, Carlton and UNM argued that the merger would strengthen ONdigital—and we would expect the same argument to apply to a Granada/UNM merger. Third, they argued that the mergers would enhance ITV's ability to meet growing competition from other TV platforms and channels, to operate more effectively in international markets and to provide a stable structure pending the outcome of the Government's review of TV regulation, starting later this year. We expect the benefits under the first and second categories above to be realized in each case. We are not persuaded that an ITV consisting of two unbalanced companies would have the decision-making abilities and commonality of objectives to secure the benefits in the third category. We note, however, that a balanced position would be achieved after the expected obligatory divestments in the cases of both Granada/Carlton and Granada/UNM and in each of these cases we would, therefore, expect also that the third category of benefits listed here would be achieved.

Conclusion

2.106. We have set out in paragraphs 2.91 to 2.93 the effects of the mergers in terms of their impact on the advertising market, and have concluded that the two key points are:

- (a) the NAR shares of the two companies remaining after whichever of the mergers were to take place; and
- (b) the balance of ownership of the four leading licensees.

2.107. On the basis of the reasoning contained in paragraphs 2.99 to 2.103 and, after taking into account our expectations of the benefits referred to in 2.105, we conclude that:

- (a) The Carlton/UNM merger, even after the likely obligatory divestments, would be expected to operate against the public interest on the grounds of an imbalance of the structure of ITV in terms of NAR and leading licences, which would lead to a distorted advertising market. The specific adverse effects would be that ITV advertising rates would rise, at least in the regions covered by the merged entity, and that value for money to advertisers would be reduced.
- (b) A similar expectation of distortion in the advertising market, with detrimental effects on ITV advertising rates and value for money, would have been expected in the case of both proposals made by Granada. However, in these cases we find that the obligatory divestments would be expected to create a situation in which the detrimental effects would not occur. Accordingly, and for this reason only, we conclude that Granada's proposals to acquire either Carlton or UNM would not, if implemented, be expected to operate against the public interest.

Remedies

2.108. Whilst we take the view that the Carlton/UNM merger as currently proposed contains elements which would not be in the public interest, we believe that the detriment could be removed in such a way as to enable it to proceed without the adverse effects identified in paragraph 2.107(a). In considering remedies we took as our criterion that they should be proportionate as well as effective.

Behavioural remedies

2.109. Carlton and UNM put it to us that any concerns regarding the effect of the merger proposal on advertising prices should be met by behavioural remedies. They argued that the immediate price effects could be dealt with by an undertaking on their part that for an agreed period they would roll over existing contracts with their current terms. They also offered to meet our concerns over share deals by undertaking not to pursue any further such deals which included an obligation on the advertiser to allocate a share of advertising expenditure to ITV as a whole.

2.110. As regards the proposal for rolling-over the terms of existing contracts, we noted that it would limit the free play of market forces and would call for extensive monitoring. In addition we were concerned that, as put to us, it operated entirely in relation to discounts from the SAP. It would leave it open to a dominant airtime seller to seek to increase SAP and thereby increase prices even if existing contract terms were frozen. We also took the view that such arrangements would restrict the freedom of advertisers to seek changes in their contract terms more generally, in that any customer who felt the need to change any term of the contract could

be inhibited from proposing it for fear of losing the element in it which provided for the frozen discount. For these reasons we felt that the offer would not be a proper remedy for the detriment we have found.

2.111. As regards the cessation of ITV-wide ('all-ITV') share deals, we found considerable merit in the proposal but, again, did not see it as an effective means of removing the public interest detriment we had identified.

2.112. In neither case did these proposals address the structural detriments.

Divestment

2.113. In forming our conclusions on a suitable divestment, we first considered a proposal from UNM of a divestment for a limited period of its sales house (TSMS) together with a right to sell UNM advertising airtime to enable competition in airtime sales to continue on the basis of three sales houses, as now. We studied this proposal carefully but concluded that, even though it recognized the need for audit to provide ongoing reassurances of the divested sales house's independence from the merged Carlton/UNM entity, such a situation of independence would be difficult to achieve in practice. Moreover, we doubted the commercial attractiveness to an independent buyer, particularly given the envisaged temporary nature of the arrangement.

2.114. We concluded that only a structural remedy affecting licences could adequately meet the detriment.

2.115. In doing so, however, we took note of representations by Carlton and UNM that any disposal over and above that required as part of the obligatory divestment would be both disproportionate and ineffective. They felt that divestment was an uncertain remedy if the objective were to achieve balance, since there could be no assurance that if the merged entity were to divest a licence it would be bought by Granada at a proper market price. Moreover they argued that divestment would be a disproportionate remedy for what they saw as a temporary situation, given the continued fall in ITV audience and NAR shares and the prospect of forthcoming legislation. They also argued that a two-company structure of different sizes in which the majority of income was assured by regional licences was unlikely to be less competitive than a balanced duopoly. We have dealt with this last point in paragraph 2.97.

2.116. They also represented to us (see paragraph 2.96) that, in any attempt to define a balance between companies, account should be taken of production activities.

2.117. As regards proportionality and the view that the situation after the mergers will be temporary, we are in no position to judge at this point in time the outcome of the forthcoming public consultation and review of broadcasting, whether in terms of the Government's policy proposals in the expected White Paper, or of the view that Parliament will take of those proposals, or of the timescale in which any new legislation would be enacted. We can consider only the mergers referred to us, how they affect the existing situation in the relevant markets, and how that situation might be expected to develop within its current legislative framework.

2.118. We have attempted in what follows to recommend a structure which would be likely to endure for a sufficiently long period as to permit the review of broadcasting legislation referred to in paragraph 2.43 to take place against the background of a stable ITV.

2.119. As regards the submission that production should be taken into account, we have already set out in paragraph 2.96 our reasons for rejecting it.

2.120. We accordingly concluded that a licensee divestment was the only effective basis on which the merger should be allowed to proceed, and we considered which licensee it would be most appropriate to recommend. In doing so we have built on our assumption in paragraph 2.99 that any divested licence will be acquired by the non-merging party, as being the expected outcome given the desire expressed by each of the parties to see a consolidation within ITV. It is also the outcome which would be most likely to achieve the balance within ITV that we regard as desirable (see paragraphs 2.93 to 2.97). However, it is clearly not within the Secretary of State's power to require a non-merging party to purchase, nor can we be sure that a third party might not emerge with an offer which the divesting group could not, in the interests of its shareholders, reject: if either of these events were to occur, while we would regret the consequent erosion of the balance between the two major companies that we have sought, we would accept the divestment as achieving at least the desired reduction in the dominant party's role. To that extent we would regard it as an acceptable, if not optimal, satisfaction of our aims.

2.121. The divestment needed will require to be of a leading licence in order to meet our requirement for balance. Together, Carlton and UNM have three such licences—Carlton TV, Central TV and Meridian TV. Granada could not realistically buy Carlton TV because of the prohibition on holding the two London licences. It would also be disproportionate to require the divestment of such a major licence as Carlton TV.

2.122. The divestment of Central TV would, if made to Granada, raise that group's audience share to above the statutory limit. Moreover we believe that to recommend the divestment of Central TV would be disproportionate, given its audience share (4.5 per cent) and its share of total NAR (10.0 per cent).

2.123. Accordingly, we recommend that, for the Carlton/UNM merger to be allowed to proceed, the merged entity should be required, within a period of six months from the date of completion of the merger, to complete the divestment of Meridian TV (audience share 2.4 per cent, total NAR 6.9 per cent) to a buyer approved by the DGFT. The resulting NAR ratio between the merged company and Granada if it acquired Meridian TV would be 1.08:1. Compliance with obligatory requirements could then be achieved by the company reducing its holding in GMTV so that none of the latter's audience share was any longer attributed to it. In such circumstances no divestment of the holding in Channel 5 would be obligatory (see paragraph 2.100).

Other matters

2.124. We make the following additional observations for note or action by the DGFT or the ITC as the case may be:

- (a) Following the achievement of the balance within ITV that would flow from the combination of obligatory divestments and those recommended by us, we question whether there would be any further need to maintain regulatory limits on shares of NAR.
- (b) Pursuant to paragraph 2.97, we wish to place no limits on the ability of the smaller companies to place their airtime sales activity wherever they desire. The removal of regulatory limits as recommended above would assist in this direction. We suggest further that the DGFT/ITC should seek voluntary undertakings from the sales houses to release the smaller companies from their existing contracts within six months of the date of notification of their wish to change their sales house.
- (c) In paragraph 2.81 we expressed our concerns over the risks to the processes of commissioning and scheduling of programmes deriving from any one company having a

position of dominance within the Network Centre. We observe that the implementation of the obligatory divestments and those recommended by us would remove these concerns.

- (d) While it does not form a part of our public interest finding, we found the existence of share deals requiring commitments by advertisers to a share for ITV as a whole to be an anti-competitive feature of the advertising market in which these companies operate. We welcomed offers made by all three main parties to end such arrangements. We suggest that the ITC should consider giving a direction under the licences preventing this practice.
- (e) In paragraph 2.105 we said that we expected the full benefits set out in that paragraph to be achieved following the obligatory divestments in the cases of Granada/Carlton and Granada/UNM. Following the implementation of our recommendations in respect of Carlton/UNM we would, by the same logic, expect the third category of benefits described in paragraph 2.105 to be available in this case also.
- (f) Concerns have been expressed to us that all divestments should operate to effect a total and unconditional severance of the interests involved from those of the divesting party. So far as the effectiveness of our own recommendations is concerned, we have recommended that each of the divestments should be to a party to be approved by the DGFT and we propose that the latter should ensure that such a severance of interests is achieved. We have no power to make a similar recommendation as regards the obligatory divestments but we do suggest that the DGFT should play a similar role in this respect.