

UNDERTAKINGS GIVEN BY CARLTON COMMUNICATIONS PLC AND GRANADA PLC TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY PURSUANT TO SECTION 88 (2) OF THE FAIR TRADING ACT 1973

Notice of possible variations to the undertakings

Introduction

1. Following the Competition Commission's (CC's) 2003 report on the proposed merger of Carlton Communications Plc (Carlton) and Granada plc (Granada) to form ITV plc (ITV) (the 2003 report), undertakings were given by Carlton and Granada and accepted by the Secretary of State for Trade and Industry under section 88(2) of the Fair Trading Act 1973.¹ In relation to the sale of commercial advertising airtime on the 'Regional Channel 3 Services'² (ie ITV1),³ the Undertakings set out the contract rights renewal (CRR) remedy. The undertakings became effective from 14 November 2003 and Carlton and Granada merged to form ITV on 2 February 2004.
2. In October 2006 ITV asked the Office of Fair Trading (OFT) to conduct a review of those clauses of the Undertakings relating to the CRR remedy (the CRR Undertakings).⁴
3. On 29 May 2009, in exercise of its powers under Schedule 24, paragraph 16, of the Enterprise Act 2002, the OFT gave its advice to the CC.⁵ The OFT's advice recommended that, if the CRR Undertakings are retained in any form, we should change the definition of ITV1 to reflect changes in the way this channel can be delivered. The OFT also recommended that we give 'further consideration to whether the decline in ITV1's market position means that the remedy can be varied to provide effective protection against the remaining detrimental effects of the merger arising from ITV's strength in mass audience programming, but impose fewer costs and distortions than the remedy in its current form'.⁶
4. We have set out our assessment of the changes of circumstance since the 2003 inquiry in our *Provisional decision as to changes of circumstance* (the Provisional Decision).⁷ We identified changes of circumstance in relation to:
 - (a) a decline in ITV1's market share and an increase in the ability of media buyers to run certain campaigns effectively without ITV1. However, we found the adverse effects identified in 2003 continue to be a concern due to the difficulties in substituting ITV1 arising in part from ITV1's advantage in delivering large audiences. (See paragraphs 6.105 to 6.108).
 - (b) certain unintended effects of the CRR Undertakings. (See paragraphs 7.35 to 7.36).

¹The full text of the Undertakings can be found at Appendix A of the Provisional Decision.

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

³In 2003, the ITV1 channel was known as ITV. We have used ITV1 throughout this Notice.

⁴The CRR Undertakings under review relate specifically to clauses 5–11 and Annex 1, which relate to the sale of commercial airtime, clauses 12–18 and Annexes 2 and 3, which relate to adjudication, and clauses 23–25, which deal with interpretation.

⁵www.offt.gov.uk/shared_offt/register_of_orders_and_undertakings/CRR-review/exec-sum.pdf.

⁶OFT advice, paragraph 2.3.

⁷Review of ITV contract rights renewal undertakings—Provisional decision as to changes of circumstance, 15 September 2009.

5. We have provisionally decided that the changes of circumstance have not sufficiently changed the competitive environment identified in the 2003 report or the operation and effect of the CRR remedy to warrant ITV's release from the CRR Undertakings. However, we consider that there may be a case for some variation in the CRR Undertakings to take into account the changes of circumstance.⁸
6. We note that, given the interrelated nature of the elements comprising the CRR Undertakings, it is difficult to identify variations which take into account the changes of circumstance while preserving the effectiveness of the remedy in continuing to address the adverse effects of the merger. Nonetheless, we invite views on possible variations to the CRR Undertakings which achieve this objective (see note at the end of this Notice).

Possible variations on which views are sought

7. We seek views on possible variations, which would:
 - (a) take into account the decline in ITV1's market share and the increase in the ability of media buyers to run campaigns effectively without ITV1; or
 - (b) mitigate the unintended effects of the CRR Undertakings,while addressing effectively the continuing adverse effects identified in the 2003 report.

Variations which take into account the decline in ITV1's market share and the ability of certain types of campaigns to be run effectively without ITV1

8. We invite views on two alternative variations which could take into account the decline in ITV1's market share and the ability of certain types of campaigns to be run effectively without ITV1:
 - (a) Limiting the scope of CRR to address only ITV1's advantage in delivering large audiences; or
 - (b) Removing elements of CRR while maintaining protection of media buyers through a requirement on ITV to offer airtime on fair and reasonable terms.

Limiting the scope of CRR to address only ITV1's advantage in delivering large audiences

9. In order to achieve a variation that would limit the scope of CRR to ITV1's advantage in delivering large audiences, it is likely that sale of ITV1 airtime would need to be separated into regulated and unregulated parts (where the regulated parts would relate to delivering large audiences). There are a number of issues with such a variation, including:
 - (a) Separation of airtime sales would require at a minimum separate contracts for each type of airtime, but such separation may require additional safeguards;

⁸See paragraph 8.2 of the Provisional Decision.

- (b) Sale of ITV1 airtime cannot be easily divided by reference to audience size of programmes, and may require use of some sort of proxy, such as peak and off-peak airtime;
 - (c) There could be considerable practical problems, including the possible need for a transitional period while separation took place; and
 - (d) There is considerable risk of unintended effects, including from any change that would be required to the audience ratchet mechanism (ARM).
10. Despite these concerns, we invite views on this variation and any other variations to the CRR Undertakings that are able to preserve the effectiveness of the CRR remedy while limiting its scope to address only ITV1's advantage in delivering large audiences.

Removing elements of CRR while maintaining protection of media buyers through a requirement on ITV to offer airtime on fair and reasonable terms

11. We considered a variation that would remove elements of the roll-over rights provisions of the CRR Undertakings while maintaining protection of media buyers through a requirement for ITV's dealings with media buyers to be conducted on fair and reasonable terms (including in relation to the relationship between changes in share of broadcast (SOB) commitment and associated discounts). There would be an ongoing role for the Adjudicator in cases of dispute.⁹
12. In our view, this variation has a number of significant drawbacks:
- (a) it would be difficult to establish and apply consistently a fair and reasonable test in relation to the pricing of television airtime given the multi-faceted and varied aspects of many media buyers' contracts with ITV without reference to the 2003 contracts.
 - (b) The loss of certainty in terms of outcomes for media buyers could reduce the effectiveness of the remedy in addressing the adverse effects of the merger.
 - (c) It would be likely to lead to an increase in the number of disputes between media buyers and ITV regarding what was 'fair and reasonable'. This would require an expanded role for the Adjudicator.
13. For these reasons, we are not minded at present to pursue this variation. However, we invite views on whether, and if so how, practical guidance could be established to assess whether terms proposed by ITV are fair and reasonable.

Variations which mitigate the unintended effects of the CRR Undertakings

14. We invite views on variations that would retain the CRR remedy but make adjustments in order to mitigate the unintended effects of the CRR Undertakings in respect of:
- (a) the definition of ITV1 in the CRR Undertakings;

⁹This would most likely mean that clauses 5 to 11 of the undertakings would need to be deleted or altered to take the proposed variation into account. Part of clause 10(a), for example, would need to be deleted but part would need to be retained and expanded. However, clause 10(h) preventing ITV from changing the way it sells airtime would need to be retained.

- (b) incentives for ITV to focus primarily on maximizing ITV1's share of commercial impacts (SOCl); and
- (c) the difficulties for ITV in reacting to changing demand.

Definition of ITV1 in the CRR Undertakings

15. The current definition of ITV1 in the undertakings relates to the 'Regional Channel 3 Services' licence and not to ITV1's programme schedule. It does not therefore include all methods of delivering the ITV1 programme schedule—an ITV1 high definition (ITV1 HD) or potential time-shifted ITV1 (for example, ITV1+1 or other delivery).¹⁰ As a result, we found that ITV is disincentivized from launching alternative ways of delivering ITV1 as impacts generated by these channels would not be counted towards ITV1's SOCl, and indeed could reduce it.
16. We are minded to vary the CRR Undertakings accordingly. To the extent that such a variation is allowed, we would expect any alternative methods of delivering ITV1 content to carry the same or substantially the same¹¹ programmes and advertisements as ITV1 and any impacts generated by them to be counted towards ITV1's SOCl.
17. We invite views on whether such a variation should encompass any other formats, platforms or delivery technologies and whether, if introduced, it should be accompanied by any other measures (in particular, whether requirements should be placed on ITV to broadcast identical output on ITV1 and any other delivery of ITV1, such as ITV1 HD and ITV1+1). We invite views on whether transitional arrangements would be required and the nature of any such arrangements.

Incentives for ITV to focus primarily on maximizing ITV1's SOCl

18. In the Provisional Decision we considered whether, because the ARM is based on SOCl as a measure of ITV1's market share, it creates incentives for ITV to focus primarily on maximizing ITV1's SOCl. The possible unintended effect of this incentive is that ITV generates impacts in ways that are less than optimal for advertisers, for example generating daytime impacts, because peak-time programming is more expensive to produce, or adding episodes to popular programmes such as *Emmerdale* or *Coronation Street*, which attract large audiences but tend to increase campaign frequency rather than reach. We found in paragraph 7.17 of the Provisional Decision that it was difficult to attribute these unintended effects solely to CRR but that it was worth examining whether there are ways in which the ARM could be adjusted to minimize these effects.
19. We considered two variations that could address the incentives for ITV to focus primarily on maximizing ITV1's SOCl:
 - (a) using an alternative measure of ITV1's market share other than SOCl in the ARM; or
 - (b) changing the ARM formulation by altering the relationship between the change in SOCl and change in SOB commitment.

¹⁰Also impacts on ITV1 broadcast on satellite and cable platforms are not counted in CRR but have been considered in this way to date.

¹¹There are some technical limitations on the degree of regional differentiation of content that can be achieved with digital as opposed to analogue broadcasting.

Using an alternative measure of ITV1's market share in ARM

20. We considered possible alternative measures to SOCI of ITV1's market share that could be used in the ARM. These included peak SOCI (SOCI relating to the peak period) or share of commercial viewing (share of viewing rather than impacts).
21. In our view, alternative measures may introduce fresh unintended consequences, for example less investment in off-peak programming. They may also have a number of specification problems relative to SOCI, in particular they may:
 - (a) lack reliable measurement;
 - (b) need to define a specific time of day or set of programmes; and
 - (c) only capture one aspect of coverage or frequency.
22. Views are invited as to the extent to which referencing the ARM to an alternative measure of ITV1's market share would mitigate the incentives for ITV to focus primarily on maximizing ITV1's SOCI, whether it would be likely to introduce fresh unintended effects, whether any such variation could be specified practicably, and whether any consequential adjustments would be appropriate.

Changing the ARM formulation

23. Under the current ARM formulation, if ITV1's SOCI falls, a media buyer may reduce its SOB commitment proportionately, whilst still being entitled to the discount it had been allowed under the higher SOB. However, the present 1:1 ratio between SOCI and SOB commitment in the CRR Undertakings may not appropriately reflect the relationship between the two. We therefore considered a variation in which the ARM would be changed so that, in the event that ITV1's SOCI fell, ITV's customers would be entitled to a lower automatic reduction in SOB commitment to ITV1 than under the present formulation. This change in formulation would reduce ITV's incentive to focus primarily on maximizing ITV1's SOCI.
24. However, in our view:
 - (a) this variation would prevent media buyers from automatically reducing their SOB commitment to ITV1 by as much as they might wish, undermining the effectiveness of the remedy in addressing the adverse effects of the merger.
 - (b) it is not clear on what basis an appropriate alternative ARM formulation could be derived; and
 - (c) there may be unintended effects by distorting the incentives of ITV, other broadcasters and media buyers.
25. Views are sought on the likely effects of this variation and on what basis an alternative relationship between reductions in SOCI and reductions in SOB commitment could be arrived at.

The difficulties for ITV in reacting to changing demand

26. We found in paragraph 7.33 of the Provisional Decision that many of the largest contracts are renegotiated each year, albeit often only in relation to relatively minor contractual terms. In paragraph 7.34, we considered that it was worth examining whether there are ways in which the CRR Undertakings could be varied to introduce

more flexibility into the negotiation process between ITV and media buyers, whilst ensuring the CRR Undertakings continue to address the adverse effects of the merger. We invite views on any variations that could do so.

Next steps

27. ITV and other interested parties are requested to provide any views on the proposals contained in this Notice in writing (especially those views requested in paragraphs 10, 13, 17, 22, 25 and 26, including any practical alternative variations to the CRR Undertakings they wish the Group to consider, by 6 October 2009 (see note at the end of this Notice).

Diana Guy
Group Chairman
15 September 2009

Note: This notice of possible actions to vary the CRR Undertakings is given having regard to the Provisional Decision announced on 15 September 2009. Parties have until 6 October 2009 to respond to the Provisional Decision. The Group's decision may alter in response to comments it receives on its Provisional Decision, in which case the Group may consider other possible variations to the CRR Undertakings, if appropriate.