OFFICE OF FAIR TRADING

Review of the Contract Rights Renewal Undertakings

OFT Advice to the Competition Commission

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CONTENTS

1 EXECUTIVE SUMMARY

1.1 The Contract Rights Renewal remedy was applied to the sale of advertising on ITV1 in 2003 as a precondition for permitting the proposed merger of Carlton and Granada. It was part of a package of undertakings designed to alleviate concerns that the Competition Commission had about the merger.

1.2 In January 2009, following our initial review of the CRR remedy which was conducted with the assistance of Ofcom, we published a consultation document which set out our preliminary view that it was now appropriate that the Competition Commission vary the remedy.

1.3 In the five years since the remedy has been in place, ITV1 has lost market share. In our consultation document we put forward a preliminary view that, compared to 2003, there are more advertising campaigns which can now achieve their objectives without relying on ITV1. We proposed that it is likely that this increased substitutability with other channels has, to some extent, reduced the potential adverse effects of the merger.

1.4 We also said that, despite the changes in the market, it was possible that at least some of the concerns expressed by the Competition Commission persisted. We noted that ITV1 still supplies the vast majority of mass audience programming on commercial television and some advertisers, in particular those which require fast coverage in a short space of time, may not be able to meet their objectives without it.

1.5 In our consultation document, we suggested that it may be appropriate to ease CRR if a remedy could be found that effectively addressed any remaining detriments arising from the merger. We proposed that one such easement could be to remove the requirement that ITV1 rolls over contracts but retain some safeguards to prevent ITV from discriminating against those advertisers which still heavily rely on ITV1. We put forward a number of potential safeguards, and invited views and alternatives to the proposition.

1.6 The consultation document also suggested that it may be appropriate to remit the matter to the Competition Commission because there had been changes in the way that the ITV1 programme schedule was delivered. This included the development of a High Definition channel and a potential time shifted (+1) channel. These channels are not currently included in the relevant definitions of ITV1. Neither is the ITV1 channel which is delivered over cable or satellite. We expressed a view that, if the CRR remedy is retained in any form, it should cover all methods of delivering the ITV1 programme schedule. This issue is quite separate from those relating to ITV1's market position.

Stakeholder Responses to the Consultation Document

1.7 The vast majority of stakeholders, including ITV, agreed with our suggestion in the consultation document that, if CRR was retained, the remedy should be amended to include all methods of delivering the ITV1 programme schedule.

1.8 There was much less agreement with the preliminary view we put forward in relation to ITV1's market position. Stakeholders raised issues with the quality of the available evidence about the decline in ITV's market share and provided some further arguments and evidence to support their view that ITV1 remains necessary because the channel still puts out the vast majority of mass audience programming. They told us this means that advertisers remain dependent on ITV1 for reaching large audiences in a short space of time. Some stakeholders also believed that mass audiences – or ITV1's audiences in general – are of a particularly high quality because the viewers are more attentive or have other valuable characteristics.

1.9 Many stakeholders also argued that the position of ITV's digital channels was relevant. They said that, without CRR, ITV would negotiate across all of its channels simultaneously. This would further enhance its ability to extract extra revenue from media buyers, increasing prices on all of its channels, including ITV1. They did not believe that the current conditional selling rules would be effective in preventing such behaviour.

1.10 Most stakeholders said that the proposed safeguards against price discrimination would not provide adequate protection, as ITV would not need to target individual advertisers to increase its revenue. Rather, it would insist on terms that were generally less attractive to advertisers and media buyers. Few alternative easements were suggested. Most stakeholders believe that it is most appropriate for CRR to stay in place with only minor adjustments to account for the definition of ITV1.

1.11 ITV, on the other hand, provided further evidence and arguments that ITV1 no longer has any of the unique features which gave rise to the Competition Commission's concerns. It maintained that fast mass coverage could be attained using a combination of other channels and that ITV1 does not have any other advantages in terms of better quality impacts. It argued that the remedy should therefore be fully removed without delay and without any safeguards being needed.

Updated Findings

1.12 With Ofcom's assistance, we have considered the further evidence and arguments put to us in response to our consultation. The evidence remains difficult to assess. ITV1 has put forward a large volume of evidence supporting its position, but this evidence does not fully prove its arguments. Other stakeholders put forward further evidence to support the position that CRR remains necessary, but this evidence also has weaknesses.

1.13 Overall, we believe it remains possible that, without CRR, ITV1's negotiating power would be such that it would be able to extract more revenue from media buyers. This may be achieved even without targeting specific advertisers, so safeguards against price discrimination may not be sufficient. The ability to increase revenue derives from ITV1's position in the supply of mass audiences. It is not clear that ITV1 has any unique advantages over and above this.

1.14 Nevertheless, we believe circumstances have changed since 2003, and ITV1's market position does appear to have eroded to some extent.

This may mean that a less burdensome remedy may effectively address the remaining concerns. Such a remedy could, for example, be more explicitly targeted at ITV1's position in the supply of mass audiences.

1.15 Some stakeholders requested that a market investigation reference should be launched into the sale of TV advertising. In most cases, the requests related to the wider market position of ITV plc as opposed to ITV1. We consider that Ofcom would be best placed to consider whether a market investigation reference is appropriate. Pending the outcome of the CRR Review, Ofcom has indicated that it does not consider it appropriate to open a market investigation at this time.

Recommendation to the CC

1.16 The OFT remains of the view, endorsed by most respondents, that it is necessary to remit this matter to the Competition Commission in order to amend the definition of ITV1 in the remedy to take account of various ways in which the programme schedule is delivered.

1.17 We recommend that the Competition Commission should also consider whether the decline in ITV1's market position means that it is now possible to find a more proportionate remedy, which creates less costs and distortions than CRR but would nevertheless address any remaining detrimental effects of the merger arising from ITV1's unique position in the supply of mass audiences.

2 OFT ADVICE TO THE CC

2.1 We believe that changes of circumstance since 2003 mean that the Competition Commission (CC) should reconsider the CRR remedy.

2.2 New means of delivering ITV1's programming such as +1 and High Definition channels have developed. This means that the CRR remedy requires, at least, updating. We recommend that, if the CRR remedy is retained in any form, the CC should change the definition of ITV1 to reflect changes in the way this channel can be delivered. The current definition of ITV1 in the remedy relates to ITV1's licence and not to the ITV1 programme schedule. Thus it does not cover advertising on all the various methods of delivering the programme schedule. We believe that the definition of ITV1 should be flexible enough to cover all methods of delivering the channel, rather than being linked to licensing arrangements. The CC should review the remedy for this reason alone.

2.3 We also believe there has been some decline in the market position of ITV1, although its strength in the supply of mass audiences mean that some of the CC's concerns about the merger may still remain. Our consultation document suggested a number of potential easements which could be put in place to reflect the decline in ITV1’s market position. The responses to the consultation document suggested that these may not be appropriate but neither were any obviously better alternatives put forward – stakeholders views on alternative remedies are summarised in Annexe A. We recommend that the CC gives 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.

3 INTRODUCTION

3.1 The CC's 2003 Findings

3.1 When the CC considered the merger of Carlton and Granada in 2003, it considered that there was competition between the two companies in the sale of TV advertising airtime which would be lost after the merger. This competition was particularly focused in London, where the parties held franchises which overlapped geographically, albeit not temporally, but the CC also found that there was a degree of competition between regional ITV1 licensees more generally.[1]

3.2 The CC considered that this competition limited what advertisers and media buyers could be charged by Carlton and Granada, in particular by limiting the share of broadcast commitment (SOB)[2] that could be required for a particular level of discount to station average price (SAP)[3]. The CC considered that the commercial television channels sold by competing sales houses were not close enough substitutes to ITV1 to maintain adequate competitive pressure on the merged sales house. The CC therefore thought that the merged company, ITV Plc (ITV), would be able to increase its overall revenue to the detriment of advertisers and other commercial broadcasters. Particular examples of the ways in which the CC feared ITV might exploit its enhanced market position post-merger were:

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[1] The ITV1 channel was known as ITV at the time of the CC report. We will use the current channel name throughout this document.

[2] The share of broadcast commitment (or SOB) is the proportion of total TV advertising spend that a media buyer commits to spending with a particular sales house or channel.

[3] Station average price (SAP) is an industry term which relates to a benchmark price, related to the average price per commercial impact (a commercial impact is a person of the advertiser's target demographic that views an advert for thirty seconds). SAP is not known until after the month has elapsed and the number of viewers and the total revenue for the month can be calculated. SAP is not a simple mathematical average, such that it is possible for the majority of deals by value to be struck below SAP.

- offering less attractive terms (financial or otherwise) to advertisers or media buyers
- engaging in a greater degree of price discrimination and/or
- changing the system of selling TV advertising airtime to the advantage of the merged entity.

3.2 The Undertakings

3.3 The Secretary of State, after considering the OFT's advice, asked the OFT, assisted by the ITC (now Ofcom), to negotiate Undertakings to address the CC's concerns. [4]

3.4 The text of the CRR Undertakings is set out in Annexe B. The Undertakings give purchasers of ITV1's airtime the right to roll forward the contracts that they had before the merger – these are known as protected contracts – and, if a new contract is negotiated, to choose to protect this contract and roll it forward. These contracts set out various terms and conditions including the discount from SAP the buyer is entitled to and the SOB that the buyer commits to ITV1.

3.5 The Undertakings also allow for an audience ratchet mechanism (ARM) which adjusts the SOB commitment downward if there is a decline in ITV1's share of commercial impacts (SOCI).[5] The calculation of the revised SOB commitment is set out in Annexe C. ITV is also required to ensure that any terms included in new ITV1 contracts are fair and reasonable, and is prohibited from materially changing its airtime sales system without the consent of the OFT.

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[4] The OFT's advice was given on 18 September 2003 and published on 7 October. The Secretary of State's decision was announced on 7 October 2003.

[5] A commercial impact (or just impact) is one viewing of an advertisement by a member of the target audience. It is usually measured in thousands.

3.6 The Undertakings only relate to ITV1. The ITV digital channels which existed at the time, ITV2 and ITV News, are not covered. The CC did have concerns about ITV's increased ability to leverage spend on to these channels[6] but the ITC indicated that it intended to review its airtime sales rules,[7] and restate rules on the conditional selling of channels, which would mean that sales houses had to make digital channels available separately from its main channels and vice versa.[8] The conditional selling rules are enforceable by means of ITV's Channel 3 broadcasting licences. A breach of a broadcast licence carries penalties of up to 5 per cent of qualifying revenue, which includes all advertising and sponsorship revenue,[9] and in more serious cases can lead to the revocation of the licence itself.

3.7 The Undertakings were effective from 14 November 2003 and the independent Office of the Adjudicator (the Adjudicator) was established to monitor compliance and advise industry players on the interpretation of the Undertakings. The Adjudicator is funded by Ofcom which is, in turn, fully reimbursed by ITV.

3.8 The Adjudicator provides regular confidential reports to the OFT and Ofcom. Redacted versions of these are published on the Adjudicator's website. These reports suggest that CRR is generally functioning well. Some concerns have been expressed about the bundled selling of advertising airtime of ITV's digital channels, although no formal, or informal, complaints about conditional selling have been made to Ofcom.

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[6] Paragraph 2.111 of the CC report.

[7] Paragraph 7.295 of the CC report.

[8] The current airtime sales rules, including the prohibition against conditional selling, are available at http://www.ofcom.org.uk/static/archive/itc/uploads/Airtime_Sales_Rules.pdf.

[9] See Section 41 of the Broadcasting Act 1990 (and Section 345 and paragraph 3 of Part 1 of Schedule 13 of the Communications Act 2003).

3.3 The Review Process

3.9 In October 2006, ITV asked the OFT to conduct a review of clauses 5 to 11 of the Undertakings, covering CRR and the associated clauses.[10] ITV believed that significant changes in the market place had occurred since the Undertakings had been put in place and that these changes made it appropriate for CRR to be reviewed.

3.10 After considering the matter under our draft prioritisation principles,[11] we published a statement in September 2007 saying that we intended to start a review in January 2008. On 30 January 2008, we launched our review, explaining that we would be working in partnership with Ofcom.

3.11 We published a statement of issues on 13 February 2008 which set out the key areas which would be considered in the review.[12] The OFT and Ofcom met industry stakeholders and received written submissions during the first half of 2008. Supplementary questions were sent to ITV and some other stakeholders.

3.12 On 15 January 2009, we published a consultation document which set out our preliminary views based on the evidence collected to date, and requested any further evidence and views on the issues.[13] We presented this document to some stakeholders on 20 January 2009,

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[10] Specifically, 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 relate to the interpretation of words and expression used in the CRR Undertakings.

[11] The finalised principles can now be found at http://www.oft.gov.uk/shared_oft/about_oft/oft953.pdf

[12] http://www.oft.gov.uk/shared_oft/register_of_orders_and_undertaki/CRR-review/CRR-issues-statement.pdf

[13] http://www.oft.gov.uk/shared_oft/register_of_orders_and_undertaki/CRR-review/oft1050con.pdf

and met with a wide range of stakeholders to discuss any further submissions during February and March 2009. We are very grateful to all who have assisted in the review.

3.13 We will now send our advice to the CC, which will take the final decision on the matter. In addition to this advice, we will supply the CC, in confidence, with all the submissions and representations made to us to date. The Memorandum of Understanding (MOU) between the OFT and CC on the variation and termination of undertakings sets out the process that the CC will follow.[14]

3.14 The complexities of this case have meant that we have found it appropriate to depart, in some ways, from the usual process set out in the MOU. In particular, we consulted on our provisional view and are publishing our final advice at the same time as we are sending our recommendation to the CC, rather than delaying publication until the CC publishes its provisional decision.[15] Although we are publishing our advice, as the MOU explains, it is not envisaged that main and third parties will make direct representations to the CC at this stage.[16] In particular, parties should not resubmit evidence or restate arguments that have already been submitted to the OFT. The CC will consult on any provisional decision in due course. Further enquiries about the CC process should be addressed to Tim Oyler, Remedies Manager (Tim.oyler@cc.gsi.gov.uk, Tel 020 7271 0421).

3.4 Legal Framework

3.15 The Undertakings were accepted by the Secretary of State under section 88 of the Fair Trading Act 1973 (FTA73). Under the Enterprise

[14] The OFT and the CC Memorandum of Understanding, published on 17 February 2009, is available at http://www.oft.gov.uk/shared_oft/595316/595319/oft1060.pdf.

[15] MoU paragraph 23 and footnote 13.

[16] MoU paragraph 28

Act 2002 (EA02) the power to supersede, vary or release Undertakings under section 88 passed from the Secretary of State to the CC,[17] and thus it falls to the CC to consider any advice given by the OFT that the Undertakings should be varied, released or superseded.

3.16 The OFT is required by law:

(i) to keep under review the carrying out of Undertakings, and from time to time to consider whether, by reason of any change of circumstances, they are no longer appropriate and either the parties can be released from them or they need to be varied or superseded by new undertakings and

(ii) if it appears to the OFT that ITV can be released from them or that the Undertakings need to be varied or superseded, to give such advice to the CC as is thought proper in the circumstances.[18]

3.17 The CC will decide whether to act upon the advice provided by the OFT and it is likely to consult on any proposals which it considers appropriate.

3.18 In order to assess whether there has been a relevant change of circumstances it is necessary to consider the degree to which the adverse effects to the public interest identified in the CC's Report remain. The CC presented its conclusions on the adverse effects to the public interest based on a series of factors which suggested that advertisers and media buyers could not switch away from ITV, which at the time of the merger was effectively ITV1, and which meant that ITV plc, if unrestrained, might be able to exercise its enhanced market position to their detriment. It is therefore necessary to assess whether these factors have changed since 2003. If the adverse effects have

[17] This is subject to designation of the relevant Undertakings by an Order made by the Secretary of State. The Undertakings which form the subject of this review were so designated by The Enterprise Act 2002 (Enforcement Undertakings and Order) Order 2004 SI 2004/2181.

[18] Schedule 24, paragraph 16 EA02 and section 88(4) FTA73.

decreased, the remedy in its current form may no longer be appropriate and if no significant adverse effects remain the remedy may no longer be necessary at all.

3.19 We have looked at the same factors as were considered by the CC in its report on its consideration of the effects of the merger on the sale of advertising airtime on ITV1. Where possible and practicable, we have used the same approach as the CC, although we also took into account any additional information that was available to us.

3.20 The CRR review is limited to examining the adverse effects to the public interest identified by the CC as a result of the 2003 merger. It is therefore restricted to considering the sale of ITV1 airtime, which appears to have been the CC's concern in 2003, rather than the price of advertising on ITV's family of channels. The position of the digital channels is only relevant to this review in so much as it could affect ITV's ability to increase the price on ITV1. It also falls outside the scope of the legal powers of this review to extend the remedy to cover other ITV digital channels. Wider competition concerns that are not directly related to the merger situation, such as possible issues surrounding the advertising trading mechanism, also fall outside the scope. Issues outside the scope of the review are considered further in Section 7.

4 MARKET DEFINITION

4.1 Introduction

4.1 Market definition is a concept used to determine the product and geographic scope within which a competitive assessment is carried out.[19]

4.2 In 2003, the CC concluded that TV advertising was a distinct product market. The CC considered that substitutability with advertising in newspapers, on radio, outdoors, and online was insufficient to widen the market definition. It noted that television is a particularly powerful and important medium for advertisers, both because it combines visual imagery, sound and movement and because television viewing is an extremely popular leisure activity.[20]

4.3 In this section we consider whether this definition remains appropriate today.

4.2 Substitutability with Internet advertising

4.4 There has been a rapid growth of Internet advertising since the CC's 2003 report. In 2008 the Internet accounted for 20.1 per cent of all advertising, up from only 2.9 per cent of all UK advertising in 2003.[21] This growth has corresponded with a decline in the share of some forms of advertising, particularly press and direct mail. During this period, however, TV advertising has been broadly stable suggesting that the growth in Internet advertising has not been at the expense of TV advertising.

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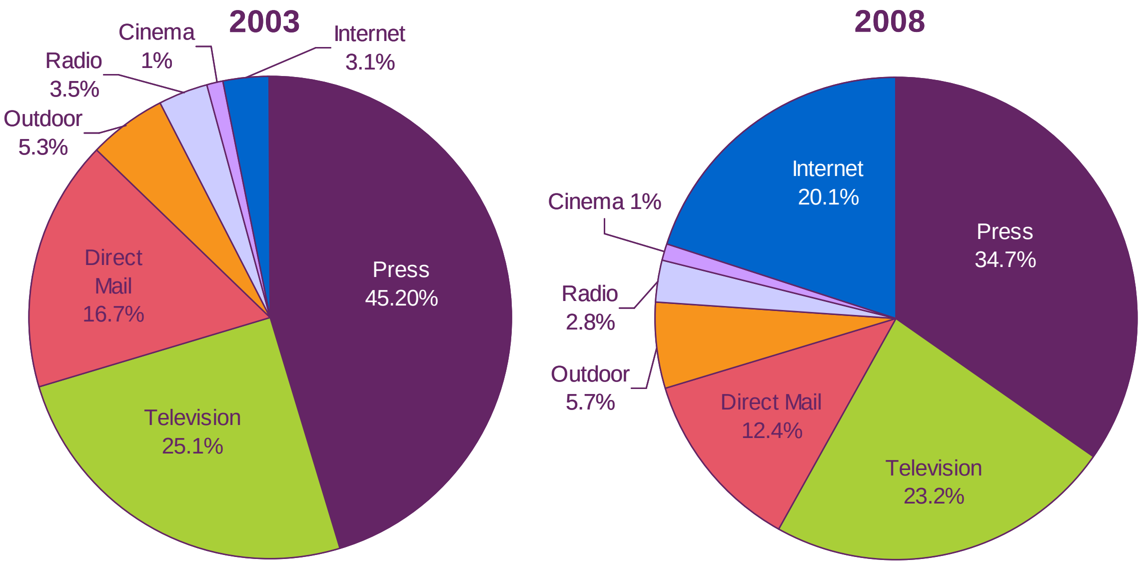
[19] For further information see, 'Market Definition', OFT, December 2004 available on: http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft403.pdf.

[20] Paragraph 3.12 of the CC report.

[21] Advertising Association, The Advertising Statistics Yearbook 2008.

Chart 4.1: Advertising revenue by medium



Source: Advertising Association's Quarterly Survey of Advertising Expenditure (Q4 2008). Note figures include agency commission, but exclude production costs and directory advertising revenue.

4.5 Furthermore, almost 80 per cent of Internet advertising is search and classified advertising.[22] [23] This is quite distinct from the moving images and audio of TV and may therefore only be a weak substitute.

[22] Classified advertisements are generally grouped within a publication or featured on the internet under headings classifying the product or service being offered. These adverts are usually text-based and can consist of as little as the type of item being sold and a telephone number to call for further information. Generally no pictures or other graphics are featured within the advertisement, though a logo may occasionally be included. A sub-category of classified advertising is found on the internet: search-driven advertising. Search advertising is delivered by means of a keyword search and accounts for the bulk of internet advertising (58%). Search engines identify key words and use these as the basis for directing an advertising message to the 'searcher' or potential customer.

[23] Source Ofcom, based on figures from Advertising Association's Quarterly Survey of Advertising Expenditure (Q4 2008).

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4.6 Display Internet advertising resembles TV advertising more closely and accounted for just over 20 per cent of total Internet advertising in 2008.[24] [25] Even display Internet advertising, however, has certain characteristics which may limit its substitutability with TV advertising. For example, online display advertisements are less likely to be viewed simultaneously by large numbers of people. Media buyers have also told us that there is (as yet) no sophisticated measurement system, standard to all online display advertising, which could enable advertisers to assess the success of their campaigns to the same degree of detail and reliability as for TV advertising and Internet users are unaccustomed to being interrupted by audio-visual commercials.

4.7 Overall, stakeholders told us that they did not regard online advertising as a substitute for TV advertising in particular for certain advertising campaign goals such as brand building although it was potentially a complementary product in delivering certain types of campaigns.

4.8 The distinction between TV and Internet advertising is supported by the fact that there are significant differences between the lists of the largest television advertisers and online advertisers.[26]

4.9 The CC took a similar view in its recent report on the BSkyB-ITV merger which concluded that TV advertising was a distinct market from online advertising.[27]

[24] Display advertising is advertising that combines text with other graphical information, such as logos, photographs, diagrams, moving images, location maps etc and may include audio elements.

[25] Source Ofcom, based on figures from Advertising Association's Quarterly Survey of Advertising Expenditure (Q4 2008).

[26] See Advertising Association, The Advertising Statistics Yearbook 2008.

[27] Paragraph 4.143 of the final report, published by Secretary of State for Business, Enterprise and Regulation reform dated 20 December 2007.

4.10 ITV expressed the same view in the OFT's investigation of Project Kangaroo, a joint venture between ITV, BBC Worldwide and Channel 4 related to the video on demand sector.[28] ITV and the other parties to the joint venture maintained the same position before the CC.[29] The CC also maintained this conclusion in its final report on the joint venture.[30] The CC also referred to the European Commission's view in its investigation of the Google/DoubleClick merger, which pointed to differences in the purposes of online and offline advertising because of: differences in targeting capabilities i.e. online advertising could be targeted more specifically at particular audiences than TV advertising; differences in measurement effectiveness; and pricing mechanisms.[31]

4.11 We believe that Internet and TV advertising still form separate relevant markets. We note that there is potential for further convergence in the future, for example if the coverage of Internet advertising increases, or the ability to monitor the effectiveness of Internet advertising improves, but we have limited information on which to assess the speed or significance of this change.

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[28] OFT decision given on 14 July 2008, at paragraph 86, available at http://www.oft.gov.uk/shared_oft/mergers_ea02/2008/Project_Kangaroo.pdf.

[29] Parties' Joint Position Paper on Market Definition, at paragraph 3.68, available at http://www.competition-commission.org.uk/inquiries/ref2008/kangaroo/pdf/main_party_submission_ukvod_3.pdf. This also points out that media buyers have generally separate buying teams and budgets between online and TV advertising and that the pricing of online advertising is based on page impressions, videos served and 'click throughs', as opposed to ex post valuation based on impacts for TV advertising. It is argued that this constitutes further evidence of separate markets. The CC noted that some third parties supported this view: see paragraph 4.147 of the CC report, available at http://www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/543.pdf.

[30] Paragraph 4.151 of the CC report

[31] Paragraph 4.150 of the CC report

4.3 Substitution between different TV channels

4.12 In 2003, the CC considered whether TV advertising should be subdivided, for example into advertising on terrestrial or free-to-air (FTA) television and advertising on pay television, but concluded that boundaries were blurred.[32]

4.13 The boundaries between advertising on FTA television and pay television are further blurred today, due to the greater number of multichannel television households. We therefore consider it is not appropriate to segment the market for TV advertising by platform.[33] The same conclusion was reached by the CC in its 2007 report on the BSkyB-ITV merger.[34] This view was shared by both BSkyB and ITV.[35]

4.14 The CC also considered whether ITV1, on its own, might form a separate relevant market, and concluded that although ITV had certain advantages compared to other commercial broadcasters, those were not tantamount to a finding that advertising on ITV1 constituted a distinct relevant market.[36] Like the CC, we consider that ITV1's unique features can be suitably assessed within TV advertising as a whole.

[32] Paragraph 5.33 of the CC report.

[33] Note this conclusion would not necessarily carry over to the viewer side of the market i.e. FTA and pay TV could well be in separate viewer markets.

[34] Paragraph 4.140 of the final report, published by Secretary of State for Business, Enterprise and Regulation reform dated 20 December 2007.

[35] Paragraph 7.10 and 7.25 of the CC's report, available at http://www.competition-commission.org.uk/inquiries/ref2007/itv/main_party_submissions.htm.

[36] CC Report, paragraph 5.32.

4.4 Substitution between demographics

4.15 Our consultation document considered the possibility that competitive conditions for the various demographic groups may differ to such an extent that each demographic group (or some subset of them) could form a separate relevant market.[37] This hypothesis was based on stakeholders' statements that advertisers target campaigns at specific demographics and are generally not willing to substitute to other demographic groups. We suggested that this might be more relevant now than in 2003 since the growth and proliferation of digital multi-channels has meant that channels increasingly focus on narrower demographic groups.[38]

4.16 In response to this, ITV argued that, in practice, the "true" audience targeted by advertisers for a specific campaign is normally narrower and more specific than those audiences commonly traded by broadcasters. Some major advertisers confirmed this view.[39] Therefore, although true target audiences are rigidly specified by advertisers, there is normally a degree of flexibility when choosing which demographics to trade against, provided that advertisers can reach their true target audience as efficiently across different (overlapping) trading demographics. This suggests that there is a degree of demand side substitutability between different trading demographics.[40]

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[37] See paragraph 4.14 of the consultation document.

[38] See Ofcom Communications Market Report 2008, Section 3.1.6.

[39] For example, [*redacted]* explained that the trading audience is a means to an end and that the actual target audiences are much more varied than traded audiences: e.g. career seekers, drivers, 16-19 year olds etc. Similarly, [*redacted*] a large FMCG advertiser suggested that while the traded audiences may be as broad as Housewives with Children or Women ABC1, the actual target audience could be as specific as indulgent nutritionists or married with kids.

[40] In this respect, ITV noted that in 2008 [*redacted*] of ITV1's total revenue was booked against more than one traded demographic to advertise the same brand, at different point across the year – e.g. up to [*redacted*] demographics to advertise the same product.

4.17 The overlaps between certain demographics may mean it is appropriate to widen the market because of chains of substitution. For example, although the "Men" and "Women" demographics may not be direct substitutes for each other, they could both be substitutable with the "Adult" demographic. So the price of "Men" may be constrained by the price of "Adults", which may in turn be constrained by the price of "Women". This might suggest that all demographics should be within a single market.

4.18 In addition, most programmes attract viewers from across demographics and broadcasters' optimisation processes usually indicate there are several demographics against which the airtime could be traded efficiently. Indeed, broadcasters normally do not decide which demographic a spot is sold against until just before the point of broadcast. ITV reported that in 2008 more than [*redacted*] per cent of ITV1's total traded airtime by value was optimised against [*redacted*] (or more) demographics over a single ad break. Broadcasters therefore have some degree of flexibility to switch between the sale of different demographics.

4.19 Broadcasters can also change their supply of different demographics by adjusting their programming mix but this may be a less relevant consideration because, according to stakeholders, the time-to-market for a new programme can be up to 18 months. It is also not clear that broadcasters will readily move their demographic focus – this may, for example, require significant re-branding.

4.20 For the purposes of this review, we have defined a single product market for all trading demographics, while recognising that the competitive constraints may differ between different audiences to some extent. No respondents proposed demographic markets.

4.5 Geographic Market

4.21 The 2003 CC report concluded that the relevant geographic market was national. In the consultation document, we proposed this was still appropriate now.

4.22 A number of stakeholders responded that a regional market was more appropriate. We acknowledge that some advertisers do not require national coverage. Some of these may be happy to substitute between different regions, for example in order to test a campaign. Others, local advertisers in particular, may not consider different regions as substitutable.

4.23 We note that the same was also true at the time of the CC's report. The CC appears to have considered regional advertising within the context of the impact on negotiating overall deals between sales houses and media buyers.[41] Although stakeholders have told us there have been some changes in the ability to access regional coverage through other channels, we do not believe that this necessitates a move away from the CC's geographic market definition. We therefore consider regional advertising as an influence on ITV's overall negotiating position.

4.6 Conclusion

4.24 We have concluded for the purposes of reviewing these Undertakings that the relevant market is the national sale of TV advertising. This is the same market definition used by the CC in 2003.

[41] See, for example, Paragraph 5.34 and 2.127 of the CC report.

5 ANALYSIS OF ITV1'S MARKET POSITION

5.1 Introduction

5.1 This section considers the market position of ITV1. The CC report noted that ITV1 had certain “must have“ features for some advertisers. These included unique access to very large audiences, including a high share of peak evening viewing, giving the ability to achieve high levels of coverage in a short period of time. The CC also considered that ITV1 had other unique attributes, such as better viewer engagement, which further increased the value of those audiences. It believed that no other commercial channels could match ITV1, either individually or jointly.[42] The CC did, however, suggest that ITV1’s position was declining, and looked set to decline further in the future.

5.2 In this section, we consider how ITV1's market position has, in fact, changed since 2003. We consider the extent to which other channels are now better able to match the unique features of ITV1. If competition from other channels has increased, ITV may no longer have the potential to exert the detrimental effects which were of concern to the Competition Commission.

5.3 It is beyond the scope of this review to look at the effects of the merger on the sale of airtime on the digital channels but the position of the ITV digital channels is relevant in as much as it affects ITV's ability to raise prices on ITV1. For example, a media buyer's threat to reduce SOB on ITV1 will be less effective in constraining the ITV sales house if ITV believes that this means that media buyers would have to increase spend on other ITV channels. Some media buyers have also suggested that, despite conditional selling rules, ITV can increase spend on ITV1 by threatening to deny access to – or demanding very high prices for – its digital channels.

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[42] CC report paragraph 2.131.

5.4 In the consultation document, we proposed to include GMTV as part of the ITV family of channels. GMTV sells its advertising airtime through a separate sales house but it is partially owned by ITV. At the time of the CC report, the merging parties held a combined 45 per cent interest in GMTV plus an option over an additional 5 per cent, taking the merged entity's interest in GMTV to 50 per cent.[43] The CC looked at the share of net advertising revenue (NAR) of ITV1 and GMTV combined but did not reach a final view on whether the merging parties would control GMTV. However, since that time, ITV has increased its share holding and now has a controlling interest in GMTV, amounting to 75 per cent.[44]

5.5 Some stakeholders commented on the inclusion of GMTV. One agreed that GMTV should be included, as it could be brought within the ITV sales house in future. [*redacted*], on the other hand, argued that [*redacted*] it should not be included. We are still of the view that GMTV should be included. Even if GMTV's airtime is sold separately and independently now, it could be brought within the ITV sales house in future.[45] The Competition Appeal Tribunal's recent decision regarding the BSkyB/ITV case supports this approach.[46] We note, however, that the inclusion of GMTV does not materially affect the analysis.

5.6 In line with our conclusion on market definition, we consider ITV's position as a whole, i.e. across all audiences, but also consider variations across individual demographics. There are many different

[43] Paragraph 5.114 of the CC report.

[44] See the OFT merger decision of 17 September 2004.

[45] We also note that ITV includes GMTV's NAR as part of ITV plc NAR in its financial reports: see, for example, ITV Interim Report, August 2008, at page 12, available at http://www.itvplc.com/investors/reports/ (visited on 19 November 2008).

[46] http://www.catribunal.org.uk/files/1.Judg_revised_BSkyB_1095_Virgin_Inc_1096_290908.pdf.

demographics and no individual demographic group represents a very large segment of the overall market, but it is useful to consider any exceptions to the general trend.

5.7 This section is structured as follows:

- Section 5.2 looks at a number of basic indicators of ITV's market position, such as the overall market shares of ITV and ITV1, the size of individual channels, audience sizes and power ratios.

- Section 5.3 looks at technical analyses of coverage, and the criticisms and elaborations of these techniques.

- Section 5.4 considers ITV1's other possible advantages. These include delivery of light viewers, unique reach, audience engagement and other qualitative benefits as well as the ability to deliver regional coverage.

- Section 5.5 considers indicators of media buyers' countervailing buyer power. It looks at information on which categories of advertisers need ITV1, the proportion of revenue that could be switched away from ITV1 and the size of media buyers.

- Section 5.6 looks at ITV's overall bargaining power in relation to media buyers, and its ability to use this to increase revenue on ITV1.

- Section 5.7 considers whether other broadcasters' ability to enter and/or expand their sale of TV advertising has changed since 2003.

- Section 5.8 considers recent events in the TV market and future trends.

- Finally, Section 5.9 concludes on the extent to which ITV's market position has changed since 2003.

5.2 Indicators of ITV's Market Position

Market Shares

5.8 Market shares in advertising airtime may be measured either as SOCI or as share of NAR. Both market shares are considered here. In general, the OFT considers that revenue shares are a better indicator of market position than volume shares as they incorporate an element of value although volume shares may nevertheless be informative.[47] In this case, however, revenue shares may have been affected by the CRR remedy. CRR is likely to have suppressed ITV's revenue and, as such, ITV's revenue shares are likely to understate its actual market position. In addition, the remedy may have boosted the revenue of some other major broadcasters in which case revenue shares with CRR in place might overstate the position of these channels in the absence of the remedy. We have therefore also considered SOCI, but to the extent that a channel, or group of channels, is of better quality, SOCI will understate its importance.

5.9 Shares for ITV1, ITV sales house and the digital channels alone are discussed below. Some stakeholders claimed that ITV negotiates across all its channels, which would suggest that the market shares of the sales house as a whole should be considered but, to the extent that conditional selling rules limit ITV's ability to leverage the digital channels, the ITV sales house shares will overstate its ability to raise price on ITV1. When considering the market shares of ITV1 alone, on the other hand, it should be born in mind that, regardless of conditional selling rules, the digital channels cannot be considered a competitive constraint on ITV1. As such the market share of ITV1 alone overstates the extent to which it faces competition, although the smaller the digital channels' share the smaller this effect.

[47] See OFT's Guidelines on Assessment of Market Power, OFT415, paragraph 4.7, available at: http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft415.pdf.

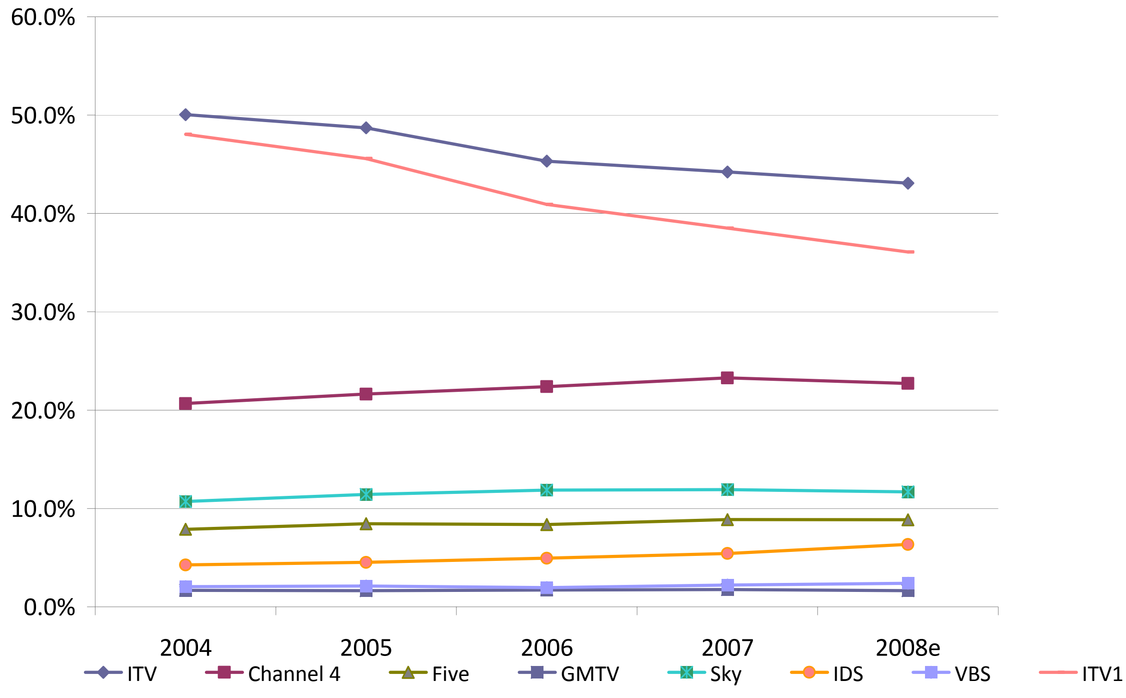
5.10 Revenue shares from 2004 to 2008 are shown in Chart 5.1. We do not have reliable figures for 2003. This shows that ITV1's share of advertising revenue has declined since the merger, falling from 48 per cent of NAR in 2004 to 36 per cent in 2008. Chart 5.2 shows ITV1's Adult SOCI. This has decreased from 40 per cent in 2004 (43 per cent in 2003) to 30 per cent in 2008.

5.11 The ITV digital channels have grown rapidly over the period. Their share of NAR has increased from 2.0 per cent in 2004 to 7.0 per cent in 2008. The SOCI of the ITV digital channels has also increased, although at a lesser rate, going from 3.6 per cent in 2004 (3.1 per cent in 2003) to 8.9 per cent in 2008.[48]

5.12 Overall the ITV sales house share of NAR (including GMTV) has declined from 52 per cent in 2004 to 43 per cent in 2008. Its Adult SOCI has decreased from 49 per cent in 2003 – or 47 per cent in 2004 - to 42 per cent in 2008.

[48] This increase reflects, in part, the increased penetration of digital multichannel platforms which reached 88.9 per cent in the fourth quarter of 2008 (up from 54.2 per cent in the fourth quarter of 2003); with just over 60 per cent of all secondary TV sets (72 per cent of all TV sets) being converted to digital multichannel: see Ofcom, Digital Television Update – 2008 Q4, available at http://www.ofcom.org.uk/research/tv/reports/dtv/dtu_2008_04/.

Chart 5.1: Shares of NAR, 2004- 2008



Source: Ofcom

Chart 5.2: Adult SOCI by sales houses, 2003- 2008

[*redacted*]

5.13 Ofcom also examined the changes in SOCI for a number of other demographic groups. Ofcom told us that, in the main, these broadly show the same pattern as the Adult demographic, although Men 16-34, 16-44s and Children saw somewhat larger declines.

5.14 The CC report noted that ITV1's share of commercial impacts in peak-time was particularly high.[49] ITV1's share of commercial audience in peak-time was [*redacted*] per cent in 2008, which is higher than its overall SOCI and more than three times the share obtained by Channel 4.[50] There has, however, still been a decline of more than 12 percentage points since 2003, when its share of peak was 51.2.[51]

In summary, the market shares indicate a significant decline in the market position of ITV1. The market shares of ITV's digital channels have been growing, capturing around half of the loss in share on ITV1, but still remain low.

Channel Sizes

5.15 In order to consider the importance of individual channels, we have considered the Adult SOCI of the 15 channels attracting the highest number of viewers in 2003 and 2008. These are shown in Chart 5.3 below. ITV1 now attracts [*redacted*] adult impacts compared to [*redacted*] impacts in 2003 but it still remains by far the single most popular commercial channel. Although Channel 4 has grown somewhat, ITV1 remains more than twice its size. The remaining top channels have also increased in size. Many stakeholders argued that,

[49] Paragraph 5.101 of the CC report.

[50] Based on BARB data, supplied by Ofcom.

[51] [*redacted*] reported that in 2003 ITV1's average peak audience size was 3.42 times larger than the average size for all commercial broadcasters other than ITV1, whereas it increased to 5.13 times in 2008.

overall, the market is more fragmented, and this has increased their reliance on mass audiences provided by ITV. [52]

5.16 The chart also shows that ITV's digital channels have grown in size, and ITV2 and ITV3 the largest digital channels, although they are still considerably smaller than any of the analogue channels. Stakeholders have suggested that this gives them an important position, despite their low overall market shares.

Charts 5.3 (a): Adult impacts for top 15 channels, 2008, millions

[*redacted*]

[52] We note that the merging parties made the same remark before the CC in 2003: see, CC Report, paragraph 5.106 ('(...), given the increase in fragmentation in television viewing, the relative benefits of ITV's mass audience had increased').

Chart 5.3 (b): Adult impacts for top 15 channels, 2003, millions

[*redacted*]

5.17 Ofcom has also examined the changes in the top 15 channels between 2003 and 2008 for a number of demographics. Ofcom told us that overall changes in the pattern of viewing shown by the Adult demographic appear to be replicated across most other demographics. That is, whilst ITV1 remained the single largest supplier of impacts, its SOCI fell between 2003 and 2008 and the difference between it and its nearest competitor decreased. However, the extent of change was more significant for the Men 16-34 demographic where the gap between ITV1 and Channel 4 was almost entirely closed in 2008. There was also a marked decline for the Children demographic, probably reflecting ITV1's cut in children's programming.

Programme Sizes

5.18 We have also considered the sizes of the audiences drawn by the programming shown on ITV1, as the CC considered that ITV1's ability to attract mass audiences was one of its key unique factors.

5.19 The number of television programmes delivering audiences in excess of 3, 4, 5 and 6 million has declined by around 30-35 per cent since 2003. This is shown in Chart 5.4 below. This suggests TV viewing may now be more fragmented.

Chart 5.4: Number of Mass Audience Programmes on commercial TV channels, 2003 - 2008

[*redacted*]

5.20 ITV1 has, however, maintained its share of such programming. It still has an almost exclusive position in delivering audiences over 6m and significant leadership in delivering audiences over 3m. This is shown in Chart 5.5.

Chart 5.5: ITV1's share of high rating programmes, 2003 - 2008

[*redacted]*

5.21 During 2008, ITV1 accounted for 993 of the top 1000 commercial programmes in terms of numbers of adult viewers.[53] This proportion has barely changed since the merger.[54] The only other commercial channel which ranked in the top 1000 programmes was Channel 4.

5.22 Ofcom told us that this pattern is not reflected across all demographic groups. Most notably, ITV1's proportion of top 1000 commercial programmes for the16-34 demographics has materially declined. The number of times that ITV1 features in the top performing shows for the Men 16-34 demographic has decreased by more than a quarter from 825 in 2003 to 631 in 2008 (compared to Channel 4's 349). The decline in the other younger demographics is also more pronounced.

[53] Source Ofcom

[54] ITV1 accounted for 995 of the top 1000 commercial programmes in 2003 and 933 in 2002.

5.23 Despite this decline,[*redacted*] observed that ITV1 is still uniquely positioned in terms of mass audience delivery even for younger demographics. For example, in 2008 ITV1 delivered 32 programmes with audiences above 1 million for the Men 16-34 demographic, compared to just 2 programmes on Channel 4 and none on Five. ITV1 also showed 50 programmes with an audience share of over [*redacted*] per cent of all 16-34 year old men, compared to just [*redacted*] on Channel 4 and [*redacted*] on Five.[55]

5.24 In response to the consultation document, ITV challenged the importance of ITV1's unique ability to deliver mass audiences on a regular basis. It argued that, provided a campaign delivers the desired reach and frequency, advertisers should be largely indifferent as to how and when their adverts are broadcast. We agree that mass audiences are a means to an end but consider ITV1's proportion of mass audiences may be indicative of its ability to gain reach and coverage, although the ITV1's reach and coverage is analysed in further detail on the section on technical substitutability. Mass audiences may also have advantages other than reach and coverage, such as higher audience engagement leading to more product sales. This is also discussed in further detail below.

5.25 ITV also argued that despite delivering high audiences, its highest rated programmes perform very poorly in terms of delivering reach, since they tend to deliver the same viewers repeatedly.[56] It showed evidence

[55] Similarly, [*redacted*] observed that even in the sub-demographic where ITV1 is weakest, namely Adults 16-34, ITV1's share of top 500 programmes was 82.2 per cent in 2008. Based on BARB/AdvantEdge data, [*redacted*] reported that ITV1 showed [*redacted*] out of the top 50 top rating programmes in 2003, down to [*redacted*] in 2008.

[56] ITV analysed a single week in October 2008 and compared the reach delivered if an advert was broadcast in each of the top 10 ITV1 programmes in that week with a profile with the same number of television ratings (TVRs) but allocated according to natural delivery. The latter profile was [*redacted*] in that it delivered [*redacted*] per cent in terms of Adults 1+ coverage levels, [*redacted*] percentage points than the hypothetical campaign made up by the weekly top 10 ITV1 programmes.

of requests from media buyers not to have airtime for a specific campaign repeatedly booked on programmes such as Coronation Street or Emmerdale. We note that over a quarter of ITV's top rated programmes are accounted for by different episodes of Coronation Street, and acknowledge that this may be detrimental to the ability to achieve reach with only mass audience programmes. However, we consider that the most important question is not whether advertisers could achieve their campaign goals by using only ITV1's mass audiences, but whether it would be possible without using ITV1 at all.

5.26 Finally, we note ITV still markets itself on its ability to deliver such audiences, particularly in an increasingly fragmented market.[57] Moreover, in response to a survey of advertisers and media buyers undertaken by ITV 94 per cent of respondents who considered that ITV1 was essential said that this was because of its ability to deliver large audiences.

The indicators above suggest that ITV1 has maintained its position in mass audiences, potentially providing it with a strong advantage over other channels.

Power ratios and use of CRR contracts

5.27 We have also considered how prices have changed on ITV1 and other broadcasters since 2003. Prices are often discussed by reference to

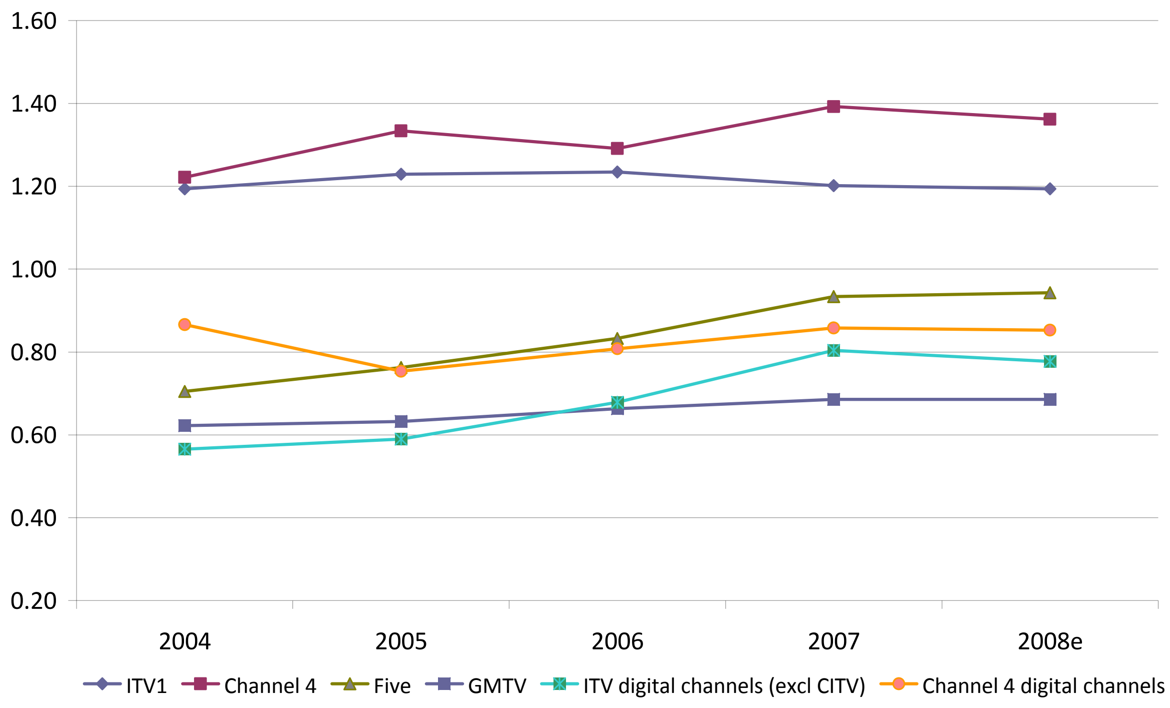
[57] David Pemsel, ITV's Group Marketing Director, states on ITV's website: "... we deliver volumes of audiences which enable our customers to get reach and mass very quickly, which in a fragmented market is an absolute must": *see* http://www.itvinsights.co.uk/default.asp?section=110&page=629&subpage=2341 (as visited on March 26, 2009). Jeff Henry's presentation at the Bernstein conference, 24 September 2008, page 4, available at http://www.itvplc.com/investors/presentations/ (visited on 19 November 2008) states that ITV1 was also the only commercial channel to have delivered audiences above 6m in the first half of 2008. John Cresswell's presentation at the Morgan Stanley TMT conference, 20 November 2008, page 12, notes that Channel 4 seldom gets more than 4 million viewers even when the Channel 4+1 viewers are included in the total available at http://www.itvplc.com/investors/presentations/ (visited on 16 December 2008).

"power ratios" – the ratio of share of NAR to Adult SOCI multiplied by 100. This gives a crude measure of the average price per impact.

5.28 The power ratios on ITV1 are highly likely to have been affected by the CRR contracts. In particular, as the ARM allows media buyers to withdraw spend in line with the decline in SOCI, we might expect the power ratio to be broadly flat while CRR is in place. This is particularly so as there has been little movement away from CRR contracts. Indeed, it has been suggested that this continued reliance on CRR is, in itself, evidence that media buyers rely on CRR to provide favourable terms. We have noted this, but, as described in Section 6.5, it is also possible that CRR has reduced dynamism in the media buyer market, inhibiting movement away from CRR for reasons over and above fears about ITV exploiting the market position of ITV1.

5.29 Although ITV1's power ratio is broadly flat, there is a slight increase in 2005 and 2006. This is shown in Chart 5.6 below.

Chart 5.6: Power Ratios, 2003 - 2008



Source: Ofcom

5.30 The consultation document noted that the small increase in ITV1's premium could reflect some limited opportunity for ITV to exploit its enhanced market position even with CRR in place. These possible weaknesses in CRR protection are discussed in Section 7. If, as stakeholders have commented, ITV1 has become more valuable in an increasingly fragmented environment, it is also possible that media buyers optimally chose not to withdraw the full value of the ratchet. ITV, on the other hand, argued that the increase in power ratio reflected better terms and conditions offered.

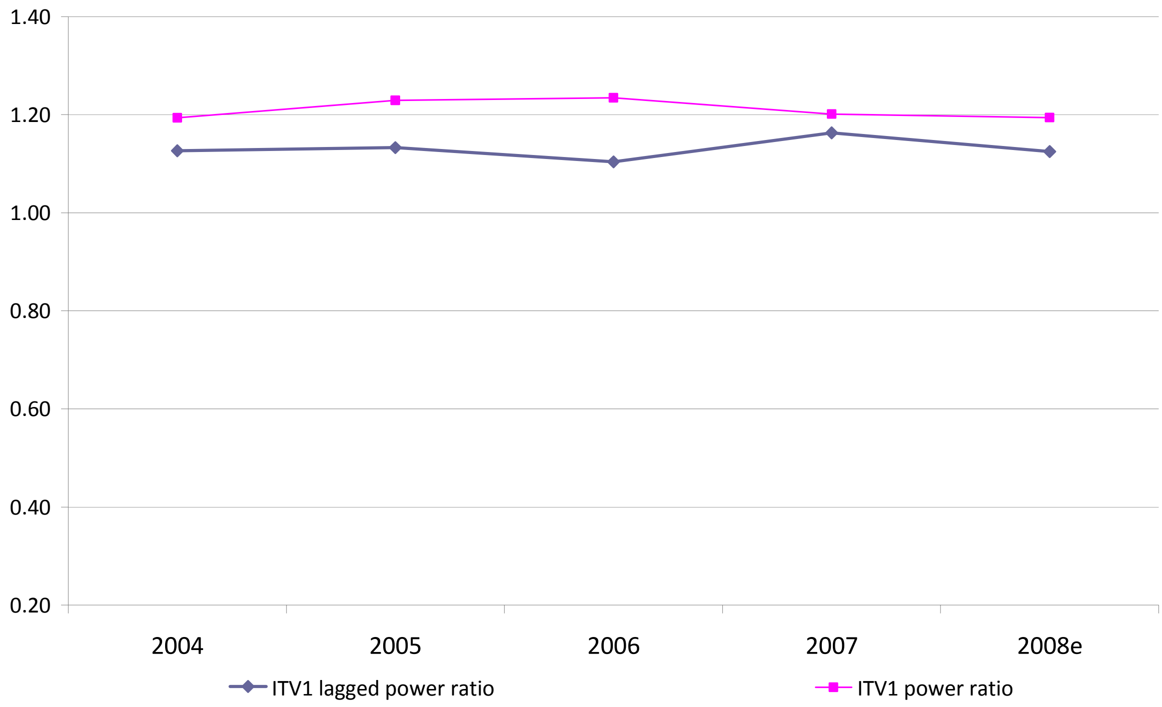
5.31 In response to the consultation document, many third parties reiterated their view that power ratios provide evidence that the enhanced market position created by the merger persists today. Moreover, they argued that without CRR protection, ITV's ability to leverage this market position would become much greater.[58]

5.32 There may, however, be other explanations for the slight increase in premium. For example, the ARM means that SOB commitments changed with a lag, causing fluctuations in the power ratio. For example, if the decline in audience in a given year is 1 per cent, then up to 1 per cent of spend could be removed the following year, but if audience then fell by 2 per cent in that year, the power ratio would increase. More generally, when the rate of decline in SOCI increases, the power ratio will increase. Conversely, when the rate of decline of SOCI is slows, the power ratio should decrease. For example, if the decline in audience in a given year is 2 per cent, then up to 2 per cent of spend could be removed the following year, but if audience then only fell by 1 per cent, the power ratio would decrease.

[58] Many stakeholders commented that the fact that ITV's power ratio was higher than other channels was, in itself, evidence that that advertisers were captive to ITV, as they wouldn't pay a premium if they did not have to. We do not view this as relevant – ITV's premium was higher than other channels before the merger – we are concerned with ITV's ability to increase premiums over and above that level.

5.33 If this were the only explanation for the fluctuations in the power ratio, the "lagged" version of the power ratio (that is the ratio of share of NAR to Adult SOCI in the previous year multiplied by 100) should be flat. Chart 5.7 shows that the lagged premium does not have such an evident increase, although there are still some fluctuations.

Chart 5.7: ITV1's current and lagged power ratios, 2004- 2008



Source: Ofcom

5.34 The changes in the audience mix may also have an impact on the power ratio. For example, it may be that ITV1 is able to better optimise its impacts because there is a better fit between the audience demand and the audience supplied. This would increase its power ratio.

5.35 If the change in audience mix meant that more impacts were sold against more expensive audience groups, the power ratio would be pushed up or, alternatively, if there was a move to buying less expensive audience groups, the power ratio would fall. This would happen even with the ARM as the ratchet does not depend directly on the change in SOCI, but is weighted to reflect the losses in the demographic group which the media buyer purchases. So, for example, if there was a particularly large loss in 16-34 men, a media buyer who bought a particularly large amount of this demographic would be able to reduce its SOB by a greater extent.

5.36 [*redacted*] argued that power ratios are more meaningful if the shares of impacts are weighted according to the value of demographics within a channel audience. [*redacted*] provided figures for ITV sales house (excluding GMTV) and ITV digital channels. The weighted power ratio for the ITV sales house between 2003 and 2008 was flat, while the former experienced a steep increase. This suggests that the weighted power ratio for ITV1 may have actually been decreasing.

Chart 5.8: weighted power ratios by sales houses

[*redacted*]

5.37 The effect of the audience mix is hard to disentangle. The distribution of ITV1's revenue by demographic has switched in favour of broad demographics such as Adults ABC1, Adults and Housewives with Children, and these audiences have performed relatively better than, say, Men ABC1 and 16-34s. This suggests that optimisation may have improved, which would push up the power ratio. On the other hand, if media buyers are buying audience groups with lower CPTs[59], this would tend to push down the power ratio. Thus it is not clear whether audience mix effects are responsible for the increase in premium or whether the premium increased in spite of these.

All in all, we do not believe that we can infer much about ITV1's market position from the power ratios with CRR in place. The increase in the power ratio is very slight and there are several possible explanations for this, between which it is difficult to distinguish.

[59] CPT, or cost per thousand, is the cost of a thousand impacts of the target demographic.

Summary of Indicators

5.38 In summary, ITV1's market share, channel size and mass audience size have all declined since 2003. Some audiences, such as Housewives, appear to have held up better than others, with the decline in 16-34 Men being particularly pronounced. Nevertheless, ITV1 has maintained its leadership in terms of attracting large audiences, although the number of programmes attracting such audiences has decreased. Stakeholders also argued that the increased overall fragmentation only adds to the value of ITV1's concentrated mass audiences.

5.39 It has been argued that ITV1's increased power ratios also provide an indication that the potential for detrimental effects of the merger remain. We are unable to draw such a strong conclusion as the increase is slight and there are a number of possible explanations for the effect. Stakeholders also noted that most media buyers continue to rely on CRR protection to a very great extent, and claim this shows that on-going protection is required. We have noted this, but, as described in Section 6.5, there are other reasons for inhibiting movement away from CRR for reasons over and above fears about ITV1 exploiting its market position.

5.40 We have also considered the indicators of the position of ITV's digital channels. These have grown considerably and ITV2 and ITV3 are now the largest digital channels, with ITV4 consistently in the top ten. They are, however still very small relative to the PSB broadcasters, and are below the size usually associated with any significant degree of market power. Neither do they appear to have any strong advantage in terms of mass audience programmes. Stakeholders also told us that these channels were substitutable.

5.3 Simulations of ITV1's substitutability

Technical Simulations on a Campaign by Campaign Basis

5.41 The CC considered whether it would be possible for a hypothetical advertiser to plan a TV advertising campaign without using ITV1 while achieving similar coverage and frequency targets, conventionally measured in terms of 1+ and 4+ cover levels.[60] The analysis it considered indicated that in 2002 for certain key target demographics it was theoretically possible to achieve a greater coverage without ITV1 than could be achieved with ITV1 at the same cost – the main exceptions were the ABC1 Adults, Adults and Housewives, where excluding ITV led to a decline in 1+ coverage of between 1 and 3 percentage points.[61] The ability to obtain equivalent coverage with or without ITV1 was due the lower price of advertising on other channels which meant that a greater number of TVRs[62] could be bought so that the same levels of coverage and frequency were achieved, despite ITV1's more efficient delivery.

5.42 The increase in commercial impacts on other channels today might make it easier for advertisers to do without ITV1. We therefore asked ITV to provide a similar analysis for comparison with the figures used in the CC report. ITV argued that 2002 figures were not comparable with 2008 results as the 2002 data were generated with SPC Xpert, but ITV currently use InfoSys. The two software packages differ with the algorithm adopted by InfoSys treating ITV1 as more important to the delivery of reach. ITV told us that it believed the 2003 figures were more comparable with later years.

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[60]Coverage is generally expressed as the percentage of the target audience that views the campaign. 1+ cover (or reach) refers to the percentage of the target audience seeing the advert at least once. Frequency refers to the number of people who have seen an ad campaign more than once over a given period. So a frequency of 4+, or 4+ cover, refers to the percentage of the target audience seeing the advertisement at least four times.

[61] Paragraph 5.111 of the CC report and Table 5.22

[62] The effectiveness of advertising in reaching a target demographic group is measured in television ratings, or TVRs. For a particular campaign, one TVR represents 1% of the target group. Thus, a 30 second advert in a programme that reaches 25% of a particular demographic group delivers 25 TVRs.

5.43 In the consultation document we compared data for later years with 2002 figures in the CC report, and also with figures ITV provided for 2003. Stakeholders did not generally express any strong opinions about whether 2002 or 2003 was a better comparator. In addition, ITV told us that even by using the same software, the comparison would not be reliable due to a technical anomaly in the raw data for 2002.[63] Ofcom confirmed this. We have therefore used 2003 as a comparator.

5.44 Table 5.1 compares the simulation results provided by ITV for March 2003 and April 2008 of a 400 TVRs campaign run over a period of four weeks. We also asked the IPA to perform a similar analysis using the same assumptions as ITV. The IPA's conclusions were broadly consistent with ITV's.

Table 5.1: Estimated change in percent of +1 and 4+ cover if ITV1 is excluded for four week 400 TVR campaign in 2003 and 2008

	Mar-03		Apr-08		Difference	
	1+	4+	1+	4+	1+	4+
Adults	-	+	-	+	+	+
ABC1 Adults	-	+	=	+	+	+
Adult 16-34	+	+	+	+	+	+
Men ABC1	-	+	+	+	+	+
HW	-	-	-	+	+	+
HW + CH	-	+	+	+	+	+

Source: ITV[*Actual numbers were contained in the confidential advice sent to the Competition Commission*]

5.45 The results suggest that there has been an improvement in ITV1's substitutability since 2003. By April 2008, excluding ITV1 would not reduce 1+ coverage levels for most demographics, the exceptions being Housewives and Adults. 4+ coverage would actually improve for

[63] ITV argued that in 2002 the BARB panel was reconfigured, which led to a reduced weight being put on ITV1, as evident from a discontinuity in the curves representing ITV1's SOCI by demographics.

all demographics. ITV replicated the results excluding all ITV digital channels, but this did not have a material impact on the results.[64]

5.46 We also considered the results for campaigns delivered over a one-week period. Table 5.2 below presents the simulation results for a 400 TVRs campaign over one week in March 2003 and April 2008.

Table 5.2: Estimated change in percent of +1 and 4+ cover if ITV1 is excluded for a one week 400 TVR campaign in 2003 and 2008

	Mar-03		Apr-08		Difference	
	1+	4+	1+	4+	1+	4+
Adults	-	-	-	+	+	+
ABC1 Adults	-	+	-	+	+	+
Adult 16-34	-	+	+	+	+	+
Men ABC1	-	+	-	+	+	+
HW	-	-	-	+	+	+
HW + CH	-	+	+	+	+	+

Source: ITV [*Actual numbers were contained in the confidential advice sent to the Competition Commission*]

5.47 This shows that, even for 400 TVR campaigns conducted over one week, the advantage of using ITV1 has decreased since 2003. Nevertheless, the results suggest that excluding ITV1 still results in a loss in cover for certain audiences. This is consistent with stakeholder views that ITV1 is required for fast coverage. The results showed that, compared to natural delivery, excluding ITV1 would lead to a drop in 1+ coverage for all demographics, but for Adults 16-34 and, to a lesser extent, Housewives with Children. For 4+ coverage levels there would be generally an improvement in coverage for all demographics if ITV1 was excluded.

5.48 ITV compared these results with simulations of the cover and frequency levels that could be reached without either of the merging party in 2003. It suggested that advertisers could substitute away

[64] We also asked ITV to analyse the impact of including or excluding GMTV from the mix of substitute channels. ITV told us this had no material impact on the results.

from ITV1 more easily than they could substitute away from either Carlton or Granada pre-merger. We have considered this analysis but believe it to be unreliable. This is discussed in detail in Annexe D.

5.49 We asked several media buyers to use their planning models to compare the delivery of campaigns with and without ITV1, and excluding all ITV channels, for those campaigns that need to have ITV1 in their channel mix. Although the results were mixed, and the methodology was not always provided, the majority of those simulations indicated that it would still be more expensive to obtain similar cover levels without ITV1. However, some results suggested that it would be now possible to obtain similar levels of cover without ITV1 at the same budget. Some suggested that substitutability had improved since 2003, and others that there had been no discernible pattern of change.

5.50 A few stakeholders suggested that the results obtained using these techniques were open to manipulation. Some provided other methods of estimating the effect of ITV1's reach. For example, [*redacted*] used econometric analysis to estimate the effects on sales from a drop in its target coverage levels due to a removal of ITV1 and ITV family of channels based on a campaign run in January 2008. This indicated that sales would fall by 7.4 per cent without ITV1 and by 8.5 per cent if no ITV channels were included in the channel mix.[65] Stakeholders also

[65] [*redacted*] provided evidence which they claimed showed the importance of ITV1's peak time. They provided an example of a promotion for [*redacted*], which showed that there was a greater effect on sales in regions where it showed on Channel 4 than on ITV in the same night. This may be because the programme on Channel 4 had lesser reach than on ITV. We believe that although this suggests that the programme Channel 4 may have a lower reach (or lower quality impacts) than the programme on ITV, it does not in itself, indicate that, with additional programmes on other channels, the same coverage and reach could not be obtained without ITV.

emphasised that only a small drop in coverage had an important effect on sales.[66]

Overall, the results seem to indicate that ITV1 is now substitutable for a larger number of campaigns, although it is still not entirely replaceable for 1+ coverage for some demographics, particularly for fast mass coverage. We note, however, that these results may not be entirely reliable. Some specific criticisms of them are discussed below.

Campaign Parameters

5.51 Although stakeholders generally endorsed the coverage and frequency parameters chosen in the substitutability models, some advertisers and media buyers pointed out that campaign goals may vary for each campaign. For example, performances can be measured against 3+ cover levels or even frequency ranges such as between 2+ and 5+ cover.

5.52 ITV argued that the parameters for the example of fast coverage were not appropriate. In other words, 400 TVRs in one week are not representative of the way TV advertising campaigns are conducted. ITV looked at the campaigns booked in the last year to work out what parameters are actually representative of "fast build" campaigns. It found that not a single campaign with such parameters was booked, but that the bulk of the activity would be run at between 60 to 100 TVRs across all channels in a single week.

5.53 ITV considered campaigns that only lasted one week. Stakeholders, in contrast, suggested fast mass build was required at the initial stages of

[66][*redacted*] observed that in a recent pitch for a client worth [*redacted*], the differential in claimed coverage build between the successful and unsuccessful pitching agencies was [*redacted*] per cent.

longer campaigns, and some supporting evidence was provided.[67] A campaign covering 400 TVRs over a week would correspond to an average of less than 60 TVRs in a day. If these were distributed according to natural delivery, this would correspond to about 18 daily TVRs on ITV1. These daily campaign parameters would not be implausible for advertisers of the entertainment sector e.g. advertising supporting film, CD, DVD and video game releases, even if they were not sustained throughout the week.[68]

We agree that the analyses provided do not cover all possible campaign parameters, although we have looked at a range of analyses provided by ITV and other stakeholders. As the CC did in 2003, we consider the analyses to be one potential indicator of the extent to which similar coverage and frequency can be obtained without ITV1.

Campaign Targets

5.54 A further criticism of the approach is that that the coverage analyses do not reflect the true target of a campaign or the coverage it delivers. Several stakeholders suggested that although advertisers nominate a specific audience sub-demographic (e.g. Women 16-34, ABC1 Men etc) this is still in the knowledge that their TV advertising will reach a wider group, particularly if shown in a mass audience programme. For example, an advert aimed at men will also pick up some female viewers. Similarly, an advert targeted at a broad demographic will also reach some of the more valuable narrower audiences, so an advert aimed at housewives will also target some women 16-34. The

[67] For example, [*redacted*] and [*redacted*] provided the details of timings and TVRs of FMCG advertisers in 2008, showing that, typically, the activity was focussed during the first two weeks.

[68] For example, [*redacted*] provided examples of three actual campaigns using around 60 TVRs daily. [*redacted*] also pointed out that retailers often buy much higher weights than 100 TVRs per week and over shorter periods and provided an example of an advertisers using an average weekly weight of 350 TVRs per week.

simulations considered do not account for the additional benefit of this effect.

5.55 We were told that these “spillovers” are valued, in particular (but not exclusively), in the context of brand building activity. Stakeholders provided evidence that ITV1 is the only commercial channel with the ability to deliver these wider audiences consistently and cost effectively, especially among broad female groups (e.g. Housewives and Women). [69] [*redacted*], on the other hand, argued that spillovers would be more valuable on Channel 4 as they generally had a more up-market audience groups so, for example, if the target is Men ABC1, there would tend to be a lot of Men 16-34.

5.56 More generally, advertisers may feel that the demographic groups do not adequately reflect its true target group. For example, it may believe that ITV1 housewives are better targets than housewives on other channels. This would not be picked up by the coverage analyses. This feature of ITV1’s mass broadcasting may explain ITV1’s importance to large retailer multiples targeting broad female demographics. For example, [*redacted*] justified its reliance on ITV1 by observing that there is a close brand fit with ITV1 viewers across all the major demographics.[70] [71] [*redacted]* advanced a similar argument with reference to [*redacted*].[72]

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[69] [*redacted*] provided an example of a campaign where the target was the Housewives with Children but the advertiser also looked to maximise cover against the wider Housewives group. The results showed that while the exclusion of ITV1 reduced the 1+ coverage for the prime target by 1.5 per cent, the cover loss for the broader audience group was 8 per cent.

[70] [*redacted*] also provided evidence suggesting that 94 per cent of people who shopped at its stores in 2008 were ITV1 viewers, although it is not clear how "ITV1 viewers" were defined.

[71] Further support for this is provided by ITV's survey commissioned by [*redacted*] (discussed in detail later in this section). This showed FMCGs all cited “*viewer profile that matches my target audience*” as the main reason why they considered ITV to be essential. It is also worth noting that this category of advertisers had a significantly higher percentage of respondents who cited “*content that fits well with my brand*” than the full sample. ITV's [*redacted*] analysis of the

5.57 The OFT notes, however, that neither advertisers nor media buyers have provided us with evidence showing that these spillover effects were taken into consideration when planning, executing and monitoring their TV campaigns. Indeed, the ideas were only raised in response to the consultation document. The effects are therefore likely to be at most secondary in nature.

Overall, it is not clear that spillover effects are a very significant criticism of the coverage analyses as we have seen limited evidence that these are taken into account in practice.

Excessive frequency

5.58 The CC report also noted that, even if the same coverage was available elsewhere, using ITV1 ensured that viewers did not see advertisements too many times and become irritated by them.[73] Several stakeholders told us that they considered that this was still relevant.

5.59 Media buyers told us that there was no consistent definition of an 'excessive' level of frequency, as it would depend on the specific campaign goals and target demographics. Some stakeholders suggested that 8+ coverage would be an appropriate threshold.

5.60 ITV provided data showing the extent of 6+ and 10+ cover which arose in the technical analyses presented above. In the absence of any other data, the OFT has used 6+ and 10+ coverage as indicators of

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channel mix strategies of the different newspapers groups shows how the use of ITV1 is, to some extent, polarised: while [*redacted*] are heavily reliant on ITV1, [*redacted*] are hardly present on ITV1. This may also reflect differences in the true target audience.

[72] [*redacted*] also provided evidence showing the ITV1's share of expenditure for several retailers in 2008 were in excess of the industry average. This might suggest that they are more dependent on ITV1, although other factors, such as their exact deal on ITV, might also have an effect.

[73] CC report, Paragraph 2.108.

excessive frequency. This showed that the amount of 6+ and 10+ cover does increase if ITV1 is excluded from the channel mix. In most instances, the increase in frequency was between 2 and 6 percentage points. For example, 10+ frequency for Adults on a 400 TVR campaign over a four-week period increased from 10.3 per cent to 13.4 per cent when ITV1 was excluded.

5.61 In response to the consultation document, ITV noted that no evidence had been produced to support the argument that multiple viewings of an advert may be detrimental to advertisers as it increases the chance of irritating viewers. It argued that, as long as advertisers can reach their target coverage and frequency levels within the same budget, the fact that the higher frequency levels are also reached, but at no additional cost, should not be treated as "wastage" until the cost of these additional impacts outweighed the benefit.

5.62 We agree that additional impacts are not necessarily detrimental. They will only become so once the value of the extra impacts is outweighed by the cost, although no reliable evidence was provided to support the idea that excessive frequency was a concern in practice.

5.63 The consultation document also noted the lack of equivalent figures for 2002, which meant that it was difficult to determine whether wastage has increased. In its response, ITV provided a comparison between March 2003 and March 2007. The analysis showed that since 2003 6+, 8+, 10+ and 20+ frequency levels in general have increased due to greater audience fragmentation. The increment in frequency levels due to the exclusion of ITV1 from the channel mix has, however, lowered as it accounts for lower levels of SOCI and so less spend needs to be moved to replace it. This meant that the exclusion of ITV1 would lead to a lower increment in levels of excessive frequencies compared to 2003.[74]

[74] We note that the use of SPC Xpert instead of InfoSys may have produced the opposite result. This is because InfoSys attaches a lower weight to ITV1 which would reduce the effect of ITV1's reduced SOCI while the effect due to audience fragmentation would remain broadly the

Overall, it is possible that ITV1 may still offer benefits relative to other channels, as there is less risk of excessive frequency but we have no evidence that suggests this is a significant factor for advertisers.

Predictability

5.64 Several media buyers and advertisers criticised the methodology adopted by ITV as the analyses are based on actual viewing figures, which makes it easy to identify where coverage can be replaced most effectively and cost efficiently. They claimed that, in actual fact, the impact of a campaign is variable and hard to predict, and this becomes more of a factor if ITV1 is excluded.

5.65 ITV maintained that its analytical framework is sound, in that although campaign modelling is carried out on a forward looking basis, it would still be based on historic BARB data. ITV also argued that there is no reason to presume that ITV1 is more predictable than the other channels. The use of optimisers based on the natural delivery assumption such as InfoSys or SCP Xpert is therefore adequate to infer the degree of substitutability on a forward-looking basis.

5.66 ITV explained that the only data input in to InfoSys is BARB audience ratings, which are subject to the same margin of error on all channels. BARB told us that there are differences in the sampling errors of the various channels, where large established channels like ITV1 have lower sampling errors than minor digital channels. Therefore, although the exact levels of viewing cannot be perfectly predicted on a forward looking basis, the level of accuracy of BARB ratings for ITV1 is better than for minor digital channels. BARB also explained that the sampling error would be eased when aggregated across channels (in other

same. We also noticed that figures provided by ITV were incongruent with figures previously submitted. ITV argued that the differences were due to changes in the level of granularity of the rounding factor adopted by InfoSys: from the nearest 10 TVRs to the nearest 5 TVRs.

words, the risks would be pooled), but this would not fully offset the higher statistical errors for low audience ratings.[75]

5.67 Moreover, a larger number of spots are required to obtain the same coverage without ITV1. [*redacted*] suggested that a campaign that originally ran over 1,202 spots to reach 255 TVRs in the Adults ABC1 demographic would require almost 2,000 more spots to replace ITV1. Stakeholder suggested that, as many more spots are needed, each of which have an uncertain outcome, the overall variability, comprised of the variability of each of the programmes, may be much higher than if ITV1 is used on its own.

5.68 [*redacted*] argued that this hindsight issue also means that excessive frequency levels are also under-reported.

Overall, we consider that it is possible that the coverage achieved without ITV1 may be harder to predict than with ITV1. We are, however, unable to quantify the extent of this difficulty and neither have we seen any evidence that this is taken into account when campaigns are actually planned.

Practical Issues

5.69 The CC was concerned that, although ITV's technical analysis holds in theory, it does not work in practice, for example due to difficulties in purchasing sufficient number of suitable spots.[76] Suitable spots may be limited if there are clashes with other adverts of a similar nature (e.g.

[75] BARB provided a guideline showing that, for example, the 95 per cent confidence interval for a 100 TVRs campaign targeted at Housewives and made up of 1000 spots with average audience 0.1 TVR would be subject to a statistical error of +/- 3.6 per cent, that is, 96.4 - 103.6 TVRs; whereas for similar 100 TVRs campaign but made up of 10 spots averaging 10TVRs the statistical error would be +/- 2.2 per cent, so the confidence interval would be 97.8 - 102.2 TVRs. BARB further confirmed that the relationship between statistical error and different levels of average audience will be similar for other target audiences.

[76] Paragraph 2.128 of the CC report.

two car adverts) or if the advert was already being shown a large number of times on that channel.

5.70 Media buyers have claimed that these concerns still remain relevant. They mentioned problems due to clashing with other competing brands, advertisers' own restrictions on which channels they will allow their advert to be shown on, and regulatory restrictions such as those imposed on food and drink high in fat, salt or sugar (HFSS foods).

5.71 To address those claims, ITV commissioned an independent auditor, [*redacted*], to show how actual campaigns which have been run using ITV1 could be replicated without it, taking into account practical considerations such as the sales policies of sales houses.[77]

5.72 The consultation document described [*redacted*] [*the auditor's*] methodology in detail. In brief, six actual campaigns corresponding to around 400 TVRs over four weeks were selected from March 2007, which represented the following demographics: Adults, Adults 16-34, Adults ABC1, Men ABC1, Housewives and Housewives with Children. The broad approach was to replace actual ITV1 slots used in each campaign with those available on other channels to see if the resulting levels of cover and frequency would match the original actual campaign outputs, while taking into account the sales practices of the different broadcasters (for example, their optimisation policies) such as Channel 4's weekly weight of advertising restriction.[78]

5.73 A further analysis also distinguished between regular ITV1 airtime and so-called "super-peak", where the latter was described as airtime

[77] The analysis did not consider the impact of excluding ITV's digital channels, although this may not be a significant consideration, as it made little difference to ITV's technical exercise.

[78] [*redacted*] [T*he auditor*] had to exceed a rating count of 50 TVRs per week on Channel 4 on two occasions, albeit only marginally.

which delivers higher TVRs than are available in any non-ITV1 environment.[79]

5.74 The simulations for 2007 showed broadly the same patterns displayed in ITV's technical simulations for 2007 – that most demographics were substitutable even for super-peak. The only exception was housewives where ITV1 airtime delivered better results, particularly in super-peak. This simulation exercise was not applied to the situation pre-merger.[80]

5.75 In response to the consultation document, advertisers and media buyers reiterated that, despite [*redacted*] [*the auditor's*] analysis, in reality they would face practical difficulties to find and obtain the necessary replacement spots. These practical difficulties would be particularly problematic for campaigns running at high weekly rates and/or requiring weight on particular days or periods (e.g. Christmas sales).

5.76 To address these further concerns, [*redacted*] [*the auditor*] was asked to extend its analysis to fast-build campaigns. These were defined as campaigns running at 100/150/200/250 TVRs over a single week in 2008. The results followed a similar pattern to the previous results. In all cases, except for the Housewives demographic, the same 1+ and 4+ coverage levels could be achieved without ITV1 but [*redacted*] [*the auditor*] noted that on several occasions they clearly ended up with a revised schedule with over 50 TVRs on Channel 4 in a single week, which is against the channel's normal sales policy. [*redacted*] [T*he auditor*] had to significantly exceed this threshold for all campaigns above 200 TVRs, and twice (out of a sample of five campaigns) above

[79] For each target audience a list of top rating spots was generated (from DDS using the PRANK report within the TARGET tool) for ITV1, C4, five & MCH. These were then compared to see at what level of TVRs the other channels (primarily C4) could consistently deliver spots. All ITV1 airtime delivering a higher level of rating point than this are labeled as "super-peak".

[80] ITV also updated [*redacted*] [*the auditor's*] analysis with figures for April 2008 reaching similar conclusions and also showing an improvement in the degree of substitutability of ITV1 since March 2007.

150 TVRs. We further observe that the revised schedule made use of ITV's digital channels.

5.77 Stakeholders also raised additional criticisms of [*redacted*] [*the auditor's*] analysis. In particular, they claimed that the analysis excluding ITV was conducted with the benefit of hindsight, which makes it easier to pick the top performing spots. As discussed above, variability in other channels may make it difficult to predict coverage accurately on a forward-looking basis. More importantly, the slots on ITV1 were the actual ones used and so did not benefit from hindsight.

5.78 [*redacted*] [T*he auditor's*] replacement schedule in April 2008 for a 400 TVR campaign over 4 weeks targeted at the Adult ABC1 demographic would only require an additional 296 spots for a total of 3,008 spots.[81] In comparison, the forward-looking estimate provided by a media buyer, [*redacted*], suggests a campaign that originally ran over 1,202 spots to reach 255 TVRs in the Adults ABC1 demographic, would require almost 2,000 more spots to replace ITV1, with the number of average TVRs per spot basically halved in comparison to the original campaign. This may provide an indication of the extent of this hindsight bias.

Overall, the [*redacted*] [*auditor's*] analysis seems to suggest that although some campaigns can be substituted, there are difficulties in substituting fast campaigns as this may require large numbers of slots on, in particular, Channel 4 which is against the channel's normal sales policy. The results are, however, subject to the criticism that slots on channels other than ITV1 were picked with the benefit of hindsight.

Analysis of switching large volumes of spend

5.79 The CC raised questions in 2003 about the validity of results which analysed the ability to switch one campaign at a time. It noted that ITV

[81] [*redacted*] [T*he auditor*] reached similar results in two other simulations for the Women ABC1 and Housewife demographics.

may respond to any advertisers and media buyers who attempted to take revenue out of ITV1 by offering punitive rates on the remaining spend.[82] Therefore, to credibly restrain ITV, media buyers and advertisers may have to be able to switch away large amounts of spend from ITV1. It suggested that for very large amounts of advertising expenditure this might not be possible in practice as it would quickly lead to price increases on the other channels. These price increases would prevent them from purchasing equivalent levels of cover and frequency for their advertising campaigns without ITV1, within the same budget.

5.80 To address this concern ITV has reworked its previous theoretical simulation to show that it could be possible to achieve similar cover and frequency targets without ITV1 for a campaign of 400 TVRs over one or four weeks while remaining within the original budget, even after £205 million of advertising expenditure had already been switched from ITV1 to other channels.[83] This analysis allowed for price adjustments – new CPTs for other channels were calculated by assuming that the £205m of advertising revenue switched away from ITV1 was redistributed in line with natural delivery (i.e. in line with SOCI).

5.81 ITV also revised the practical exercise undertaken by [*redacted*] [*the auditor*] to consider the practical impacts of switching £205 million worth of advertising expenditure from ITV1. The only substantive methodological change in the new analysis involved the recalculation of new CPTs for other channels after the redistribution of the £205 million according to the weights shown in Table 5.3 below.

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[82] Paragraph 2.128 of the CC report.

[83] ITV submitted that the figure of £205m was appropriate for a number of reasons. First, based on ITV's survey results (see below) [*redacted*]. Second, it represents 15% of ITV's total revenue for 2007, or approximately 200 campaigns, or 40 billion impacts. Third, it is nearly 7 times the level of switching from ITV1 to other channels needed to constrain ITV1 from demanding on increased spend commitment. Finally, it is also greater than the amount that most agencies spent in total on ITV1 in 2007.

Table 5.3: Allocation of Spend Assumed by [*redacted*][*the auditor*]

	Adults	Adults 16-34	Adults ABC1	Men ABC1	Housewives + Kids	Housewives
C4	55%	65%	48%	46%	43%	40%
Five	15%	10%	10%	11%	10%	15%
GMTV	0%	0%	0%	0%	5%	10%
Sky	6%	12%	15%	20%	10%	5%
Ids	10%	5%	10%	10%	12%	15%
ITV Sales	8%	3%	7%	5%	9%	8%
C4 Digital	4%	5%	9%	8%	7%	5%
Other	2%	0%	1%	0%	4%	2%

Source: [*redacted*]

5.82 This meant that proportionately higher amounts of the £205m were allocated to Channel 4 and Sky than would have been the case under a more simple SOCI allocation. The same set of replacement spots originally selected for the first exercise was used. The analysis showed that their initial results held even allowing for price inflation caused by large amounts of other spend having previously switched away.

5.83 Media buyers produced broadly similar estimates of the effect of moving spend on the inflation of prices on other channels. For example, [*redacted*] suggested that moving £300 million out of ITV would cause prices on other main channels to inflate by around 15 per cent; and [*redacted*] assessed that if £205 million were distributed across the other channels according to their shares of NAR, this would result in 11 per cent inflation in prices. These estimations are broadly comparable with what [*redacted*] [*the auditor*] assumed in its simulations (see Table 5.4 below).

Table 5.4: Percentage changes to channels CPT after £205 million are shifted away from ITV1

[*redacted*]

5.84 Media buyers and advertisers claimed that there would not be enough airtime to accommodate the additional spend.[84] ITV, on the other hand, maintained that the effects of moving the spend would simply be to change the relative CPTs of the channels, but that, under the SAP mechanism, it is always possible to buy additional airtime at the higher price.

5.85 We agree that the relevant question is whether, at the higher price, the same coverage can be achieved. However, the methodology adopted appears to assume that the inflated CPTs on other channels apply only to the spend that is substituted away from ITV1. If advertisers are already advertising on other channels, they would also have to pay the increased price on their existing non-ITV spend. This would further reduce coverage on that campaign.

Overall, we believe that the evidence on the ability to move large amounts of spend is not conclusive. The effects on the prices charged for advertising already shown on other channels may not be accounted for, and the general problems of this type of analysis, discussed elsewhere in this section, also apply here.

Overall Conclusion on Reach/Coverage Analysis

5.86 The analysis of reach and coverage suffers from some disadvantages and we have been cautious in our reliance on it. Even though the results tend to overestimate the extent of coverage attainable on other channels, the results appear to show that it is not possible to attain the same coverage without ITV1 for at least some campaigns. More generally, the analysis does seem to confirm that ITV1's comparative advantage lies in fast delivery of the broad demographics, but this

[84] Several noted that other channels, in particular Channel 4, would not accept the extra money, or would only do so at unfavourable terms. This argument may apply if money is moved in the middle of a deal season. However, this analysis considers media buyers ability to switch spend at the point at which deals are negotiated. At this point, other broadcasters are likely to accept the extra revenue.

advantage has declined since 2003, i.e. the degree of substitutability has increased.

5.4 Other Features of ITV1

Light viewers

5.87 The term light viewers refers to individuals whose weekly viewing hours fall into the lightest percentile of all viewing i.e. they are the most difficult to reach through a TV advertising campaign.

5.88 ITV provided evidence to show that the lightest one third of TV viewers, *as a percentage of its own viewers*, has declined from 19 per cent in 2003 to 14 per cent in 2007.[85] It noted that the proportion for the next best provider for such viewers, Channel 4, has remained stable at roughly 10 per cent.

5.89 Others argued that the proportion of light viewers out of ITV1's overall viewers is irrelevant – what counts is ITV1's *overall* share of all light viewers. This was what was presented in the CC report.[86] [*redacted*] and [*redacted*] submitted data showing that ITV1 continues to outperform its nearest competitors in terms of light viewers, even though its proportion has declined since 2003. Several other stakeholders, including the [*redacted*], presented other metrics of light viewers showing a similar trend. We consider that the most relevant metric of light viewers is ITV1's share of all light viewers but in any event all metrics indicate broadly the same trend.

5.90 Some stakeholders told us that light viewers were less of a distinguishing feature of ITV1 now compared with 2003. In ITV's customer survey only [*redacted*] per cent of respondents which viewed

[85] 2008 figures were not provided

[86] Paragraph 5.137 of the CC report stated that ITV had a share of 44 per cent among the lightest one sixth of adult viewers, with Channel 4's share at 26 per cent.

ITV1 as essential cited access to light viewers as a reason. Two major media buyers, [*redacted*] and [*redacted*], said that the focus on light viewers may be outdated, given that it was unclear to what extent this category of viewers is responsive to TV advertising. They further argued that a deeper understanding of the importance of viewers' ad recall, and therefore campaign's effectiveness, had shifted the focus towards heavy viewers. This is discussed in the section on audience engagement.

Overall, we have not seen any evidence that suggests that light viewers are particularly important to advertisers. ITV1 seems to have reduced its coverage of light viewers, although it is still more successful than other channels, whose coverage has also declined.

Unique Reach

5.91 ITV argued its mass audiences may have been a relevant consideration for the CC in 2003 given its overall effect on ITV1's ability to deliver unique reach but this is no longer the case. This is because the proportion of people that only watch ITV1 has declined, and the proportion of people that do not watch it at all has increased.

5.92 To demonstrate this, ITV used BARB data and InfoSys software to compare the proportion of the audience base that could only be reached through ITV1 during a one week and a four week period in September 2003 and September 2008, with the proportion that could solely be reachable on other channels excluding ITV1. They found, for example, for a four week period in September 2003, [*redacted*] per cent of the Adults demographic was reachable solely via ITV1, whereas [*redacted*] per cent of this demographic were exclusively reachable on all other channels combined. In 2008, these percentage figures were, respectively, [*redacted*] and [*redacted*] per cent. This trend was more pronounced for other demographics, and when a period of only one week is considered.

5.93 Other stakeholders have not tended to emphasise the unique reach of ITV1 as a specific benefit.

We agree that unique reach does not seem to be a particularly important distinguishing feature of ITV1.

Audience engagement

5.94 The CC report also considered that ITV1 had an advantage in terms of better programme engagement and levels of attention. The CC's view was based on the findings of a research project called tvWorks, which concluded that advertising on ITV may be more effective than a combination of other channels in terms of expected sales uplift for FMCG goods.[87]

5.95 The consultation document observed that ITV provided market research conducted in 2008 – for purposes other than this review – showing that the level of engagement with ITV1 programming is broadly in line with other major broadcasters.[88] Third parties generally questioned the reliability of this evidence, in particular, by noting that it was at odds with the output of a recent piece of research commissioned by ITV in 2008, labelled "Event TV", which has been extensively quoted in its marketing material. The corresponding presentation discusses programmes, defined as Event TV, attracting a high proportion of viewers who are more engaged with or more influenced by what they watch – defined as True Fans.[89] ITV's presentation concludes that it shows the majority of Event TV programmes across almost every programme genre, apart from Lifestyle and US Drama, which is reflected in ITV1's leadership in delivering the highest number of group viewers, both overall and across main genres.

[87] Paragraph 5.138 of the CC report.

[88] ITV1 Marketing research additional data, submitted on 20 October, 2008.

[89] See http://www.itvmedia.co.uk/default.asp?section=107&page=8272 (as visited on March 14, 2009).

5.96 The evidence referred to in the consultation document was the raw data underlying the Event TV presentation. It showed that [*redacted*]. That is, it supports the idea that [*redacted*]. ITV1 also has a greater share of top ratings programmes for shared/joint viewing typically broadcast in peak-time, although the levels of joint viewing had fallen across all channels. Other stakeholders provided similar evidence.[90]

5.97 Several media buyers made similar arguments that there is a positive relationship between programme ratings and effort to watch, which is believed to be a good proxy for the corresponding level of audience engagement and level of attention.[91]

5.98 Others provided evidence that ITV1 had a benefit in terms of *heavy viewers*. They argued, with some supporting evidence, that this was valuable because recent exposure to the advertisement is crucial to viewers' responsiveness and the longer the uninterrupted viewing time, the higher the recall of commercials that appear in the advertising breaks in the programming.[92]

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[90] [*redacted*] and [*redacted*] observed that in 2003 ITV1's peak programming was viewed by an average of 1.52 viewers per household, compared to an average figure of 1.42 across non-ITV1 channels; this relative advantage was maintained in 2008, when both figures declined to, respectively, 1.49 and 1.39.

[91] [*redacted*] referred to a piece of research commissioned by [*redacted*] showing a possible positive relationship between effort to watch and programme's TVRs. [*redacted*] presented research results showing that ITV1 owned the majority of commercial programmes across the main demographic groups for which viewers tried their hardest not to miss. [*redacted*] provided analysis showing that ITV1 had a clear leadership in terms of viewing persistence among programme delivering in excess of 1 million adult viewers. In all cases, the research was conducted in 2008/2009 but we were not able to analyse the methodology closely.

[92] [*redacted*] provided data showing since 2003 that ITV1 has maintained a comparative advantage against Channel 4 and Five in terms of the weekly reach of adult viewers with viewing sessions of at least 20 minutes. [*redacted*] quoted a piece of research by [*redacted*] showing that ITV1's weekly reach of the heaviest 3rd of TV viewers has increased from 95.3% in 2003 to 96.2% in 2008. [*redacted*] submitted a similar research output dated February 2007 showing that for FMCG categories an important attribute for advertising responders was being

5.99 Some third parties submitted additional indicative evidence showing evidence of sales uplift. In some cases this seemed to show that ITV1 did have an advantage.[93] In other cases the evidence was a little ambiguous and showed that ITV1's impacts were *less* effective in terms of creating an intention to purchase FMCG products.[94] Several studies were quoted that showed the positive effect in terms of sales of TV advertising in general, but the studies do not single out the contribution of ITV1 in particular. These studies therefore support the conclusion in market definition that TV is not substitutable with other means of advertising but provide limited information on ITV1's position within the market for TV advertising.

Overall, it seems likely that there is no specific tendency for audiences to engage more with ITV1's event programming, or mass audience programming than event or mass programming on other channels. ITV1 does, however, have a greater share of such programmes. As event programming tends to draw larger audiences, ITV1's advantage in terms of audience engagement seems again, therefore, to boil down to a greater number of mass audience programmes.

Other qualitative benefits

5.100 We were also told that advertisers use ITV1 for more subjective reasons, for which there is little direct proof of the benefits on sales. For example:

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heavy ITV1 viewers. [*redacted*] made a similar argument referring to recent studies ran by [*redacted*].

[93] [*redacted*] submitted a chart showing that ITV delivers better sales uplifts compared to other channels for the categories they compete in.

[94] [*redacted*] The study submitted by [*redacted*], mentioned in footnote 93 also shows that breakfast time is the part of the day that shows the best performance. However, we were unable to obtain a full explanation of the underlying methodology and data used in this study.

- media buyers have told us that many advertisers still have an 'emotional' attachment to ITV1 – and Channel 4

- others suggested that being seen on ITV1 conferred status on the advertisement

- FMCG advertisers argued that large multiples demand that their suppliers advertise on ITV1 in order to drive "footfall"[95]

- other advertisers pointed to the affinity between its customer base and ITV1's audience, which meant that targeting was more effective on ITV1

- some suggested that the different programming environments made the different channels more or less suitable for certain advertisers. [*redacted*] noted that ITV1 has a "safer" environment whereas broadcasters such as Channel 4, Sky and IDS are more "edgy" with more adult content than ITV1.

5.101 Stakeholders told us that, to some extent, these beliefs came about because advertisers have been historically "educated" by media buyers on how best to run their TV advertising campaigns, in particular, in respect to the importance of ITV1, and Channel 4, in their channel mix.

5.102 We requested evidence to show that these effects were a consideration in choosing ITV1 and on the extent of their importance. We received some evidence prepared for the purpose of the consultation which showed that targeting is better with ITV1 because of spillovers but we have seen little evidence that this was taken into account in planning a campaign. We also received a little evidence on overall sales uplift effect, although this was a little mixed. Finally, we note that in ITV's customer survey, 24 per cent of respondents which

[95] For example, [*redacted*] and [*redacted*] explained that campaigns will be pre-agreed with the retailers, showing details of timings and channel mixes.

viewed ITV1 as essential cited "water cooler programming" as a reason, which might be interpreted as evidence of status.

5.103 [*redacted*] argued that the views of market participants constitutes evidence in itself, and that – although it is not as reliable as quantitative evidence – it should nevertheless be taken into consideration. In particular, ITV's bargaining position would be strengthened if advertisers believed ITV1's programmes to be of higher quality, regardless of whether or not that belief is supported by empirical data. However, we have little evidence of these factors actually being taken in to account in choosing between channels.

> As we do not have any concrete evidence that these factors are actually taken into account when planning a campaign, we put little weight on them. Even if such beliefs are held, it is not clear that the effect is significant enough that advertisers would not shift away to other channels if ITV1 became more expensive. Furthermore, to the extent that these beliefs are not supported by data, and are possibly a result of historical education by media buyers, they may be relatively easily revised.

Regional Advertising

5.104 Many stakeholders have stated that they value ITV1 for its ability to deliver local and regional coverage. Here, we use local advertising to refer to advertising confined to a single area, and regional advertising to refer to advertising covering more than one region, but not all regions. Stakeholders have pointed out that the reliance on ITV1's local and regional delivery has increased since the merger, given that both Channel 4 and Five have reduced their regional reach.[96]

[96] IPA reported that, in 2003, it was possible to deliver 73% of total television impacts regionally, whereas by 2007 this had fallen to 48%. Similarly, [*redacted*] observed that Channel 4 is only able to accommodate a maximum of 25 adult TVRs per week for regional campaigns, and Five between 4-8 TVRs, amounting to 50 per cent in terms of 1+ coverage of all adults over four weeks – that is, far from what would be considered a critical level of 70-75 per cent.

5.105 Local advertising is unlikely to have been affected by the merger since Carlton and Granada only overlapped geographically in London. In other words, local spend would have been largely captive to one or other sales house even without the merger. Therefore, we do not believe that ITV1's appeal to local advertisers has a large impact on our analysis.

5.106 Other stakeholders have, however, argued that it is not just local advertisers that value regional access. Advertisers can switch between regions to test campaigns. Some advertisers, including COI, advertise in more than one region but do not use all ITV's regions. Some such advertisers may have limited scope to choose between different regions but the CC considered that some such advertisers could switch between Carlton and Granada, and so may have been affected by the merger, although this does not appear to have been the main driver of the CC's concerns. Stakeholders also put less emphasis on it than other features of ITV1.[97] Nevertheless, to the extent that such advertising is significant, their dependence on ITV1 may have now increased, if other channels have reduced their regional coverage.

Conclusion on Quality Factors

5.107 Overall, the additional evidence provided in response to the consultation document seems to point to a conclusion that ITV1 appears to have maintained a comparative advantage in the quality of its impacts – in particular, in comparison with Channel 4 and Five. This is, however, largely by virtue of its prominence in mass broadcasting during peak-time, where the bulk of high-quality impacts seem to be concentrated. We have much less evidence that ITV1's impacts have any particular quality advantage over and above their association with mass audiences.

[97] Paragraph 2.127 of the CC Report.

5.5 Countervailing Buyer Power

Introduction

5.108 The sections above suggest that ITV1 still has some unique features. In particular, there was general consensus from stakeholders, apart from ITV, that its mass audiences are critical for providing fast mass coverage. There was some suggestion that mass audiences may provide other quality features which may give ITV some leverage in negotiations with media buyers.

5.109 This section discusses the factors which influence media buyers' ability to exert countervailing buyer power during negotiations with ITV. It first considers evidence on which advertisers require ITV1, and the proportion of spend which cannot be switched away. It then looks at evidence on the overall size of media buyers relative to ITV1.

Which Advertisers need ITV1?

5.110 In the consultation document we noted that we had little information on precisely which advertisers now required ITV1. Stakeholders had told us that advertisers which particularly value mass audiences for their ability to attain fast reach and coverage include, in particular, those promoting fast-moving consumer goods (FMCGs) as well as other advertisers running time dependent campaigns including newspapers and retailers with particular promotions, product launches, re-branding etc.[98]

5.111 In response to this, ITV contended that there are no particular categories of advertisers that are reliant on ITV1 airtime in order to meet their campaign objectives. To demonstrate this, ITV commissioned [*redacted*] [*an auditor*] to consider whether FMCG advertisers are any different from other advertisers in respect of their

[98] Consultation document para 5.14

typical campaign parameters.[99] [*redacted*] [*the auditor*] found that in aggregate FMCGs' share of ITV1 airtime in 2008 ([*redacted*] per cent) was in line with the market average. Moreover, there appear to be no typical allocation in the channel mix adopted by FMCG advertisers – indeed, the channel mixes adopted by [*redacted*] and [*redacted*] ([*redacted*]) diverged significantly. According to [*redacted*] [*the auditor*], this suggests that FMCG advertising schedules can be constructed effectively in a variety of different manners with no channel being essential in all cases. Moreover, FMCG advertising campaigns have a similar impact distribution by dayparts to other types of advertisers, with slightly higher levels of impacts delivered in the early part of the day and slightly lower levels delivered in early and late peak time.

5.112 With regards to time-dependent campaigns run by newspaper advertisers, ITV observed that these promotional campaigns are typically run at the weekend, in order to achieve maximum coverage in proximity of the Saturday and Sunday editions. As such, ITV argued that, pre-merger, newspapers advertisers who wish to run this kind of campaign had no choice but to use Granada in London as Granada's LWT was the weekend provider of ITV1 in London. Therefore, the degree of reliance of newspaper advertisers has not changed since the merger.

5.113 Other stakeholders argued that a very wide range of advertisers, indeed almost all, require ITV for fast build at some stage.[100] As discussed in paragraphs 5.52 - 5.53, ITV claimed that only very few

[99] [*redacted*] [T*he auditor*] defined FMCG advertising as activity which promoted packaged goods as packaged goods. This essentially covers food, soft drinks and beverages, cosmetics and toiletries, pharmaceuticals and all household stores – accounting for about 39% of all TV airtime. We note that while [*redacted*] [*the auditor's*] classification includes [*redacted*], other major retailers like [*redacted*] are excluded. ITV argued that [*redacted*].

[100] Some suggested a possible exception of advertisers aiming at children and direct response advertising.

advertisers require fast build, but stakeholders suggested fast mass build was required at the initial stages of longer campaigns, and some supporting evidence was provided.[101]

5.114 Some further examples were also advanced as specific advertisers, or groups of advertisers, that require ITV1. For example, it was suggested that those buying broad audiences, particularly housewives, were also more captive. Regional advertisers were also identified as important.

Although there is general consensus that ITV1 is particularly necessary for fast, mass coverage, we still do not have clear information on precisely which advertisers require such coverage. It seems most likely that it is a diffuse group of advertisers which require access for some portion of their business.

Proportion of non-contestable spend

5.115 We also sought information on what proportion of spend was not able to substitute away from ITV1.

5.116 The consultation document presented the results of a survey commissioned by ITV conducted by an independent research firm,[*redacted*]. This looked at how much spend advertisers and media buyers would switch away in response to a 5 or 10 per cent price increase. It suggested that 74 per cent of respondents thought ITV1 was "essential", compared to 70 per cent for Channel 4 and 40 per cent for Five. Nevertheless, 69 per cent said they would switch some spend away from ITV1 in response to a 5 per cent price increase, and 81 per cent would switch spend away in response to a 10 per cent price increase. ITV calculated that, overall, a 5 per cent price increase would lead to a decrease in revenue of [*redacted*] per cent and a 10

[101] For example, [*redacted*] and [*redacted*] provided the details of timings and TVRs of FMCG advertisers in 2008, showing that, typically, the activity was focussed during the first two weeks.

per cent price increase would lead to a decrease in revenue of [*redacted*] per cent.

5.117 The survey also asked what proportion of essential spend – spend for which respondents thought ITV was essential – would be moved in response to price increases. The results suggested 42 per cent of respondents would switch some essential spend away in response to a 5 per cent price increase and 59 per cent would move some essential spend away in response to a 10 per cent price increase. ITV calculated that this would lead to a loss in revenue of [*redacted*] per cent for a 5 per cent price increase and a loss of [*redacted*] per cent of revenue for a 10 per cent price increase. It claims that this shows that even price increases targeted at that portion of spend which most relies on ITV1 would not be profitable.

5.118 In the consultation document, we pointed to certain weaknesses inherent in surveys relying on stated preferences. In particular, there is a risk that responses can overstate the likely degree of actual reactions to the imposition of worse terms and conditions. We were also concerned that the survey overlooked the complex negotiation procedure involved in buying airtime, and assumed that advertisers were able to move spend elsewhere without considering the impact of that move on the terms of other airtime bought from ITV.

5.119 Stakeholders generally expressed a widespread lack of acceptance of the survey's results. They agreed with us that the survey overlooked the complex negotiation of the procedure.[102] Many also stated that the

[102] [*redacted*] maintained that the survey was flawed in that the price increase was not framed in terms of SOB commitments, which is the base of negotiations at the deal season stage. ITV however deliberately avoided this. It believed the results would be more accurate if it generated the full implications of a 5%/10% increase on the cost of buying airtime. If the survey had used any metric other than annual spend, an increase in spend on one channel would have to be balanced across all channels (i.e. if ITV1 costs more, the advertisers would have to give all other broadcasters more in order to ensure its share comments would stay balanced). This would distort responses. The approach ITV adopted sought to avoid this problem.

sample surveyed was not representative, in particular, in terms of the level of seniority of responders –[*redacted*], for example, argued that the results are more likely to be indicative of junior buyers' *bravado* than of the detailed, considered analysis such questions would normally merit.

5.120 ITV argued that [*redacted*] carefully screened respondents to guarantee their role as decision makers. When we requested the list of respondents ITV said this was not possible as [*redacted*] had guaranteed confidentiality to all respondents.

5.121 ITV stated that the sample represented 75 per cent of TV advertising expenditure. We note that advertisers are arguably disproportionately represented, as they accounted for over 40 per cent of the respondents, while more than 90 per cent of TV advertising spend is normally negotiated directly by media buyers. ITV presented the results separately for advertisers and media buyers and showed that looking at media buyers alone did not have a large effect on the results. It is, however, possible that the composition of media buyers may not be representative. The sample used by [*redacted*] appears to be skewed towards small-sized media buyers, whereas a small number of large media buyers account for the bulk of TV advertising expenditure.

5.122 Nevertheless, as noted in the consultation document, ITV conducted a sensitivity analysis to tackle these concerns and showed that even if the degree of switching was highly overstated a 5-10 per cent price rise would not be profitable. ITV suggested it will be inhibited from raising prices even if it leads to a small revenue loss. This is because, in the short to medium term, its costs are fixed so any business it loses is a reduction in profits that is not offset by any cost savings.

5.123 We asked stakeholders for evidence on the proportion of non-contestable spend. Most implied that it was still significant, although there was limited supporting evidence. Some noted that advertisers that are generally considered particularly captive to ITV1 (e.g. FMCG, retail, music) are typically large spenders therefore representing a large proportion of each media buyer's portfolios.[103] However, as discussed above, we have little evidence that these specific groups are captive to ITV1. Another stakeholder, [*redacted*], estimated that advertisers captive to ITV1 account for 60 per cent of spend although no supporting evidence was provided for this. [*redacted*] reported that it invests more than [*redacted*] per cent of its TV advertising expenditure in ITV1's peak programming. We note, however, that it is not clear that all of that spend necessarily requires ITV1.

5.124 Moreover, some stakeholders suggested that media buyers educated advertisers to believe they needed ITV when they, in fact, did not. These advertisers may be more willing to switch, if sufficient evidence is provided to them, but we have no way of knowing what proportion of advertisers these represent. We note that many large advertisers may have sophisticated purchasing departments which are unlikely to invest large amounts of spend unnecessarily.

5.125 Regional and local advertisers were also identified as an important group. ITV estimate that regional advertising accounts for [*redacted*] per cent of its gross revenue, [*redacted*] per cent in 2003. Local advertising accounted for [*redacted*] per cent of gross revenue in 2003 and [*redacted*] per cent in 2007, where local advertising is defined as advertising covering one region only.[104] Local advertisers would, however, have been captive pre-merger. Some regional advertisers with no flexibility over choice of region may also have been captive

[103] [*redacted*] provided some examples of the proportion accounted for by certain advertisers, which suggested that a few large FMCG clients typically represented about one third of a media buyers' portfolio.

[104] Based on MMS data, [*redacted*] observed that around 6 per cent of ITV1 advertising revenue in 2006-08 was derived from advertisers who advertised in three or fewer of the 13 ITV regions, although over the last 3 years, only around 60-66 per cent of ITV1's advertising revenue was derived from advertisers using all the 13 regions. [*redacted*] reported that, based on data sourced by DDS for September 2008, of a total of 947 TV advertisers, 624 used ITV1, 459 of these did not use it in all its regions and 366 used it in a few regions only.

pre-merger. Other regional advertisers which advertise in almost all of its regions may consider national coverage on other channels. It is therefore not clear what proportion of this group has been affected by the merger, although the proportion may have declined since 2003 in line with the general decrease in regional advertising.

Overall, ITV's survey provides the best available evidence of the level of captive spend, but, although ITV has attempted to make the survey robust, there may be problems with it. As with all surveys, it may be subject to an upward bias. Furthermore, it is not easily comparable to levels of contestable spend in 2003. ITV argues that its calculations show that price rises would be unprofitable, but we are not sufficiently confident that the survey is, on its own, robust enough to support this conclusion. In particular, it may not capture the complex nature of negotiations, including ITV's ability to retaliate against media buyers attempts to move away spend.

Buyer Concentration

5.126 The CC report noted that there had been considerable consolidation among media buyers during the years prior to its investigation.[105] However, it did not consider that this gave media buyers' sufficient countervailing bargaining power to alleviate the possible detrimental effects of the merger.

5.127 Since 2003, Group M and Mediacom have merged. In addition, other media buyers within the same groups have begun to negotiate jointly. For example, OMD and PHD have formed the buying group Opera and, more recently, Zenith Optimedia and Starcom have formed a buying group named VivaKi. The result of this is that the top six buying points accounted for around 83 per cent of total TV advertising revenue in 2008. This compares with 69 per cent in 2003.

[105] Paragraphs 2.123 of the CC report.

5.128 We have considered the scale of each individual buyer in relation to ITV sales house and vice versa. For the top six media buyers, Table 5.5 shows the amount of spend each agency puts on ITV1 as a proportion of ITV1's overall income (Agency % of ITV1) and, conversely, the size of ITV1 as a proportion of the agency's overall TV revenue (ITV1 % of agency), for 2003 and 2008. These figures are also presented for the sales house as a whole.[106]

Table 5.5: Mutual degree of reliance between media buyers and ITV sales house in 2003 and 2008

[*redacted*]

5.129 The table suggests a high degree of mutual dependency between ITV and the media buyers. In 2003, this was strongly tilted in favour of ITV – each media buyer accounted for [*redacted*] per cent of its revenue, but ITV1 accounted for around [*redacted*] per cent of the media buyer's budget. The balance has equalised somewhat since then, particularly for the largest media buyer, which now accounts for [*redacted*] per cent of ITV1's revenue, with the remaining media buyers accounting for [*redacted*] per cent to [*redacted*] percent. ITV1 now accounts for [*redacted*] per cent of each media buyer's budget.

5.130 Media buyers argue that they still have little bargaining power because ITV1 is irreplaceable for some of its clients, while ITV1 is more able to replace the media buyer. They also argue that their increased size is, in fact, a weakness. These arguments are considered in further detail in section 5.6 below.

[106] Zenith Optimedia and Starcom formed a buying group named VivaKi in 2008. However, ITV provided us only with data at an individual agency level.

The relative size of ITV1 and media buyers suggest that each media buyer is still more dependent on ITV sales house than vice versa, although the scale of this dependence may have reduced since 2003.

5.6 Overall Assessment of ITV's Negotiating Strength

Introduction

5.131 This section draws on the evidence and discussion presented above to consider ITV's ability to use its negotiating strength to increase prices on ITV1. We discuss how this may have changed since 2003. We first consider how media buyers can respond to unfavourable terms demanded by ITV, and how this may compare to the 2003 situation. Then we consider the flip-side, namely how ITV can respond to demands from media buyers.

Media Buyers' Leverage on ITV

5.132 Media buyers have leverage over ITV because they can threaten to reduce the amount of revenue they spend with the broadcaster. ITV maintained that this threat was sufficient to prevent it from imposing less attractive terms on media buyers. ITV noted that it was very sensitive to revenue losses as any loss of revenue would be a direct hit on its profits without any offsetting reduction in costs. We note that the effect of a media buyer switching away spend will be softened if ITV is then able to attract additional spend from other media buyers. The effect may also be softened if the media buyers' actions result in some of its clients switching to another media buyer and continuing to advertising on ITV1.[107]

[107] During discussions, one stakeholder [*redacted*] suggested the SOB mechanism would also soften the effect of a fall out on ITV. This is because the SOB mechanism guarantees that ITV would not suffer any revenue loss from a prolonged stand-off with a major agency, provided that the agency would eventually capitulate. For example, if an agency refused to accept ITV's position for the month of January, but eventually accepted the terms imposed by ITV at the end of the month, ITV would recover the revenue lost in January, given that the agency would still

5.133 It is clear from Table 5.5 that since 2003 several media buyers have grown relative to ITV, and that, particularly in the case of Group M, the loss of a even a portion of their ITV1 revenue would be significant to ITV. Moreover, the evidence on substitutability suggests that the reduction in spend on ITV1 would have a reduced effect on the ability to fulfil campaign goals.

5.134 On the other hand, the discussion also strongly suggested that some advertisers still require access to ITV1's mass audiences at least some of the time. Besides this there may be practical problems moving large amounts of spend away. These factors suggest that it is not credible to do without ITV1 altogether for any significant period of time.[108]

5.135 Media buyers told us that their increased size actually reduced their leverage with ITV. This is because, as they grow bigger, they have an increased amount of spend that requires ITV1. We note, however, that the amount of spend which it can switch away also gets larger. In other words, as a media buyer grows in size the value of business dependent on ITV1 grows, but so does the value of the business that can be moved away from it. There is no obvious reason why the balance between these two groups of revenue should change as media buyers grow in size.

5.136 Media buyers further argued that, although a greater sum of revenue was substitutable, the capacity constraints on other channels meant that it became increasingly difficult to move that spend away. Therefore, the increase in revenue dependent on ITV1 was not offset

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be obliged to meet the agreed SOB commitment within the remaining 11 months (although the final agreement may be at a lower SOB to the initial one, in case the media buyer succeeded in partly renegotiating its SOB commitments).

[108] We note that P&G, which negotiates directly with ITV rather than through a media buyer, has moved brands off ITV1 for periods of time. P&G's ability to pull campaigns off ITV1 may be affected by the fact that it negotiates directly for its own advertising. It therefore does not need to obtain third party consent from its customers before committing to such actions and neither does it need to be concerned about loosing an account completely as a result of such actions.

by an ability to move more spend off ITV1. There is some evidence to support this argument as it does seem more difficult to move larger amounts of spend away (see paragraphs 5.79). Moreover, the price repercussions of moving larger amounts of spend will favour the media buyer's competitors. Prices on ITV1 will decline by a little more and prices on other channels will increase by a little more. This increases the risk that a media buyer will lose clients to competitors with a greater SOB allocated to ITV1. These effects do suggest there may be some disadvantages to increased size, but it is not clear that they are significant enough to completely outweigh the advantages. On balance, it seems likely that an increase in size would favour media buyers.

Overall, it appears that the increase in substitutability and the size of media buyers means that media buyers now have more leverage over ITV than in 2003. It seems unlikely, however, that they can credibly threaten to move off ITV1 entirely.

ITV's Leverage over Media Buyers

5.137 ITV can react to a media buyer's attempts to pull spend off ITV1 by imposing much higher prices on the remaining spend, or reducing the quality of access in other ways, such as denying access to certain key programmes. The dispute could also result in no deal being signed at all for a while at least. Advertisers and media buyers reiterated their concerns that delays in signing contracts mean that they would not be able to guarantee their clients access to ITV1 from 1 January, which is particularly crucial for some advertisers. Media buyers claimed one of the benefits of CRR was that it always gave them a fallback position and so they could never be left without access to ITV1.

5.138 Stakeholders said that ITV can also respond by exerting pressure on the current contracts during negotiations. The deal season typically runs between November and December, that is, in the middle of the Christmas sales season. Stakeholders claimed that ITV could worsen aspects of access to ITV1 which are not fully specified in contracts – such as access to premium content, central breaks, position in break – for a few key clients striving to promote their product for Christmas sales. [109] This would put media buyers in a difficult position with those clients and increase pressure on media buyers to agree to their demands for the next deal season.[110]

5.139 Stakeholders also suggested that ITV could use its digital channels as additional leverage in negotiations. For example, if media buyers did not agree to terms on ITV1, ITV could retaliate by worsening terms on the digital channels. They argued that conditional selling rules were ineffective and would not prevent ITV from behaving in this way.

5.140 The sections above provided evidence suggesting that a portion of advertising revenue still requires ITV1, suggesting worsening or denying access to this channel would give still ITV some leverage. We have little evidence that suggests that ITV's digital channels are particularly important.

5.141 In considering its actions, a media buyer must weigh up the effects of deteriorated access to ITV1 against committing a greater amount of revenue to ITV1, some of which may be more effectively spent on other channels. If a media buyer pulls revenue off ITV1 and ITV retaliates, the media buyer then risks losing the business of those clients which require ITV1.[111] On the other hand, if the media buyer agrees to ITV's demands for greater SOB, it may have to commit some spend which does not require fast, mass coverage. The media buyer then risks losing the business of clients less dependent on ITV1. The way a media buyer views this trade-off depends on the balance of spend requiring access to ITV1 against that which could be placed elsewhere.

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[109] ITV clarified in its response to the consultation document that [*redacted*].

[110] We note that, if new contracts were negotiated in the absence of CRR, it may be possible to include terms to cover such access, although it will be inevitably hard to design contracts which specify every aspect of trading. Alternatively, it may be possible to move time at which contracts are signed to a less critical period.

[111] [*redacted*]

5.142 We have little information about the exact proportion of revenue that does, or doesn't require ITV1, although it appears that many advertisers need access to ITV1 at some point, suggesting dependent advertisers may be significant. Since 2003, however, ITV1 has become more substitutable suggesting the balance must have tipped towards not accepting ITV's terms. In other words, a media buyer will be less inclined to put up with any given threat to worsen terms on ITV1.

5.143 There are, however, two factors which may "soften" the effect of agreeing to greater SOB. First, media buyers can mitigate the effect of price increases on clients which do not require access to ITV1 by passing the increase in price on to other clients. In other words, it is not necessary for ITV itself to discriminate against clients that require access to ITV1, media buyers can do this instead. If the media buyer believes that ITV is adopting similar tactics with other media buyers, and that other media buyers are passing on their reduced discounts in a similar fashion, this will not result in it losing business of those advertisers requiring access to ITV1.

5.144 Such price discrimination will obviously increase the burden on the ITV1 dependent clients, and there will be a point when prices are such that even these clients do not find it worthwhile to advertise on ITV1. This point is likely to be lower than in 2003, as substitutability has increased. This suggests the extent to which ITV can impose price rises is likely to have decreased.

5.145 Second, we have been told that media buyers are often chosen on the basis of their ITV1 price, rather than the overall price at which they are able to provide reach and coverage across all channels. This suggests that a media buyer has little incentive to react to price increases on ITV1 which it believes are likely to be across the board, even though moving away from ITV1 may enable them to provide advertisers with coverage and frequency at a lower cost.[112] [113] Several stakeholders

[112] [*redacted*]

suggested that they are incentivised to persuade advertisers they need ITV1 because it enables media buyers to commit greater amounts of spend to ITV1, and may get better discounts in return.[114] Again, this means that media buyers will be less sensitive to increases in price on ITV1.

5.146 This effect is reinforced because, as the CC noted in its 2003 report, media buyers themselves are not directly hurt by increases in prices, and may even gain. This is because they are remunerated on either a commission basis, by flat flee, or on a performance related bonus based on media auditors' monitoring activity. As such, they do not directly lose revenue if the overall price of advertising increases, provided they are performing well relative to one another. To the extent that they are paid by a commission, media buyers may actually gain revenue if prices increase.[115] We have no reason to believe that the remuneration of media buyers has changed since 2003.

5.147 It is possible that this lack of dynamism in the market is, in part, related to the presence of CRR and that without the remedy, media buyers and advertisers would be more active in seeking out the best deals for their campaign objectives. This is discussed in Section 6.5.

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[113] This levelling effect, whereby the widespread presence of countervailing bargaining power actually diminishes a supplier's ability to price discriminate among seemingly powerful buyers, is also called "me-too" or "anti-waterbed" effect. Statements from one stakeholder suggest that this effect is relevant to the sale of TV advertising airtime. [*redacted*] submitted that "the consolidation of a significant amount of the market into 3 or 4 major buying points will actually have a neutralizing effect. The reason for this is that we do not think that the broadcaster can afford to significantly differentiate between any of the major buying points because to do so would mean that ultimately a sharply cheapened price for one would have to be matched by sharply cheapened prices for everyone else."

[114] In a meeting, one media buyer told us that it is actually those that don't require ITV1 that are the most difficult to deal with.

[115] Paragraph 5.147 of the CC report.

Overall, it seems likely that media buyers' dependence on ITV1 means that ITV still has significant leverage over them, although the extent of this leverage is likely to have declined since 2003.

Conclusion on ITV's overall negotiating position

5.148 In summary, media buyers clearly still seem to need some access to ITV1, and if a media buyer reduces its SOB ITV has a powerful threat of increasing prices on the remaining spend (or deteriorating access in other ways). On the other hand, the substitutability and size of media buyers has increased since 2003, suggesting that media buyers also have more countervailing power over ITV and advertisers would be less willing to tolerate increases in price on ITV1. The effect of this may be some what softened as there appear to be mixed incentives on media buyers to negotiate hard with ITV to resist price rises, particularly if other media buyers are facing similar price rises, although it is possible that this lack of dynamism may be partly due to the presence of a relatively rigid remedy.

5.149 It is very hard to make judgements about the degree of negotiating power. In our view, however, there is insufficient evidence to suggest that the increase in media buyers' relative negotiating position is sufficient to substantially reduce the CC's concerns. This is because ITV1 still has a unique position in mass audiences, which still appear to be highly valuable for a potentially significant number of advertisers.

5.150 Our view is therefore that ITV's negotiating position appears to have declined since 2003, but is still such that, without any form of protection, it may be able to extract additional revenue from media buyers. It is likely to do this by demanding incremental increases in SOB from all media buyers, rather than by discriminating against particular media buyers or advertisers.

5.7 Entry and expansion barriers

5.151 Market power can generally only exist if there are persistent barriers to entry and/or expansion. If barriers to entry and expansion are low, any attempt by those in the market to raise prices above competitive levels would be expected to trigger entry by new competitors and/or expansion by existing ones. In the context of this investigation, ITV's attempts to worsen terms to media buyers and advertisers may be ineffective if this prompted expansion or entry by competing sales houses.

5.152 Sales houses may now be somewhat more able to expand the amount of advertising they offer than in 2003. This is because digital channels now have greater penetration, making it more attractive to launch such channels.

5.153 Nevertheless, in the consultation document we noted that there may be difficulties in expanding into the provision of the key area of mass audiences. As discussed above, ITV1's prominence in mass broadcasting appears to have largely persisted. Channel 4 observed that viewing figures show that there is a clear hierarchy in which BBC1 and ITV1 can attract significantly larger audiences than any other channels, followed by Channel 4, followed in turn by Five, with multichannel some way behind.[116]

5.154 Five suggested that its difficulties in growing audiences and become a commercial challenger to ITV1 since they launched almost 12 years ago were proof of the fact that there are expansion barriers to develop mass broadcasting.

5.155 Several anecdotal examples were given of the effect of programmes moving off ITV1 which it was suggested show the difficulties other commercial channels have in maintaining mass audiences:

[116] As further evidence of the advantages that ITV1 had, [*redacted*] further noted that ITV has not transferred mass audience programmes from ITV1 to ITV2 (or other digital channels) where it could monetise its mass audience free of CRR restrictions and retain 100 per cent of advertising expenditure (i.e. rather than 92 per cent and also having to share pro-quota with independent licensees).

- *Home & Away*: when it moved from ITV1 to Five in 2001 its viewing figures fell by around 40 per cent in multichannel homes.

- *Neighbours*: after moving from BBC1 to Five in February 2008, its lunchtime audience fell by half and evening audience by a quarter.

- *Richard and Judy*: when it moved from ITV1 to Channel 4 its audience fell from 3 million to 2 million; and having moved to Watch, it now commands audiences of only around 20,000 viewers.

- Sky reported that the live coverage of the *final of the Champions League* is broadcast simultaneously on Sky Sports and ITV1 each year. In the last three years, ITV1 has attracted between [*redacted*] and [*redacted*] per cent of viewers watching the final in Sky Sports households.

5.156 There may be other concurrent explanations for these results – such as more popular commentators for live sports events, changes to programme formats or times, the inclusion of advertising when a programme moves from BBC1 to a commercial channel, or that these programmes were already in decline. Nevertheless, we believe that these examples are indicative of the presence of viewing inertia, favouring ITV1 over other commercial channels. This inertia may be because of the importance of ITV1's brand. It has also been suggested that it reflects channels' EPG positioning, as viewers tend to watch primarily those channels that are clustered at the top of the EPG listing, although we note that Channel 4 is also at the top of the listing. It was also argued that the use of ITV1's own promotional airtime means that it is able to generate audiences for new programmes that no other commercial channel is capable of doing.

5.157 We were also told that these difficulties in gaining mass audiences reflected broadcasters' difficulties in investing aggressively in new content either via internal production, outsourcing or by bidding for performance rights. For example, [*redacted*] conceded that although it would be possible in theory to invest more heavily in programming in order to compete more effectively with ITV, this would require a huge programme deficit which they would never be sure of recouping.[117]

5.158 Several third parties observed that Channel 4 was unlikely to expand into mass audiences as focusing on absolute audience size would run contrary to its 'alternative' remit.

5.159 Finally, if ITV is able to extract larger amount of advertising expenditure, this would reduce the share of advertising revenue available to other broadcasters. This reduces the financial resources available to the broadcasters, making it even more difficult for them to respond by investing in mass audience broadcasting themselves.

5.160 Overall, it is possible that the growth of multichannel digital homes has made it easier for broadcasters and sales houses to expand by launching new channels. However, it seems unlikely that other broadcasters/sales houses would extend the amount of mass audience programming shown.

5.8 Future Trends

Introduction

5.161 There are a number of recent events and future changes in the market which may impact on ITV1's market position going forward including:

- the effects of the current economic downturn
- possible structural changes in the market resulting from Ofcom's PSB review and the Digital Britain report
- the possible further growth of internet advertising.

[117] [*redacted*].

The Impact of the Downturn

5.162 The current economic downturn is having severe effects on advertising revenues. The second half of 2008 saw TV advertising revenues fall by 9 per cent and some forecasts put the decline for the whole of 2009 at 10 per cent.[118] Several broadcasters, including ITV, are reported to have announced cuts in programming budgets.[119]

5.163 The decline in the market affects all commercial broadcasters and, in itself, does not mean that the detrimental effects of the merger cannot materialise. It is quite possible for a firm to have market power in an industry experiencing hard times. In this case, it is still possible for ITV1's market position to be such that, without CRR, it would be able to demand additional revenue to the detriment of advertisers. This depends, primarily on ITV1 maintaining its relative position in the supply of mass audiences, and on the continuing importance of such audiences. We note, however, that it is not clear that it will maintain this position – there are a number of independent predictions that ITV1's performance will continue to decline,[120] although their digital channels may continue to grow in strength.

5.164 That said, it is possible that the downturn will tilt the balance of negotiating power towards the media buyers for all sales houses. This is because the amount of advertising airtime will stay the same while the total demand for the inventory declines. This means that sales houses may become more dependent on each media buyer to fill their inventory and cover their costs. It is hard for us to judge the extent to which this will impact on the balance of negotiations going forward or

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[118] Advertising Association Forecast of Advertising Expenditure to Q4 2010.

[119] See, for example, http://news.bbc.co.uk/1/hi/business/7922770.stm http://www.guardian.co.uk/media/2009/may/06/channel-4-programme-budget-cut

[120] ITV plc, UBS Investment Research, 5 November 2008; TV and ITV NAR to 2012, Enders Analysis August 2008

the extent to which the situation will persist. The latter will depend on the length of the downturn.

Other Regulatory Reviews

5.165 There are also a number of other reviews currently underway which may have an impact on the structure of the TV industry, with possible knock on effects on ITV's position in the sale of TV advertising airtime.

5.166 Ofcom's second Review of Public Service Television Broadcasting (PSB Review), completed on 21 January 2009, set out a series of recommendations to government and Parliament on public sector broadcasting.[121] Amongst other things, this recommended that there should be a financially robust alternative provider of public service content alongside the BBC, with Channel 4 at its heart, preferably based on partnerships, joint ventures or mergers. Any change in the market position of Channel 4 may have knock on effects of the position of ITV1. The review also suggested changes to the public service commitments of ITV1.

5.167 On 29 January 2009 the Government also published a plan to secure Britain's place at the forefront of the global digital economy (Digital Britain).[122] The interim report contains more than 20 recommendations, including specific proposals on the creation of a second public service provider of scale. The outcome of the Digital Britain review, and any proposals implemented, may therefore have the potential to change the future structure of the sector and PSB content provision. The Government is expected to publish its final report in June 2009.

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[121] http://www.ofcom.org.uk/consult/condocs/psb2_phase2/statement/

[122] Digital Britain, The Interim Report, Department for Culture, Media and Sport and Department of Business, Enterprise and Reform, January 2009 available at http://www.culture.gov.uk/images/publications/digital_britain_interimreportjan09.pdf

5.168 The outcomes of these reviews are as yet uncertain, and at this time it is not possible to predict the impact that these changes might have on ITV1's market position.

Growth of the Internet

5.169 It is possible that internet advertising may grow and become more substitutable with TV in future. This may be, for example, because the coverage and use of the internet increases or the ability to monitor the effectiveness of Internet advertising improves. At this point, however, we have limited information on which to assess the speed or significance of this change so it appears to us to be inappropriate to place much weight on the anticipation of any dramatic change in ITV's market position.

Conclusion

5.170 In summary, there are a number of changes occurring in the TV market which may or may not affect the position of ITV1. Some trends might suggest a further decline in ITV's market position, although the impact of others is unknown to us at this point in time. We recommend that the CC should be alive to the possible changes in the market that these may bring about, and the effects this may have on their preferred outcome and/or any triggers for a change in their preferred outcome.

5.9 Conclusion on ITV1's market position

5.171 This section has considered evidence on ITV1's market position. The CC considered that ITV1 had a number of unique features which could not be replicated by other channels, individually or uniquely. A key feature among these was ITV1's mass audiences.

5.172 Despite its general decline in market share, ITV1 still supplies the vast majority of mass audiences today although such audiences account for a lower proportion of overall viewing. This suggests that ITV1 may still be irreplaceable for some purposes.

5.173 ITV believes that, despite their position in mass audiences, the same coverage and reach can be obtained without ITV1. There are, however, several weaknesses in the analyses presented which suggests that they cannot be relied on as conclusive proof that equivalent coverage and reach can be achieved without ITV1. Indeed, in some cases, the analysis seems to confirm that this is not always possible. The analyses are, however, useful for making comparisons. They suggest that there has been an increase in the amount of coverage and reach that can be achieved without ITV1 since 2003 and that ITV1's advantage remains in delivering fast mass coverage in broad demographics.

5.174 The CC also suggested that ITV1 may have other attributes which increase the quality of its impacts. Stakeholders have maintained that this remains the case today. Evidence suggests that ITV1's audiences may be valuable for reasons other than reach or coverage, but again this seems to derive primarily from its provision of mass programming.

5.175 Overall, therefore, evidence suggests that some advertisers remain dependent on ITV1 for access to mass audiences. We have little information on which advertisers require such access, although it is possible that many advertisers are dependent on mass audiences at some point or other. Neither do we have good information on the proportion of spend this represents. This makes it difficult to assess ITV1's negotiation position.

5.176 Nevertheless, on balance, it is our view that without any protection ITV's negotiating position may be enhanced such that it could increase revenues on ITV1 to the detriment of advertisers and media buyers. Media buyers have grown in size, and substitutability has increased meaning that media buyers have more leverage than 2003 and the extent to which ITV can impose price increases on ITV1 has fallen, but this does not seem sufficient to fully offset ITV1's position in mass audience programming. This means access to ITV1 is still required for a potentially wide group of advertisers and ITV's threat to significantly worsen conditions for access to ITV1 for that spend still remains very powerful.

5.177 The CC also had concerns that ITV may be able to leverage its market power by changing the trading mechanism in a way that increased its revenue through an enhanced degree of price discrimination. Given that some advertisers remain dependent on ITV1 this may still be a concern. For example, it was suggested that ITV could change the trading mechanism such that mass audiences were sold at a premium.[123]

5.178 It seems unlikely that other broadcasters would defeat such price rises by expanding into mass audiences themselves. While it is now easier to expand by launching new channels, we have no strong evidence that broadcasters are likely to expand into the key area of mass broadcasting.

In summary, ITV1's market position does seem to have declined since 2003 but our view is that the CC's concerns about the possible detrimental effects of the merger remain significant. There are a number of future developments which may or may not affect this position in the near future. We recommend that the Competition Commission should consider how best to accommodate such changes going forward.

[123] Price discrimination, in itself, is not necessarily detrimental to competition. Price discrimination among advertisers may be a beneficial part of the TV advertising market, allowing a limited supply of commercial impacts to be efficiently allocated among advertisers with varied and changing needs. Nevertheless, in this case, an inability to further price discriminate between advertisers may prevent ITV from exercising its enhanced market position as it is not able to target high prices at those customers who are less willing or able to substitute away from ITV1 but which could have moved away pre-merger.

6 DISTORTIONS

6.1 Introduction

6.1 All behavioural remedies impose some level of costs and distortions on the market, and these may increase if the remedy is in place for a long period of time. The Competition Commission will generally seek to minimise such distortions subject to the remedy effectively addressing the adverse effects of the merger.[124]

6.2 Stakeholders have suggested a number of distortions may have been created by the CRR remedy. These are considered under the following broad themes:[125]

- the definition of ITV1
- pricing on other channels
- pricing on ITV1
- media buyers' incentives to respond to changes in the market
- ITV's ability to honour its contracts and
- effects on programming schedules.

6.3 In addition to these distortions, there are direct costs of simply maintaining, monitoring and reviewing the remedy. ITV, OFT and Ofcom all incur costs associated with this. ITV estimates that the costs of maintaining the Adjudicator's Office, compliance teams within ITV

[124] For further details of the CC's approach to remedies see Merger Remedies: Competition Commission Guidelines, November 2008.

[125] One stakeholder [*redacted*] suggested that CRR might also be depressing advertising revenues across the industry but did not elaborate on how this was happening.

and ITV's reporting obligation to Ofcom and OFT amount to approximately [*redacted*] per annum.

6.2 Definition of ITV1

6.4 The current definition of ITV1 in the CRR remedy relates to ITV1's Channel 3 licence rather than the ITV1 programme schedule itself. Thus it does not include all methods of delivering the ITV1 programme schedule such as high definition channels and any time shifted ITV1 channel.

6.5 ITV has suggested that this discourages investment in such channels. These investments might be valued by advertisers and consumers, and may allow ITV1 to better compete with other channels. The disincentive arises because impacts on ITV1+1 or ITV1 HD channels would not be counted as ITV1 impacts for the purposes of the ratchet mechanism. ITV claims that since these channels would broadcast almost identical content as ITV1, they could reasonably be expected to cannibalise impacts on ITV1, reducing ITV1's SOCI. The ratchet mechanism would then allow media buyers to decrease their SOB commitment in line with this decrease in SOCI, reducing ITV's incentive to innovate in this way.

6.6 In the course of this review, we also found that cable and satellite impacts are technically excluded from the scope of the CRR protection and ratchet mechanism because they are provided under a different licence to that covered by the definition in the Undertakings – this appears to have been a drafting oversight. To date, the impacts on ITV1's satellite and cable platforms have been treated as if they were covered by the remedy. In other words, they are sold at CRR discounts and included in ITV1's SOCI for the purposes of the ratchet.

6.7 ITV suggested that, as an interim solution pending the outcome of the CRR review, CRR should be adjusted so that the ratchet mechanism takes into account impacts on any ITV1+1 and ITV1 HD channels, as well as on ITV1 broadcast on satellite and cable platforms.

6.8 In the consultation document, we proposed that the CRR remedy should apply to the ITV1 programme schedule and not to the licence regime. So, if the CRR mechanism is retained, the definition of ITV1 impacts in the CRR Undertakings should be changed to incorporate impacts from identical programming on all platforms and channels.

6.9 The vast majority of stakeholders agreed with this proposal. Only a minority of stakeholders disagreed, and these were mostly broadcasters rather than those that purchased ITV1's impacts. In some cases the concern was that this would further increase ITV's revenues and decrease the revenue available to other broadcasters. We do not believe this is a concern. CRR protection would remain, if necessary, to prevent ITV exploiting any increase in market position due to the merger.

6.10 Others suggested that the impacts which were not delivered on the standard ITV1 channel, particularly the +1 channel, were of lower quality, in which case they may not need to be rewarded at the same level. This was because the channels would not deliver mass coverage. It seems to us, however, that these channels would contribute to mass coverage as the viewers would generally be different to those that watched the main channel, adding to its coverage.[126]

> We therefore still propose that, if the CRR mechanism is retained, the definition of ITV1 impacts in the CRR Undertakings should be changed to incorporate impacts from identical programming on all platforms and channels.

[126] Some stakeholders also commented that Video on Demand should not be included because of a dearth of measurement techniques. If there are measurement problems on Video on Demand, it may not be practicable to include these in the ARM, regardless of their value. The CC may therefore with to consider excluding them on this basis.

6.3 Pricing on other channels

6.11 A number of stakeholders have commented that the CRR mechanism has affected the negotiating position of other sales houses. This is because the ratchet mechanism means that other sales houses can calculate approximately the SOB that media buyers are able to remove from ITV1 while still maintaining their CRR contracts. The sales houses can then open negotiations by demanding a portion of this amount. Stakeholders have stated this has benefited Channel 4 and Five in particular. Stakeholders tell us that ITV also adopts similar negotiating tactics for its digital channels, although ITV argues it would always have been aware how much spend could have been switched away from ITV1. As discussed in Section 7, some stakeholders went further and claimed that ITV also increased the power ratios on its digital channels by leveraging ITV1's market position.[127]

6.12 Chart 5.6 did show that there were increases in the power ratios on ITV's digital channels, Channel 4, and Five. There are, however, alternative explanations. For example, It may also be that media buyers expected these channels to grow faster than they actually did, and so allocated a SOB that was, in retrospect, unwarranted.

6.13 It has also been suggested to us that the increase in premium on these channels may reflect increased value. Several stakeholders said that the premium on large channels might be due to the increase in value to advertisers of reaching large audiences, given increasing viewer fragmentation. This increase in fragmentation would not explain the increased premia on the ITV digital channels and Channel 4 digital channels, which do not provide mass audiences. It was suggested that the increase in these channels might be related to their increased reach, which is significantly greater reach than pay TV channels, due

[127] Cross-promotion opportunities were also mentioned. We believe that cross-promotion of ITV's programmes may increase SOCI, and so NAR, but it is not clear how this would increase the power ratio, which would require NAR to increase at a greater rate than SOCI.

to the increased penetration of digital TV.[128] We note that this increase in reach would also have increased SOCI, and it is not immediately clear why NAR should have increased over and above this.

6.14 There may be other elements of value which have increased. For example, the demographic mix may have shifted so that more valuable impacts are bought or so that optimisation improves. Chart 5.8 showed that Channel 4's weighted power ratio is much flatter, as is that of its digital Channels, but Five's weighted power ratio and, more dramatically, those of ITV's digital channels still increase.

6.15 It is possible that other aspects of the quality on these channels may also have increased, although we have been told by ITV and others that ITV's digital channels do not have any particular quality advantage.

> We consider that there may be some reason to believe that CRR has increased the negotiating position of sales houses competing with ITV. CRR may also have contributed to increase the premium on ITV's digital channels. However, the available evidence is not conclusive.

6.4 Pricing distortions on ITV1

6.16 The CRR ratchet mechanism as proposed by the merging parties means that ITV1's pricing varies directly with its SOCI. A decrease in SOCI means that advertisers can withdraw a proportionate amount of SOB. Although it seems clear that, all else being equal, a reduction in SOCI reduces the amount a media buyer would want to commit to ITV1, it is less clear that the intrinsic value of ITV1 decreases with its SOCI in the exact linear fashion specified by the ratchet. Thus there may be an element of specification error in the ratchet – indeed, some degree of specification bias is inherent in any behavioural remedy which controls

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[128] According to Ofcom, there are 9.7 million viewers which only have DTT. ITV2 has a reach of [*redacted*]% which compares to Sky One's reach of [*redacted*]%.

pricing.[129] ITV point out that the share deal mechanism suggests that any miscalculation of ITV1's SOB will also affect pricing on other channels.

6.17 It is possible to argue that a 1 per cent decline in SOB should entitle media buyers to more than a 1 per cent reduction in SOCI. This is because, as ITV1 loses SOCI, it also loses its mass audience advantage to some extent. Media buyers may therefore want to withdraw more than the loss in SOCI to reflect the diminished mass audience effect.

6.18 On the other hand, it is also possible to argue that the increased fragmentation across all channels might mean that, all else equal, the mass audiences ITV1 attracts are now increasingly valuable. This would mean that a one per cent reduction in SOCI should be followed by less than a one percent reduction in SOB.

6.19 We are unable to determine the extent to which the ratchet reflects competitive market conditions, or what the correct level of the ratchet should be, or even what direction it may be biased towards. It is, however, unlikely that the ratchet is set at exactly the optimal level. For example, fragmentation on the other channels will affect the value of ITV1 and this is not accounted for by the ratchet which depends only ITV1's own SOCI. Thus CRR is likely to be causing some distortion in pricing, although, on the basis of current evidence, it is hard to say how significant this is or whether it has worsened due to audience fragmentation.

6.20 The vast majority of stakeholders either did not propose changes to the ratchet specification or believed it remains appropriate. Only one, [*redacted*], suggested that it was inappropriate as impacts on ITV1 were generally lost to impacts on +1 or digital channels of inferior channels. It believed that the ratchet should reflect the absolute amount of ITV1 impacts rather than its share of impacts. This may not

[129] See para 4.2 (a) "Merger Remedies: Competition Commission Guidelines" Competition Commission, November 2008.

be workable as it does not reflect the way the industry trades. For example, it is not clear how a fall in ITV1's impacts would be translated into a reduction in SOB, if not through SOCI. Neither is it clear how the revenue loss per impact could be adjusted to reflect changes in the general price of TV advertising impacts.

Given that most stakeholders did not object to the current ratchet, and a lack of a clearly preferable alternative, it is not clear to us that an adjustment to the ratchet mechanism would be beneficial.

6.5 Media buyers' incentives to respond to changes in the market

6.21 A number of stakeholders have suggested that CRR may be inhibiting dynamism in the media buyer market. They argue that to depart from their existing protected contract – for example, to change their channel profile, target audiences, trading parameters and so on – necessitates renegotiation which is a potentially protracted process. They also argued that if media buyers involved the Adjudicator to decide on fair and reasonable terms, it risked reprisal from ITV. They said that the status quo therefore represents a safe option and is the path of least resistance.

6.22 ITV argues that agencies would have to have significant negotiations without remedies. Therefore CRR cannot be seen as inhibiting the dynamism of media buyers. To the extent that it does offer media buyers an easier negotiation process, this is a benefit of the remedy, not a cost.

6.23 Some media buyers also consider that the CRR remedy has increased the complexity of contract negotiations, with agreements becoming increasingly legalistic where every aspect of the deal is covered. While these more formalised agreements may have the advantage of certainty, it is also considered by some stakeholders that they reduce flexibility. One also commented that the industry had become more focused on price and less on strategic planning.

6.24 Other stakeholders presented an alternative view. One said that it was easy to negotiate minor changes to contracts, and another believed that there were similar levels of changes to ITV's contracts as on other channels.

6.25 It is hard to evaluate the significance of these concerns. We have considered the amount of renegotiation of contracts. There are some examples where protected contracts have been renegotiated or varied, without the protection being lost, to take into account a change in the media buyer's client base. However, ITV suggested that 31 per cent of contracts were not renegotiated each year, with over a quarter of contracts remaining unchanged since pre-merger. This may suggest that there has not been full adjustment to changes in the market. ITV claim that the extent of change on those contracts which were renegotiated was marginal, suggesting even these contracts may not fully reflect changes in the market.

Overall we consider that it may be the case that the CRR remedy is inhibiting dynamism in the market, possibly beyond what was expected at the time the remedy was put in place, but we have not seen any conclusive evidence of this.

6.6 Effects on ITV1's (and other channels') programming

6.26 ITV has raised concerns that the CRR remedy has dulled its incentive to invest in high quality, diverse programming that advertisers and viewers value.

6.27 ITV argues that the ratchet provides it with an incentive simply to maximise ITV1's SOCI.[130] This is because, during contract negotiations, media buyers may simply withdraw the amount allowed by the ratchet, regardless of changes in the quality of ITV1's impacts. Of course, ITV would have an incentive to increase SOCI, even in the

[130] This argument can therefore be viewed as a reformulation of the argument that the ratchet specification is incorrect.

absence of CRR – the change in SOCI is the one of the key metrics used in negotiations with media buyers. But ITV argues that, in the absence of CRR, it would also aim to maximise reach and 'halo effects' i.e. positive association over and above ratings derived, for example, from more desirable demographics and programming or brand-investment. Such investments are not rewarded under CRR.

6.28 The consultation document noted that the ratchet is not simply linked to SOCI – it does allow some flexibility to adjust for different levels of decline across different types of impacts. This is because the adjustment in SOB within a contract is revised in proportion to the levels of advertising expenditure weighted by different demographics, regions and time periods currently contracted for. So if a media buyer uses a lot of peak advertising, and the decline in peak is lower than ITV's overall decline, it will be able to withdraw less than the decline in overall adult SOCI. In response to this, ITV pointed out that the degree of adjustment is, however, limited as not all demographics, regions or time periods are separately contracted.

6.29 ITV also argues that CRR has incentivised it to be less innovative. This is because the ratchet mechanism will 'automatically penalise' ITV for any risky programming which doesn't provide high viewing figures – even if this was a one-off. For example, it has invested more in day-time, rather than peak, and in soap operas rather than innovative new programming such as 'big event' entertainment. It has also reduced the amount of time that ITV1 can devote to testing new programming.

6.30 Many stakeholders responded that the choice of ITV1's programme schedule had been driven by factors other than CRR, such as a general risk aversion that applied pre-merger as well as in recent years. A few stakeholders did agree that while the CRR remedy encourages ITV to produce programmes and schedules that will deliver high audience levels for ITV1, it may also discourage innovation and experimentation.

6.31 ITV has provided some evidence that it has invested more in day-time, rather than peak,[131] and in soap operas. However, there is no clear evidence which links these investment decisions directly to the CRR remedy.

6.32 ITV further submitted that the CRR remedy and the way it incentivises SOCI maximisation on ITV1 also has an impact on the long term growth and development of ITV's overall family of channels. In particular, there would be a reduced incentive to invest in the wider family of ITV channels as this ultimately leads to a reduction in ITV1 SOCI, both through the cannibalisation of ITV1 impacts and, where a new channel is established, by an increase in total volume of impacts available. We note impacts on ITV's digital channels are likely to cannibalise those of ITV1 even without the CRR remedy. Moreover, ITV's digital channels have experienced a strong growth in terms of share of NAR and SOCI, even with CRR in place. ITV, however, argues that the automatic relationship between the SOCI on ITV's digital channels and its revenue on ITV1 increases the amount of cannibalisation.

6.33 ITV has also submitted that the automated nature of the ratchet calculation means that other broadcasters automatically benefit the more ITV1's SOCI can be reduced, with very little risk for the broadcaster. As a result, these broadcasters may be overly incentivised to launch new free-to-air channels, particularly +1 channels, that assist in reducing ITV1 SOCI. A number of stakeholders made a similar observation.

[131] Since 2003, ITV has argued its investment in daytime programming has increased by [*redacted*] per cent while, at the same time, ITV's investment in programming outside daytime has fallen by only [*redacted*] per cent. ITV also states that its delivery of commercial impacts increased marginally between 2006 and 2007, but impacts in peak time fell and the growth was primarily driven by growing impacts in daytime. We note that this trend is not evident throughout the period as ITV lost impacts in daytime up until 2006.

Overall, we consider that no behavioural remedy can perfectly replicate the working of a competitive market. The CRR remedy may have had some effect on the programming choices made on ITV1, ITV's digital channels, and also on other channels, but we have little evidence by which to judge the significance of these effects.

6.7 ITV's ability to honour its contracts

6.34 ITV has also argued that changes in the market mean that it is increasingly hard for it to fulfil its protected contracts. This is because the protected contracts specify a pattern of discounts which reflects the balance of supply and demand of demographics in 2003. ITV claims that market circumstances have now changed, in that advertisers are more interested in buying narrower demographics. ITV has claimed that CRR constraints have limited its ability to offer terms which reflect these changed market conditions, resulting, in particular, in deal debt and an inability to fully optimise its schedule in order to meet these changing market conditions. Deal debt was a significant issue for ITV in 2005 and 2006, although the issues eased in 2007 due to a number of scheduling 'events'.[132]

6.35 ITV submits that there have been substantial changes in the proportion of money it booked against several important audience groups, and provided data to demonstrate that revenue which it booked against certain demographics had changed. Two thirds of the initial protected contracts have been varied since 2003, but we do not know to what extent these variations have altered the structure of discounts and made it easier for ITV to honour its contracts. ITV claims that many contracts were only marginally renegotiated and it was not able to reflect these changes in the pattern of discounts it offered. Moreover, it cannot instigate renegotiations – this can only be done by agencies.

[132] For example, the UEFA Champions League, Rugby World Cup and Formula 1 all had significantly larger audiences than were anticipated at the time campaigns were scheduled.

6.36 ITV also argues that, even if contracts were renegotiated, ITV would not be able to fully optimise its inventory. This is because the new contracts would not necessarily become the new protected contracts going forward. Thus, ITV argues, while negotiating the contract it must be in a position to deliver both the terms of any newly negotiated deal and meet the possibility that any or all of these negotiations may result in the advertiser/media buyer falling back on its CRR protected contract. It claims that this was not envisaged at the time of the merger. Instead, it was presumed that most – if not all – contracts would be renegotiated. Agencies have chosen not to do this in order to avoid the substantial costs involved with renegotiation.

6.37 Stakeholders did not believe that CRR was preventing ITV from honouring its contracts. Many pointed out that the deal debt had been eroded even with CRR in place. One suggested that the deal debt was caused by giving away more discount to dissuade media buyers from withdrawing the full ratchet. Another suggested it was due to lack of audience supply. Some suggested that ITV had made use of its digital channels to deliver on deals and that this was mutually acceptable. Another pointed out that the Undertakings allow it to negotiate new fair and reasonable terms if necessary, for example when the regulations on food and drink high in fat, salt or sugar (HFSS foods) came into place.

> CRR clearly imposes some restrictions on ITV's negotiating flexibility, in order to prevent any exploitation of its enhanced market position. There is, however, limited evidence to determine the extent to which this has prevented ITV from adjusting to changes in the demand and supply of different demographics.

6.8 Conclusion on Distortions

6.38 This section has discussed the costs and distortions that CRR may have created. It has outlined a number of ways in which CRR may affect the behaviour of ITV, broadcasters and media buyers, above and beyond protecting against the detrimental effects of the merger. It is hard to find evidence with which to evaluate the exact significance of these effects or the extent to which they have worsened due to changes that have occurred since 2002. Nonetheless, it is clear that the effects of CRR are not immaterial – it has significantly changed the nature of negotiation across the broadcasting industry.

6.39 We do, however, consider that, if the remedy is retained, a variation is necessary to amend the definition of ITV1 to relate to the programme schedule and not to any particular licence. This would mean that the impacts on identical programming broadcast on, for example, HD or time-shifted versions of ITV1 are sold under the terms specified on the protected contracts and would count towards the calculation of ITV1's SOCI for the purposes of the ratchet mechanism.

7 ISSUES OUTSIDE THE ORIGINAL SCOPE OF THE REVIEW

7.1 Introduction

7.1 A number of issues have been raised in the course of our review that fall outside its initial scope. These are set out in turn below.

7.2 Other Aspects of the Undertakings

7.2 Some of the ITV1 minority licensees have requested that the OFT reviews particular aspects of the Undertakings other than the CRR remedy. We consider that, to the extent that these requests do merit a review of the Undertakings, it is not appropriate to consider such issues within this exercise. This is because the issues concern only a small number of stakeholders within the ITV Networking Arrangements and public consultation is not necessary. In the consultation document, the OFT proposed to consider these issues separately, and there was no significant disagreement with this approach.

7.3 Possible Weaknesses in the Remedy

7.3 Although stakeholders generally thought that the remedy was effective, a number of stakeholders mentioned that ITV could circumvent it to some extent.

7.4 Some pointed out that the protected contracts do not specify all aspects of dealing with ITV, and suggested this had given ITV some opportunity to exploit an increase in market position. For example, stakeholders have suggested that ITV could use negotiations over timings of campaigns and sponsorship deals as leverage to increase revenue.[133] Many also suggested that late bookings were used as

[133] For example, a stakeholder recorded that for an advertiser, ITV demanded a 100% CRR retention in order to accommodate a request for [*redacted*]. Similarly, a stakeholder understood that ITV included CRR considerations in negotiations over major sponsorship deals; or offered not to take back the value of impacts over-delivered on the ITV digital channels in one year in exchange for a lower disinvestment out of ITV1. A stakeholder reported the ITV refused to

leverage. Many stakeholders told us that late bookings are often required as ITV requires media buyers to commit to bookings weeks in advance, but that campaigns were often planned to very tight deadlines. Not all CRR contracts specify late booking fees although the fees are subject to fair and reasonable terms, and media buyers have consulted the Adjudicator on this issue. Pre-merger Carlton and Granada had been fairly tolerant of changes beyond the deadline, but we were told that since CRR has been in place ITV had been much stricter about its application. We have not seen any evidence by which to gauge the significance of this effect.

7.5 Many stakeholders pointed to the increase in ITV1 power ratios as evidence of ITV's ability to leverage its market position to a limited extent, despite CRR. As discussed in Section 5.2 there has been a small increase in ITV1's power ratio. A portion of this is related to the "lag" in the ARM. There are various explanations for the remaining increase between which it is hard to distinguish conclusively.

7.6 Many stakeholders suggested that ITV could also use the weakness in the CRR protection to leverage spend on the digital channels, rather than on ITV1. Stakeholders suggested that ITV has an incentive to do this as it retains 100 per cent of the revenue from its digital channels but only 92 per cent of spend on ITV1 (with the remaining 8 per cent going to regional licensees). Leveraging ITV1 in this way may contravene conditional selling rules, although, as discussed below, stakeholders allege that these rules are ineffective. As discussed in Section 6.3, there are a number of competing explanations for the increase in the power ratio ITV's digital channels and it is hard to be definitive about these different effects.

engage with an advertiser on a sponsorship deal; another advertiser described an unconstructive attitude from ITV's sales personnel in reference to another sponsorship deal.

7.4 Conditional Selling

7.7 Many stakeholders raised the issue of the prohibition against conditional selling in Ofcom's Airtime Sales Rules, which they consider to be ineffective.

7.8 As noted above, they claimed that, despite these rules, ITV had been able to leverage spend from ITV1 on to the digital channels. Moreover, if CRR protection was removed, media buyers feared that ITV would have even more leverage, and would be able to increase revenues on ITV's digital channels to an even greater extent.

7.9 Stakeholders also believed that the digital channels could be leveraged to reinforce the ITV1's market position – for example, if terms were not agreed on ITV1 then access to the digital channels would also be denied – although we have no evidence to suggest this effect would be great.

7.10 Many stakeholders said that one of the main problems with the rules were that complaints were not taken to the Adjudicator for fear of reprisals from ITV in later years although we note that it is possible that if conditional selling became a greater concern in the absence of CRR, media buyers may be more inclined to take action. Media buyers said that it was also difficult to gather evidence, particularly within the time constraints in which they operated. There also appears to be confusion between conditional selling and bundling and tying. Many stakeholders felt that the rules could not be made workable.

7.11 We were not provided with any evidence of conditional selling aside from the increase in power ratios on ITV's digital channels, which, as discussed above, is inconclusive. Neither have any formal or informal complaints been made to Ofcom to date, although the Adjudicator has noted the concerns raised by stakeholders in his reports. We therefore have little concrete evidence on the effectiveness or otherwise of the rules.

7.5 Other Issues

7.12 A number of other issues have been raised that pre-date, or go beyond the merger situation. Questions have arisen in relation to the current trading mechanism i.e. the use of SAP, SOB, and umbrella deals [134]. In particular, it was suggested that SOB deals favour large broadcasters and reduces the amount of spend available to small broadcasters. This may have detrimental effects on competition.

7.13 Some stakeholders suggested that the CRR mechanism should be extended to Channel 4 as well as the ITV digital channels.

7.14 In addition, various stakeholders have also suggested that the market between media buyers and advertisers is not functioning well, despite the widespread use of auditors. In particular, although auditors compare prices obtained on the various channels, they do not usually compare outcomes across channels. Therefore, advertisers may be aware whether or not they are getting a good deal on a particular channel, but may be unaware of whether or not they should be spending less on a particular channel and more on others, in order to get the same amount of coverage for reduced spend. It is claimed that this is inhibiting competition in the market.

7.6 Conclusion on Scope

7.15 The statement on the scope of the CRR review[135] stated that if we received evidence which indicates competition issues which could not be dealt with by the review, the OFT would need to consider using alternative legal powers. The obvious means by which these issues

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[134] An umbrella or agency deal is a type of agreement between a media buyer and a particular channel or sales house, where the agreement specifies the media buyer's SOB commitment and the discount level it will receive in aggregate. It is often contrasted with "line-by-line" deals which are specific to an individual advertiser.

[135] http://www.oft.gov.uk/shared_oft/register_of_orders_and_undertaki/CRR-review/Scope-CRR-review.pdf

might be directly addressed would be to consider making a Market Investigation Reference to the Competition Commission. The OFT and Ofcom have concurrent powers under the Enterprise Act 2002 to make an MIR. In keeping with the principles of concurrency, the OFT considers that Ofcom, because of its role as the sector regulator, would be best placed to make such an MIR if this was considered to be an appropriate course of action.

7.16 In response to our consultation, some stakeholders requested that a MIR into the sale of TV advertising should be made. These requests mostly linked to concerns around conditional selling and the wider market position of ITV plc – as opposed to ITV1. Some stakeholders also requested that a reference could look at other issues, such as the way in which advertising was traded. Many felt such an investigation should be conducted in advance of any decision to remove or replace CRR.

7.17 On the substance of issues raised, Ofcom believes that any concerns about the market position of ITV1 will be addressed through this CRR review. Concerns about the wider market position of ITV plc, and complaints about conditional selling in particular, may be addressed by the Airtime Sales Rules, which prohibits conditional selling. Should Ofcom receive any reasoned requests from stakeholders for a MIR to consider other competition concerns these will be given due consideration. Ofcom would expect such requests to address the factors identified in the OFT's guidance on market investigation references, with particular reference to the distortion of competition and possible remedies, which would form an essential part of any assessment.[136] Any decision as to whether to open an investigation would also be based on administrative priorities.

7.18 Nevertheless pending the outcome of the CRR Review, Ofcom does not consider it appropriate to open such an investigation at this time. In

[136] Market investigation References - Guidance about making reference under Part 4 of the Enterprise Act (OFT 511, March 2006)

addition, the current economic climate and the ongoing Digital Britain review further increase the level of uncertainty in television advertising which provides further reason not to conduct such a review at the present time.

7.19 Ofcom will closely monitor any market developments and any stakeholder concerns, particularly in the light of any changes resulting from the CRR Review.

ANNEXE(S)

A SUMMARY OF STAKEHOLDER VIEWS ON EASEMENTS

A.1 Our consultation document put forward a number of potential easements of CRR and invited views and further evidence on these.

A.2 We suggested that the most appropriate easement might be to remove the requirement to roll over contracts but maintain safeguards against price discrimination. Stakeholders suggested that this would be ineffective as ITV would be able to increase its revenue without discriminating against particular advertisers. For example, ITV might demand an increased SOB allocated to ITV1 from all (or most) or most, of its customers for the same level of discounts. The evidence and arguments put forward in support of this was discussed in Section 5. We believe that this suggested that ITV1 may be able to increase revenue in without price discriminating against particular advertisers, so that protections against price discrimination may not fully address the concerns about the remaining detrimental effects of the merger.

A.3 It was also not clear that the safeguards put forward would be fully effective in preventing price discrimination. Some stakeholders said they would go some way to protecting against price discrimination. Others raised concerns that ITV could price discriminate even with the suggested safeguards in place. For example, stakeholders told us it was common knowledge which advertisers were covered by which media buyers and their degree of dependence could be inferred from previous years spend, so umbrella deals would not conceal a media buyers' dependence on ITV. Others suggested that even if ITV is inhibited from price discriminating, media buyers can themselves discriminate between advertisers (see Section 5.6).

A.4 The vast majority of stakeholders favoured the outcome that CRR could be left in place with only the minor changes to deal with the definition of ITV1. Most felt that the other options were not suitable. A few felt that a separation of the sales house might be viable, but many said it would have to be fully independent. One suggested fair and reasonable terms could be workable, but most believed otherwise.

A.5 The consultation document invited suggestions for alternative variations or easements which may reflect the change in ITV1's market position. Only a few alternative easements were put forward and it is not clear that these would be appropriate.

A.6 One stakeholder suggested rebasing the ratchet at 2009 levels and using a ratchet based on share of commercial viewing (SOCV) rather than SOCI. It believed that the move to SOCV would be advantageous as any change in rules on advertising minutage in the RADA review would not leave SOCV unaffected. It also believed that this change would address ITV's claim that they were focused on impacts and not the quality of viewing. We do not consider this variation appropriate. It does not appear to link to the changes of circumstance identified and we cannot see any clear reasons why replacing SOCI with SOCV would reduce any of the distortions identified by CRR – ITV would still be incentivised to maximise viewers and not the quality of their experience.

A.7 Another stakeholder suggested that umbrella deals gave ITV1 leverage and that agencies should be able to unbundle these subject to fair and reasonable terms. It also suggested that ITV1 should be compelled to make peak airtime available at a capped rate. We do not have sufficient evidence that unbundling umbrella deals would reduce ITV1's leverage but we consider that there may be some merit in further exploring remedies which are limited to peak airtime, as it is ITV1's position in peak which gives rise to concerns surrounding the easing of CRR.

A.8 Finally, one stakeholder suggested that CRR should be removed and, in parallel, ITV1 should adopt a demand-led pricing structure that allows the market to operate efficiently and be immune from accusations of 'exploitation of undue market power'. It is, however, not clear how this could be achieved.

B TEXT OF THE UNDERTAKINGS[137]

PROPOSED AGREED MERGER OF CARLTON COMMUNICATIONS PLC AND

GRANADA PLC

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

WHEREAS:

(a) On 16 October 2002, Carlton Communications plc and Granada plc announced a proposed agreed merger;

(b) On 11 March 2003 the Secretary of State for Trade and Industry referred the proposed merger to the Competition Commission under sections 64, 69(2) and 75 of the Fair Trading Act 1973 (the 'Act');

(c) The report of the Competition Commission (the 'Report') was presented to

Parliament in October (Cm 5952) and sets out such conclusions as are mentioned in section 73(1) of the Act;

(d) Pursuant to a request by the Secretary of State, the OFT has consulted with

[137] The full text and all annexes, with a guide to the provisions. are available on the website of the Adjudicator www.adjudicator-crr.org.uk

Carlton and Granada with a view to obtaining from them Undertakings to take action in accordance with section 88(1) of the Act;

NOW THEREFORE Carlton and Granada hereby give to the Secretary of State the following Undertakings (the 'Undertakings') pursuant to section 88(2) of the Act for the purpose of remedying or preventing the adverse effects on the public interest specified in the Report.

Effective date of these Undertakings

1. These Undertakings shall take effect from the date that, having been signed by Carlton and Granada, they are accepted and dated by the Secretary of State.

Other Licensees

2. Carlton and Granada shall, directly or indirectly,

   (a) convene the Network Council at least twice a year to: (i) consult the Other Licensees; and (ii) ensure that the Other Licensees are properly and fully informed of the Channel 3 Network's broadcasting and programme strategy, as presently referred to in Clause 4 of the Network Supply Contract. They shall circulate in good time the agenda and supporting papers for such meetings, and provide minutes of such meetings to the Regulator in a form approved by it from time to time;

(b) ensure that any Other Licensee's contribution, net of any discount, rebate or abatement currently provided in the Network Supply Contract, to the Network Programme Budget in any year does not increase from such net contribution to the 2003 Network Programme Budget (excluding the costs occasioned by Exceptional Events and excluding the discount relating to the Premier League) by more than the cumulative rate of inflation since December 2002, measured by reference to the Retail Prices Index, save to the extent necessary to meet a fair and reasonable share of the increased costs occasioned by Exceptional Events which is, at the date hereof, deemed to be the Agreed Share as defined in the Network Supply Contract;

(c) not make the commissioning or broadcasting of a programme conditional on using Carlton and/or Granada for Programme Compliance for that programme;

(d) at no extra cost provide Grampian TV, Scottish TV and Ulster TV (and any future Licensee for the respective Regional Channel 3 Services authorised by such companies' Licences at the date of entry into force of these Undertakings) with a Clean Broadcast Feed from the Channel 3 Network to the extent and on the same basis as it is provided at the date hereof (save as amended from time to time by mutual agreement);

(e) offer the Licensee for Ulster (currently Ulster TV) equivalent terms to those made available to Scottish TV following devolution in Scotland, if its local programming obligations set out in its Licence change as a result of devolution in Northern Ireland;

(f) report to the Regulator monthly, in a form specified by the Regulator, the number and value of Network Hours by genre and supplier that they have purchased; and

(g) use their best endeavours to procure any changes to the Networking Arrangements required to enable them to comply with the Undertakings.

3. Carlton and/or Granada shall offer to each Other Licensee, for the duration of its Licence from time to time, terms similar to those in effect on 1 November 2003 (as amended from time to time by mutual agreement) between it and Carlton and/or Granada for the sale of Commercial Airtime and programme sponsorship.

4. Carlton and/or Granada shall offer to any future Licensee for a Regional Channel 3 Service currently supplied by any Other Licensee, for the duration of its Licence from time to time, the terms last agreed between that Other Licensee and Carlton and/or Granada for the sale of Commercial Airtime and programme sponsorship (which may be amended from time to time by mutual agreement).

The sale of Commercial Airtime

5. The conclusion of any contract for the sale of Commercial Airtime with Carlton and/or Granada is without prejudice to Clauses 12-18 below.

6. Carlton and Granada shall offer to each person that holds or has held a Protected Contract the option of contracting for the purchase of Commercial Airtime on the same terms (including duration) as those contained in such Protected Contract. Carlton and/or Granada shall make this offer to each such person at least two months before any contract with that person for the supply of Commercial Airtime expires. Each such offer shall remain open until accepted or a new agreement for the sale of Commercial Airtime with Carlton and/or Granada enters into force.

7. If a Protected Contract contains any Share of Broadcast provisions, such shares will be revised annually in direct proportion to changes in the Regional Channel 3 Services' share of Commercial Impacts, calculated against the base level of the average share of Commercial Impacts achieved by the Regional Channel 3 Services in 2002, or the relevant Base Year defined in Annex 1.

8. Such revised shares shall not at any time exceed the Initial Share of Broadcast Commitment (as defined in Annex 1) specified in the relevant Protected Contract.

9. The revised Share of Broadcast shall be weighted by the mix of demographic audience, regions and specific time periods contracted for. Annex 1 states how this shall be calculated.

10. Carlton and Granada agree that:

(a) they must offer Commercial Airtime on fair and reasonable terms to any person, including any person seeking to vary a contract (whether a Protected Contract or not) for the sale of Commercial Airtime. Any Protected Contract existing on 1 November 2003 (or as modified in relation to any Share of Broadcast provision pursuant to Clause 7) is presumed to be fair and reasonable;

(b) where an Advertiser under an Umbrella Agreement switches to a new Media Buyer, that Media Buyer may apply the terms of its Protected Contract to the purchase of Commercial Airtime on behalf of that Advertiser, where the terms of the Protected Contract so provide, or otherwise with the consent of Carlton and/or Granada as the case may be. They may withhold such consent only:

(i) to the extent necessary to avoid Overtrading to a material extent;

(ii) to the extent necessary to avoid materially increasing existing Overtrading;

(iii) to the extent that such switching would put Carlton and/or Granada as the case may be in breach of pre-existing contractual arrangements relating to the use of particular advertising slots; or

(iv) if such switching would result in a material reduction of the Advertiser's Share of Broadcast commitment; Should Carlton and/or Granada withhold consent in the circumstances detailed in Clause 10(b), they shall nevertheless offer fair and reasonable terms to the new Media Buyer with the aim of accommodating such Advertiser and shall offer for such terms to become part of the new Media Buyer's Protected Contract.

(c) where an Advertiser under a Line-by-Line Agreement switches between Media Buyers, Carlton and/or Granada shall offer terms for that Advertiser to the new Media Buyer no less favourable than those that the Advertiser enjoyed with its previous Media Buyer;

(d) a person, who has not done so since 31 December 2000, may purchase Commercial Airtime by agreement with a Media Buyer and benefit from such Media Buyer's Protected

Contract with Carlton and/or Granada, subject to Carlton's and/or Granada's consent which they may only withhold:

(i) to the extent necessary to avoid Overtrading to a material extent;
(ii) to the extent necessary to avoid materially increasing existing Overtrading; or

(iii) to the extent that the proposed agreement would put Carlton and/or Granada in breach of pre-existing contractual arrangements relating to the use of particular advertising slots;

(e) a person that holds or has held a Protected Contract may agree with Carlton and/or Granada that a new or replacement contract, or any variation to its Protected Contract, becomes its Protected Contract. Carlton and/or Granada shall not unreasonably withhold or delay their agreement;

(f) Advertisers, which purchase Commercial Airtime under Line-by-Line Agreements, that cease to be distinct may:

(i) apply the terms for the supply of Commercial Airtime enjoyed by the larger or largest of those Advertisers with Carlton and/or Granada (calculated by reference to spend on Commercial Airtime), although Carlton and/or Granada may decline to provide Commercial Airtime on that basis:

(aa) to the extent necessary to avoid Overtrading to a material extent;

(bb) to the extent necessary to avoid materially increasing existing Overtrading; or

(cc) to the extent that to do so would put Carlton and/or Granada in breach of pre-existing contractual arrangements relating to the use of particular advertising slots;

(ii) apply the weighted average (calculated by annual spend on Commercial Airtime) of those Advertisers' terms contained in their Protected Contracts, or

(iii) exercise their rights under Clauses 5 to 10 for each Protected Contract separately;

(g) Media Buyers that cease to be distinct may:

(i) apply the weighted average (calculated by annual spend on Commercial Airtime) of the terms of their Protected Contracts; or

(ii) exercise their rights under Clauses 5 to 10 for each Protected Contract separately; and

(h) they shall not change their Current Airtime Sales System without the consent of the OFT in a way that materially alters the basis on and the way in which they offer Commercial Airtime for sale.

11. The Undertakings in Clauses 5 to 10 inclusive only apply to Commercial Airtime sales in relation to the Regional Channel 3 Services provided by Licensees.

Adjudication

12. Carlton and Granada agree to comply with and fulfil any obligations placed upon them under the CRRA Scheme and the CRRA Rules.

13. Any decision of the Adjudicator shall bind Carlton and/or Granada as the case may be. Notwithstanding any conflicting provision contained in a contract with Carlton and/or Granada, they shall offer such terms as are required to comply with the Adjudicator's decision.

14. Carlton and Granada shall at all times expressly maintain the offer (whether or not such offer has previously been rejected) to insert the following clause into all contracts with Media Buyers and Advertisers for the sale of Commercial Airtime:

 'In the event of any inconsistency between this paragraph and any other provision *in these Terms and Conditions/of this Agreement*, the provisions of this clause shall prevail.

 As regards any dispute between the parties arising out of the interpretation or exercise of the rights given to or obligations upon Advertisers, Media Buyers, Carlton and Granada in relation to contracts for the sale of Commercial Airtime pursuant to the Undertakings given by Carlton Communications Plc and Granada Plc to the Secretary of State for Trade and Industry dated COMPLETE 2003 (the "Undertakings"), including any dispute relating to the interpretation, termination or enforcement of such contracts to the extent referable to such Undertakings, the interpretation of any provision of the Contracts Rights Renewal Adjudication Rules, the Contracts Rights Renewal Adjudication Scheme, or the Adjudicator's jurisdiction to determine the dispute, *name of Advertiser or Media Buyer* may refer the dispute to the Contracts Rights Renewal Adjudicator for determination in accordance with the Contracts Rights Renewal Adjudication Scheme and Contracts Rights Renewal Adjudication Rules annexed to the Undertakings and as amended from time to time.'

15. If an Advertiser or Media Buyer accepts this offer and accordingly to be bound by the CRRA Scheme and CRRA Rules, it may refer disputes referred to in Clause 14 to the Adjudicator.

16. Carlton and/or Granada shall offer to persons not holding a contract with them for the sale of Commercial Airtime, for the following disputes to be referred to the Adjudicator for determination in accordance with the CRRA Scheme and CRRA Rules:

(a) if a person considers that Carlton and/or Granada have not complied with their obligations under Clauses 10(a) and 10(d);

(b) if an Advertiser considers that Carlton and/or Granada have not complied with their obligations under Clause 10(b) and 10(c); and

(c) if an Other Licensee considers that Carlton and/or Granada have not complied with their obligations under Clause 3.

17. If a person, Advertiser or Other Licensee accepts this offer and to be bound by the CRRA Scheme and CRRA Rules, it may refer the dispute to the Adjudicator.

18. Carlton and Granada consent to the Regulator providing the Adjudicator with any documents and information received from them relevant to the operation of the CRRA Scheme and CRRA Rules.

Compliance

19. Carlton and Granada shall provide to the OFT or the Regulator such documents and/or information as they may from time to time require for the purposes of ascertaining whether Carlton and Granada have complied with these Undertakings.

20. Carlton and Granada shall deliver a report to the OFT and the Regulator annually, on, or if not a business day on the next business day following, the anniversary of these Undertakings coming into force. It shall include a detailed and accurate account of:

(a) steps taken during the preceding year to ensure compliance with the Undertakings;

(b) instances where a breach or potential breach of the Undertakings has been identified;

(c) how the report was compiled.

21. Carlton and Granada shall comply promptly with such written directions as the OFT may from time to time give:

(a) to take such steps as may be specified or described in the directions for the purpose of carrying out or securing compliance with these Undertakings; or

(b) to do or refrain from doing anything so specified or described which they might be required by these Undertakings to do or to refrain from doing.

Transitional provision

22. In relation to any Protected Contract that expires prior to 1 February 2004, Carlton and Granada shall be regarded as having complied with the obligation to make an offer as required in Clause 6 if they make that offer as soon as reasonably practicable following the effective date of these Undertakings.

Interpretation

23. The Interpretation Act 1978 shall apply to these Undertakings as it does to Acts of Parliament.

24. Any word or expression used in these Undertakings shall, unless otherwise defined herein and/or the context otherwise requires, have the same meaning as it has in the Fair Trading Act 1973 or the Enterprise Act 2002, as the case may be.

25. Further, in these Undertakings:

'Advertiser' means a purchaser of Commercial Airtime for the purpose of broadcasting advertisements;

'Adjudicator' means the Adjudicator established under these Undertakings;

'Carlton' means Carlton Communications plc and:

(a) any person who directly or indirectly controls Carlton Communications plc from time to time; and

(b) any person directly or indirectly controlled by Carlton Communications plc from time to time; and

(c) any person that from time to time is directly or indirectly controlled by any person falling within paragraph (a) above; where such person is a Licensee or carries on any activity that involves or is related to or connected with the broadcast or sale of Commercial Airtime;

'Channel 3 Network' means the nationwide system of television broadcasting services to be provided by Licensees under the Networking Arrangements;

'Clean Broadcast Feed' means the provision of a broadcast transmission feed of the Channel 3 Network schedule of all programmes including end credits but free from all end credit promotions and end credit announcements, commercials, other promotions, interstitial material and continuity announcements not relevant to the regions served;

'Commercial Airtime' means the television transmission time that a television channel may sell to third parties to show advertisements in relation to the Regional Channel 3 Services provided by Licensees;

'Commercial Impact' means the viewing by one member of the target audience of an advertisement (including an interactive advertisement), as currently measured by BARB (the Broadcasters' Audience Research Board);

'CRRA Rules' means the rules set out in Annex 2 as amended from time to time;

'CRRA Scheme' means the scheme set out in Annex 3 as amended from time to time;

'control' shall be construed in accordance with section 65 of the Act, and

'controlled' and **'controlling'** shall be construed accordingly;

'Current Airtime Sales System' means the features and processes currently used by Carlton and Granada in relation to the sale of Commercial Airtime. This includes: the use of SAP, the sale of Commercial Impacts in all regions by all demographic audiences, specific time periods, time length factors and day part definitions as currently sold by Carlton and

Granada, and the current limited sale of 'specials' outside contracts for the sale of Commercial Airtime between Carlton or Granada and Advertisers and Media Buyers;

'**Exceptional Events**' means UK parliamentary elections, international conflicts or major international sporting events (namely the Olympics, European Athletics Championships, Football World Cup, European Football Championships, Cricket World Cup, Rugby World Cup and Commonwealth Games);

'Grampian TV' means Grampian Television Limited;

'Granada' means Granada plc and:

(a) any person who directly or indirectly controls Granada plc from time to time; and

(b) any person directly or indirectly controlled by Granada plc from time to time; and

(c) any person that from time to time is directly or indirectly controlled by any person falling within paragraph (a) above;

where such person is a Licensee or carries on any activity that involves or is related to or connected with the broadcast or sale or Commercial Airtime;

'ITV Network' means ITV Network Limited or any successor body which is

responsible for the provision of the Networking Arrangements;

'Licence' means a licence granted by the Regulator to provide a Regional

Channel 3 Service;

'**Licensee**' means a person holding a Licence;

'Line-by-Line Agreement' means a type of agreement between a Media Buyer and a particular channel or sales house where the agreement specifies the specific Share of Broadcast commitment and the discount level received by some or all of the Advertisers on whose behalf the Media Buyer is contracting;

'Media Buyer' means a purchaser of Commercial Airtime on behalf of an

Advertiser;

'**Network Council**' means the council of ITV Network as constituted under the ITV Network Memorandum and Articles of Association, or any successor body carrying out the same, or similar, functions;

'Network Hour' means an hour of transmission of Channel 3 Network programming, measured in terms of 'slot times' i.e., including advertising breaks, programme trailers and presentation material during and at the end of programmes;

'Network Programme Budget' means for each financial year of ITV Network the total amount of money to be raised for the purposes of the Channel 3 Network programme transmission budget for that year by the payment by each Licensee of its agreed share, as currently set out in Clauses 8 and 9 of the Network Supply Contract;

'Network Supply Contract' means the agreement between the Licensees and ITV Network entered into under the Networking Arrangements which, inter alia, authorises ITV Network, acting on behalf of the Licensees, to commission and acquire ITV Network programmes, to procure that these programmes are made available by ITV Network to each of the Licensees and to set out the financial contributions to be made by each Licensee to ITV Network in relation to such network programmes;

'Networking Arrangements' means, prior to the entry into force of section 291 of the Communications Act 2003, such networking arrangements as are for the time being approved by the Regulator under section 39 of the Broadcasting Act 1990 (as amended), and otherwise approved networking arrangements within the meaning of section 291(2) of the Communications Act 2003 or networking arrangements imposed pursuant to section 292 of the Communications Act 2003, without prejudice to the operation of paragraph 36 of Schedule 18 to that Act;

'Other Licensees' means any Licensee other than one controlled by Carlton and/or Granada;

'Overtrading' means a situation in which Carlton and Granada are or would become unable to meet their contractual obligations to supply Commercial Impacts. This may occur on a total national basis, or for a particular region, for a particular demographic audience, specific time period, or specific airtime slot;

'Programme Compliance' means procedures for the verification of the rights underlying particular programming or the availability of cash-flow finance or production monitoring or for ensuring that a programme complies with the relevant statutory and regulatory provisions, for example the Regulator's Programme Code;

'Protected Contract' means a contract for the purchase of Commercial Airtime:

(i) between an Advertiser or Media Buyer and Carlton or Granada that has been in force at any time between 1 January 2001 and 1 November 2003 inclusive. Where an Advertiser or Media Buyer has had more than one such contract, or its terms have been altered during this period, the most recent such contract or set of terms is the Protected Contract; or

(ii) concluded between a person and Carlton and/or Granada who has not held a contract with Carlton or Granada that has been in force between 1 January 2001 and 1 November 2003 inclusive, provided that, without prejudice to Clause 10(e), where an Advertiser or Media Buyer enters into more than one such contract or varies its terms, only the first such contract, or contract as unvaried, shall be a Protected Contract.

Where Carlton and/or Granada have terminated a Protected Contract lawfully due to a breach by an Advertiser or Media Buyer, such contract shall no longer be a Protected Contract;

'Regional Channel 3 Service' has the meaning ascribed to it in section 14(6) of the Broadcasting Act 1990 (as amended);

'**Regulator**' means the Independent Television Commission ('ITC') and/or the Office of Communications ('Ofcom'), as the context requires and their statutory powers and duties require and/or permit;

'Scottish TV' means Scottish Television Limited**;**

'Share of Broadcast' means the proportion of an Advertiser's or Media Buyer's total TV advertising spend that it has committed, as part of its contract, to a particular channel or sales house in return for a given discount and which may be specified by reference to any one or more of a total share on a national basis, or for a particular region or regions, or for a particular demographic audience or audiences or for a particular time period or periods;

'Station Average Price' or 'SAP' means a benchmark price for delivery of a specific target audience. It is defined for each target audience and for each region sold. It is calculated as:

$$SAP_{\text{Demographic A}} = \frac{\text{Total Revenue committed to that station (all audiences)}}{\text{Total number demographic A impacts}}$$

'Ulster TV' means Ulster Television Limited;

'Umbrella Agreement' means a type of agreement between a Media Buyer and a particular channel or sales house, where the agreement specifies the Media Buyer's Share of Broadcast commitment and the discount level it will receive in aggregate; and

unless the context requires otherwise, the singular shall include the plural and vice versa.

SIGNED FOR AND ON BEHALF OF CARLTON COMMUNICATIONS PLC

… … … … … … … … Signature	… … … … … … … Signature
… … … … … … … … Name	… … … … … … … Name
… … … … … … … … Title	… … … … … … … Title
… … … … … … … … Date	… … … … … … … Date

AND GRANADA PLC

… … … … … … … … Signature	… … … … … … … Signature
… … … … … … … … Name	… … … … … … … Name
… … … … … … … … Title	… … … … … … … Title
… … … … … … … … Date	… … … … … … … Date

C THE ARM: CALCULATION OF REVISED SOB COMMITMENT

Under a given Initial Share of Broadcast Commitment within a Protected Contract a Media Buyer or Advertiser will have purchased Commercial Airtime in the Current Year against *n* different demographic audiences with Carlton and Granada, where

$n \geq 1$. For audience *a* let S_a be the share of the total revenue committed by the Media Buyer or Advertiser against a given audience under that Initial Share of Broadcast Commitment in the Current Year, calculated as follows:

$$S_a = \frac{\text{Sum of all REVENUES bought against Audience } a \text{ committed in the Current Year by the Advertiser or Media Buyer under the Protected Contract in the Regions and, where relevant, in the Time Periods to which the Initial Share of Broadcast Commitment relates.}}{\text{Sum of all REVENUES bought against all } n \text{ Audiences committed in the Current Year by the Advertiser or Media Buyer under the Protected Contract in the Regions and, where relevant, in the Time Periods to which the Initial Share of Broadcast Commitment relates.}}$$

Such that:

$$\sum_{a=1}^{n} S_a = S_1 + S_2 + S_3 + K + S_n = 100\%$$

of the total spend committed by the Advertiser or Media Buyer under the Initial Share of Broadcast Commitment(s) within the Protected Contract in the Current Year.

For these same *n* audiences, the relevant share of Commercial Impacts, or SOCI% across year *y* (where y may be the Current Year, the Base Year or Year 2002, as explained below), is calculated from BARB data (subject to note 1 below) as follows:

$$I_a^y = \frac{\text{Sum of all REVENUES bought against Audience } a \text{ committed in the Current Year by the Advertiser or Media Buyer under the Protected Contract in the Regions and, where relevant, in the Time Periods to which the Initial Share of Broadcast Commitment relates.}}{\text{Sum of all REVENUES bought against all n Audiences committed in the Current Year by the Advertiser or Media Buyer under the Protected Contract in the Regions and, where relevant, in the Time Periods to which the Initial Share of Broadcast}}$$

The CRR Ratchet

The ratchet *R* is to be applied to the Initial Share of Broadcast Commitment(s) ($SOB_{Initial}$) to determine the Revised SOB Commitment(s) pursuant to Clause 7 of the Undertakings, as shown in the calculation below.

For the given Protected Contract across *n* demographic audiences given and S_a (as I_a^y defined above) and *Current Year* and *Base Year* (as defined below)

$$R = S_1 . \frac{(I_1^{Current})}{I_1^{Base}} + S_2 . \frac{(I_2^{Current})}{I_2^{Base}} + S_3 . \frac{(I_3^{Current})}{I_3^{Base}} + \ldots + S_n . \frac{(I_n^{Current})}{I_n^{Base}}$$

Unless *R* is greater than one in which case *R* is capped at one i.e.

If R ≤ 1 then R = R, however, if R > 1 then R = 1

Calculation of Revised SOB Commitment

The Revised SOB Commitment(s) shall be calculated annually as soon as reasonably practicable after the relevant data becomes available and shall take effect on the same day of the year the Protected Contract came into force, for each Initial Share of Broadcast Commitment as follows:

Revised SOB Commitment = R x $SOB_{Initial}$

Definitions

Base Year means the following:
Where a Protected Contract came into force prior to 1 January 2004, Base Year is the calendar year 2002 if the Protected Contract runs on a calendar year basis, or, if the Protected Contract runs on any other basis, 2002-2003 on that same basis;
Where a Protected Contract came into force on or after 1 January 2004, Base Year is the 12 month period prior to the Protected Contract coming into force.

Current Year means the 12 month period prior to the date on which the Revised SOB Commitment takes effect pursuant to clause 7 of the Undertakings.

Initial Share of Broadcast Commitment(s) ($SOB_{Initial}$) means the following:
Where a Protected Contract came into force prior to 1 January 2004, $SOB_{Initial}$ is the Share of Broadcast committed by the Media Buyer or Advertiser to Carlton and Granada (including to individual regions) under that Protected Contract in the final 12 months of that Protected Contract;
Where a Protected Contract came into force on or after 1 January 2004, $SOB_{Initial}$ is the Share of Broadcast committed by the Media Buyer or Advertiser to Carlton and Granada (including to individual regions) in the first 12 months of that Protected Contract;

Region means an ITV franchise region which is available individually to Advertisers and Media Buyers for purchase of Commercial Airtime.

Revised SOB Commitment means the Share of Broadcast Commitment(s) which will apply pursuant to clause 7 of the Undertakings.

Time Period means any period of time of less than a week which is specified in the Protected Contract as the sole time period for which the Advertiser or Media Buyer will purchase Commercial Airtime against a given audience (including without limitation peak, off-peak, weekend, weekday, children's airtime).

Explanatory Notes

Note 1:
BARB does not report multichannel impacts by region. The data processing organisation, DDS, uses a series of factors to impute impacts at a regional level and, in the future, other organisations may provide such a service.

Note 2:
Where the Protected Contract contains a Share of Broadcast Commitment specific to a particular Region or Time Period, then the Ratchet shall be calculated at the level at which that Share of Broadcast Commitment is contracted. Where the Protected Contract contains any 3 *other form of specific quantified commitment to a particular Region or Time Period, the Ratchet will be weighted to reflect the form of this commitment.*

Note 3:
Carlton and Granada undertake to provide Media Buyers and Advertisers with the most accurate forecasts of Commercial Impacts available to them and the estimated Revised SOB Commitment at least two months prior to calculation of the Revised SOB Commitment and updates upon request of the Media Buyer or Advertiser throughout the negotiations. Where the Revised SOB Commitment is calculated on the basis of an estimated level of Commercial Impacts, the Revised Share of Broadcast Commitment shall be subsequently adjusted once the
Commercial Impacts figures are finalised.

D ITV'S COMPARISON OF 2008 AND PRE-MERGER SIMULATIONS

D.1 In its response to the consultation document, ITV presented an assessment of advertisers' dependence on Carlton and Granada pre-merger by estimating the cover and frequency levels that could be achieved without either one of the merging parties in March 2003. These were compared with corresponding figures but excluding all ITV1 in April 2008, which are presented above.[138] The analysis showed that advertisers could substitute away from ITV1 more easily than they could substitute away from either Carlton or Granada pre-merger.

D.2 We have some reservations about the validity of these results. We considered the sum of the loss of cover due to the exclusion of Carlton and Granada in March 2003. The loss in cover levels due to the exclusion of all ITV1 regions in 2003 should be less than this figure because Carlton and Granada overlap in London. Therefore the loss of cover due to the exclusion of, say, Carlton could have been partly recouped by hitting at least some of the same viewers in London through Granada, and vice versa. Without ITV1 at all, all ITV1 viewers in London would be lost. To illustrate, imagine there are 100 people who only watch ITV1, 20 of which are in London, 40 in Carlton's region and 40 in Granada. Excluding Carlton's regions would result in a loss of 40 people (as the 20 in London could be caught by LWT). Similarly excluding Granada's regions would result in a loss of 40 people. The sum of these two figures is 80, but if ITV1 was excluded in its entirety all 100 viewers would be lost.

D.3 However, the sum of the loss in 1+ coverage from Carlton and Granada in 2003 is actually larger than the corresponding figures of cover losses

[138] Since Easter fell in March in 2008, ITV used April 2008 data instead as a "typical" month.

(produced by using the same software)[139] due to the exclusion of all ITV1 in March 2003.

D.4 This may be because other channels use national macros, and don't offer regional cover. This means that in compensating for the loss of coverage for Carlton through increasing use of other channels, coverage is increased nationally, including in Granada regions. Therefore excluding Granada, once Carlton has already been excluded, has a lesser effect on coverage than excluding it on its own.

D.5 ITV, however, explained the anomaly by saying that in some regions, ITV1 under-delivered relative to other channels (that is, coverage can be improved without it). Say, for example, that Granada regions under-deliver while Carlton over-delivers. If Carlton is excluded, revenues remain in Granada. But if Granada's regions are under-delivering relative to other channels then coverage will improve if revenue is also excluded from Granada. Therefore the sum of excluding Carlton and Granada separately is not comparable to excluding all of ITV1.

D.6 We note that this cannot be an issue in this case, given that the exclusion of either Carlton or Granada resulted in a loss in 1+ cover levels in both cases (apart from a small gain for the Adult 16-34 demographic due to the exclusion of Carlton). That is, coverage was worse without ITV1.

D.7 ITV further argued that to the extent that the other regions have strengths in comparison to other channels in delivering additional coverage (that is, coverage is better with ITV1), SPC Xpert will redistribute additional revenues to these non-excluded regions. The OFT believes this would only strengthen and confirm our initial reservations.

[139] ITV clarified this analysis is based on SPC Xpert, which, contrary to InfoSys, easily allows for the exclusion of either Carlton or Granada. This analysis had not been provided before because ITV purchased SPC Xpert only recently. The figures corresponding to the cover losses due to the exclusion of all ITV1 were taken from the graph on page 62 of ITV's response to the consultation document dated March 4, 2009 (which provided a comparison between SCP Xpert and InfoSys in terms of 1+ cover loss figures due to the exclusion of all ITV1 in March 2003).

This is because the redistribution to say, Carlton, if Granada were excluded, would attenuate the loss of coverage compared to a scenario where money were redistributed only to other channels. So the sum of cover losses due to the exclusion of either Carlton or Granada would further understate the loss of coverage that would result from the exclusion of all ITV1.

D.8 For these reasons, the OFT considers that ITV's analysis of the degree of dependence pre-merger may be unreliable.