

## WITHOUT PREJUDICE

### Submission from ITV plc, 24 February 2010

### Review of the Contract Rights Renewal Undertakings

### ITV's revised RPA proposal

#### 1. Introduction

- 1.1 On 15 September 2009 the CC published its provisional decision as to changes of circumstance (**Provisional Decision**)<sup>1</sup> in connection with its review of the Contract Rights Renewal Undertakings (**CRR**). The Provisional Decision acknowledged that there have been substantial changes in the market since 2003 but concluded that they are not sufficient to justify the abolition of CRR. ITV submitted a Response to the Provisional Decision strongly disagreeing with the CC's assessment.
- 1.2 On the same day as the Provisional Decision was published, the CC published for consultation a notice of possible variations to CRR (**Notice of Variations**).<sup>2</sup> On 19 January 2010, the CC published its Provisional Decision on remedy variations (**Provisional Decision on Remedies**)<sup>3</sup>, which sets out the CC's provisional conclusions about possible variations to CRR, in the light of responses received to its Notice of Variations.
- 1.3 In its Provisional Decision on Remedies the CC provisionally concluded that there should not be any change to CRR, save for a change to the definition of ITV1 to accommodate new channel variants like ITV1+1 and HD. In arriving at this conclusion, the CC rejected an outline proposal put forward by ITV – called the Rules for the Protection of Advertisers (**RPA**). ITV has submitted to the CC a detailed rebuttal of its criticisms of RPA.
- 1.4 In response to the Provisional Decision on Remedies, ITV has recently submitted a revised RPA proposal to the CC. Key aspects of ITV's revised RPA proposal are described in Section 2 below. The full text of the revised RPA proposal is attached as an Annex to this note.
- 1.5 As with the original proposal, ITV has submitted its revised RPA proposal without prejudice to its contention that abolition of CRR in its entirety is the appropriate outcome to this review. Also, ITV's revised RPA proposal (like the original) is submitted as an outline proposal, in the expectation that detailed provisions would be agreed with the CC as part of the process of finalising the text of revised Undertakings.
- 1.6 ITV remains firmly of the view that the case for abolition of CRR is supported by the overwhelming weight of objectively verifiable data. The comments in this document should be read and understood accordingly.

#### 2. ITV's revised RPA proposal

- 2.1 ITV's revised RPA proposal would adopt the same broad approach as the original RPA proposal. Thus it is intended to encourage flexible negotiations between ITV and

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<sup>1</sup> Review of ITV contract rights renewal undertakings—Provisional decision as to changes of circumstance, published by the Competition Commission on 15 September 2009.

<sup>2</sup> Notice of possible variations to the undertakings, published by the Competition Commission on 15 September 2009.

<sup>3</sup> Review of ITV Contract Rights Renewal Undertakings—Provisional decision on remedy variations, published by the CC on 19 January 2010.

its customers in a way that reflects the changes in ITV1's market position since 2003 as well as the original objectives of CRR<sup>4</sup>. At the same time it would reduce the market distortions and dynamic inefficiencies created by CRR.

2.2 The main change from ITV's original proposal is that the revised RPA proposal provides much greater certainty to advertisers and agencies regarding the SOB/SOCI and discount relationships and addresses the concerns raised by the CC in its Provisional Decision on Remedies.

2.3 The key changes from ITV's original RPA proposal are as follows:

- (a) **SOB commitments:** ITV would offer a SOB commitment that fairly reflected any change in ITV1 SOCI.
- An offer would be presumed to be fair (i.e. it would not be capable of Adjudication on these grounds) if it involved a direct (one-for-one) link between SOB and ITV1 SOCI (either upwards or downwards).
  - It would be open to ITV to make an offer with a SOB commitment that did not reflect a one-for-one relationship with SOCI -- i.e. that involved a downwards adjustment of SOB of less than one-for-one, or an upwards adjustment of SOB of more than one-for-one. If ITV were to make such an offer and ITV and the buyer did not agree terms, then the buyer could take ITV to Adjudication. In that case it would be for ITV to show that, in the context of the overall terms for ITV1 contained in its offer, its proposed SOB commitment was not unreasonable<sup>5</sup>.

These provisions would ensure that a direct relationship between SOB and ITV1 SOCI is retained, thereby providing buyers with certainty, as the CC claims they need.

However, whereas the SOB/SOCI ratchet under CRR is automatic regardless of other factors, the commitment in the revised RPA proposal would allow ITV to offer a different SOB commitment. If ITV did so and ITV and the buyer were unable to agree terms, the buyer could refer ITV's offer to adjudication and ITV would have an opportunity to justify before the Adjudicator its deviation from the one-for-one relationship. ITV would seek to do that by relying on factors other than SOCI, as it would have done in negotiations pre CRR -- and as channels like C4 and Five currently do when negotiating deals for the sale of their airtime.

- (b) **Discounts:**
- Overall average discount level: as envisaged under the original RPA proposal, ITV would commit to maintaining weighted average contracted discounts at not less than their current levels across ITV1 airtime as a whole. This commitment would ensure that in aggregate at least the same amount of discount would remain in the market each year, thereby

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<sup>4</sup> It is clear from the CC's Report on the Carlton/Granada merger that CRR was not intended to replace commercial negotiations. Throughout that Report, CRR was consistently referred to as a "fallback" option for advertisers (see for example paragraph 1.18).

<sup>5</sup> An offer that involved a downwards adjustment of SOB of more than one-for-one, or an upwards adjustment of SOB of less than one-for-one (ie that was more favourable to the buyer than the change in ITV1 SOCI) would not be capable of Adjudication.

alleviating any concerns that ITV might seek to increase prices of ITV1 airtime overall by reducing the overall amount of discount that it provides to its customers. The average discount would be calculated in the manner described in Annex 1 to the revised RPA proposal. Ofcom would monitor ITV's compliance with this commitment.

- Individual advertiser discount level: in addition to the above commitment, the revised RPA proposal includes a new provision which would limit the amount by which ITV could reduce an individual advertiser's discount:
  - An offer for ITV1 airtime with a discount reduction of no more than [x] percent would be presumed to be fair (i.e. it would not be capable of Adjudication on these grounds). ITV proposes that 10% would be an appropriate value for x.
  - ITV would be free to make an offer of ITV1 airtime with a discount reduction greater than 10 percent, but if it did so and ITV and the buyer did not agree terms, then the buyer could take ITV to Adjudication. In that case it would be for ITV to show that, in the context of the overall terms for ITV1 contained in its offer, the level of discount proposed was not unreasonable.
- The additional provision on discounts contained in the revised RPA proposal would limit ITV's ability materially to reduce the discount of advertisers individually. In this way the revised RPA proposal adds a layer of protection to individual advertisers about changes in the level of their discount. This is over and above the protection that would be provided to all advertisers by ITV's commitment to maintain weighted average contracted discounts on ITV1 at not less than their current levels. Thus any (small) reduction in discount to one advertiser would result in an increased discount to another advertiser.
- The certainty of discount delivered by CRR – and the unintended windfall benefits that agencies derive from it -- is one of the main reasons why agencies currently opt for their CRR offers without engaging in meaningful negotiation with ITV. The (small) flexibility on discounts permitted under the revised RPA proposal would encourage negotiations between ITV and its customers and thereby deliver a process that reflects the original objectives of CRR. It would also allow ITV to ensure that discounts are allocated more efficiently than the rigid and inefficient approach enforced under protected contracts due to CRR.

2.4 The revised RPA proposal would retain the following features of ITV's original RPA proposal:

- (a) an obligation on ITV to maintain advertisers' access to ITV1 "specials" at their current levels and at current prices; and
- (b) procedures to be adopted by ITV in making an offer for airtime on ITV1.

2.5 Under the revised RPA proposal there would be no protected contracts. Agencies and advertisers would instead derive protection on the level of their SOB commitments and discounts through the mechanisms described in 2.3 above. They would also maintain their existing entitlements to "specials". However, agencies and advertisers would not be able to roll over all the other "Terms and Conditions" in their current contracts as they can at present under CRR – i.e. as regards day parts, first-

in-break, centre break etc (**Ts&Cs**). It is clear that Ts&Cs are not remotely as important to ITV's customers as SOB commitments and discounts. Moreover, under their current contracts, ITV's customers do not have an absolute entitlement to receive them and ITV cannot in any event deliver them in aggregate. Nor are Ts&Cs relevant to the CC's (ill-founded) concerns about ITV1's "mass audiences". Thus, the revised RPA proposal envisages that Ts&Cs will be a matter for negotiation between ITV and its customers, thereby allowing ITV to allocate them efficiently to customers to whom they have particular value, as it is currently prevented from doing under the rigid system of protected contracts under CRR.

- 2.6 The revised RPA proposal includes new adjudication procedures. In the event of a dispute, the dispute would be referred to an Adjudicator (as under CRR). However, the current rules and procedures for Adjudication would be modified, *inter alia*:
- (a) To reflect the different role of the Adjudicator under RPA;
  - (b) To include new provisions designed to ensure that Adjudications are conducted with appropriate regard to the rules of fair process; and
  - (c) To provide for ITV to have a right of appeal to Ofcom in the event that the Adjudicator fails to act in accordance with the requirements of fair process in any Adjudication, or makes a decision that is unreasonable or irrational. A successful appeal to Ofcom would involve remission of the dispute to the Adjudicator.
- 2.7 As with the original proposal, the revised RPA proposal would replace the existing CRR Undertakings in so far as they relate to the sale of commercial airtime<sup>6</sup>.

### 3. **Conclusion**

- 3.1 The CC acknowledges that ITV's market position today has declined since 2003. ITV's revised RPA proposal is an amended and simplified version of its earlier proposal: it addresses all of the specific issues raised by the CC about ITV's original RPA proposal; it is a viable, workable alternative to CRR; and it imposes fewer costs on ITV than CRR. Accordingly, it is clear that RPA is a more proportionate remedy than CRR.
- 3.2 If CRR is not to be abolished in its entirety, as ITV considers it should be, ITV's revised RPA proposal should be adopted in place of CRR.
- 3.3 ITV is confident that the framework provided by its revised RPA proposal can readily be developed into viable, workable formal undertakings in place of CRR.

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<sup>6</sup> Thus, Clauses 5 – 18, Clause 22 (Transitional provisions) and Annex 1 (the ARM calculation) in the current Undertakings would be replaced in their entirety; Annex 2 (the Adjudicator Rules) and Annex 3 (the Adjudicator Scheme) would be modified or replaced in their entirety in order to reflect the revised Adjudication procedures; Clauses 19 - 21 (Compliance), and Clauses 23 - 24 (Interpretation) would require consequential amendments to Clauses 19 - 21 (Compliance), and Clauses 23 - 24 (Interpretation). Likewise, amendments will be required to Clause 25 (which sets out the definitions of terms) and in particular the deletion of any and all definitions that relate to words or phrases that are used exclusively in Clauses 5-18, Annex 1, Annex 2 and Annex 3 (i.e. only those definitions that are used in connection with the "Other Licensees" provisions in Clauses 2 - 5 of the Undertakings would remain).

## ANNEX

### Revised RPA proposal (“RPA Mark 2”)

#### ITV obligations under RPA

- ITV would be under an obligation (as under CRR) to make a separate stand alone offer on ITV1.
- ITV would be subject to an obligation to offer ITV1 airtime on fair and reasonable terms to all advertisers/agencies (both new and existing).
- ITV would be required to publish a set of Transparency Rules for Advertisers (“TRA”) which would specify parameters and processes for determining whether an offer of ITV1 airtime by ITV is fair and reasonable.
- ITV would be required to report annually to Ofcom on the detail of its compliance with the TRA. The report would provide sufficient information to allow Ofcom to ensure that any areas of residual concern that the CC identifies can be appropriately monitored.
- ITV would not be able to change the TRA without Ofcom’s consent.

#### Transparency Rules for Advertisers (TRA)

##### Price control

- ITV would commit to a form of “price control” on ITV1 airtime which would incorporate parameters for determining whether any changes in SOB commitments and discounts are fair and reasonable:

##### SOB commitments

- ITV would offer a SOB commitment that fairly reflected any change in ITV1 SOCI.
  - (1) An offer would be presumed to be fair (i.e. it would not be capable of Adjudication on these grounds) if it involved a direct (one-for-one) link between SOB and ITV1 SOCI (either upwards or downwards)<sup>7</sup>.
  - (2) It would be open to ITV to make an offer with a SOB commitment that did not reflect a one-for-one relationship with SOCI. If ITV were to make such an offer and ITV and the buyer

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<sup>7</sup> A downwards adjustment of SOB of more than one-for-one, or an upwards adjustment of SOB of less than one-for-one (ie that is more favourable to the buyer than the change in ITV1 SOCI) would not be capable of Adjudication.

did not agree terms, then the buyer could take ITV to Adjudication. In that case it would be for ITV to show that, in the context of the overall terms for ITV1 contained in its offer, its proposed SOB commitment was not unreasonable.

### Discounts

- Overall discount level: ITV would commit to maintaining weighted average contracted discounts at not less than their current levels across ITV1 airtime as a whole. The discount would be calculated in the manner described in Annex 1. Ofcom would monitor ITV's compliance with this commitment.
- Individual advertiser discount level: ITV would be limited in the amount that any individual advertiser's discount could be reduced:
  - An offer with a discount reduction of no more than [x] percent would be presumed to be fair (i.e. it would not be capable of Adjudication on these grounds). ITV proposes that 10% would be an appropriate value for x.
  - ITV would be free to offer a discount reduction greater than [10] percent, but if it did so and ITV and the buyer did not agree terms, then the buyer could take ITV to Adjudication. In that case it would be for ITV to show that, in the context of the overall terms for ITV1 contained in its offer, the level of discount proposed was not unreasonable.

### Specials

- ITV would commit to maintain access to ITV1 specials at their current levels and at current prices as specified in each advertiser/agency's current protected contracts, subject to content rights.

### Processes to be adopted by ITV when making an offer on ITV1

- ITV would make a separate stand alone offer on ITV1 (as under CRR). The offer would cover ITV1+1/ITV1 HD (subject to resolving issues about regional caveats).
- ITV would write to all advertisers/agencies that have annual deals 10 weeks before their current contract ends in order to seek confirmation whether or not they intend to purchase ITV1 airtime in the upcoming year.
- ITV would provide all advertisers/agencies who have annual deals, and who had indicated an intention to purchase ITV1 airtime in the upcoming year, with an indicative offer for airtime on ITV1 in line with the TRA 8 weeks before their current contract ends.

- ITV would provide all advertisers to whom it had provided an indicative offer with a formal offer for airtime on ITV1 in line with the TRA before their current contract ends.
- Any grounds for Adjudication would arise only in relation to ITV's formal offer.

### **Adjudication**

- In the event of a dispute, the dispute would be referred to an Adjudicator (as under CRR). The current rules and procedures for Adjudication would be modified, *inter alia*:
  - To reflect the different role of the Adjudicator under RPA;
  - To include new provisions designed to ensure that Adjudications are conducted with appropriate regard to the rules of fair process; and
  - To provide for ITV to have a right of appeal to Ofcom in the event that the Adjudicator fails to act in accordance with the requirements of fair process in any Adjudication, or makes a decision that is unreasonable or irrational. A successful appeal to Ofcom would involve remission of the dispute to the Adjudicator.

### **Internal monitoring of compliance**

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

## Annex 1: Calculating the weighted average contracted discount

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

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

Overall, the steps involved in the RPA weighting calculation are similar to those currently carried out by ITV under CRR (applied in this case to discounts rather than to SOB), though the RPA weighting process is less complex as it is not carried out on an advertiser by advertiser basis and uses less weighting factors than CRR (i.e. the RPA does not require weighting by regions or day-parts). Below, ITV sets out the step by step calculations involved in this process.

The first part of the RPA process is to calculate the weighted average contracted discount that is currently delivered (The Year 0 weighted average contracted discount). Using the indicative data from Figure 1 (which is illustrative only), this is calculated as follows:

- The first step is to calculate the actual contracted value delivered by advertiser by demographic. This is calculated by taking the actual spend by advertiser by demographic and applying the contracted discount. For example if Advertiser A spends £4000 on Adults at a 15% discount then Advertiser A realises £4706 of value. This is calculated as:  $£4000 / (85/100)$ .
- This is carried out for each advertiser for each demographic.
- The actual spend by advertiser by demographic is then summed, and the actual contracted value delivered by advertiser by demographic is also summed. This provides the total actual spend by demographic and the total actual contracted value delivered by demographic.
- The total actual spend by demographic is then summed which gives the total actual spend against all demographics. The total actual contracted value delivered by demographic is also then summed which gives the total actual contracted value delivered against all demographics.
- The overall weighted average contracted discount is then calculated based on these two numbers. Again, from the data in Figure 1 the total actual spend against all demographics is £81,200 and the total actual contracted value delivered against all demographics is £88,877 then the total weighted average contracted discount is 8.6. This is calculated as:  $100 - ((81,200/88,877) * 100)$ .

Therefore, based on the Figure 1 data, the weighted average contracted discount that ITV would be required to deliver in Year 1 would be at least 8.6%. Therefore, in negotiations for Year 1 ITV would be required to ensure that it delivers a weighted average contracted discount of at least 8.6 % to the market on the basis that the same relative audience volume demand in Year 1 is maintained as at Year 0 i.e. in negotiations



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

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

**Figure 1: Calculating the Year 0 weighted average contracted discount**

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