5 The views of UNM, Carlton and Granada

Contents

Page

Introduction ... 109
Views of UNM ... 110
In respect of a merger with Carlton ... 110
The market for viewers ... 110
The market for advertising ... 114
Commercial purpose and rationale ... 120
Advertiser flexibility ... 120
Buyer power ... 125
Procurement and scheduling of programmes by ITV ... 125
Regulatory barriers ... 128
The effects of the merger ... 129
Hypothetical remedies ... 130
In respect of a merger with Granada ... 131
Views of Carlton ... 132
In respect of a merger with UNM ... 132
The market for viewers ... 132
The market for advertising ... 134
Buyer power ... 137
Procurement and scheduling of programmes by ITV ... 138
Regulatory barriers ... 139
The effects of the merger ... 139
Hypothetical remedies ... 141
In respect of a merger with Granada ... 142
Views of Granada ... 142
The market for viewers ... 142
The market for advertising ... 143
Buyer power ... 147
Procurement and scheduling of programmes by ITV ... 148
Regulatory barriers ... 149
The effects of the merger ... 150
Hypothetical remedies ... 150

Introduction

5.1. This chapter summarizes the views of UNM, Carlton and Granada, the main parties to these inquiries, which were presented in written submissions and at hearings.

Views of UNM

In respect of a merger with Carlton

The market for viewers

5.2. UNM submitted that all broadcasters competed intensely for viewers. In the case of private sector broadcasters they had to compete to maximize one or other of advertising revenue, subscription income, or pay-per-view or other transaction-based income.

5.3. The importance of viewers was as an essential 'input' to all types of broadcasting. Commercial broadcasters had to attract viewers as the value of the advertising airtime which they had for sale depended on the number and profile of viewers reached. Pay-TV channels justified subscriptions by offering viewers different programmes from those offered on free-to-air TV: the value of the advertising time sold by pay-TV increased with their audience share. In the case of advertising-funded broadcasters, the ITC specified a maximum number of minutes permitted for advertising in a given hour. That placed a fixed limit on the number of advertising minutes that each channel could provide.

5.4. But minutes only constituted effective supply to an advertiser if adequate numbers of viewers with a profile of interest to an advertiser watched the advertising provided in the slots. The more viewers of the kind sought that a channel could attract then the more advertising it supplied and, other things being equal, the lower the price of the advertising supplied.

5.5. We asked UNM if it were not the case that the difference in funding methods made pay-TV a distinct viewing market from free-to-air commercial TV. UNM did not believe that was the case. There was one viewing market in which all the players attempted to win the viewing hours of individuals, a 'battle for the eyeballs' as UNM termed it. ITV was in competition with not only pay-TV but also Channel 4, Channel 5 and the BBC for viewers: the latter, for instance, was a vigorous competitor, largely to justify, in UNM's opinion, the licence fee. All the competitors in the market for viewers had crucial objectives, in the case of commercial stations to increase their audiences and make their viewing time more valuable to advertisers.

5.6. The two key considerations for ITV were that:

(a) the ITV share of the viewing audience had been in decline for some years now; and

(b) that decline appeared certain to continue.

5.7. As regards the existing trends, the ITV share of viewing had fallen between 1995 and 1999 from 35.6 to 29.6 per cent, a drop of 17 per cent. BBC1 had declined from 32.2 to 28.4 per cent, a reduction of 12 per cent. The notable features in the distribution of viewing shares within that period were the introduction of Channel 5, which had risen in only two years to a figure of 5.4 per cent, and the growth in the satellite/cable share (including both analogue and digital) from 7.9 to 13.5 per cent: the latter represented an increase of 138 per cent over the 1995 to 1999 period.

5.8. Not only had the overall viewing market become more diverse and competitive, but the size of the viewing 'cake' was also diminishing, as shown by the reductions in the average UK TV viewing time per person of 3.81 hours in 1992 to 3.67 in 1999. The latter figure embodied a slight but probably temporary recovery in viewing level due to the introduction of digital TV. More striking was the decline in viewing in terrestrial-only homes, where the average daily hours of viewing had dropped from 3.77 to 3.08 between 1985 and 1999. The drop in the hours viewed was important as an indicator of how TV had been faring against its wider market competitors.

5.9. The main factors underlying the intensification of competition for viewers included:

(a) an increasingly ratings-oriented approach by the BBC which intensified competition against ITV;

(b) an increasingly commercialized and less minority-oriented strategy by Channel 4, which had enabled it largely to maintain its viewing share;

(c) the introduction of Channel 5, intensifying competition for the mass market channels; and

(d) the continued increase in penetration of satellite and cable channels, giving greater channel choice to more households, combined with the growth in the numbers of channels available through the introduction of digital technology. Thus, pay-TV shares had increased from 18.7 to 24.9 per cent between 1995 and 1999 and the growth in channels and services availability brought by digital technology meant that the competition for other channels such as ITV was intensifying all the time.

5.10. UNM noted that pay-TV channels had a number of important competitive advantages over free-to-air channels which had facilitated the successful large-scale entry and expansion of pay-TV channels in recent years:

(a) Pay-TV operators had access to a charging mechanism which yielded them valuable subscription and carriage-free income not open to free-to-air channels, and increased their ability to compete for viewers by enabling them to fund the acquisition of the most attractive programming. In this regard, the valuable subscription income available to pay-TV operators and the substantial increase in licence fee income recently awarded to the BBC were leading to ITV's share of broadcast income (including advertising, subscription, and the BBC's licence fee income) falling sharply. ITV's share of broadcast income had fallen from 39.4 per cent in 1994 to 30.4 per cent in 1999, and its share was forecast by TSMS/Paradigm to fall to 23.1 per cent by 2004. These forecasts took no account of the development of new distribution platforms such as ADSL or other competitive threats posed by new technology to ITV's NAR.

(b) Certain of the more genre-specific and specialized programming shown by pay-TV and (to a lesser extent) Channel 5 and Channel 4 was a source of competitive advantage for these channels with regard to certain types of programming which made them more effective competitors against ITV at reaching specific target audiences (TV advertisers paid only for the specific target audience reached, and ITV was less effective in this regard as it was more of a 'mass audience' channel).

(c) Whilst all channels competed for all target audience profiles, increasingly advertiser demand was centred on the audience sector that ITV was less efficient at attracting, ie working up-market male and youth audiences. These audiences were forecast to migrate naturally to pay-TV services resulting in ITV having an increasing bias toward older and more downmarket viewers, the least valuable audiences to advertisers. BARB September 1999 data indicated that terrestrial-only homes where ITV had its highest viewing shares were biased towards the elderly (38.7 per cent of the adults in terrestrial-only homes are over 54 years old as opposed to 19.1 per cent in multichannel householders) and poorer households (32.5 per cent of the adults in terrestrial-only households were in the DE SEG whereas only 25.4 per cent of the adults in multichannel households were in the DE SEG).

5.11. In addition, pay-TV broadcasters (in particular BSkyB) had a number of other important competitive advantages:

(a) Pay-TV offered viewers considerably greater choice of channels (over 100 currently, compared with an estimated average of 12 in 1991) than free-to-air broadcasters, and offered greater choice in programming (such as dedicated sport, film and news channels).

(b) Pay-TV broadcasters were not bound by the various costly public service obligations which were imposed under the terrestrial free-to-air broadcasters' licences.

(c) Pay-TV broadcasters were also uniquely allowed to carry three additional minutes of teleshopping per hour. The ITC's programme sponsorship code in relation to terrestrial commercial free-to-air broadcasters was also currently more onerous than that faced by BSkyB.

(d) Whilst ITV was limited to seven minutes of advertising per clock hour, pay-TV channels were permitted 9 minutes per hour.

(e) The fact that there were a number of Channel 3 companies complicated the coordination and procurement of Channel 3 network programming, which further limited the ability of terrestrial regional Channel 3 broadcasters to compete with pay-TV broadcasters (and national broadcasters generally) who faced no such coordination issues.

(*f*) Unlike BSkyB, terrestrial Channel 3 broadcasters contributed substantial sums of money to the UK Treasury by way of annual licence fee payments.

5.12. UNM, moreover, saw clear reasons to believe that ITV's share of the viewing audience would continue to decline. The main drivers would be continued rapid technological developments, particularly in digital technology. The whole area of new technology encompassed and epitomized by the Internet would also have profound repercussions on the struggle to secure the attention of actual and potential viewers. The rates of change and their precise impact on the market for viewers were hard to forecast with any degree of precision—partly due to the inherent uncertainty of the forecasting process but also because the impact of some new developments was simply unquantifiable at this stage. Nonetheless, competition for viewers' attention would be greater over the years ahead and forecasts of the effect of that increase would in all probability understate it.

5.13. The direction of the trend the over the next five years was not in doubt. Forecasts by Zenith Media, for example, showed ITV's audience share falling from 29.6 to 27.6 per cent of total TV viewing. This was almost certainly an overestimate. Industry forecast of viewing share no doubt varied widely but it was UNM's view that Zenith Media was being too optimistic about the scale of further contraction in the ITV viewing share as well as underestimating the viewing of pay-TV channels in homes able to receive such channels. ITV viewing could be as low as 24 per cent by 2005. The precise figure was less important, being so uncertain. What mattered most was that all forecasts pointed in the same direction with respect to ITV's share of the viewing market.

5.14. UNM thought that a major factor in considering the development of the viewing share was the rapid growth of the multichannel homes, with access to both free-to-air and pay-TV channels. The UK was the only market in the world with three digital pay-TV platforms competing with each other and with free-to-air channels. There was no cost to the consumer to install digital TV if this was done by subscribing to a pay-TV platform, as both Sky and ONdigital offered free set-top boxes. Digital cable had also recently arrived and was bound to grow rapidly, especially when NTL launched its digital service later in the year. The Zenith Media forecast of multichannel households taking 18.6 per cent of total TV viewing by 2003 was almost certainly too low. Statistics apart, the key consideration to bear in mind was that in multichannel homes the scope for switching away from free-to-air channels was large and viewers were ready to switch. An important consequence of growth in multichannel penetration was to enhance total revenue generated by pay-TV platforms, through both subscription and advertising, thus providing resources for these companies to bid for attractive programming rights—which in turn attracted new households to pay-TV.

5.15. Although its influence was impossible to pick up precisely in forecasts, as Zenith Media and everyone else acknowledged, it was clear that the whole area of new technology would impact greatly on the market for viewers' time. An obvious example was the imminent introduction of ADSL services, by BT in particular. The effect would be to allow telephone networks to provide high-speed, broadband, always-on Internet access to PCs and digital video access to TV. ADSL would have the capability to distribute conventional broadcast channels, pay-per-view and VOD. A wide range of companies were seeking to exploit ADSL technology for TV services. Considerable investment was being made in relation to ADSL. For example, Kingston Communications, via Kingston Interactive Television, was offering a 50-channel TV service using ADSL, additional VOD services, email and Internet services, home shopping and a local information service. It had been reported in the press that Kingston plans to launch a national interactive service in July 2001.

5.16. In addition, Yes Television currently offered VOD to its customers. The BT Yes Television Pilot would offer VOD, together with Internet access and email services through a subscriber's TV set. Yes Television expected to offer broadcast TV commercially by the end of 2000. Yes Television had signed agreements with Warner Bros, Buena Vista, Sony and DBC giving access to movies, and was in the process of negotiating additional contracts with other Hollywood studios. It had also signed agreements with major UK-based TV companies, including BBC Worldwide, Channel 4, Pearson, HIT Entertainment and ITEL. Yes Television had an exclusive VOD content agreement with Trans World International for sport programming. Warner Bros and Buena Vista had agreed (subject to certain conditions being met) to become shareholders in the company.

5.17. In March 2000, Telewest and Andersen Consulting had announced the establishment of a joint venture to develop and license a range of services, including VOD, interactive TV, wireless home networking services, music pay-per-view and e-banking to cable and telecommunications operators and

digital terrestrial and satellite operators. In their fourth quarter results to 23 March 2000, Telewest had also announced that it had commenced trials of true VOD services in its South-East franchise and expected to launch true VOD as a full commercial service by early 2001.

5.18. VNL, which was established in the UK in 1992 to provide VOD and other interactive entertainment services, had developed its own server software and other proprietary technology and was currently trailing its services over the BT network in London under the brand name 'HomeChoice'. VNL had contracts, inter alia, with Warner Bros, Sony-Columbia, Disney, the BBC and Pearson. Sony and Warner Bros had significant warrants in VNL.

5.19. DIVA, which established its UK subsidiary (DIVA UK) in early 1999, had commercially launched its VOD services over cable in the USA. In September 1999, NTL announced that it had reached agreements with DIVA UK to supply technology components for a commercial VOD service over NTL's cable networks in the UK from mid-2000, conditional on certain technical and commercial milestones.

5.20. Finally, FutureTV (UK) Limited (an interactive TV company) was likely to provide competing VOD services in the future. FutureTV had developed MiTV, an interactive TV service that offered Internet access, email and VOD.

5.21. The fact that ADSL could also be used for high-speed Internet access would facilitate its roll-out, but did not detract from its usage for pay-TV. In addition, Internet services were in themselves increasingly competing for TV viewers, and AOL's acquisition of Time Warner reflected the convergence of Internet services and more traditional TV broadcasting.

5.22. VOD/pay-per-view was arguably the most attractive type of pay-TV from both a commercial perspective and a consumer perspective as users could be charged according to whether they watched the programming, and this offered viewers the ability to access large libraries offering a wide range of general entertainment programming (for example, wildlife programming, children's programming etc) as well as movies and sport. For movies and sport, the key drivers of pay-TV, this technology could be very attractive indeed.

5.23. These new channels presently carried little advertising. However, any observations that such channels were in their infancy and carried little advertising in their start-up mode was no guarantee that in, say, five years they would not account for a significant share of UK NAR and be able to offer highly attractive targeted premium audiences to advertisers. VOD potentially allowed broadcasters, and therefore advertisers knew exactly which individuals had watched which programming and the precise adverts watched. This was a higher level of targeting than could be achieved via any other TV medium. Advertising revenue would appear to be a significant part of these companies' business plans.

5.24. Whilst the future was hard to predict, ADSL could only increase the overall take-up of pay-TV services and the competition that free-to-air channels face in viewing, programming and advertising markets.

5.25. As regards the Internet, a recent study by Bernstein Research had projected that by 2004 there would be 4 million homes connected to the Internet, or about 17 per cent of UK households. In October 1999, Continental Research had estimated that 40 per cent of the UK population had access to the Internet, via home, work, school or college.

5.26. The effect would be twofold. Time spent in using the Internet was time diverted from watching TV, with the effect that free-to-air viewing and its capacity to attract advertisers diminished: a recent study by Fletcher Research showed that one-third of all regular Internet users listed watching TV as something they did much less of as a result. Another study, by Strategis Group, showed 44 per cent of US Internet users were spending less time watching TV. Second, advertising on the Internet was small but would increase in the years ahead. Both effects would divert revenue from ITV, reducing its capacity to invest in original production programmes and acquire rights to content. That would endanger ITV's capacity to keep or enhance its viewing share, reducing further its ability to attract viewers through its programmes and making ITV less attractive to advertisers.

5.27. These developments added up to a revolution now taking place. The competitive implications were enormous for traditional broadcasters. Further effects would flow from the spread of WAP

technology, as in the projection by Forrester Research that by 2004 about one-third of the population would access the Internet by mobile phones. TV sets would become increasingly capable of uses other than conventional TV viewing. Perhaps of greatest potential significance was the development of technologies such as personal video recorders which would allow viewers to control actively how they used the TV platform and, significantly, would enable viewers to choose to 'skip' the advertisements altogether. These devices were now available in the USA and soon to be introduced into the UK.

5.28. The net result of all these developments would be an unprecedented level of competition for viewers. The rapid increase in the number of channels over the last decade had already eroded ITV's share of viewing. The new generation of hardware and services would mean unparalleled competition for viewers and, directly or indirectly, advertisers. The merger would help to provide UNM with more effective means to respond to these great challenges.

The market for advertising

5.29. UNM noted that whilst TV advertising had certain distinctive features and advantages that distinguished it from other forms of advertising, the significance of these advantages should not be overstated. For example, in terms of TV's position as a mass medium and building 'mass awareness' more rapidly than other media, account needed to be taken of the fact that TV advertising involved long production lead times and hence a lack of immediacy. In particular, high-quality TV commercials typically took months to produce, whereas press or radio advertisements could be produced in a matter of hours.

5.30. UNM noted that cinema as well as TV offered the scope for combining colour, sound and moving images to create a high 'impact' with potential consumers. In relation to TV's ability to target particular audiences and demographic/socio-economic groups, TV was not unique in this regard. Indeed, because free-to-air TV (and especially ITV) tended to reach a high proportion of the population (depending on the time of day), it could be an expensive way to reach valuable niche target audiences. Advertisers could effectively end up paying for a lot of people outside their target audience. Direct mail, cinema (for young adults), pay-TV and specialist magazines could be much more efficient at reaching target audiences, and therefore could be extremely effective competitors against ITV and free-to-air TV generally.

5.31. With regard to the relative importance of creative considerations in influencing media choice, UNM argued that there had been a revolution in the advertising industry in recent years and there had been a very substantial increase in the number of ways of reaching consumers, which had considerably broadened the definition of the media market. For example, an article in *The Economist* of 11 March 2000 had emphasized that media buyers/planners were now taking 'centre stage' in the advertising industry and the increasing focus of media buyers on inter-media decisions. In short, media choice issues increasingly took precedence over creative issues. Evidence of this could be seen in a number of different trends:

(a) The development of a stand-alone media strategy sector. Media strategy companies were not involved in the creative design of marketing material, nor the purchasing decision, and were therefore neutral as to the chosen advertising solution. These companies (with around 800 to 1,000 individuals currently employed as media planners in London) had become established solely to maximize the effectiveness of advertising campaigns through the optimal use of a variety of media, demonstrating the importance of advertisers' choices between different types of media.

(b) Media buyers were increasingly focusing on inter-media decisions, and the move by the large agencies to provide advice across all of these channels of communication, either through in-house units, the purchase of 'stand-alone' subsidiaries or the arrangement of strategic partnerships, had enabled them increasingly to offer a 'one-stop shop' to advertisers.

5.32. More generally, UNM considered that the entire business of media buyers and media auditors was to understand which medium was most cost-effective, and they possessed very detailed information on prices both from current negotiations, recent past contracts and market analysis. Billetts' web site provided a measure of the level of detail which was readily available in relation to TV.

5.33. UNM indicated that it recognized that the characteristics of TV advertising were different from other forms of advertising. However, it was important to bear in mind that the fundamental economic commodity was ‘persuading consumers to buy the product’. In this regard, the scope of the relevant economic market and firms’ pricing decisions were determined by the marginal sensitivity of demand to price changes—price sensitivity by a substantial minority was sufficient for TV advertising not to be a separate economic market.

5.34. UNM submitted that it was essential in assessing the effects of the merger on the advertising market to understand that ITV regions were very largely complementary to, and not competitive with, each other. This was because competition for advertisers took place mainly or between national TV networks (ITV as a whole, Channel 4, Channel 5, BSkyB, etc). Advertising on the various regional ITV franchises was very largely undertaken by advertisers as complementary parts of a national campaign. A national advertiser targeted the national market and would aim to capture customers in every ITV region. An advertiser would not, on the whole, react to an increase, or the prospect of an increase, in advertising price in a particular region by increasing his advertising spend in another region(s) due to there being diminishing marginal returns for increasing advertising spend. The only significant exception to this pattern was London, where direct competition existed between the Granada weekend and Carlton weekday franchises.

5.35. It was UNM’s view that TV advertising divided into:

(a) separate local regional markets, consisting of advertising from competing local TV and other media; and

(b) multi-regional and national markets, ie advertising from competing multi-regional and national TV and other media. In such markets media covering different regions (which included ITV broadcasters) were primarily complementary.

5.36. The nature of the market was seen more clearly by considering the three main types of advertiser:

(a) ‘Local’ advertisers who advertised in a single ITV region or part of that region, in the latter case though a ‘macro’ part of the ITV licencees’ territory or via local advertising from, say, a cable TV company. Local advertising, so defined, accounted for only about 2 per cent of UNM’s advertising revenue in 1999.

(b) ‘Regional’ advertisers who advertised in two to nine ITV regions, or the ‘macro’ regions available from Channel 4 or 5 which had wider coverage than a single ITV region. Regional advertising made up about 4.7 per cent of UNM’s 1999 advertising revenue.

(c) National advertising, where a national brand advertiser covered ten or more ITV regions. National advertising accounted for about 94 per cent of UNM’s 1999 advertising revenue.

5.37. Regional advertisers, for example, could advertise in specific ITV regions or in particular ‘macro’ regions of the national broadcasters. ITV regions were often in competition with macro regions but not with each other. In national advertising, ITV regions were not substitutes for each other as an advertiser needed to cover the whole regional ITV Network to build a national TV campaign. So far as ITV competed in such cases, it was for national advertising with the national broadcasters. The macro regions of the national broadcasters such as Channel 4 or 5 had been devised to match groups of ITV regions: that had the effect of further ensuring substitutability between the national channels and ITV. The complementarity of ITV regions vis-à-vis each other was underlined by the habit of some national advertisers discussing with the three ITV sales houses how to achieve effective coordination of a national campaign—notably in the case of toys and children’s games.

5.38. A consequence of the complementarity of ITV regions was to make it meaningless to add together the UNM and Carlton shares of NAR when measuring the competitive effects of the merger. That was not only due to the nature of advertising within but also because the relevant economic market was not limited to TV advertising.

5.39. UNM considered that several factors made the degree of competition between ITV regions *de minimis*.

5.40. The standard concern about competition in merger cases, that the merged undertaking would reduce supply in an attempt to force up prices, did not apply. There was effectively no possibility of the number of advertising minutes per hour being varied due to ITC regulations, which also required the ITV licensees to clear the market i.e. sell all their minutes, even if that required prices to be lowered. The system of publishing monthly SAPs made the market transparent, enabling advertisers to compare their prices and to engage independent media auditor companies to check that they were receiving value for money. ITV had no self-interest in reducing the number of its viewers; to do that would cut total UK TV advertising revenue and the ITV share of it.

5.41. Second, the merger would have no effect on competition in the supply of advertising in London. The record showed that advertising business had been won and lost through competition between the Carlton and LWT sales houses.

5.42. Third, there was clear evidence that competition between ITV regions was strictly limited. There was not much tendency for regional or national advertisers to switch advertising expenditure from one region to another due to the diminishing marginal returns from increasing advertising expenditure in one region in response to rising prices in another and because regional and national advertisers had to advertise, to obtain sales, in all parts of the UK where they had a market. The main competition between broadcasters in advertising markets concerned the value for money of an advertising slot (ie the number and profile of viewers reached). In that respect, there was real competition between ITV and other national channels but that could be countered by improving the viewer appeal of ITV as a whole—not by ITV regions, which in any event had very similar network programme schedules, trying to compete for viewers between themselves.

5.43. UNM added that if there was a substantial degree of competition between ITV regions, then it would be expected that the share of ITV advertising expenditure accounted for by the three ITV sales houses would vary noticeably over time. But the record showed that the three ITV sales houses had a virtually unchanged share of ITV advertising revenue since the last major increase in concentration within ITV in 1994. Such shifts of expenditure between the sales houses as had occurred were very small.

5.44. UNM emphasized, however, that competition from other advertising media for ITV had been growing rapidly in recent years, reflecting the substantial increase in the number of ways of reaching consumers. That both stemmed from and reflected upon the growing number of independent media planners and buyers in the advertising market. Their concern was solely with the mix of media that best met their advertiser clients' objectives and as such they were impartial in recommending the advertising solutions.

5.45. While it was necessary to analyse relative price inflation between different advertising media over time, as advertisers were sensitive to such changes in prices and becoming increasingly so, the comparisons were not entirely straightforward. For example, absolute prices were generally not directly comparable between media as the audience of each was measured in different ways. The price of TV advertising tended to be more volatile than that of other media due to the supply of TV airtime being fixed by regulation whereas supply was either growing for other media, such as radio, or readily variable, such as page numbers for newspapers or magazines. In fact, Zenith Media data, based on 1980 and indexed at current prices, showed all TV as rising to 408 national newspapers to 257, national radio to 490, outdoor to 339 and cinema to 435, all by 1999.

5.46. A key market question was whether the merged undertaking would be able to raise advertising rates. In this connection, UNM did not consider that the issue of whether ITV constituted a separate market could be inferred by merely observing that ITV accounted for a significant proportion of TV advertising expenditure, as the fundamental question was whether a hypothetical monopoly supplier of ITV advertising space could increase prices significantly for a non-transitory period without this being rendered unprofitable by the decline in demand that would result as a consequence.

5.47. UNM noted that TV advertisers typically purchased a mixture of peak and off-peak day-parts covering the whole day, they focused on the CPT of reaching a target audience (who may be reached be very different genre programming), they typically purchased a mix of TV channels, and they showed the same advertisements on each channel purchased. Accordingly, whilst there were some differences in programme content between ITV and other channels, there was no evidence that the other channels were unattractive as a means of reaching the advertiser's desired target audience. Advertisers' main interest

was in achieving a significant number of advertising impacts across their target geographical area in relation to their target audience, rather than the actual programming their target audience is watching. ITV, Channel 4, Channel 5 and pay-TV all reach all socio-economic and demographic groups. Further support for this position is provided by the fact that MMS Monitor data for 1999 revealed that of ITV's top 100 advertisers, 82 of these are among the top 100 customers for Channel 4, 75 for Channel 5 and 73 for satellite.

5.48. Indeed, certain of the more genre-specific and specialized programming shown by pay-TV and (to a lesser extent) Channel 4 and Channel 5 was a source of competitive advantage for Channel 4, Channel 5 and pay-TV with regard to certain types of programming which made them more effective competitors against ITV at reaching specific target audiences (TV advertisers paid only for the specific target audience reached, and ITV was less effective in this regard as it was more of a 'mass audience' channel).

5.49. ITV was presented as having the unique property of enabling fast coverage building (ie the percentage of the target population reached within a week). However, in considering this perception it was important to emphasize three points.

5.50. First, given that ITV Network coverage must be purchased from a number of separate companies, the issue of substitutability should clearly be assessed with reference to advertisers switching away from ITV to a number of channels rather than to only one other channel (for example, only Channel 5). This was particularly the case given that the market definition test referred to above did not depend on customers switching to a single alternative, but a sufficient aggregate volume of business being lost as a result of a unilateral price increase. Nor did it depend on the switching leading to ITV having a zero market share as a result of the business lost, merely the loss of sufficient business to render the hypothetical price increase unprofitable.

5.51. Secondly, in practice TSMS estimated that at most 7 per cent of UK TV advertising related to advertisers who placed time-critical campaigns which needed to achieve high coverage in under a week (for example, new movie and record releases, retailer price promotions, and newspaper promotions). (High coverage levels might also be important for new brand launches, but such coverage tended not to be time critical as coverage needed to developed and sustained over weekly and four-weekly periods.)

5.52. Thirdly, ITV's property of delivering fast-build coverage had been very substantially eroded by the very substantial decline in its share of commercial viewing and advertising impacts. This trend would only continue as other channels increased their share of viewing at ITV's expense. Table 5.1 shows that for adults, ABC1 adults, 16–34 adults, housewives and men, ITV offered a universally poorer reach (ie the percentage of UK target audience reached) over a weekly and a four-weekly period than campaigns which focused on only other commercial channels excluding ITV. As regards daily reach, of the five main categories of target audience, only in relation to housewives was the reach of ITV materially greater than that of non-ITV channels. None of the main time-critical audiences, for example, new movie releases, newspaper promotions etc, were targeted at housewives.

TABLE 5.1 **Target audience reach: ITV vs other commercial channels**

per cent

	ITV			*Commercial channels ex ITV*		
	Average daily reach	*Average weekly reach*	*Four-weekly reach*	*Average daily reach*	*Average weekly reach*	*Four-weekly reach*
Adults	59.7	87.2	94.4	59.3	89.5	96.5
ABC1 adults	54.4	86.0	94.3	55.9	88.8	96.7
16–34 adults	49.8	81.8	92.0	54.9	86.5	95.6
Housewives	65.6	89.8	95.8	61.8	91.2	97.0
Men	55.7	85.7	93.5	59.8	89.2	96.5

Source: BARB/SPC 4 w/e 5/3/2000.

5.53. In addition, UNM also provided evidence showing that in relation to campaigns seeking a high weekly reach this could be achieved using combinations of other channels for a lower budget.

5.54. There were price differences between different channels (and indeed between individual ITV regions), but it was well recognized that absolute price differentials did not prove that goods were in a separate market. The general point was that two products A and B might provide different quality levels of the same product, and be in competition with each other at the margin, even though there was a price gap reflecting the quality gap. In the present context, there were differences in advertisers' perceptions of the quality of newer channels from ITV (for example, ITV's 'tried and tested status'), and accordingly certain newer channels building up audiences would be liable to sell at a lower price.

5.55. In addition, it was also important to emphasize that media auditors (such as Billetts) and other channels actively promoted the scope for advertisers to save money by diverting their budgets away from ITV to other channels—ie price differences were evidence of price competition. There was also clear evidence that the other TV channels priced with reference to ITV in an effort to win market share off ITV.

5.56. There was also a variety of other evidence that ITV faced significant competition from other channels:

(a) The long-term decline faced by the Channel 3 Network as a whole, coupled with the various competitive strengths of the other TV broadcasters, means that Channel 3's share of total UK TV advertising revenue was in long-standing decline. Over the last ten years, ITV's share of TV advertising expenditure had fallen from 95 per cent (including Channel 4 which was sold by Channel 3 prior to 1993) to its current levels of around 60 per cent. Its share was widely forecast by all independent industry reports to fall further. A key factor in ITV's decline and the corresponding growth of pay-TV had been the growth in the proportion of individuals in multichannel households. In 1994 when the 25 per cent NAR share undertakings were given, 20 per cent of individuals lived in multichannel households. By the end of 1999, penetration increased to 37.0 per cent. Further growth in the number of multichannel homes, where ITV's share of viewing was considerably lower, would lead to ITV's NAR share inexorably declining.

(b) Some of the largest TV advertisers had reduced their expenditure on ITV to an even greater extent than had been observed overall (overall ITV's share of total UK NAR had fallen from 70.1 per cent in 1995 to 60.7 per cent in 1999, a fall of 13.4 per cent). For example, the proportion of the TV advertising budget allocated to ITV by Procter & Gamble had fallen from 78.25 per cent in 1995 to 58.59 per cent in 1999 (a fall of 25 per cent); ITV accounted for 82.19 per cent of Mars' TV budget in 1995 but only 58.99 per cent in 1999 (a fall of 28 per cent).

(c) There was considerable variation in the proportion of TV advertising budgets allocated to ITV between advertisers. For example, in 1999 the five largest UK car advertisers spent between 42.52 per cent and 61.87 per cent of their TV advertising budgets on ITV. UNM considered that this provided some measure of the ability of advertisers, and the media buyers and advertising agencies which represented them, to reduce the proportion of their TV budgets allocated to ITV.

5.57. There was also evidence that ITV faced competition both nationally (ie advertisers down-weighting ITV as a whole and switching to other channels nationally) and regionally from the macro regions of Channel 4 and Channel 5. The Channel 4 and Channel 5 macro regions had, in general terms, been constructed to match those of the ITV sales houses, with separate coverage of London and Scotland also being possible under both the Channel 4 and Channel 5 macros as well as with ITV. This configuration of Channel 4 and Channel 5 macros further facilitated substitutability between ITV and the national channels. Some advertisers/media buyers suggested to us that instead of using one of the three ITV sales houses, a Channel 4/Channel 5 macro could be used, thereby ensuring national coverage.

5.58. That depended on the price elasticity of advertising demand. UNM noted that there was significant evidence with regard to the price sensitivity of demand for TV advertising:

(a) Professor David Hendry (1992), a noted econometrician, found that the demand for TV advertising was significantly price-sensitive, with an own price elasticity of demand of around –2. This result has also been confirmed by updated research by WPP's Mindshare subsidiary (May 1999). A 1999 Billetts report reached inconclusive conclusions as to the level of price elasticity of demand for TV advertising which, depending on the model adopted, ranged from –1 to –6.

(b) A structured survey of MindShare buyers, planners and clients, designed to uncover the price sensitivity included in various decision scenarios (ie the proportion of media budgets which should be allocated to TV etc on the basis of different relative prices), found degrees of price-sensitivity very similar to those suggested by the econometric models. MindShare emphasized that they found the degree of consistency encouraging, because survey method tended to under-estimate price-sensitivity (because marginal players were difficult to capture in such surveys but could have a disproportionately great influence on the market). UNM noted that demand elasticity and market definition was driven by marginal consumers, but since, by definition, these represented only a small fraction of all consumers, surveys, reporting as they did average opinion, inevitably overstated market power. Indeed, the view of all but the marginal consumers were irrelevant to market definition. Accordingly, if a survey, with its inherent bias towards narrowing the market confirmed an econometric elasticity study, this was strong evidence that the market was wider.

(c) The results of the CC's survey (not seen by UNM).

(d) MindShare, which found that the variability in real price inflation for TV had tended to fall over the course of the economic cycle, suggesting that buyers were better able to accommodate sudden changes in advertiser demand either within the TV market place or elsewhere (ie advertising demand had become more price-sensitive such that it would switch between channels or to other media in response to price increases).

5.59. Further evidence that the demand for TV advertising was price elastic was provided by various steps taken by ITV to increase supply. This was because increasing advertising supply was a profitable strategy only if demand were price-sensitive, so that the resulting fall in prices increased revenue and profits because price reductions increased ITV's revenue and profitability. In particular, ITV had:

(a) ensured that the maximum amount of TV airtime minutes permitted by ITC regulations was carried at times of peak viewing on the ITV Network so as to maximize supply; and

(b) through scheduling changes, sought to increase viewing and commercial audiences (for example, by rescheduling *News at Ten*, ITV had been able to show movies and other attractive programming so as to attract viewers and therefore advertising revenues).

5.60. Professor Hendry had made similar points with regard to the introduction of TV advertising on TV-am, and observed that it was implausible that advertisers would response to a supply increase by reducing TV budgets.

5.61. We asked UNM about the use of share deals, ie contracts, usually annual, in which an ITV sales house such as TSMS received guarantees from the customer that a minimum percentage share of his TV advertising budget would be spent on buying airtime from that sales house. Many such contracts also required the advertiser to commit a minimum share of his budget to buying from ITV as a whole. In return, the advertiser received discounts from the sales houses and their customers.

5.62. UNM explained that ITV advertising sales houses sold their advertising in a wide variety of different ways which included: deals based on the sales house's share of ITV and/or share of London ITV (in the case of the Carlton and LWT London ITV franchises); deals based on the individual sales house's share of broadcast; deals based on both individual sale house's share of ITV and its share of broadcast; deals based on both the individual sale house's share of ITV and ITV's share of broadcast; 'volume' deals (based on a minimum sum of money) with individual sales houses; and miscellaneous small deals (many of which related to advertisers buying only certain regions and spot advertising).

5.63. Within the above broad categorizations, there was also considerable variation in the nature of the deals entered into (such as with regard to the exact share of ITV and broadcast, and the extent to which these commitments were scaled down in the light of changes in ITV's share of advertising impacts). The majority of such deals were for a period of one to three years.

5.64. Outside these deals, a very small part of ITV advertising was sold on the basis of 'specials' which typically related to sporting events for which advertising was sold on a spot basis. This reflected

the fact that all deals were based on discounts off the SAP, and these events tended to have atypical audience profiles and advertiser demand such that average prices were not an appropriate benchmark. In this regard, UNM noted that such specials accounted for only 3 per cent of TSMS's NAR revenue.

5.65. There were three possible categories of share deals (which UNM referred to as 'share deals' below so as to distinguish them from volume deals and spot sales):

(a) The first was a 'share of ITV' deal in which the advertiser only committed to spend a proportion of its TV budget with one sales house, which could also include a London share of ITV in relation to Carlton's and LWT's London franchises (a share of ITV deal).

(b) The second category was a deal in which the advertiser committed to spend a minimum proportion of its broadcast budget on ITV as well as a proportion of its ITV expenditure with the sales house (an 'ITV share of broadcast' deal). This had the effect of providing that the sales house had a minimum share of the advertiser's broadcast expenditure for the duration of the contract, as well as ensuring that ITV as a whole had a minimum share of the advertiser's broadcast expenditure (which benefited all ITV sales houses rather than merely the sales house in question).

(c) The third was a 'share of broadcast' deal in which the advertiser committed to spend a minimum proportion of its broadcast budget with the sales house in question (a broadcast deal).

5.66. UNM pointed out that the exact details of the deals were, of course, confidential to the media buyers. (Such confidentiality was an economy-wide phenomenon. For example, Sainsbury did not receive detailed information on the prices offered to Tesco from its branded good suppliers.) However, it was important to emphasize that media buyers represented a large number of advertisers and commonly negotiated 'umbrella deals' for a large number of their clients. Media auditors also had detailed information on the deals negotiated by their clients. Accordingly, the market remained highly transparent, subject to the preservation of advertiser confidentiality.

5.67. It was also clearly important to consider the context in which deals were negotiated. In the majority of cases, advertisers agreed with media buyers the main objectives of their campaigns in terms of the likely TV advertising weight required, their regional requirements, the target audience etc. The media agencies had sophisticated planning tools to achieve these objectives (for example, computer models) in order to determine the optimum allocation of funds to achieve the broad advertising objectives. Once this process was completed, advertising deals were then negotiated broadly simultaneously with the TV channels.

5.68. Whilst negotiation occurred between the channels for higher share of TV advertising budgets, UNM considered that advertisers' regional requirements were largely predetermined (reflecting the geographical distribution of the advertiser's brands, and the regional strengths and weaknesses of these brands etc) and therefore that expenditure within ITV regional (which may be spent on Channel 4 and Channel 5 macros, rather than with ITV sales houses) was also largely predetermined. It was within this context that advertising deals were negotiated.

5.69. Having outlined the main elements of advertising share deals, UNM then discussed their commercial purpose and rationale as well as their effects on competition.

Commercial purpose and rationale

Advertiser flexibility

5.70. UNM considered that the first important benefit of share deals as a whole was the flexibility they provided advertisers compared with inflexible volume deals and short-term spot deals which were generally commercially unattractive to advertisers and media buyers.

5.71. The flexibility provided to advertisers within the term of the contract varied between different types of share deals, with different advertisers making very different commitments reflecting their requirements. At one extreme, share deals based on the sales house's share of ITV alone provided the

greatest flexibility to advertisers because, even during the period of the contract, advertisers were fully able to vary their expenditure on ITV by allocating more expenditure to other channels (for example, in response to changes in ITV's advertising impacts supply due to changes in viewing) as well as varying their total TV expenditure.

5.72. Within the terms of the contract, broadcast deals still permitted advertisers to vary their expenditure on TV vis-à-vis other media, and still permitted advertisers to spend less on ITV as a whole by diverting expenditure outside the regions sold by the sales house in question to the macro regions of Channel 5 and Channel 4.

5.73. UNM acknowledged that an ITV share of broadcast deal was less flexible during the term of the contract, because it had the effect of providing that the sales house had a minimum share of the advertiser's broadcast expenditure for the duration of the contract, as well as ensuring that ITV as a whole had a minimum share of the advertiser's broadcast expenditure (which benefited all ITV sales houses rather than merely the sales house in question). However, this type of deal still permitted the advertiser to vary its overall TV advertising expenditure and to divert expenditure to other media or reduce overall expenditure during the period of the contract.

5.74. UNM considered that the only alternative contract to share deals (ie apart from short-term spot deals) were volume deals which committed advertisers to spend a predetermined minimum sum of money on the stations in question. These were clearly less flexible than any share deal, as the advertiser could not divert the sums specified to other media or reduce overall advertising expenditure with the sales house for the period of the contract.

5.75. Notwithstanding the differences between different types of share deals and volume deals, all such deals permitted advertisers to vary expenditure during the course of the year, taking into account, inter alia, expected changes in the overall supply and demand balance. For example, in relation to the World Cup in June 1998, it was widely forecast that ITV prices might be up to 20 per cent higher in June due to a combination of strong demand and lower audiences in relation to certain socio-economic/demographic profiles. This expectation had led to advertising switches such that inflation was higher in May and there was no inflation in June.

5.76. UNM noted that the only alternative to advertising share-based deals and relatively inflexible volume deals was short-term spot deals. However, replacing share deals with a series of short-term spot deals would involve considerably greater administrative costs for media buyers (who would pass these costs on to advertisers), as they would need to renegotiate their spot deals frequently and would be uncertain as to whether their ongoing requirements would be met.

5.77. UNM pointed out that no particular deal type was being imposed by the ITV sales houses, as was reflected by the wide variety of different deals entered into with different advertisers and media buyers. UNM submitted that the mix of contracts it offered reflected advertisers' and media buyers' preferences.

- *The benefits of a degree of certainty of income provided by share deals*

5.78. UNM argued that, by virtue of the flexibility afforded by advertising share deals to advertisers, such deals did not guarantee that a sales house would have a specific income over the period of the contract, although they did reduce the degree of uncertainty as to income that would prevail compared with the situation if a high proportion of advertising were to be sold on a spot basis. A volume deal provided the greatest certainty, followed by share of broadcast deals and ITV broadcast deals, with a share of ITV deal providing the least certainty. UNM did not accept that ITV share deals would not serve a competitive purpose unless there were competition within ITV, because UNM considered that such deals provided a greater degree of security of income which would not otherwise exist, largely due to variations in advertisers' regional requirements within the period of the contract rather than price substitution.

5.79. UNM noted that a degree of certainty of income was necessary for broadcasters, because they needed to fund programming and other costs which did not change with NAR. Greater income instability would impede ITV's ability to compete in programming and therefore viewing markets, which would in turn reduce the value of advertising on ITV.

5.80. In addition, advertising share deals and volume deals (as opposed to short-term spot sales) permitted broadcasters to engage in forward planning which was necessary for 'optimization', ie allocating advertising campaigns to those programmes which delivered the greatest proportion of the target audience (thereby minimizing wastage and effectively maximizing advertising supply). This enabled broadcasters to offer the lowest possible prices. This was a profitable strategy as it enabled broadcasters to compete effectively for NAR share with other broadcasters, and promoted the competitiveness of TV against other media. If there were to be a substantial increase in spot sales on ITV, optimization would be very difficult to achieve, with the result that advertising prices would rise.

5.81. UNM considered that it was most likely that smaller advertisers would suffer disproportionately from any artificial limitation on share deals as they would be less able to commit to spend a given sum of money under volume deals, and as a result small advertisers would face higher prices. It might also be harder for media buyers to negotiate collectively on behalf of smaller advertisers (with such 'umbrella' deals being an important feature of the market at present) as they could make no statements as to their aggregate advertising placement over time.

5.82. UNM stated that without advertising share deals and volume deals, ITV would be less able to develop and fund programming, and therefore to compete for viewers (with viewing determining the value of ITV's advertising airtime) with other channels and activities, and small advertisers would suffer disproportionately. This would have adverse effects on viewing and advertising markets. The appeal of advertising on ITV would also be reduced as media buyers would be forced to enter into either inflexible volume deals or uncertain spot deals, which would restrict and distort ITV's ability to compete in advertising markets and therefore programming and viewing markets.

5.83. UNM considered that advertisers shared in the benefits outlined above both directly, by virtue of the discounts they received and the considerable flexibility they retained (as to the level of their expenditure and its timing), and indirectly by supporting ITV in competing for programming and viewers.

5.84. It was also clear that share of broadcast deals were also a feature of airtime trading by other channels, reflecting similar considerations for other broadcasters and advertisers.

5.85. Finally, UNM considered that any concerns as to advertising share deals should be considered in the context of ITV sales houses' partnerships with advertisers and media buyers. If ITV delivered good value for money and effective campaigns, then advertisers would continue to invest in ITV. If this were not delivered, then advertisers would very quickly switch to alternative channels and media. It was against this background that any suggestion that advertisers or media buyers would tolerate the imposition of undesirable share deals which did not serve their interests needed to be assessed.

5.86. The other media competing with ITV were many in number. They included, of course, the competing national TV channels such as Channel 4 or 5, BSkyB and other non-BSkyB channels. New competing media growing rapidly included Internet portal advertising and advertising opportunities offered by new media/distribution platforms such as DSL technologies and mobile Internet services. No doubt different advertisers would allocate advertising budgets differently to optimize sales. But overall, the effect of these competing media source was to contain materially ITV's ability to raise advertising prices.

5.87. The development of the new media, in particular, with new platforms for TV and other video services, would help to accelerate the decline in ITV's share of TV advertising revenue. We asked whether, as regards the growth of the Internet as an advertising medium, rapid growth, from a low base, would cut into ITV's share of NAR that much, in view of the forecast by Fletcher Research that advertising on the Internet by 2005 would largely be at the expense of direct mail and press advertising: UNM thought that the forecast, like all in this area, was very uncertain but that nobody could be sure the effect on advertising on ITV would be limited.

5.88. But not only were high rates of growth being achieved by the new media. The decline in the price of Internet usage charges, which continued as unmetered telephone charges became more prevalent would certainly give a further large boost to Internet usage. In addition, the new media would impinge on ITV in more than one way—whether as a supplier of a competing advertising platform or as a contestant for viewers' attention. In addition, advertised demand was increasingly directed to audience groups that

TV was less efficient at capturing (such as up-market, male and youth audiences). These would progressively gravitate further to digital satellite and cable TV—leaving ITV increasingly dependent on older and more down-market groups of least interest to advertisers.

5.89. Certainly the merger would not give rise to any competition issues if assessed in the context of all advertising or all display advertising. The UNM/Carlton share of all advertising was only 13 per cent and all TV made up only a third of all advertising.

5.90. UNM went on to argue that ITV faced intense competition from competing broadcasters.

5.91. The main source of competition for the ITV regions in the advertising market was at the national level. ITV was facing strong competition for national advertisers' TV budgets from competing broadcasters such as Channels 4 and 5 and BSkyB at both national level and that of the macro regions of Channel 4 and 5; for example, MMS/TSMS estimated that some 47 per cent of Channel 4's 1999 revenue came from airtime which was not transmitted across its whole network.

5.92. UNM noted the following key points as evidence of increased competition faced by ITV:

(a) Media auditors (such as Billetts) and other channels actively promoted the scope for advertisers to save money by diverting their budgets away from ITV to other channels, ie price differences were evidence of price competition. There was also clear evidence that the other TV channels priced with reference to ITV in an effort to win market share off ITV.

(b) Certain of the more genre-specific and specialized programming shown by pay-TV and (to a lesser extent) Channel 5 and Channel 4 was a source of competitive advantage for Channel 4, Channel 5 and pay-TV with regard to certain types of programming which made them *more* effective competitors against ITV at reaching specific target audiences (TV advertisers paid only for the specific target audience reached, and ITV was less effective in this regard as it was more of a 'mass audience' channel).

(c) ITV's property of delivering fast-build coverage had been very substantially eroded by the very substantial decline in its share of commercial viewing and advertising impacts. Accordingly, even in relation to campaigns seeking fast coverage building (ie the percentage of the target population reached within a week), this could be achieved by advertisers increasing their usage of other commercial channels which collectively offered comparable or superior reach and coverage (depending on target audience profile).

5.93. The growth of competition could be seen clearly from the statistics of NAR share won by ITV. Over the last ten years, the ITV share had fallen from 95 per cent (including Channel 4, which was sold by ITV up until 1993) to about 60 per cent in 1999. Nobody was in any doubt that the ITV share would fall further. Zenith Media, whose forecasts were the most widely used, estimated ITV share at some 54 per cent for 2005. Industry forecasts were rather lower and ITV's likely NAR share in 2005 seemed likely to be no more than around 47 per cent. The corollary of ITV's falling NAR share was the rise in its competitors' shares—for example, according to Zenith Media, over the 1999 to 2005 period, from 12 to about 18 per cent for multichannel (satellite and cable) and from 6 to 9 per cent for Channel 5 despite its beginning to broadcast only in 1997.

5.94. A striking feature of the recent evolution of the TV advertising market was the fact that some of the largest advertisers had reduced their expenditure on ITV more sharply than the overall reduction. For example, the proportion of its TV advertising budget spent on ITV by Procter & Gamble had fallen from 78.25 per cent in 1995 to 58.59 per cent in 1999; for Mars, the comparable percentages over the same period were 82.2 and 59. There were also substantial variations in the proportion of TV advertising budgets allocated to ITV by advertisers—between 45.5 and 61.9 per cent in 1999 for the five largest UK car advertisers. These examples illustrated the ability of advertisers and the agencies advising them to reduce the shares of their advertising budgets spent on ITV and as such were a further measure of the growing vulnerability of ITV.

5.95. We put it to UNM that as ITV's share of advertising revenue had fallen more slowly than its audience share, ITV's relative position was less serious than the share statistics appeared to demonstrate. UNM did not believe that was the case. There were a number of essentially temporary reasons for such disparity in the recent and foreseeable trends. One was the fact that a number of new channels were in

the process of establishing themselves in the advertising market. When they had achieved that, their market shares would grow rapidly—Channel 5 and cable being such examples. Another temporary factor was that TV advertising demand was at present being boosted by the rapid growth of 'dot.com' or high-technology businesses. But the dot.com bubble would not continue to swell. In addition, the ITV share of the TV advertising budgets of the five main growth categories of TV advertising was below ITV's overall share of 60 per cent.

5.96. Among the factors listed as contributing to ITV's relative decline, a key one was the growth in the proportion of individuals in multichannel households, from 20 per cent in 1994 to 37 per cent in 1999. The continuing increase in the number of multichannel homes, a prime characteristic of which was that ITV's share of viewing was much lower than the average, would lead to ITV's NAR share eventually declining.

5.97. UNM argued that, since the ongoing decline in ITV viewing had a major adverse effect on its share of NAR, it was essential to consider the factors influencing the supply of viewers to ITV in assessing why ITV's share of NAR was falling. In particular UNM emphasized that, given that the total minutage which could be allocated to advertising on a channel was regulated at a fixed amount by the ITC, advertising-funded channels maximized the supply of advertising capacity by delivering as many viewers as they could to a fixed number of advertising minutes (TV advertising was priced on the basis of the number of thousand target viewers reached). Therefore these channels needed to attract as many viewers as they could to watch them—which they aimed to achieve through the quality and appeal of the TV programmes they offered. In this context, an increase in commercial viewing (particularly ITV viewing as it yielded the highest ratio of advertiser impacts per viewer) would therefore lead to an increase in the supply of advertising which would result in a reduction in the price of advertising, a result which was in the best interests of both advertisers and viewers.

5.98. Due to competitive and market developments both within and outside TV, ITV had suffered a dramatic loss of viewership over the past ten years which had reduced its share of net TV advertising revenue. Current market developments were likely to accelerate this trend. In UNM's view, the principal factors which would ensure continued loss of viewership were:

(a) *Continued and increasing penetration of UK households by pay-TV*, with growth being fuelled by the introduction of digitalTV. As at January 2000, ITV's overall share of viewing was 30.2 per cent, but its share in terrestrial homes was 34.5 per cent whilst its share in digital satellite homes was 21.4 per cent. (In addition, and quite apart from how free-to-air programming affected pay-TV take-up, if ITV and other free-to-air channels did not compete against pay-TV channels, their share of viewing would not be materially affected by the presence of pay-TV channels in pay-TV homes.)

(b) *A reduction in viewership of those channels which were most effective at delivering advertising supply* (ie free-to-air channels' share of commercial impacts per viewer were materially higher than was the case for pay-TV, with ITV delivering the highest ratio of advertising impacts per viewer).

(c) A 'vicious circle' effect whereby growth in multichannel penetration enhanced total pay-TV which bid up programming and talent costs which in turn attracted more homes to pay-TV. In this regard, the valuable subscription income available to pay-TV operators and the substantial increase in licence fee income recently awarded to the BBC were leading to ITV's share of broadcast income (including advertising, subscription, and the BBC's licence fee income) falling sharply. ITV's share of broadcast income had fallen from 39.4 per cent in 1994 to 30.4 per cent in 1999, and its share was forecast by TSMS/Paradigm to fall to 23.1 per cent by 2004. These forecasts took no account of the development of new distribution platforms such as ADSL or other competitive threats posed by new technology.

(d) *The development of non-TV substitutes for viewers* such as the Internet and video games, the use of TV sets for applications other than conventional TV viewing, and video recorder developments which permitted viewers not to watch advertisements.

5.99. For the above and other reasons, there was no doubt that while the merger would improve the merged company's ability to respond to the many challenges facing ITV, that company's market position would continue to erode under the pressure of competition. By 2001, for example, the merged company's

share of TV NAR would have fallen to [✄] per cent in 2001 from 35.4 per cent in 1999: it would be [✄] per cent by 2005.

Buyer power

5.100. UNM submitted that an important development in the market during recent years was the substantial increase in buying power. Media planning and buying agencies had been divested from the larger full service advertising agencies or set up from new. The media agencies were professional planners and buyers whose job was to focus solely on the media aspects of advertising campaigns and to secure the best possible deals for their clients. As such, the media agencies had to advise on what media were most suited to deliver the clients' advertising and marketing objectives with maximum cost effectiveness and to be ready to guide the advertiser clients to switch their expenditure between different media accordingly. The media planning and buying agencies' work on behalf of clients was also facilitated by that of media auditors; their role was to audit the services provided by different media by reference to their efficiency in meeting advertisers' objectives. A good media auditor provided the media agencies and their clients with additional tools to choose the media which provided the most cost-effective delivery of desired target audiences.

5.101. The media agencies provided advertisers with more than planning and buying expertise. The agencies were also increasing the power they brought to their clients as buyers, by virtue of the growing concentration among the agencies. For example, the ten leading media agency groups accounted for 82 per cent of UK TV buying in 1999, while at the individual agency level the top ten buying points purchased 65 per cent of TV advertising. It was also important to realize that the leading UK media buyers were usually large international organizations, which increased the influence and expertise they bought to bear on their work for advertisers.

5.102. We put it to UNM that, while the development of large media agencies might indeed be helpful to their advertiser clients where these also were substantial organizations which bought large amounts of advertising, it was less likely to make any material difference to the deals secured by smaller advertisers. UNM did not consider that to be the case. The larger media agencies were also able to negotiate agency deals, a kind of bulk buying arrangement whereby the agency contracted to take TV airtime up to a guaranteed amount for, say, a year at specified and generally favourable rates. The agency was then able to make that airtime available to its advertiser clients, who would often include small or medium-sized advertisers unable, by virtue of their size, to secure equally favourable rates as individual customers of the TV sales houses. As an extreme example of buyer power, UNM noted that the media buyer Carat (which is the largest buying point) had recently decided to take all their clients' advertising off Channel 5 in 2000.

Procurement and scheduling of programmes by ITV

5.103. UNM considered that the merger would not give rise to competition concerns in relation to the production and procurement of programmes, despite the merged company's aim of increasing its share of UK TV programming above the 15 per cent aggregate of UNM and Carlton Sales. The aggregate was about the same as the programme sales by Pearson, the largest independent producer, and dwarfed by the sales of Granada and the BBC, the largest UK producers by far.

5.104. UNM noted that Granada was the leading supplier of key programming to the ITV Network Centre as was reflected by its very high market share in relation to the supply of programmes transmitted during peak viewing times (19.00 to 22.30) in 1999. (This excluded the following categories of programming which were not supplied by UK programme producers for the ITV Network Centre: sport; acquired programming (for example, movies whose programming was not originally commissioned, such as US imports; regional/local programming) and news.) UNM provided Table 5.2 which showed the proportion of original programming supplied to the ITV Network Centre in 1999 by various producers, by reference to the share of peak hours and the audience that they accounted for. The table indicated that Granada accounted for 57.4 per cent of peak time programming supplied to the ITV Network Centre by hours and 62.1 per cent by audience. Audience shares were a better measure of the value of programmes to advertisers and therefore the ITV Network Centre.

TABLE 5.2 **Producers' shares of original commissioned programming supplied to the ITV Network Centre at peak times, 1999**

per cent

Group	*Peak hours*	*Weighted audience*
Carlton	12.2	10.3
Granada	57.4	62.1
Independent	22.9	21.6
Scottish	1.2	1.1
United	6.3	4.9
Total	100.0	100.0

Source: BARB/RA; Paradigm.

Notes:

1. Share of peak hours calculated by reference to programme duration during peak times multiplied by the number of weeks the programming was shown.
2. Share of weighted audience calculated by reference to average audience multiplied by the number of peak hours that the programme was shown.

5.105. The above analysis showed that Granada-owned companies constituted the largest share of hours and an even greater proportion of ITV's network audience delivery. Granada's market share by audience was nearly five times that of the next largest competitor (Carlton), and six times that of the next largest competitor (Carlton) by viewing share.

5.106. UNM proposed that an alternative way of considering the relative competitive strengths of various producers was to identify those programmes which contributed most to ITV's peak-time performance in 1999 and to indicate the producers which were responsible for such programming. On average, in 1999 ITV peak-time programming generated an average audience of 8.859 million, and those programmes which achieved a greater volume than this average could be classified as the 'share drivers'. UNM provided Table 5.3 which showed that Granada's share of hours and weighted audience were even higher for the top peak programmes than for all programmes—further demonstrating Granada's competitive strength vis-à-vis its smaller rivals and the dependence of the ITV Network Centre on Granada as a source of key programming. *Coronation Street*, which consistently attracted mass audiences, had a major influence on this result, but there were over 30 other Granada programme titles in this top category. Carlton, on the other hand, had only nine programmes, Scottish one and UNM two. There were 11 directly commissioned programmes from independent producers.

TABLE 5.3 **Producers' shares of original commissioned programming supplied to the ITV Network Centre which attracted above-average audiences at peak times, 1999**

per cent

Group	*Peak hours*	*Weighted audience*
Carlton	8.8	7.4
Granada	63.1	67.8
Independent	25.9	22.9
Scottish	0.3	0.2
UNM	1.9	1.7
Total	100.0	100.0

Source: BARB/RA; Paradigm.

5.107. UNM noted that it was important to appreciate that Granada's high share of programme supply and the ITV Network Centre's dependence on Granada for key peak-time programming were long-standing phenomena.

5.108. In addition, Granada's position as the largest supplier of original programming to the ITV Network Centre gave Granada a number of competitive advantages:

(a) greater security of income as the main provider of key mass audience programming. This more stable revenue stream reduced the risks that its business faced;

(b) Granada's size as a producer made it less dependent on a few key programmes; and

(c) Granada's size would also enable it to achieve various economies of scale in terms of the costs of producing programming.

5.109. UNM considered that these factors strengthened Granada's competitive position vis-à-vis its smaller rivals, and gave it a very strong negotiating position with the ITV Network Centre. Granada had a clear incentive to exploit its competitive strength as its contribution to the ITV Network Centre's budget was considerably smaller than the revenue received by its programming business. UNM noted that the Granada, Yorkshire and LWT franchises (all owned by Granada) were the only net sellers of programming to the ITV Network, with net revenue of £82,180,981 in 1999. This meant that Granada could increase its total broadcasting and programming group revenue considerably by increasing the price that it charged the ITV Network Centre for its programming, because its programming business would derive 100 per cent of the revenue from higher-priced Granada programming but its contribution to the ITV Network Centre budget was considerably smaller, at slightly higher than Granada's share of ITV NAR of approximately one-third.[1]

5.110. UNM indicated that it believed Granada had exploited its position of dominance with regard to the supply of programming to the ITV Network Centre by charging prices to the ITV Network Centre which were excessive in relation to Granada's costs. UNM did not have full information on the profitability of Granada's production businesses relating to the supply of programming to the ITV Network Centre, but the analysis based on its data and independent brokers' data indicated that Granada's production business, which was associated with its Granada franchise, had consistently achieved profits which were many times in excess of those achieved by Carlton and UNM.

5.111. In addition to the evidence on profitability set out above, which in UNM's view strongly suggested that Granada's production business prices were excessive in relation to its costs, there was also direct evidence that Granada's prices to ITV were excessive. In considering this issue it was not meaningful to compare the absolute level of prices of different programmes supplied by various producers because, even within genres, there were significant differences in costs. An alternative approach to considering the issue of whether prices were excessive was to consider trends in prices to the ITV Network Centre both overall and in relation to specific genres, because there are no cost reasons for different producers' programmes to exhibit different price trends. A consideration of prices trends revealed the following:

(a) Between 1997 and 1999 Granada had achieved overall increases in price per hour of 6.0 per cent a year compared with 1.2 per cent a year for all ITV-commissioned programming (excluding sport, bought-in programming and regional programming). Equivalent figures for UNM and Carlton had been 8.1 and 1.0 per cent a year respectively.

(b) In five out of the seven genre categories of commissioned programming, Granada had achieved increases in price per hour above the average for the whole network. UNM and Carlton had achieved above-average price increases in relation to only three categories and two categories respectively.

(c) Granada achieved increases in price per hour in the two most important programme categories by value, namely drama and entertainment. (In this regard, it should be noted that Granada accounted for over 50 per cent of all network commissioned drama hours and over 60 per cent of entertainment hours.) With the exception of drama at UNM, this had not been the case for either Carlton or UNM.

5.112. Again, this was strongly suggestive that the price increases secured by Granada were not attributable to cost increases but to the exercise of market power.

5.113. We asked UNM whether the merged company's aim of investing its programme market share might cause friction within the ITV Network Centre with Granada. UNM considered that that would not be the case. The merged company's share of around 23 per cent of Network Centre programme commissions contrasted with Granada's 47 per cent and there was no reason to expect that pattern to change drastically in the short run. There were two particular considerations to bear in mind.

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[1]All the other ITV licensees derived less in programming revenue than their contributions to the ITV programme budget (calculated on the basis of NAR share), with UNM's deficit being £71,347,039 in 1999.

5.114. First, ITV was critically dependent on its programme schedule being attractive to viewers so as to maintain (and if possible increase) the ITV share of TV audiences. That was crucial in gaining advertising revenue, having regard to the fact that for UNM the ratio of revenue from advertising to that from production was about 8 or 9:1.

5.115. Second, the ITV Networking Arrangements gave independence to the Executive of the Network Centre in programme commissioning decisions: those decisions had to be made, under the Networking Arrangements, by reference to grading, relevance and cost. The merger would not materially affect the Executive's independence, the results of which could be seen in the fact that independent programme makers were presently securing around 30 per cent of Network Centre commissions as compared with the quota of 25 per cent of commissions for qualifying programmes reserved for independents under the Broadcasting Act 1990. Barriers to entry into programme productions were low, with some 1,200 independents in the UK: the real access provided by the 25 per cent quota was expanding as some major producers like Pearson were ceasing to qualify as independent producers for quota purposes.

5.116. In addition, the Networking Arrangements and the commissioning of programmes were subject to rigorous regulation and monitoring by the ITC which, for example, received detailed monthly reports on programme commissioning from the Network Centre and had the power to intervene if it were not satisfied that the Networking Arrangements were being properly implemented.

5.117. UNM emphasized, furthermore, that although the immediate interests of the major ITV companies might appear to differ, there was a very large core of common interest by virtue of their mutual dependence on the success of the ITV Network. That had the effect that ITV Network decisions were in practice made by consensus and not by formal vote. It would, in theory, have been possible for any two of three majors to have acted in concert to secure the necessary voting majority to obtain material influence over the ITV Network. But that had not happened and the consensus worked well enough, if slowly on major issues: for example, the smaller broadcasters were able to express their views and compromises were made by the majors to secure their support.

5.118. UNM accepted, however, that the merger could have the effect of bringing the merged company up to the level of 60 per cent of WQR which governed the major decisions (such as on fixing the budget or making appointments to the Executive) in the Network Centre. UNM was, therefore, very ready to consider arrangements to remove that apparent power to push through such decisions in the face of widespread opposition from other ITV members, if that step were necessary to respond to a genuine concern that the merged company would be able to change ITV policies merely to further its interests. Such a safeguard could be found by increasing the share of WQR needed to secure a formal majority to, say, 65 per cent. Another method would be an undertaking by the merged company not to exercise some part of the voting power attaching to its share of WQR for the purpose of decisions on Network Supply Contract matters.

Regulatory barriers

5.119. UNM acknowledged that the merger would have the consequence that a number of prohibitions contained in the Broadcasting Act 1990, as amended, would be infringed. The merged company would take all necessary steps to ensure that it came into compliance with the Broadcasting Act. The matters on which action would have to be taken to comply included the following:

(a) bringing the combined audience share of the merged company down to the 15 per cent limit. The merged company would have had an audience share of about 14.8 per cent but for Carlton's exercising pre-emption rights to increase its voting stake in GMTV beyond 20 per cent and UNM's exercising pre-emption rights in Channel 5 to take its voting rights to beyond 20 per cent, with the result that half (0.8 per cent) of GMTV's audience share and half (2.8 per cent) of Channel 5's share would be attributed to Carlton and UNM respectively. Appropriate divestments would be made as necessary;

(b) bringing the combined shareholding of UNM and Carlton (20 per cent each) down to the 20 per cent maximum holding in ITN, through a sale of one or other holding; and

(c) if it were deemed that the merger would have the result of the new company holding more than three multiplex licences (on which counsel's opinion submitted by UNM and Carlton to the ITC was that the merged company would not) then it was the hope of UNM that the ITC would support an approach to the Secretary of State to seek amendment through secondary legislation to modify the definition of holding in a multiplex so as to avoid any conflict with the over three holdings rule.

5.120. UNM recognized that the ITC would have to conduct a public interest test under the Broadcasting Act in respect of cross-media holdings, given that newspaper and other publications were produced by UNM, for example, *The Express* and *Sunday Express*. We put it to UNM that a competing newspaper group had expressed concern that its freedom to carry out advertising campaigns on ITV would be jeopardized by the merger, in the event of advance information about such campaigns becoming available to Express Newspapers. UNM did not believe that that was any more of a danger after a merger than it was at present. UNM had given an undertaking to a competing newspaper group in the past with respect to UNM's broadcasting activities and would be ready to repeat such undertakings if necessary. The ITC would also be able to monitor the merged company's licensees to ensure that they did not abuse their licences in that way. On 1 June 2000, the ITC held that the UNM/Carlton merger satisfied the public interest test under the Broadcasting Act.

The effects of the merger

5.121. It was UNM's view that the merger would be pro-competitive and thus in the public interest. One reason for ITV's competitive disadvantage was its inherent weakness stemming from its fragmentation: the merger would help to remedy this weakness and bring a number of additional benefits.

5.122. ITV's competitors were unified platforms which could frame and implement their strategies without having to obtain agreement between half a dozen companies. ITV, although usually able to reach consensus, had suffered the difficulty it had in reaching decisions on matters such as the development of ITV2 or Internet strategy. The reduction from three to two major companies in ITV would make it easier and quicker to reach consensus and help to offset these competitive disadvantages.

5.123. The merger would also benefit ITV's key programming activity. The synergies and benefits—amounting to some £40 million a year—from unifying the UNM and Carlton businesses would, for example, mean that extra resources should become available for the programme production business and thus help to strengthen the merged company's capacity to supply high-quality programming to the ITV Network. That could only be of benefit to ITV and to advertisers in providing more effective means of securing audiences.

5.124. The merger would also make the new company a more competitive force in non-UK markets. By achieving increased efficiency in programming and sales, it would make the company a strong player in key export markets, particularly the USA. The combination of the US offices of ITEL (a joint venture between UNM and Time Warner) and Carlton would bring a higher profile and make it easier to find high-quality partners for co-production ventures. The merged company would be the second largest UK exporter of programmes after the BBC and as such could contribute, through the improved competitiveness fostered by the merger, to reducing the UK's balance of trade deficit in TV programming.

5.125. Another benefit from the merger would be to facilitate the development of digital terrestrial broadcasting, a key part of government media policy. The bringing of another party to ONdigital, to join Carlton and Granada, would strengthen its development, for example, by increasing the scope for cross-promotion between the ITV Network and ONdigital. ITV had been disadvantaged in competing with, say, BSkyB for major events. ONdigital's role so far had been as a distribution platform for third parties' content, particularly that of BSkyB; the development of ONdigital's own content (and the increased ability to secure key rights that the ITV Network would have as a result of the merger) would be key factors in strengthening ITV's competitive ability to attract audiences and advertisers.

5.126. The merged company would also be in a better position than UNM and Carlton separately to take advantage of the growing commercial opportunities in the whole new media area. UNM had, for example, recently announced its intention to group its Internet and related activities in a new and focused division and to invest £370 million in developing that part of its business. The merged company intended, for example, to develop web sites ensuring new commercial opportunities for ITV and the

regions covered by UNM and Carlton's licences. The merged company would, by pooling the skills of UNM and Carlton, be a stronger competitor for the BBC's widely-used Internet services. Opportunities for network broadcasting and content providers were increasingly flowing from new technology developments. The merged company would be well placed to seize these opportunities, as a broadly-based and unique combination of media skills and assets: in Internet activity (where UNM's Line One joint venture with BT had a leading market position); digital TV through ONdigital; TV broadcasting and production; and national newspapers.

5.127. The most important factor in the merger was its pro-competitive nature. It would not harm competition in the market for advertising airtime. UNM had shown that, for over 90 per cent of advertising carried on ITV, the ITV regions were complements to and not substitutes for each other. Airtime prices fell as well as rose with the economic cycle and in reflection of the largely fixed supply of advertising time. Competition for ITV was strong and becoming stronger every year, particularly from Channels 4 and 5 and the multichannel segment of the market, as the constantly declining share of ITV in TV advertising revenue clearly demonstrated.

5.128. The concern of advertisers and media agencies about rising rates for ITV advertising was understandable. But the merger would put ITV in a much stronger position—through, for example, the improved competitiveness of the merged company's production and programming capacity and the more rapid decision-making that would be possible in the Network Centre's operations—to at least slow down the decline in ITV's share of the viewing audience. That would enable ITV to deliver better targeted and more productive airtime to advertisers and check the rise in the prices they paid for airspace. By improving ITV's competitiveness and increasing its appeal to advertisers, advertising revenue could be made to grow faster than it otherwise would have. That would enable ITV to invest more in attractive high-quality programmes for its schedule, improve its audience share and further enhance its appeal to advertisers as a technologically advanced and effective medium. Without the merger, a continued prospect of decline at accelerating rate faced ITV.

Hypothetical remedies

5.129. We asked UNM to comment on remedies on the hypothetical basis that the merger had been found to be against the public interest.

5.130. UNM did not consider that share deals where a condition was that the client guaranteed, in addition to a minimum share of its ITV budget for an ITV sales house, to allocate a minimum share of its advertising broadcasting budget to ITV as a whole, were potentially anti-competitive. However, UNM was prepared to consider the behavioural undertakings which should be effective in providing a remedy and permitting the merger to proceed.

5.131. The first would be to refrain from entering into share deals which stipulated a minimum share for ITV.

5.132. A second option would be to limit the duration of new advertising share deals to no more than three years, to take account of the concern that such deals could prevent the migration of TV advertising revenues between channels during the period of the contract.

5.133. As an alternative to the first option, UNM (like Carlton) would be ready, for a transitional period, to give a right to advertisers and media buying agencies to extend their contracts on the same terms and conditions.

5.134. All these undertakings would be for a three-year period.

5.135. As a last resort, in the event of the above behavioural undertakings not being accepted by the CC, UNM would be ready to hive off to an independent third party TSMS as a separate and independent sales house. That independent sales house would sell advertising airtime for the regional licences previously controlled by UNM in addition to the airtime of smaller licences such as Scottish TV currently sold by UNM, if they so wished. It would not be a permanent measure but would last until the merged UNM/Carlton licences accounted for an NAR share of around 30 to 32 per cent. The merged company would not control the supply of airtime to the independent sales house as that was mainly determined by the ITV networked schedule and the ITC. There would also be measures to ensure the new sales house

and the merged UNM/Carlton were wholly separate. The independent sales house would set advertising rates for the airtime it sold and be remunerated by a commission based on its revenue. An independent sales house of that kind would only be accepted by the merged company because:

(a) it was most likely that the only purchaser of TSMS would be management for a nominal sum with a substantial exit bonus when TSMS was reacquired by the merged company; and

(b) this remedy would prevent the integration of sales houses, and therefore the achievement of significant cost savings, collaboration between Carlton and TSMS on matters such as advertising research, and full dialogue between TSMS and the merged company as to advertisers' programming requirements.

5.136. The idea of an independent sales house as a means of making the merger acceptable to them had been discussed with advertisers and media agency representatives after the announcement of the merger, and welcomed by many of them.

5.137. UNM did not consider that there was any case for accepting a structural remedy entailing divestments by the merged company beyond what would be necessary to ensure compliance with the Broadcasting Act limits such as a 15 per cent audience share. The only purpose of such further divestment would be to try to ensure that the merged company and Granada were of broadly comparable size in terms of NAR and there was no justification for that. Granada's production business was about three times the size of the merged company's, a factor which gave Granada a position of considerable strength in the operations of the ITV Network and the market as a whole. Even though broadcasting and production were activities which could be separated and carried out by different companies, they were in the final analysis interdependent parts of any major ITV company's activities: that had to be taken into account in judging what was a position of broad balance between the companies.

5.138. Obliging the merged company to divest licences for revenue-earning regions would also be grossly unfair to its shareholders by making that company into a forced seller.

5.139. Forced divestments of ITV regions would also prevent the merged company from achieving the full gains and synergies from rationalizing and streamlining their operations. That would limit the company's scope for investing in high-quality programme making and new technologies, thus reducing the benefits to the viewing public and advertisers of a more competitive and effective ITV Network.

5.140. If a structural remedy entailing more than the minimal divestments needed to meet the Broadcasting Act limits were insisted upon, that would make the merger considerably less attractive to UNM. In the circumstances, there might be insufficient justification for proceeding to complete the merger.

In respect of a merger with Granada

5.141. UNM commented that it was not possible to provide very concrete responses about a merger with Granada. Granada had provided no information on the nature of such a merger, for example how the combined company would be structured or how the total broadcasting and production facilities would be fitted together. The Granada announcement of 7 January 2000 was no more than a spoiling tactic, not a serious statement of how an efficient and more competitive entity could be formed from combining Granada with UNM or Carlton. A number of preliminary comments about such a merger could, however, be made.

5.142. A merger involving Granada would be more difficult to reconcile with the limitations in the Broadcasting Act than would be the merger between UNM and Carlton. The larger size of Granada in audience share terms would be a complication, requiring more drastic divestments in order to achieve compliance with the 15 per cent audience share limit: a Granada/UNM merger would have 20.2 per cent, against 18.3 per cent for a Carlton/UNM merger.

5.143. Granada's much greater size in programme production also created other problems. A merger between UNM and Granada would mean that the merged company accounted for some 55 to 57 per cent, on recent figures, of ITV Network Centre commissions. Despite the quality and undoubted viewer popularity of many of Granada's programmes, that would be a position of undue dominance in the

programming activity of the Network Centre: as such, it could not be conducive to ITV's competitive strength, ability to attract viewers or to the interests of the other ITV companies. Granada was already the only ITV company in surplus on its transactions with the ITV Network Centre. There was evidence also, as set out in detail by UNM, that Granada was able to charge unjustifiably higher prices to ITV for the programmes it commissioned from Granada as compared with UNM or Carlton. The additional production programming power which a merger between Granada and one of the other two companies would confer on the merged company could only be expected to lead to Granada exercising decisive influence over ITV.

5.144. While it could be argued that production and broadcasting were different and thus separable activities, their integration made for a more competitive and better-balanced TV company. To that extent, the disparity between Granada's dominant position in programme production and the much smaller production business of UNM and Carlton must be taken into account.

5.145. UNM did not find at all convincing Granada's argument that a merger between UNM and Carlton without divestments other than required to meet the limits in the Broadcasting Act would leave Granada as a smaller company at a serious competitive disadvantage. Granada would still be a very significant TV business and one perfectly capable of looking after its interests. Its dominance in production and in the commissioning of programmes by the ITV Network Centre, in particular, would provide Granada with ample means to safeguard itself. Granada's concerns should not be allowed to frustrate the merger between UNM and Carlton, which would create a company better equipped than its two separate components to challenge ITV's competitors for audiences and advertisers. That could only be to the advantage of ITV as a whole, Granada included. On the contrary, a merger between Granada and UNM or Carlton would create a company not only dominant in production, but also having a strong position in terms of ITV advertising revenue. This would create an unstable ITV with much weaker competition in production than that created by a UNM/Carlton merger.

Views of Carlton

In respect of a merger with UNM

The market for viewers

5.146. Carlton considered that all TV broadcasters were in the market for viewers. Private sector broadcasters competed to obtain one or more of advertising revenue, subscription income, or pay-per-view or other transaction-based income.

5.147. Viewers were an essential 'input' to all types of broadcasting. Commercial broadcasters had to attract viewers as the value of the advertising airtime which they had for sale depended on the number and profile of viewers reached. Pay-TV channels justified subscriptions by offering viewers different programmes from those shown on free TV: the value of the advertising time sold by pay-TV increased with their audience share. For advertising-funded broadcasters, the ITC specified a maximum number of minutes permitted for advertising in a given hour and required that each channel sold all its minutes.

5.148. However, minutes only constituted effective supply to an advertiser if adequate numbers of viewers with a profile of interest to an advertiser watched the advertising. The more viewers of the kind wanted by an advertiser that a channel could attract the more advertising it effectively 'supplied' and, other things being equal, the lower the price of the advertising and the more attractive that airtime to advertisers.

5.149. We asked Carlton if it were the case that the difference in funding methods made pay-TV a distinct viewing market for free-to-air commercial TV. Carlton did not agree that that was so. There was one viewing market in which all the players attempted to win the viewing hours of individuals. ITV competed for viewers not only with pay-TV but also Channel 4, Channel 5 and the BBC.

5.150. The two key considerations for ITV were that:

(a) the ITV share of the viewing audience had been in decline for some years now; and

(b) that decline appeared certain to continue.

5.151. As regards the existing trends, the ITV share of viewing had fallen between 1995 and 1999 from 35.4 to 29.6 per cent, a drop of 16 per cent. BBC1 had declined from 32.2 to 28.4 per cent, a reduction of 12 per cent. The notable features in the distribution of viewing shares within that period were the introduction of Channel 5, which had risen in only two years to a figure of 5.4 per cent, and the growth in the satellite/cable share (including both analogue and digital) from 8.3 to 14.0 per cent: the latter represented an increase of 69 per cent over the 1995 to 1999 period.

5.152. Not only had the overall viewing market become more diverse and competitive, looking back to 1992/93, the size of the viewing 'cake' was also showing some signs of diminishing, for example among Internet users, with a reduction in the average UK TV viewing time per person. Expectations going forwards were that the viewing 'cake' size would continue to diminish. The fall in hours viewed was important as an indicator of how TV had been doing against its wider market competitors.

5.153. The main factors underlying the intensification of competition for viewers included:

(a) an increasingly commercialized and less minority-oriented strategy by Channel 4, which had enabled it largely to maintain its viewing share;

(b) the introduction of Channel 5, intensifying competition for the mass market channels; and

(c) the continued increase in penetration of satellite and cable channels, giving greater channel choice to more households, combined with the growth in the numbers of channels available through the introduction of digital technology. Pay-TV viewing shares had increased sharply between 1995 and 1999 and the growth in channels and services availability brought by digital technology made the competition for ITV keener all the time.

5.154. The rapid growth of pay-TV was a clear example of the growing intensity of competition for viewers. Free-to-air broadcasters such as ITV were at a disadvantage in competing against pay-TV broadcasters. The latter, for example, received subscription income as well as advertising revenue; and were not bound by costly public service obligations imposed under free-to-air broadcast licences. Nor did they suffer from the problems caused to the ITV licensees in having to agree on coordination and programme procurement decisions.

5.155. Carlton was in no doubt that ITV's share of the viewing audience would continue to decline. The main cause would be the growth of existing pay-TV platform penetration and continued rapid technological developments, particularly in digital technology. The area of new technology exemplified by the Internet would also have profound repercussions on the struggle to secure the attention of actual and potential viewers. The impact of some new developments was particularly difficult to assess at present. But in general, competition for viewers' attention would be even greater over the years ahead and forecasts of the effect of that increase would in all probability understate it.

5.156. The direction of the trend over the next five years was not in doubt. Widely-used forecasts by Zenith Media showed ITV's audience share falling from 29.6 per cent in 1999 to 27.6 per cent in 2005 of total TV viewing. That was almost certainly an overestimate, as the Zenith Media methodology, for example, consistently underestimated the rate of take-up of pay-TV and took insufficient account of the inroads into the ITV viewing share in multichannel homes, particularly in multichannel homes without pay-TV. In multichannel homes with pay-TV, ITV had a viewing share of 22.6 per cent compared with 33.5 per cent in other TV households. Industry forecasts of ITV's total viewing share no doubt varied widely but it could be as low as 24 per cent by 2005. The precise figure was less important than the fact that all forecasts pointed in the same direction for ITV's share of the viewing market.

5.157. Carlton believed that, in considering the development of the viewing share, the rapid growth of the multichannel homes with access to both free-to-air and pay-TV channels was particularly significant. Both BSkyB and ONdigital offered free set-top boxes. Digital cable was also bound to grow rapidly and in the future more and more new TV sets purchased would be integrated digital TVs capable of receiving free-to-air digital channels without subscribing to any pay-TV platform. The Zenith Media forecast of multichannel stations taking 18.6 per cent of total TV viewing by 2005 or multichannel households taking 41 per cent of total viewing by 2005 was, Carlton argued, certainly too low. Statistics apart, the key consideration to bear in mind was that in multichannel homes the levels of switching away from free-to-air channels were high and capable of further growth. An important consequence of that growth was to enhance total revenue generated by pay-TV platforms, through both subscription and advertising. That then provided resources for these companies to bid for attractive programming rights—which in turn attracted new households to pay-TV.

5.158. Although its influence was impossible to pick up precisely in forecasts, as Zenith Media and everyone else acknowledged, it was clear that new technology would impact greatly on the market for viewers' time. An obvious example was the imminent introduction of ADSL services, by BT in particular. A wide range of companies were seeking to exploit ADSL technology for TV and video services and most of the major Internet service providers were actively working on how to use ADSL for high-speed Internet access.

5.159. Some time spent in using the Internet would be time diverted from watching TV, with the effect that free-to-air viewing and its capacity to attract advertisers diminished. Second, although advertising on the Internet was small it would increase, perhaps very substantially, in the years ahead. Both effects would divert revenue from ITV, putting pressure on its capacity to invest in original production programmes and acquire expensive rights to content. That would endanger ITV's capacity to look after its viewing share, reduce further its ability to attract viewers through its programmes and make ITV less attractive to advertisers. Yet because of the sheer uncertainty in forecasting it, some of the estimates such as those from Zenith Media did not expressly take account of the effect of Internet penetration on ITV.

5.160. These developments added up to a revolution now taking place. The competitive implications were enormous for traditional broadcasters.

5.161. The net result would be an unprecedented level of competition for viewers. The rapid increase in the number of channels over the last decade had already deeply eroded ITV's share of viewing. The new generation of hardware and services would also mean unparalleled competition, directly or indirectly, to attract advertisers. The merger would better equip Carlton and UNM to respond.

The market for advertising

5.162. Carlton argued that at the level of market definition, the relevant market was that for display advertising as a whole. In Carlton's view, a significant proportion of their advertising expenditure on ITV and on other TV stations could be switched to other media in response to increases in prices. Carlton gave a number of examples of advertisers switching expenditure in this way. The share of all display advertisers taken by ITV advertising was falling, being now down to 28 per cent against 35 per cent five years ago—and, as the MMS system did not cover the whole spectrum of advertising, ITV's share of the all-display market was probably slightly exaggerated. Carlton and UNM would together have about 13 per cent of the UK display advertising market (or about 20 per cent if classified advertising were excluded).

5.163. If the CC were not disposed to accept display advertising as the relevant market, Carlton was firmly of the view that TV advertising as a whole was the correct definition. That was, for example, the interpretation underlying the adoption by the OFT of the 25 per cent ceiling in 1994 based on NAR for TV. Even on that definition, the merger did not, in Carlton's opinion, raise any major competition issues.

5.164. Carlton believed that there were two key considerations in understanding the effects of the merger on the advertising market. First, ITV regions were very largely complementary to, and not compete with, each other. That was because competition for advertisers took place mainly between national TV networks (ITV as a whole, Channel 4, Channel 5, BSkyB, etc). Advertising on the various regional ITV franchises was largely undertaken by advertisers as complementary parts of a national campaign. A national advertiser targeted the national market and would aim to capture customers in every ITV region. An advertiser would not, on the whole, react to an increase, or the prospect of an increase, in advertising price in a particular region by increasing its advertising spend in another region(s), due to diminishing marginal returns from increasing advertising spend in that way. The only significant exception was London, where direct competition existed between the Granada weekend and Carlton weekday franchises: London accounted for just over a quarter of ITV NAR.

5.165. TV advertising was usually analysed as divisible between:

(a) separate local regional markets, where advertising was based on competing local TV and other media; and

(b) multiregional and national markets, ie based on advertising using competing multi-regional and national TV and other media. In such markets media covering different regions (which included ITV broadcasters) were primarily complementary.

5.166. The nature of the market was seen more clearly by considering the three main types of advertiser:

(a) 'local' advertisers who advertised in a single ITV region or part of that region, in the latter case perhaps in a sub-region of the ITV licensee's territory or with local advertising from, say, a cable TV company. Local advertising, so defined, accounted for only about 1.8 per cent of Carlton's advertising revenue in 1999;

(b) 'regional' advertisers who advertised in two to nine ITV regions, or the 'macro' regions available from Channels 4 or 5 which had wider coverage than a single ITV region. Regional advertising made up about 16 per cent of Carlton's 1999 advertising revenue; and

(c) national advertising, where a national brand advertiser covered ten or more ITV regions. National advertising accounted for about 82.2 per cent of Carlton's 1999 advertising revenue.

5.167. Thus, for example, regional advertisers sought to cover a certain number of regions by advertising via specific ITV regions or in particular 'macro' regions of the national broadcasters. ITV regions were often in competition with macro regions but not with each other. In relation to national advertising, ITV regions were not substitutes for each other as an advertiser needed to cover the whole regional ITV Network to build a national TV campaign. So far as ITV competed in such cases, it was for national advertising with the national broadcasters. The macro regions of the national broadcasters such as Channels 4 or 5 had been devised to match groups of ITV regions, which had the effect of further ensuring substitutability between the national channels and ITV. The complementary nature of the ITV regions was reflected in the sharp differences in advertising prices, ranging from £4 to £13 per thousand adult impacts.

5.168. A consequence of the complementary nature of ITV regions was that it was meaningless to add together the UNM and Carlton shares of NAR in assessing the competitive effects of the merger. That was not only due to the nature of advertising within ITV but also because the relevant economic market was not limited to TV advertising.

5.169. Carlton argued that a number of factors needed to be borne in mind when considering the degree of competition between ITV regions, which was marginal.

5.170. The standard concern about competition in merger cases, that the merged undertaking would reduce supply in an attempt to force up prices, did not apply. The number of advertising minutes per hour were fixed by the ITC , which also required the ITV licensees to clear the market, ie sell all their minutes, even if that required prices to be lowered. The system of providing advertisers/buyers with monthly SAPs made the market transparent, enabling advertisers to compare their prices and to engage independent media auditor companies to check that they were receiving value for money. Nor had ITV any interest in reducing the number of its viewers; that would cut total UK TV advertising revenue and the ITV share of it.

5.171. Second, the merger would have no effect on competition in the supply of advertising in London. The record showed that advertising business had been won and lost through competition between the Carlton and Granada sales houses in London.

5.172. Third, there was clear evidence of strictly limited competition between regional ITV licences. There was no evidence of regional or national advertisers switching significant advertising expenditure from one region to another due to the diminishing marginal returns from increasing advertising expenditure in one region in response to rising prices in another and because regional and national advertisers had to advertise, to obtain sales, in all parts of the UK where they had a market. The main competition between broadcasters in advertising markets concerned the value for money of an advertising slot (ie the number and profile of viewers reached). In that respect, there was real competition between ITV and other national channels. This could only be countered by improving the viewer appeal of ITV as a whole—not by ITV regions, which in any event broadcast broadly the same network programme schedule and did not compete for viewers between themselves.

5.173. Carlton argued further that if there was much scope for competition between ITV regions the share of ITV advertising expenditure accounted for by the three ITV sales houses should vary perceptibly. However, the three ITV sales houses had a virtually unchanged share of ITV advertising revenue since the last major increase in concentration within ITV in 1994. A study for Carlton by Frontier

Economics showed that switches of revenue between sales houses in response to prices (as opposed to changes in advertisers' regional marketing strategies) probably amounted to no more than 1 or 2 per cent a year of ITV NAR, excluding London which was clearly a competitive market.

5.174. Carlton argued further that a major reason why the rapidly growing competition from other advertising media for ITV had become so acute in recent years was the increasing influence of media agencies providing a specialized and professional planning and buying service to advertisers. Their concern was solely with the mix of media that best met their advertiser clients' objectives and as such they were impartial in influencing the advertising solutions chosen.

5.175. The other media competing with ITV were many in number. They included, of course, the competing national TV channels such as Channels 4 or 5, BSkyB and other non-BSkyB channels, as well as the press, radio, outdoor, cinema and direct mail. New competing media growing rapidly included Internet portal advertising and advertising opportunities offered by new media/distribution platforms such as DSL technologies and mobile Internet services. No doubt different advertisers would allocate advertising budgets differently to optimize sales. But overall, the effect of these competing media sources was to contain materially ITV's ability to raise advertising prices.

5.176. The development of the new media, in particular, with new platforms for TV and other video services, would help to accelerate the decline in ITV's share of TV advertising revenue. We asked whether, as regards the growth of the Internet as an advertising medium, rapid growth from a low base would cut into ITV's share of NAR that much, in view of the forecast by Fletcher Research that advertising on the Internet by 2005 would largely be at the expense of direct mail and press advertising. Carlton thought that that forecast was very uncertain and that nobody could be sure that the effect on advertising by ITV would be limited. There was research evidence that Internet users reduced the amount of time devoted to watching TV.

5.177. But not only were high rates of growth being achieved by the new media. These new media would impinge on ITV in more than one way—whether as a supplier of a competing advertising platform or as a contestant for viewers' attention. In addition, advertiser demand was increasingly directed to audience groups that TV was less efficient at capturing (such as up-market, male and youth audiences). These would progressively gravitate further to digital satellite and cable TV—leaving ITV increasingly dependent on older and more down-market groups of less interest to advertisers.

5.178. Certainly the merger would not give rise to any competition issues if assessed in the context of all advertising or all display advertising. The UNM/Carlton share of all advertising was only 13 per cent and all TV made up only a third of all advertising.

5.179. The growth of competition from other broadcasters would be seen clearly from the statistics of NAR share won by ITV. Over the last ten years, the ITV share had fallen from 95 per cent (including Channel 4, which was sold by ITV up until 1993) to about 60 per cent in 1999. Nobody was in any doubt that the ITV share would fall further. Zenith Media, whose forecasts were the most widely used, estimated ITV share at some 54 per cent for 2005. Industry forecasts were rather lower and ITV's likely NAR share in 2005 seemed likely to be no more than around [✂] per cent. The corollary of ITV's falling NAR share was the rise in its competitors' shares—for example, according to Zenith Media, over the 1999 to 2005 period, from 12 to about 18 per cent for multichannel (satellite and cable) and from 6 to 9 per cent for Channel 5 despite its beginning to broadcast only in 1997.

5.180. We asked Carlton what effect it believed that a merger with UNM would have on advertising prices. Carlton referred us to a study it had commissioned from Frontier Economics of UK TV advertising prices and revenues over the period 1988 to 1999. The study showed that the average price of TV advertising had risen by 2 per cent over that period in real terms, made up of: a decrease greater than that in TV NAR between 1988 and 1992; an increase greater than the TV NAR increase between 1992 and 1996; and a slower rise than in NAR from 1996, with the strong rise in demand offset by a significant increase in supply of impacts. ITV, BSkyB and Channel 4 had rates above the average but Channel 5 and other pay-TV rates below it; the relative prices of these latter channels could be expected to rise as they gained viewing share. That London's share of ITV NAR had remained stable at a time when its relative price had risen was consistent with Carlton's view that advertisers allocated expenditure by reference mainly to inter-network competition rather than the relative prices of ITV regions. Otherwise, it would have been expected that advertisers would switch away from London and London's NAR share fall—which it had not. The factors driving advertising expenditure and prices (demand for advertising, closely

related to the economic cycle; supply of TV advertising, in terms of commercial audiences; and quality of supply of TV advertising, in the audience mix and volumes delivered) were largely outside the control of the ITV sales houses. There was, therefore, according to Frontier Economics, no reason to believe that the Carlton/UNM merger would have an adverse effect on TV advertising prices.

5.181. We asked Carlton about the use of share deals, ie contracts, annual or for longer periods, in which an ITV sales house received a guarantee from the customer that a minimum percentage share of his TV advertising budget would be spent on buying airtime from that sales house. Was the purpose or effect of these deals to reduce the scope for inter-regional substitution at the margin by the advertiser and if not why did the sales houses have them?

5.182. Carlton replied that the main characteristic of such deals, which stemmed from competition with other TV channels, was typically to set out the share of the advertiser's or agency's TV or ITV and/or to ITV as a whole. In return for the assurance that was thereby given to the sales house for its planning purposes, the advertiser or agency received discounts from SAPs. Expressing share deal commitments in budget share terms had another advantage for the advertiser or agency in being more flexible than commitment to a particular level of advertising spend, as the advertiser remained free to alter both total expenditure on advertising and its mix between media.

5.183. A striking feature of the recent evolution of the TV advertising market was the fact that some of the largest advertisers had reduced their expenditure on TV and/or ITV sharply. For example, the proportion of its advertising budget spent on ITV by Procter & Gamble had fallen from 95 per cent in 1995 to 81 per cent in 1999; Mars had reduced its spend on TV by 8 per cent and sharply increased its spend on outdoor advertising. The ITV share of McDonald's TV advertising had fallen from 77 to 59 per cent since 1996. Peugeot had cut TV spending by 31 per cent between 1998 and 1999, in favour of a significant increase in expenditure on outdoor and cinema. These examples illustrated the ability of advertisers and the agencies advising them to reduce the shares of their advertising budgets spent on ITV and as such were a further measure of the growing vulnerability of ITV.

5.184. We asked whether, as ITV's share of advertising revenue had fallen more slowly than its audience share, ITV's relative position was less serious than the share statistics appeared to demonstrate. Carlton did not believe that was the case as there were a number of essentially temporary reasons for such a disparity in the recent and foreseeable trends. A number of new channels were in the process of establishing themselves in the advertising market but, when they had achieved that, their market shares would grow rapidly—Channel 5 and cable and satellite being such examples. Another temporary factor was that TV advertising demand was at present being boosted by the rapid growth of 'dot.com' or high-technology businesses. That was, for now, favouring ITV, in particular, because of its ability to reach a large audience rapidly. But the dot.com bubble would not continue to swell.

5.185. For the above and other reasons, there was no doubt that while the merger would improve the merged company's ability to respond to the many challenges facing ITV, that company's market position would continue to erode under the pressure of competition. By 2001, for example, the merged company's share of TV NAR would have fallen to [✂] per cent in 2001 from 35.4 per cent in 1999: it would be [✂] per cent by 2005.

Buyer power

5.186. Carlton believed that an important development in the market during recent years was the substantial increase in buying power. The media planning and buying agencies had been divested from the full service advertising agencies or set up from new. These agencies, often large organizations and/or parts of international groups, were professional planners and buyers whose job was to focus solely on the media aspects of advertising campaigns and to secure the best possible deals for their clients. As such, the media agencies had to advise on what media were most suited to deliver the clients' advertising and marketing objectives with maximum cost-effectiveness and to be ready to guide the advertiser clients to switch their expenditure between different media accordingly. The media planning and buying agencies had developed advanced techniques for measuring advertising effectiveness and for assessing and developing different media strategies. These systems enabled advertisers to analyse the cost-effectiveness of different TV networks and different media.

5.187. The media agencies provided advertisers with more than planning and buying expertise. The agencies were also increasing the power they brought to their clients as buyers, by virtue of the growing concentration among the agencies. Its ten leading media agency customers (ie agencies like Zenith Media) now accounted for 80 per cent of Carlton's advertising sales whereas its top ten advertising customers took only 15 per cent of Carlton's sales.

5.188. We put it to Carlton that while the development of large media agencies might indeed be helpful to their advertiser clients where these also were substantial organizations which bought large amounts of advertising, it was less likely to make any material difference to the deals secured by smaller advertisers. Carlton did not consider that to be the case. The larger media agencies were also able to negotiate agency deals, a kind of bulk buying arrangement whereby the agency contracted to take TV airtime up to a guaranteed amount for, say, a year at specified and generally favourable rates. The agency was then able to make that airtime available to its advertiser clients, who would often include small or medium-sized advertisers unable, by virtue of their size, to secure equally favourable rates as individual customers of the TV sales houses. It was important to bear in mind that an agency (or an advertiser) did not negotiate about the proverbial marginal pound of advertising expenditure: it negotiated on large slices of advertising commitment and as such was in a better position to obtain favourable deals for its clients.

Procurement and scheduling of programmes by ITV

5.189. Carlton did not believe that the merger would give rise to competition concerns in relation to the production and procurement of programmes, despite the merged company's aim of increasing its share of UK TV programming above the 5 to 10 per cent aggregate of Carlton and UNM sales. That aggregate was considerably less than the programme sales by Pearson, the largest independent producer, and of the sales of Granada and the BBC, the largest UK producers by far.

5.190. We asked Carlton whether the merged company's aim of increasing its share of the programme production market might cause friction with Granada in the ITV Network. Carlton did not think that would be the case. The merged company's share of around 23 per cent of Network Centre programme commissions contrasted with Granada's 48 per cent and there was no reason to expect that pattern to change much in the short run, for two major reasons.

5.191. ITV was critically dependent on its programme schedule being attractive to viewers so as to maintain (and if possible increase) the ITV share of TV audiences. That was crucial in gaining advertising revenue, having regard to the fact that for Carlton (and UNM) the ratio of revenue from advertising to that from production was about 8:1. Granada was a long-established and highly successful maker of programmes and accounted for many of the most popular programmes with ITV audiences. These were essential to maintain the audience share secured by ITV. The merged company would hope that the benefits of bringing together its production skills put it in a better position to win new Network Centre commissions, but did not expect to do so other than on merit.

5.192. Second, the ITV Networking Arrangements gave independence to the Executive of the Network Centre in programme commissioning decisions. The merger would not materially affect the Executive's independence, the results of which could be seen in the fact that independent programme makers were presently securing around 32 per cent of Network Centre commissions as compared with the quota of 25 per cent of commissions for qualifying programmes reserved for independents under the Broadcasting Act 1990. Barriers to entry into programme productions were low, with some 1,200 independents in the UK: the real access provided to independents by the 25 per cent quota was in effect growing as some major producers like Pearson were ceasing to qualify as independent producers for quota purposes.

5.193. In addition, the Networking Arrangments and the commissioning of programmes were subject to rigorous regulation and monitoring by the ITC which, for example, received detailed monthly reports on programme commissioning from the Network Centre and had the power to intervene if it were not satisfied that the Networking Arrangments were being properly implemented.

5.194. Carlton added that although the immediate interests of the major ITV companies might appear to differ, there was a very large core of common interest by virtue of their mutual dependence on the success of the ITV Network. That had the effect that ITV Network decisions were in practice made

by consensus and not by formal vote. It would, in theory, have been possible for any two of three majors to have acted in concert to secure the necessary voting majority to obtain material influence over the ITV Network. But that had not happened and the consensus worked well enough, if slowly on major issues: for example, the smaller broadcasters were able to express their views and compromises were made by the majors to secure their support.

5.195. Carlton thought it doubtful that the merger would have the effect of bringing the merged company up to the level of 60 per cent of WQR which governed the major decisions (such as on fixing the budget or making appointments to the Executive) in the Network Centre. Carlton was, however, happy to consider arrangements to remove the possibility of that power being attained and used to push through such decisions in the face of widespread opposition from other ITV members, if such arrangements were necessary to respond to a genuine concern that the merged company would be able to change ITV policies in its interests. Such a safeguard could be found by increasing the share of WQR needed to secure a formal majority to, say, 65 per cent. Another method would be an undertaking by the merged company not to exercise some part of the voting power attaching to its share of WQR for the purpose of decisions on Network Supply Contract matters. The latter was probably the better of the two as it could more readily be varied or terminated when there was no longer any further need for it.

Regulatory barriers

5.196. Carlton recognized that the merger would have the consequence that a number of prohibitions contained in the Broadcasting Act 1990, as amended, would be infringed. The merged company would take all necessary steps to ensure that it came into compliance with the Broadcasting Act. The matters on which action would have to be taken to comply included the following:

(a) bringing the combined audience share of the merged company down to the 15 per cent limit. The merged company would have had an audience share of about 14.56 per cent but for Carlton's exercising pre-emption rights to increase its voting stake in GMTV beyond 20 per cent and UNM's exercising pre-emption rights in Channel 5 to take its voting rights to beyond 20 per cent, with the result that half (0.8 per cent) of GMTV's audience share and half (2.8 per cent) of Channel 5's share would be attributed to Carlton and UNM respectively. Appropriate divestments would be made as necessary, for example, to bring the GMTV shareholding back down below the point where any of its audience share was attributed to the merged company and the present UNM shareholding in Channel 5 would no doubt be looked at in the same light;

(b) bringing the combined shareholding of UNM and Carlton (20 per cent each) down to the 20 per cent maximum holding in ITN, through a sale of one or other holding; and

(c) if the merger had the result of the new company holding more than three multiplex licences (on which counsel's opinion submitted by UNM and Carlton to the ITC argued that the merged company would not) then it was understood that the ITC would support an approach to the Department of Culture Media and Sport for an amendment by secondary legislation to modify the three multiplex limit.

5.197. Carlton acknowledged that the ITC would have to conduct a public interest test under the Broadcasting Act in respect of cross media holdings, given that newspaper and other publications were produced by UNM, for example, *The Express* and *Sunday Express*. As Carlton did not own any newspaper interests, the merger should not make any difference to whatever cross-media issues might already arise for UNM.

The effects of the merger

5.198. It was Carlton's strongly-held view that the merger would be pro-competitive and thus in the public interest. ITV had been at a competitive disadvantage mainly due to the inherent weaknesses stemming from its fragmentation: the merger would help to remedy those weaknesses and bring a number of benefits.

5.199. ITV's competitors were unified platforms which could frame and implement their strategies without having to obtain agreement between half a dozen companies. ITV, although usually able to reach

consensus, had suffered the difficulty it had in reaching decisions on matters such as the development of ITV2 or Internet strategy. The reduction from three to two major companies in ITV would make it easier and quicker to reach consensus and help to offset these competitive disadvantages.

5.200. The merger would also benefit ITV's key programming activity. The synergies and benefits—amounting to some £40 million a year—from unifying the Carlton and UNM businesses would, for example, mean that extra resources should become available for the programme production business and thus help to strengthen the merged company's capacity to supply high-quality programming to the ITV Network. That could only be of benefit to ITV and to advertisers in providing more effective means of securing audiences.

5.201. The merger would also make the new company a more competitive force in non-UK markets. By achieving increased efficiency in programming and sales it would make the company a strong player in key export markets, particularly the USA. The combination of the US offices of ITEL (a joint venture between UNM and Time Warner) and Carlton would bring a higher profile and make it easier to find high-quality partners for co-production ventures. The merged company would be the second largest UK exporter of programmes after the BBC and as such should contribute, through the improved competitiveness fostered by the merger, to reducing the UK's balance of trade deficit in TV programming. Carlton accepted, in reply to our question, that the two companies could have entered into a joint venture at any time to develop their overseas market business without the need for a merger but believed that the merger would achieve that objective more effectively than the narrower approach of a joint venture.

5.202. Another benefit from the merger would be to facilitate the development of digital terrestrial broadcasting, a key part of government media policy. The bringing of another party to ONdigital, to join Carlton and Granada, was in Carlton's view a crucial feature of the merger. First, the merger would align UNM's interests with those of Carlton and Granada and thus make it easier for ITV and ONdigital to agree on common policies. Secondly, the merger would allow greater investment in ONdigital. Large-scale investment was essential to launch DTT. Carlton had invested substantially in the DTT platform via ONdigital—£176 million in 1999. It was noteworthy that [

Details omitted. See note on page iv.

]. The enlarged group would be financially stronger and better able to support this substantial high-risk investment, increasing the probability of ONdigital achieving its ambitious targets. Thirdly, a merger between Carlton and UNM would also go a long way to strengthening ONdigital's development, for example by increasing the scope for collaboration between the ITV Network and ONdigital with respect to the acquisition of rights, for example, for major sports events. ITV had been disadvantaged in competing with, say, BSkyB for major events due to its fragmented structure or lack of subscription revenue. ONdigital's role so far had been mainly as a distribution platform for third parties' content, particularly that of BSkyB; the development of ONdigital's own content in collaboration, for instance with ITV (and the increased ability to secure key rights that the ITV Network would have as a result of the merger), would be key factors in strengthening ITV's competitive ability to attract audiences and advertisers.

5.203. The merged company would also be in a better position than Carlton and UNM separately to take advantage of the growing commercial opportunities in the whole new media area. The merged company intended, for example, to develop web sites ensuring new commercial opportunities to ITV and the regions covered by Carlton and UNM licences.

5.204. The overriding quality of the merger was its pro-competitive nature. It would not harm competition in the market for advertising airtime. Carlton had shown that, for over 98 per cent of advertising carried on ITV, the ITV regions were complements to and not substitutes for each other and that substitution by advertisers between ITV sales houses was marginal, for good reasons. As stated in paragraph 5.180, the factors driving advertising, expenditure and prices are largely outside the control of the ITV sales houses. Airtime prices fell as well as rose with the economic cycle and in reflection of the largely fixed supply of advertising time. Competition for ITV was strong and becoming stronger every year, particularly from Channels 4 and 5 and the multichannel segment of the market, as the constantly declining share of ITV in TV advertising revenue clearly demonstrated.

5.205. The concern of advertisers and media agencies about rising rates for ITV advertising was understandable. But the merger would put ITV in a much stronger position—through, for example, the improved competitiveness of the merged company's production and programming capacity and the more rapid decision-making that would be possible in the Network Centre's operations—to at least slow down

the decline in ITV's share of the viewing audience. That would enable ITV to deliver better targeted and more productive airtime to advertisers and check the rise in the prices they paid for airspace. By improving ITV's competitiveness and increasing its appeal to advertisers, prospects for advertising revenue would be better than would otherwise have been the case. That would enable ITV to invest more in attractive high-quality programmes for its schedule, improve its audience share and further enhance its appeal to advertisers as a technologically advanced and effective medium. Without the merger, a continued prospect of decline at an accelerating rate faced ITV.

Hypothetical remedies

5.206. We asked Carlton about remedies on the hypothetical basis that the merger had been found to be against the public interest.

5.207. Carlton did not consider that share deals where a condition was that the client guaranteed, in addition to a minimum share of its ITV budget for an ITV sales house, to allocate a minimum share of its advertising broadcasting budget to ITV as a whole, were potentially anti-competitive. However, Carlton was prepared to consider behavioural undertakings which should be effective in providing a remedy and permitting the merger to proceed.

5.208. The first would be to refrain from entering into share deals which stipulated a minimum share of broadcast expenditure for ITV. Every share of ITV clause in existing contracts would be converted into a share of broadcast.

5.209. Carlton would also be willing to give a right to advertisers and media buying agencies to extend their current contracts on the same terms and conditions. The renewal offer would include London, so far as Carlton was concerned.

5.210. All these undertakings would be for a two- or three-year period, on the Carlton and UNM assumption that by 2003 the NAR share of the merged company would have fallen to around [✂] per cent.

5.211. Carlton would also be prepared to see STV, S4C and Ulster TV released from their contractual obligations to TSMS, to enable them to establish another sales house or to have their sales handled by Granada or Channels 4 or 5. [*Details omitted. See note on page iv.*]

5.212. Carlton was strongly opposed to any idea of a structural remedy entailing divestments by the merged company beyond what would be necessary to ensure compliance with the Broadcasting Act limits such as a 15 per cent audience share. The only purpose of such further divestment would be to try to ensure that the merged company and Granada were of broadly comparable size in terms of NAR and there was no justification for that. Such a remedy would fail to take account of the consideration that imbalance between leading companies was helpful to competition, as established in EC competition jurisprudence.

5.213. But even with a so-called unbalanced structure of Carlton/UNM and Granada after the merger, Granada would remain a major business within a very sizeable group. It would still account for a large slice of TV NAR, around 20 per cent, and would continue to be able to offer attractive opportunities to advertisers. In addition, its production business was about three times the size of the merged company's and that factor alone would continue to give Granada a position of considerable strength in the operations of the ITV Network and the market as a whole. Even though broadcasting and production were activities which could be separated and carried out by different companies, they were in the final analysis interdependent parts of any major ITV company's activities: that had to be taken into account in judging what was a position of broad balance between the companies.

5.214. Obliging the merged company to divest licences for revenue-earning regions would be disproportionate and grossly unfair to its shareholders by making that company into a forced seller, especially bearing in mind the continuing fall in ITV's NAR share.

5.215. Forced divestments of ITV regions would also prevent the merged company from achieving the full gains and synergies from rationalizing and streamlining their operations. That would limit the

company's scope for investing in high-quality programme making and essential new technologies, thus reducing the benefits to the viewing public and advertisers of a more competitive and effective ITV Network.

5.216. If a structural remedy entailing more than the minimal divestments needed to meet the Broadcasting Act limits were insisted upon, that would make the merger considerably less attractive to Carlton. In the circumstances, there might be insufficient justification for proceeding to complete the merger.

In respect of a merger with Granada

5.217. Carlton, like UNM, found it hard to offer comments about a merger with Granada in the absence of information about a merger plan. At the level of principle, it was not apparent that a merger between Granada and Carlton would be contrary to the public interest just as Carlton believed that its merger with UNM was not contrary to the public interest. As for Granada's greater current strength in programme production compared with Carlton and UNM, two things could be said. Broadcasting and programme production were separate areas of activity and could be carried on separately. But a successful combination of them in one business gave economic strength which was important in enabling the business concerned to play its full part in the difficult transition period, for example, with the development of digitalization that commercial TV was going through.

5.218. Carlton did not accept Granada arguments about there being an intrinsic difference between the southern or 'prime' licence regions and other ITV regions. The Carlton/UNM merger would make no difference in itself to advertisers' interest in ITV regions other than those of the merged company. The merger would not give the merged company dominance or make advertisers any more reluctant to advertise in particular regions than they otherwise would have been, as determined by their own marketing objectives. As already argued, the ITV regions were complementary rather than substitutable, as more than 98 per cent of ITV revenue cannot be contested by any other licensee. Owning a 'prime' licence could not therefore mean that that licensee could in any way reduce the ability of other licensees to perform to optimum effect.

Views of Granada

The market for viewers

5.219. We asked Granada about the market for viewers. Granada thought that the market for viewers was interconnected with the market for advertising and for programmes. The more viewers who were induced to watch a TV channel by the quality and diversity of its programmes, the more attractive that channel was to advertisers. Increased advertising revenue in commercial TV, particularly ITV, funded increased programme budgets, enabling the companies to offer more varied and higher-quality programmes to the viewers. If even more viewers were thereby attracted then so would advertisers be—and so on. However, Granada did not consider that any of the mergers would materially affect the market for viewers because ITV regions did not, apart from a small area of overlap, compete for viewing audiences.

5.220. It was Granada's firm belief that all TV channels, whether free-to-air or pay-TV, were in the same market for viewers. That could be seen quite simply from the audience share statistics. Since the launch of new channels, whether cable or satellite or Channel 5, it was quite clear that ITV had lost audience to these. That loss was likely to continue.

5.221. The penetration of pay-TV in particular was likely to continue to increase, which would further reduce ITV's share of TV viewing. Other new developments such as the growth in Internet usage would also contribute to reduced viewing as time spent on the Internet was time that could have been devoted to watching TV.

5.222. Granada observed that the latest ITC statistics for the year to 31 March 2000 showed that the ITV share of the viewing audience continued to decline. It was now down to 28.8 per cent. ITV's share of the peak period audience was also down for the first quarter of 2000: that was a disappointment after

last year's increase. ITV's position would probably continue to worsen. Having regard to the expected developments in digital multichannel and pay-TV the Zenith Media forecast of an ITV viewing share of 27.6 per cent in 2005 was probably too optimistic.

The market for advertising

5.223. Granada told us that it did not regard the relevant market for advertising as the total display market. There was some competition between TV advertising and other media but it was very much at the margins. The major national advertisers, if they could afford it, preferred to use TV, particularly ITV, as best able to give them wide market coverage at various times of the day, particularly at the peak. The relationship between TV advertising and other media was mainly a complementary one, except for the marginal area of overlap: the latter tended to be driven by price more than longer-term or strategic conditions.

5.224. It was also the case that advertising agencies and advertisers tended to organize their businesses in separate departments for different media, which reinforced the tendency for competition between TV and other media to be at the margins. The relative share of the main media within display advertising as a whole had remained stable over a lengthy period. Granada did not envisage much change occurring in that respect.

5.225. It was also Granada's firm view that TV advertising was a single market. There was a high degree of competition between the ITV regions and the national channels, ie Channel 4, Channel 5 and multichannel particularly satellite. Over the last five years ITV's share of NAR had fallen by ten percentage points, to the benefit of the other channels. The market was also very competitive in terms of the different types of audience delivered to advertisers. For example, Channel 4 had a relatively young and more affluent audience. The strong selling point of BSkyB was its attraction of a male and younger audience. Advertisers were naturally sensitive to the differences between the main offers in viewer terms of the different channels. The market for advertising airtime was very competitive and largely influenced by the performances of the different programme schedules in delivering audiences to advertisers.

5.226. We asked Granada about its view that most advertisers tended to buy 'airtime' first from the national channels and then turn to ITV with the remainder of their TV advertising budget. Granada thought that was a change which had occurred mainly in response to Channel 4 starting to sell its own airtime from 1993, after being sold by the ITV sales houses. The effect of that change was being intensified by the growth of advertising on pay-TV and the arrival of Channel 5.

5.227. The national channels had more sharply-defined viewer profiles which increasingly enabled the advertiser to target his budget first on these channels and then seek to drive the best bargain possible between the three ITV sales houses for the remaining share of his budget. These were fundamental changes in the advertising market place, as shown by Channel 4 having grown to take around 20 per cent of NAR and Channel 5 to 7 per cent over two years.

5.228. Granada considered that these developments in the advertising market confirmed the validity of its strongly held strategic view that ITV would be best served by consolidation continuing and the present rather unstable and unfavourable equilibrium being replaced by two strong but balanced companies. The sensible and inevitable final goal was a single company leaving ITV as a truly national and unitary channel competing with the other channels. They were all national and not, unlike ITV, fragmented into regions. However, it would take not less than three to five years for the necessary changes to primary legislation and for a single ITV company to emerge from the current ITV configuration.

5.229. Until there was a single ITV company, it would be much better if any consolidation of the three major ITV companies resulted in two strong balanced players. They would be able to compete head-on with the other channels. That would be more to the advantage of the advertiser than if the current situation ended with two of the three merging but in a way which led to the creation of one strong ITV company and one much weaker one.

5.230. We put it to Granada that a single ITV company would be in a very dominant position indeed, with, according to the main independent forecasts, as much as 50 per cent of NAR in five years' time; and that would not necessarily facilitate competition in the advertising market.

5.231. Granada considered that this was an issue that the Government and regulator would take into account in deciding on the timing of a move to a single ITV company. However, Granada considered that there would be regulatory (as well as other) advantages in having a single ITV company. The regulator could, for example, impose regional content or programming objectives on that national company, just as happened at present in respect of regional licences. The danger of any North/South divide being exacerbated, or the interests of regions in the North of England being jeopardized, would be much less than at present because the single company would have an interest in all ITV regions. It would in many ways be an inherently easier task for the regulator to deal with one company. And ITV would be in a better position to respond to fundamental developments such as the growth of digital penetration until the analogue signal was switched off in the latter part of the decade.

5.232. We asked Granada to what extent a framework of analysis based on NAR shares adequately illustrated the dynamics of change taking place in the TV markets, particularly that for advertising.

5.233. Granada did not believe that NAR shares alone (or even in combination with viewing audience shares) were sufficient for that purpose. The imposition of 25 per cent NAR shares in 1994 was a mechanism for dealing with a particular set of circumstances that had existed at that time but had ceased to be an efficient way of assessing how the ITV sector could best move forward. It was now too blunt an instrument.

5.234. As regards the market for programme production, Granada responded to our question that the most appropriate definition was all programming provided to UK broadcasters. That covered original commissions, repeats, sporting or other events—in short, all the genres. A wide definition of that kind had the advantage of taking into account shifts in the relative importance of different parts of the market, such as the increasing emphasis on acquired rights. These were cheaper on the whole for new channels to acquire than original programming. But a consequence of that was to drive up the costs of acquiring rights for any TV channel as seen in the escalating costs of buying major sporting events essential to maintain ITV's attractiveness to all viewer profiles. The result would increasingly be to deprive ITV of resources needed to fund the original programming which it was renowned for, except in so far as ITV was able to increase its operating efficiency.

5.235. We questioned Granada about its key argument that ITV licence areas fell into two groups, 'prime' and 'non-prime'.

5.236. Granada said that there were four recognized prime licences, namely the two London licences, Central TV and Meridian TV. It saw as prime licences those regions which were 'must have' for all or most advertisers. In technical terms, it defined prime licences as those which had the largest shares of advertising revenue and where the CPT was higher than the national weighted average. On the index thus described, the London Weekend licence area had a ranking of 183, Carlton TV 168, Meridian TV 135 and Central TV 102. (Anglia TV had an index of 110 but was only seventh largest in terms of revenue.)

5.237. Prime licence regions also accounted for large shares of advertising revenue. Each of the main four listed in the previous paragraph accounted for over 10 per cent of ITV NAR—they were the only regions to do so. The four prime licences, to take other indicators, accounted for about 40 per cent of ITV's audience share or 55 per cent of ITV advertising revenue.

5.238. Over time the prime licence areas were also gaining advertising revenue shares from the non-prime licences. Some had lost a substantial share of revenue. Since 1983 the prime licence areas had increased their share of ITV advertising revenues by 15 per cent at the expense of the other ITV licences. Because the prime licences were all located in the southern half of England, the concept of prime licences was sometimes characterized as the North/South divide.

5.239. The combination of size of revenue and advertising price premium gave the prime licence regions disproportionate strategic importance for advertisers. These were prepared to spend nearly twice as much to reach the ITV viewer in the prime licences as in the rest of the UK. That was particularly significant for products targeting the higher consumers or the luxury market. A current example was the sharp growth in recent months in 'dotcom' advertising on ITV. Over two-thirds of that spending had been targeted on the prime southern licences due to their predominance in providing the affluent and young audiences.

5.240. If one ITV company were allowed to control three of these prime licences it would cause a serious imbalance within ITV. Because of their 'must have' nature for advertisers, the result would be that in many cases advertisers would first apportion the necessary share of their budgets to the holder of the prime licence regions. What was left would then be allocated to the non-prime ITV regions and/or to other competing national channels. As the growing choice of TV channels and platforms made it easier for advertisers to target their desired audiences more accurately, as channels had their different audience profiles, it even became possible in some particular product areas for advertisers to supplement their prime licence regions with advertising on the national channels or their macro regions without having to take space in some or other of the non-prime ITV regions.

5.241. We put it to Granada that it was not apparent why any given advertiser should act differently merely because a merger meant that more than two of the so-called prime licence regions were under one control, as would be the case in a merger between UNM and Carlton. Such a change in the landscape of ITV did not self-evidently make any difference to an advertiser's marketing objectives.

5.242. Granada argued that a merger that allowed one company to control three prime licences would change the market's dynamics in favour of that sales house. In effect that sales house would be able to increase its prices in the knowledge that advertisers would have no alternative other than to accept its terms. Granada called that process 'tipping'. It would make itself felt in the following manner.

5.243. The sales house selling for three prime licence regions would be in a strong position to use some key large advertisers to lever up overall average advertising rates for its regions. It would be able to offer such advertisers increased discounts in return for their being willing to commit a larger share of their advertising budgets to that sales house. Having succeeded in so persuading some key advertisers, the sales house would then be able to make it a condition of continuing discounts at their existing level to the wide range of smaller advertisers that they likewise increased the shares of their advertising budgets committed to that sales house: the consequence of not doing so would be a reduction in the discounts they received. In either event, the advertising revenue to the sales house would increase.

5.244. The implication of that process would be smaller shares of many advertisers' budgets left to spend in the non-prime regions. Even if an advertiser spending more of his budget in the prime regions did not switch a higher share to, say, the macro regions of Channel 4 or 5 competing with the non-prime ITV regions, there would be less of his budget left to spend in the latter regions. Although in some cases advertisers' budgets might be increased to enable expenditure to be maintained in the non-prime ITV regions, that would either not happen in many cases or only after a lag. In either event there would be a temporary or continuing diversion of ITV advertising revenue away from non-prime licences.

5.245. We put it to Granada that the process it had described reflected a pattern in essence no different from the long-run development of different areas in the British economy. It was hardly surprising that over time the evolution of the economy should show up in shifts of NAR between ITV regions. Yet north of the central ITV regions there were millions of consumers and it seemed unreasonable to believe that advertisers would lose interest in them simply as a result of a merger between Carlton and UNM.

5.246. Granada contended that the concentration of three prime licences in a single sales house would allow that sales house to leverage its position to attract revenue over and above the extra revenue that might otherwise 'naturally' flow towards the prime regions. Two related developments also made the danger stemming from overconcentration of prime licence regions much greater than before. One was the considerable expansion in competing channels for ITV. An advertiser which had covered a large part of its need in the prime ITV regions had the choice of topping up either in the non-prime regions or in the national channels such as Channels 4 and 5 or through satellite. In fact, for some products, it was possible for an advertiser with a sharply focused audience profile to avoid using ITV at all: premium lagers were a case in point and it was possible to target an audience (young, affluent, ABC1) through Channel 4 and multichannel homes. It was that growing capacity to target particular audiences through the ever-increasing range of competing channels instead of a scattergun approach which increased the threat to the ability of the non-prime ITV regions to attract advertisers after the prime licence regions had been provided for first by the majority of advertisers.

5.247. Granada's concerns about prime licences and tipping were not theoretical. Its earlier experience with the Time Exchange sales house, which had had no prime licences to sell for and had been seriously disadvantaged as a result, showed that its fears were real.

5.248. Granada went on to argue that the 25 per cent NAR ceiling put in place at the time of the last major consolidation in control of ITV regions in 1994 had achieved its purpose. But it was now hindering ITV's ability to meet the rapid and substantial growth of competitive channels and the challenge of technology and new media. The NAR ceiling should, therefore, be relaxed. However, that should be done only in a balanced and sensible and orderly way which did not endanger the ability of ITV to use the freedom from NAR restrictions to make itself more competitive and improve its offering to viewers and advertisers.

5.249. We asked Granada about share deals and the part these played in its sales operation, including the question whether its deals specified shares of advertisers' broadcasting budgets to be allocated to ITV in addition to a share for Granada.

5.250. Granada said that share deals were arrangements which benefited advertisers and their media agencies as well as ITV sales houses. Advertisers did not wish to commit themselves to offering a sales house a particular cash value of advertising spend over a period ahead, typically the year for which sales contracts were entered into. It was much more flexible to advertisers to be able to offer a percentage share of their advertising budgets to a sales house. That provided the sales house with sufficient assurance, based, for example, on its knowledge of past or likely spend by advertisers, of its prospective income flow to be able to plan its operations and fit the advertisers' needs into the forward scheduling of the regions for which it was selling airtime.

5.251. In return for the assurance that such share deals provided, the sales houses, such as Granada's, were able to offer discounts from the SAP.

5.252. Granada did not speak for other sales houses on the question of how common were share deals that specified a minimum share of advertisers' broadcasting budgets for ITV as a whole as well as a minimum share for the sales house concerned. The three ITV sales houses did compete with one another. It made no sense for any sales house such as Granada's to negotiate share deals with the object of guaranteeing a slice of revenue to those of UNM and Carlton. Of Granada's share deal contracts since 1997, some two-thirds included a share of ITV and share of total broadcast spend; about 15 per cent did not contain any share commitment, 10 per cent were for share of ITV only and the same amount for share of total broadcast only.

5.253. However, it was also the case that since 1997, by which time ITV share of NAR had fallen to 65 per cent, some 45 per cent of Granada's share deals had also included a clause setting a minimum share of total broadcast spend to be applied to ITV as a whole. Such a clause was a guideline only, not enforceable against an advertiser, and for the purpose only of enabling Granada to know what the advertiser's share of broadcast or ITV commitment meant specifically for Granada. Granada's interest was in securing the maximum share of an advertiser's spend for itself, not for any other ITV sales house.

5.254. We asked Granada about the prevalence of 'special' deals where an advertiser bought airtime shown during key sporting or other major events. As these were bought at undiscounted SAP or at a premium over SAP, their frequency clearly had an effect on the overall average discounts given, and on SAP as a whole. That could add another twist to the spiral of advertising price inflation since 1995.

5.255. Granada did not see special deals in the same light. These were legitimate arrangements which simply reflected the attractiveness of airtime slots at different times. Granada was concerned always to devise innovative methods of attracting advertisers, for example through sponsorship deals, or by reslicing and repackaging airtime in various ways that added value. Probably no more than around 5 to 10 per cent of Granada's airtime was sold as specials.

5.256. We put it to Granada that the SAP was a complex pricing mechanism, difficult for those outside ITV to understand and as such much less transparent than those in ITV often asserted. Granada said that it held no particular loyalty towards SAP as opposed to any other potential pricing mechanism that accommodated the legitimate requirements of the sales houses and advertisers and it had on occasion gone on the record to support possible moves towards an alternative pricing structure.

5.257. However, it was not feasible for Granada or any other party to disregard market forces and to break away from SAP. Yorkshire TV had tried to do so, in favour of a system of fixed prices, in the early 1990s, before it was part of the Granada group. Yorkshire TV had been punished by advertisers with a significant loss of business and had to retreat.

5.258. We asked Granada about the extent to which the sales houses exchanged information and/or coordinated their activities. Granada said that information on revenue was provided to the ITC and made public each month by all sales houses so that SAPs could be calculated by the market, using also audience delivery information available to it, for the ITV regions and the national channels. The ITV sales houses also met periodically in the Network Centre to look at market trends or advise the Centre of the need to take account of particular demographic/profiling factors in their programme scheduling: the latter was necessary to enable ITV to market itself as effectively as possible by offering advertisers targeted audiences to optimize ratings. Such information and general marketing exercises were the limit of cooperation between the sales houses.

5.259. We asked Granada if it would favour an increase in advertising minutes per hour for ITV, as the current limits allowed by the ITC were below the maximum permitted by the EC directives. Granada acknowledged that many of the advertisers, including the ISBA, were in favour of increasing the hourly minutes as they believed that the expansion in potential supply would help to drive down advertising prices. However, the IPA believed that an increase in minutage would decrease the effectiveness of the advertising. There were many studies on how to maximize the effectiveness of TV advertising, whether by varying the total amount of advertising time, the different parts of the day when advertising was shown and the length of advertising slots. One widely held view was that lengthening slots tended to bore viewers and increase the risk of their switching channels. No doubt the debate would continue.

Buyer power

5.260. We asked Granada whether it believed that buyer power as represented by the leading advertisers and media agencies was increasing and, if it were, what the implications might be.

5.261. Granada considered that the media agencies, which were expert media professionals on the buyer side of the market, were without doubt continuing to consolidate. In 1985, for example, around 85 per cent of the Granada sales house airtime was purchased by the leading 20 media agencies: the same proportion was now purchased by the top ten media agencies. These were professional organizations which were becoming increasingly demanding on their clients' behalf in asking for guarantees about, for example, access to prime programming, the split between slots at different parts of the day, the audience profiles delivered, etc. The process of negotiating with the agencies was now much tougher and more intensive for sales houses.

5.262. The consequences of the increasing professionalization and concentration of the media planning and buying function were, however, in Granada's view, more far reaching than the driving of harder bargains on behalf of advertiser clients. The media agencies would have it in their power to exacerbate the problem of prime licences imbalance that a merger between Carlton and UNM could create. The leading media agencies would negotiate first with the sales house which had the most prime licences and would ignore the other sales house: even though the latter, for example, Granada, had a London licence, that would not make any difference as advertising on the London weekend licence was substitutable by the London midweek licence. The other sales house would not be involved in the first round of negotiations and could then be faced with a take-it-or-leave-it situation after the agencies had completed their deals with the dominant sales house. That was what had happened to Granada when it participated in the Time Exchange sales house. That practice could start to operate as early as September this year, when negotiations for 2001 deals began, if an unbalanced UNM/Carlton merger were sanctioned before then.

5.263. Granada had tested out its hypothesis on one of the leading independent media agencies. That agency's head had agreed that a sales house selling for three prime southern licences would become much stronger than the other, through the operation of the tipping effect. Revenue would flow to the strong sales house and, by unbalancing a key part of its structure, weaken the whole combined undertaking that made up the ITV Network.

5.264. The effect of tipping through prime licences provided by the growing strength of the media agencies would be intensified by the marketing strategies of, in particular, Channels 4 and 5 and GMTV. They would offer higher discounts to advertisers for the non-prime regions. But these national channels were seldom willing to compete and offer a macro deal to advertisers in respect of the London or South-East prime regions.

Procurement and scheduling of programmes by ITV

5.265. Granada considered that the issue of prime licences and balance between ITV companies had potential ramifications for the programmes area as well as advertising revenues. A merger that unbalanced ITV by leaving a dominant company with three prime licences would be likely to see that company—particularly if it were a Carlton/UNM merger—attempt to change arrangements in the programmes area also to its own advantage. That would be doubly disadvantageous to Granada. It would find itself losing both advertising revenue, through having possession of only one prime licence, and thus its capacity to invest in the high-quality and innovative programming for which Granada was famous. Granada had spent heavily in production not only in the Granada region but also, as a deliberate policy to encourage and to make the best use of creative talent, in its other ITV regions too.

5.266. Granada emphasized that there was nothing to prevent Carlton and UNM at any time, without a merger, investing more in creative programme making of a kind which could attempt to win those two companies, on merit, a higher share of ITV commissions. Both had chosen previously the status of publisher/broadcaster at earlier licence bidding rounds but had subsequently decided that they needed to build up their own production efforts. Although Granada had the lion's share of ITV commissions, it did so on merit given that 60 per cent of programme commissions were either originally commissioned or re-commissioned each year by the ITV Network Centre. Even such popular programmes as *Coronation Street* had to be recommissioned by the network every two years (or even more frequently).

5.267. We put it to Granada that a Carlton/UNM merger, whether or not the new company controlled three so-called prime licences, would be seen as unlikely to lead to any attempt by the new company to induce ITV to commission significantly more programmes from it and fewer from Granada. It would be commercial suicide for the merged company to attempt to do so, in view of ITV's dependence on so many popular Granada-made programmes for the network schedule. Granada considered that a Carlton/UNM company would necessarily see it that way. There was a view heard from time to time that there needed to be more southern-oriented programmes made and shown on ITV to take fuller account of the interests and demographic profiles of viewers in the southern prime licences. As for their programme exporting organizations, there was nothing to prevent UNM and Carlton entering into a joint venture at any time without the need for a merger.

5.268. We asked Granada if a merger, particularly one involving Granada, which led to the merged company being in a more favourable position to win Network Centre commissions might be at the expense, at least in part, of independent producers. Granada did not consider that there was much chance of that happening. The independents were protected by the statutory reservation to them of not less than 25 per cent of ITV commissions, and were at present getting over 30 per cent. The independents were also being helped considerably by the fact that some major independent producers such as Pearson had recently ceased to qualify as independent producers for the purposes of the quota. That did not cause the size of the quota to be changed but did mean that fewer independents had to fight over its distribution. On the whole, Granada saw no reason to believe that a merger would be harmful to the independent sector. It remained strong.

5.269. We asked Granada whether the operation of the Network Centre would be affected materially by a merger.

5.270. Granada said that the ITV Network was a very delicately balanced federation. The Networking Arrangements had operated very effectively and continued to do so. There were two key conditions for that state of affairs to continue. One was that the Network Centre Executive should continue to operate independently of the member companies in those areas delegated to the Executive, in particular the commissioning of programme productions and the day-to-day operation of the network schedule. 60 per cent of the ITV programme schedule was originally commissioned or recommissioned each year so there was ample scope for any company to put in competitive proposals to the Executive. The other condition was that there be a balance between the major companies in ITV. The Networking Arrangements catered well for the smaller licensees and were deliberately framed to do so, for example in the budgetary structure of ITV and flexibility to meet their particular programme needs when these were inconsistent with the general scheduling formula.

5.271. Granada believed, however, that a merger which destroyed the equilibrium between the new companies would be very damaging to ITV. A dominant company with three prime licences would have a strong incentive to interfere with the current working of the Networking Arrangements, to further its

own interests. That would jeopardize the ITV Executive's operational independence and it might, for example, become impossible to recruit a new Chief Executive of high quality if he/she were to be open to meddling and interference from a dominant company. Also, if that company were the result of a merger between Carlton and UNM, then there would be a danger of a southern-centric bias being forced into the ITV schedule. Pressures of such kind already existed within the Network Centre.

5.272. We asked Granada whether, in the event of such a merger, the Networking Arrangements should perhaps be amended to avoid dominant behaviour, for example, by increasing the 60 per cent of WQR target needed (in the absence of consensus without a vote) to push through decisions on major matters under the network supply contract. Granada did not consider that such a remedy would be effective to prevent the operations of the Network Centre being distorted in favour of a dominant company, whatever formal voting requirements were in place.

5.273. We put it to Granada that the kind of southern-centric bias concerns it was expressing might be thought just as likely to arise in the single ITV that it favoured. The four prime licences would still be found in the southern half of England. Where would the counterweight be to any tendency to import a southern-central bias, as contrasted with the existing state of affairs in which Granada with its programming strength provided the counterweight? Granada argued that a single ITV company would have a stake in all ITV regions and its performance in terms of audiences and advertising. Granada also argued that such checks and balances could more readily be built into the regulatory framework that movement to a single ITV company would entail than within the present regulatory process. However well the latter worked, it would always be vulnerable in a situation where a dominant ITV company controlled three prime licences and thus had the revenue necessary to call the tune within the ITV Network.

5.274. Granada believed also that a balanced merger would have positive effects on the production of new programmes. Savings on the media side of the business from a merger involving Granada would probably be similar to the £40 million a year estimated to accrue from a Carlton/UNM merger. Some of those savings could be devoted to leveraging the finance available for programme production. In some genres, programme production commissions did not cover total costs and profit. The risk fell with the programme maker and/or its backers. Even a part of any savings and synergies from a merger could, therefore, be valuable in covering the risk element in production; as the basic finance could usually be obtained for good production projects, an increased ability to fund the risk element would, through the multiplier effect, give a boost to production in toto.

5.275. We put it to Granada that its importance in programme production within ITV and the growing stress on competitiveness in content provision in broadcasting gave it great strength which had to be borne in mind when discussing advertising revenue shares. The two revenue streams, from programming and advertising, surely had to be taken fully into the picture when considering what constituted dominance? Granada did not agree. Although Granada was the strongest of the big three companies in programming, its revenues from broadcasting compared with production were in a 3:1 ratio—less than Carlton or UNM but still showing a significant preponderance in favour of broadcasting. The way that ITV worked in the UK, it was the broadcaster rather than the programme maker who derived the highest financial benefit. Moreover, Granada did not consider itself to be a dominant programme maker for ITV in the wider market: Granada accounted for only around 7.5 per cent of the total UK programme market and probably could not hope to expand that market share very much, however hard it did and would try to.

Regulatory barriers

5.276. Granada recognized that there were a number of regulatory hurdles to overcome in a merger, notably those laid down in the Broadcasting Act 1990 as amended.

5.277. Granada could not yet be certain about how it would meet the 15 per cent audience share limit for a number of reasons. One was that the ITV share of the audience was continuing to decline. But as a working hypothesis, the CC could assume that, in the event of a merger with Carlton, Granada would not continue to hold the London Weekday licence or, if necessary, to comply with the limit, Westcountry. In the event of a merger with UNM, Granada would not keep HTV or the UNM holding in the SDN multiplex, should the regulation in force require it.

5.278. Granada saw no problem arising from either merger so far as ITN was concerned. A holding would have to be disposed of but Granada had been in that situation before and understood that the ITC was likely to allow reasonable time in which to find a buyer.

5.279. In relation to the restrictions on holding multiplex licences, Granada noted that the ITC had stated that it saw no problem with the multiplex ownership limits being relaxed and had so advised DCMS.

5.280. We asked Granada about various permutations of the NAR ceiling. Granada said that maintaining the current ceiling at 25 per cent would prevent a merger involving Granada whereas Carlton or UNM could, on Granada's current calculations, put together a viable merger in a fairly short time from now: the 15 per cent audience share limit would prevent Granada from fitting a merger within the 25 per cent NAR figure. As for raising the NAR ceiling to 30 or 35 per cent, it was doubtful in any event if analysing the implications by reference to various permutations and combinations of NAR shares yielded useful answers. It made more sense to look at the key market drivers. In Granada's view, the prime licence issue remained crucial. Any solution needed to ensure that no single company controlled three of the four crucial prime licences. Preventing the emergence of such a dominant company would also safeguard the interests of the smaller licences without sales houses of their own.

5.281. We asked Granada if it had a preference between Carlton or UNM as a partner to merge with. Granada said that its view would depend on what the regulatory framework was. It had done detailed work on both the other companies but could not say now in a vacuum which would be the preferred merger partner. If a merger between Carlton and UNM were not permitted, Granada would still wish to merge with one of them if allowed to do so.

The effects of the merger

5.282. Provided that the outcome was one in which no single company controlled a majority of the prime licences and the smaller companies retained their ability to choose which of the sales houses would represent them, Granada did not consider that a merger would be contrary to the public interest. But those tests would have to be met whatever the combination of the three companies in the merger. However, an unbalanced outcome, in which the merged company controlled three prime licences would be very unstable, inimical to the continuing health of ITV and contrary to the public interest.

5.283. A balanced merger would bring a number of benefits, as Granada had argued. The operation of the ITV Network would be streamlined, with benefits from, for example, reduction in costs due to duplication and swifter decision making on key issues. Some of the economies could be devoted to investment in high-quality programme making and acquisition of increasingly expensive rights. ONdigital, Granada's joint venture with Carlton, would benefit from a greater concentration of resources in the large-scale investments needed for its continuing development and, depending on the make-up of a merger, a more focused and simpler chain of decision making. Above all, a balanced merger would equip ITV better to meet the many challenges facing it both from its competitors and the developments in new media and technologies.

Hypothetical remedies

5.284. We asked Granada for its comments on remedies, on the hypothetical basis that the mergers were expected to be contrary to the public interest.

5.285. We put it to Granada whether there might be advantage, from the standpoint of the advertiser, for example, in separating the sales houses from their shareholding links with the ITV companies. The sales houses would be reconstituted as, in effect, independent wholesalers of advertising airtime or, alternatively, could act as independent brokers remunerated by commission.

5.286. Granada said that it would be necessary to be clear first on the nature of any problem being dealt with. It was doubtful that separating the sales houses from the ITV companies would achieve any useful results. The most important question would remain that of who owned the broadcaster. If any one ITV broadcaster controlled more than two prime licences, it would have a dominant position in the market. In that event, tinkering with the sales house arrangements would not provide any real safeguard

against abuse of that position. In addition, there was nothing to prevent anybody, such as the large media agencies, from already creating a new market in airtime sales if they judged it worthwhile.

5.287. We asked Granada whether, on the widely held premise that the two London ITV licences were genuinely competitive with each other, competition might be facilitated by adopting a comparable weekend/weekday split in other major regions. Granada replied that the London franchise was split into a four and a half and a two and a half day licence. One effect of repeating that pattern might well be to make the weekday licences inevitably the stronger of the two, in a greater degree than was intrinsically justified by the time split. Some other ITV licence areas had in the past been divided between weekday and weekend so there had no doubt been reasons for departing from the pattern except for London. Granada also argued that limiting the ownership of more than two prime licences was effectively an extension of the London split, it having been recognized that, in a multi-company ITV, no single company should be allowed to control the strategically most important regions for advertisers.

5.288. We asked Granada how it saw the transition to a balanced market being brought about, if that were the outcome to be put in place as a result of the inquiry. Granada replied that the answer would partly depend on circumstances. The key to balance would remain that no one company should control more than two prime licences. If either of its two mergers went ahead, Granada would clearly have to make divestments to comply with the Broadcasting Act audience share limit: but, that done, either of the mergers should result in a competitively balanced ITV structure. If Granada decided not to bid, or if a bid were unsuccessful, Granada would still hope to be able to acquire at least the prime licence that Granada considered UNM and Carlton should be required to divest as a condition of their merger being permitted to go ahead.

5.289. It was accepted by Granada that UNM and Carlton could not be required to sell any licence, prime or otherwise, to Granada as a condition of a merger. Granada accepted that one of the smaller ITC companies or a non-ITV company might in theory successfully bid for a divested prime licence. Although in either case a balance might not be achieved, it would not be the worst outcome as the imbalance created by a single dominant company controlling three prime licences would have been avoided.

5.290. Despite its reservations about the effectiveness of amending the formal machinery of the Network Centre to prevent a dominant company resulting from the current merger proposals and obtaining the 60 per cent WQR vote which would give it control over key decisions, Granada had no objection to such amending action as a condition of a merger being allowed to proceed. Granada would be content with either of the two possibilities which other parties had raised with the CC—ie *(a)* to increase the majority required above 60 per cent; or *(b)* to accept an undertaking that a dominant company would not exercise all its voting power, so as to remain below the 60 per cent figure.

5.291. Of the two options, Granada preferred the latter as simpler to achieve. It was also more readily capable of being made temporary, to be withdrawn when a divestment of the licence(s) causing the 60 per cent to be exceeded took place.