

# REVIEW OF ITV'S CONTRACTS RIGHTS RENEWAL UNDERTAKINGS

## Final report

Published: 12 May 2010

The Competition Commission has excluded from this published version of the report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X]. Non-sensitive alternative wording is also indicated in square brackets.

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## Glossary

# Summary

## Background to the review

1. In October 2003, the Competition Commission's (CC's) report ([the 2003 report](#)) was published on the proposed merger between Carlton Communications Plc (Carlton) and Granada plc (Granada) to form ITV plc (ITV). The CC, in its advice to the then Secretary of State for Trade and Industry, found that the merger would be likely to result in an adverse effect on future competition for the sale of television advertising airtime and concluded that the merger might be expected to operate against the public interest.
2. The CC found that this adverse effect would centre on the enhanced market position of a merged Carlton/Granada and might manifest itself in a number of ways, including, in particular, the parties' ability, post-merger, to:
  - (a) insist on terms that were generally less attractive to advertisers or media buyers;
  - (b) enhance the degree of price discrimination; and/or
  - (c) change the system under which television advertising airtime is sold to the advantage of the merged entity.
3. The CC concluded that the merger should only be allowed to proceed subject to certain conditions, including that a remedy be put in place to protect advertisers in the sale of commercial advertising airtime on 'Regional Channel 3 Services' (ie ITV1). The remedy would also protect other commercial broadcasters. This remedy was described as the contracts rights renewal (CRR) remedy. Undertakings including the CRR remedy were given by Carlton and Granada ([the Undertakings](#)) and accepted by the then Secretary of State for Trade and Industry under the Fair Trading Act 1973 (FTA).
4. The CRR remedy gave all existing customers of ITV1 the option of renewing the terms of their pre-merger contracts; it also allowed customers to negotiate different contract terms and to nominate any new contract as a 'protected contract'. Under the CRR remedy ITV was required to offer any variation to existing contracts for ITV1 on fair and reasonable terms. The CRR remedy also set out a mechanism which provided for any share of broadcast (SOB) commitment to ITV1 to vary in direct proportion to ITV1's share of commercial impacts (SOCI), subject to a cap set by the SOB commitment in the protected contract. An independent Office of the Adjudicator (the Adjudicator) was established at ITV's expense to rule on contractual disputes. ITV was also prohibited from materially changing its current airtime sales system (CASS) without the consent of the OFT.
5. The OFT has a duty to consider whether, by reason of any changes of circumstance, existing undertakings are no longer appropriate and either the relevant parties can be released from undertakings or the undertakings need to be varied or superseded. If the OFT concludes that change may be required to existing undertakings, it provides advice to the CC regarding the changes of circumstance. It is then for the CC to decide whether the existing undertakings are no longer appropriate, and, if so, whether they should be superseded, varied or released. A memorandum of understanding (MOU) between the CC and the OFT sets out the process for review of undertakings and orders under the FTA and the Enterprise Act 2002 (the Act).

6. In October 2006, ITV asked the OFT to conduct a review of that part of the Undertakings relating to the CRR remedy (the CRR Undertakings). It said that significant changes in the market for the sale of television advertising airtime had occurred and that ITV should be released from the CRR Undertakings. The OFT, with assistance from the Office of Communications (Ofcom), began its review on 30 January 2008.
7. On 29 May 2009, the OFT published its advice which stated that changes of circumstance since 2003 meant that the CC should review the CRR Undertakings and consider variations to them. Ofcom submitted its views and analysis to the OFT and to the CC. Ofcom published its submission in April 2010 following a Freedom of Information request.
8. The OFT recommended that, if the CRR remedy were to be retained in any form, the CC should change the definition of ITV1 to reflect new means of delivering ITV1's programming such as +1 and High Definition (HD) channels. The OFT also recommended that the CC consider whether the decline in ITV1's market position since 2003 meant that the CRR remedy could be varied to impose fewer costs and distortions than the CRR remedy in its current form but still provide effective protection against the remaining detrimental effects of the merger arising from ITV's strength in large audience programming.
9. Following receipt of the OFT's advice, we undertook a review of the CRR Undertakings. Due to the expected complexity of this review, the OFT and the CC have had considerably greater interaction with both ITV and third parties (including other commercial broadcasters, media agencies, advertisers, the Adjudicator and Ofcom) than would normally be the case in a review of undertakings.

### **Internet advertising and the relevant market**

10. Advertising can be categorized as either 'classified' or 'display', depending on its function. Television advertising is treated as display advertising and in 2008 it accounted for 22.1 per cent of total advertising expenditure, down from 23.6 per cent in 2003. Internet advertising has grown significantly from 2.9 per cent of total advertising expenditure in 2003 to 19.3 per cent in 2008. Figures from the World Advertising Research Center (WARC) suggest that in 2009 total expenditure on Internet advertising overtook by a small margin total expenditure on television advertising. However, Internet display advertising, which is closest in nature to television advertising, accounts for only 20 per cent of Internet advertising (less than 5 per cent of total advertising expenditure). Expenditure on Internet display advertising in 2009 amounted to just over one-fifth of television advertising expenditure in that year.
11. Despite changes in advertising expenditure by media since 2003, we concluded that the relevant market for the purposes of this review remained television advertising in the UK. Advertisers and media agencies said that they did not regard Internet advertising as a substitute for television advertising, although it was potentially a complementary product in delivering certain types of campaigns. We saw no evidence that the sale of television advertising was constrained by Internet display advertising, or would be likely to become constrained in the near future.

### **The sale of television advertising airtime**

12. The vast majority of advertisers use media agencies to negotiate terms for advertising airtime with ITV and other broadcasters although some deal directly with ITV. We use the term 'media buyers' to include both media agencies acting on behalf of

advertisers and advertisers acting on their own behalf. Advertisers use media auditors to assess the value for money they are obtaining from their media agencies.

13. Television advertising airtime is generally sold on behalf of broadcasters by sales houses. The broadcasters determine the programme schedule for their channels, where to include advertisement breaks and the length and number of those advertisement breaks.
14. Contracts for the sale of television advertising airtime are typically negotiated between sales houses and media buyers on an annual basis. The vast majority of contracts between media buyers and ITV specify a SOB commitment from a media buyer in exchange for a discount off the price of advertising television airtime and access to advertising at particular times of day or particular programme breaks. Many contracts with media agencies take the form of 'umbrella' deals, which cover the requirements of the media agency's advertising clients. Contracts also tend to cover a wide range of other terms, often in great detail and often specific to particular advertisers. Throughout the year sales houses and media buyers negotiate airtime schedules for individual campaigns.

### **Changes of circumstance**

15. We considered whether, as a result of any changes of circumstance, the CRR Undertakings were no longer appropriate. The scope of our review was to consider the ongoing need for the CRR Undertakings, which relate only to ITV1 and not to other ITV channels or to other sales houses. Although a number of broader concerns about the market were raised with us, these fall outside the scope of our review (see paragraph 38).

### ***Changes in the enhanced market position of ITV1***

16. We assessed the constraints on ITV1 from other commercial broadcasters and from media buyers. We found that there had been significant changes in the television industry since 2003. In particular, the number and availability of television channels (including new channels and time-shifted (+1) channels) have increased as a result of digital broadcasting and the increased penetration of digital television in UK households, leading to increased fragmentation of audiences across channels. There have also been changes in the technical quality of television transmission since 2003, in particular with the increased availability of HD programming.
17. We looked at the change in various market indicators since 2003. We found that, since 2003, ITV1's SOCI and share of net advertising revenue (NAR) had declined. ITV1, however, had remained by far the single largest commercial channel in terms of both SOCI and share of NAR. Channel 4 was the next largest channel with a share of NAR and SOCI less than half that of ITV1. Some of ITV1's lost share had gone to ITV's own digital channels. ITV1's premium (its share of NAR divided by its SOCI) had increased from 1.18 in 2003 to 1.34 in 2009 despite the CRR remedy being in place.
18. The 2003 report highlighted a number of ITV1's unique features and barriers to switching and found that the constraints on ITV1 from other commercial channels were insufficient to prevent adverse effects arising. We considered the change since 2003 in the extent to which individual advertising campaigns could be run without ITV1 but still achieve their objectives.

19. We found that, as in 2003, ITV1 continues to have unique features which limit its substitutability. Although the most popular programmes attracted smaller audiences than in 2003, ITV1 had largely retained its relative advantage over other commercial channels in delivering large audiences. In 2009, ITV1 accounted for 982 of the top 1,000 most watched programmes on commercial television for all adults, compared with 995 in 2003. In addition, ITV1's share of programmes delivering audiences in excess of 3, 4, 5 or 6 million on commercial channels was above 90 per cent in 2009.
20. ITV provided various analyses which examined the extent to which individual advertising campaigns, with or without advertising on ITV1, could achieve similar coverage (the proportion of the target audience seeing the advertisement at least once) and frequency (the proportion of the target audience seeing the advertisement at least a particular number of times). Using media planning software, ITV's analyses asserted that campaigns were able to get closer to their coverage and frequency objectives without ITV1 in 2009 than in 2003.
21. We found that, without ITV1, media buyers would still not be able to achieve the same coverage for certain campaigns (in particular, fast-build and time-critical campaigns) in certain demographics (notably 'Housewives' and 'Adults').
22. In any case, we found that such analyses could not provide a complete picture of the substitutability of ITV1 and may not be indicative of what media buyers would do in practice following a price increase on ITV1. Media buyers continued to believe that ITV1 was able to offer unique benefits in terms of the size of its audiences and the 'quality' of its impacts. We found that, as in 2003, difficulties remain in switching advertising expenditure away from ITV1. Most advertising is bought through media agencies and we found that a media agency could not threaten credibly to withdraw all its business from ITV1 because it needs access to ITV1's large audience programmes for certain campaigns.
23. We did not find that the increased concentration of media agencies since 2003 had resulted in their having countervailing buyer power. We therefore found that ITV remains in a strong negotiating position. In our view, media buyers who seek to reduce their SOB commitment to ITV1 are likely to be offered significantly less favourable terms on their remaining ITV1 advertising. These terms include both discounts off the price of advertising airtime as well as a wide range of other contractual terms which are important to media buyers. Any worsening of terms, particularly of discount, would undermine the ability of a media agency to compete with other media agencies for advertising clients. As a result, media agencies are unlikely to switch or threaten to switch a sufficient amount of their expenditure away from ITV1 so as to constrain ITV.
24. We considered whether the possibility of expansion or entry by other commercial broadcasters might constrain ITV1's ability to exploit its enhanced market position. We found that there was little likelihood of other commercial broadcasters developing in such a way as to be able to compete with ITV1 in attracting large audiences. Entry or expansion would not therefore act as a competitive constraint on ITV1.

### ***Costs of the CRR remedy***

25. CRR was designed to prevent ITV from using the enhanced market position created by the merger between Carlton and Granada to increase its revenue. We found that the CRR remedy had created some costs, primarily in deterring ITV from providing ITV1+1 or ITV1 HD services. However, at most, only a small proportion of many of the other costs which ITV had attributed to CRR in fact derived from it. We found that

ITV's programming decisions were adopted for a wide range of reasons and that CRR still allowed ITV and media agencies to negotiate.

### ***Conclusion on changes of circumstance***

26. Although we found that there had been some significant changes in the television industry since 2003 and that ITV1's market position, as represented by its SOCI and share of NAR, was not as strong as in 2003, we concluded that ITV1 retained an enhanced market position as a result of the merger between Carlton and Granada, primarily due to its unique ability to deliver large audiences. We concluded that these changes of circumstance since 2003 did not warrant ITV's release from the CRR Undertakings and that a remedy was still required to address the likelihood that adverse effects would otherwise arise. In particular, we were concerned that, absent an effective remedy, ITV would be able to worsen terms to advertisers overall through seeking higher SOB commitments, reducing discounts or worsening terms and conditions. If ITV used its enhanced market position to increase SOB commitments from media buyers, this would reduce the amount advertisers would spend on other commercial broadcasters.
27. We concluded that CRR had created some costs, primarily in deterring ITV from providing ITV1+1 or ITV1 HD services, and that we should therefore consider variations to the CRR Undertakings such that ITV1's enhanced market position could be addressed in a way that imposed lower costs on ITV.

### **Possible variations rejected**

28. We assessed possible variations to the CRR Undertakings that might address the changes of circumstance we had found. We concluded that possible variations to:
  - (a) address ITV1's advantage in delivering large audiences;
  - (b) remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms;
  - (c) address incentives for ITV1 to focus primarily on maximizing ITV1's SOCI; and
  - (d) address difficulties for ITV in reacting to changing demandwould not be effective remedies to the adverse effects of the merger.

### ***ITV's remedy proposal***

29. Following the publication of our Provisional Decision as to Changes of Circumstance in September 2009, we considered several variants of a remedy proposal put forward at different points by ITV (the Rules for Protection of Advertisers (RPA)). This proposal would deem certain terms in agreements fair and reasonable while others would be subject to an adjudication process.
30. We found that, under this remedy proposal, ITV would be able to reduce an individual media buyer's discount each year within a specified threshold and to worsen a range of terms and conditions without the possibility of being taken to adjudication, provided ITV maintained a 1:1 relationship between the change in SOB commitment required from the media buyer and the change in ITV1's SOCI.

31. If the 1:1 SOB/SOCI relationship was not maintained and/or if discounts were reduced by more than the specified threshold, the effectiveness of the remedy would depend on media buyers taking a dispute to adjudication and the effectiveness of the adjudication process. We found that media buyers would, in some circumstances, be likely to commit to a higher SOB than would be consistent with the change in ITV1's SOCI in order to retain discount and/or terms and conditions, rather than initiate an adjudication process. This would also have an adverse effect on other commercial broadcasters, who would consequently receive a smaller share of media buyers' budgets than they would otherwise. We also found that, in any case, the protection offered by the proposed adjudication process would be inadequate given the need for guidance on 'fair and reasonable' terms, the lack of an effective fall-back position for media buyers and the potential risks and delay introduced into the negotiation process in this complex market. An adjudicator would find it difficult to weigh the value of SOB commitments, discount and terms and conditions against each other for any given media buyer.
32. We concluded that ITV's RPA proposal would not be able to remedy effectively the adverse effects of the merger.

### **Variation proposed**

33. We decided that CRR had been an effective remedy in addressing the adverse effects identified in the 2003 report. However, we considered whether there were ways to vary the CRR Undertakings to take into account changes of circumstance whilst retaining the effectiveness of the remedy in addressing the adverse effects of the merger.
34. We concluded that changing the definition of ITV1 in the Undertakings to include ITV1+1 and ITV1 HD services would address changes of circumstance. This remedy (CRR as varied) would be effective in addressing the adverse effects that would otherwise arise from the merger. We concluded that, in order for impacts on such services to be counted towards ITV1's SOCI in the CRR remedy, ITV1+1 and ITV1 HD services should be exact replicas of ITV1 save for certain differences caused by time-delay constraints and regional variations.

### **Proportionality**

35. We found that CRR as varied would be less costly and less restrictive than CRR in its current form. We compared the costs of CRR as varied with the size of the adverse effects that would be likely to arise absent a remedy, taking into account the changes of circumstance identified.
36. We found that the costs of CRR as varied were not disproportionate to the likely size of the adverse effects. Although we found that the size of the adverse effects may have fallen to some extent due to the decline in ITV1's share of NAR since 2003, we found no evidence to suggest that this decline was sufficient to make CRR as varied disproportionate.
37. We therefore concluded that the CRR Undertakings should be varied to include ITV1+1 and ITV1 HD in the definition of ITV1.

### **Final observations**

38. Although it was outside the scope of our review, third parties suggested to us that many aspects of the way in which television airtime is sold, such as SOB commitments and media agencies' 'umbrella' deals, were anti-competitive. In our view, the

way in which television airtime is currently sold has a significant influence on the need to retain a variant of the CRR remedy.

39. Ofcom, in its submissions to the OFT in June 2009, said that it did not believe that a wider review of the market was appropriate at that time. It recognized, however, that, in due course, a wider review of the television advertising sector may be necessary. As in 2003, we continue to believe it appropriate for there to be a review of the wider market for selling television airtime.

# Findings

## 1. Introduction

- 1.1 In October 2003, the CC published its report on the proposed merger between Carlton and Granada to form ITV. The CC, in its advice to the then Secretary of State for Trade and Industry, found that the merger would be likely to result in an adverse effect on future competition for the sale of television advertising airtime and concluded that the merger might be expected to operate against the public interest.<sup>1</sup> The CC concluded that the merger should only be allowed to proceed subject to certain conditions, including, in particular, that a remedy be put in place to protect the interests of advertisers and other commercial broadcasters. This remedy, the basis of which was initially proposed by Carlton and Granada, was described as the CRR remedy (see paragraph 3.11).
- 1.2 Undertakings including the CRR remedy were given by Carlton and Granada and accepted by the then Secretary of State for Trade and Industry under section 88(2) of the FTA for the purpose of remedying or preventing the adverse effects on the public interest specified in the 2003 report. The full text of the Undertakings, which were effective from 14 November 2003, is set out in Appendix A. The Undertakings set out the CRR remedy in relation to the sale of commercial advertising airtime on 'Regional Channel 3 Services'<sup>2</sup> (ie ITV1).<sup>3</sup>
- 1.3 The merger of Carlton and Granada to form ITV became effective on 2 February 2004.
- 1.4 In October 2006, ITV asked the OFT to conduct a review of the CRR Undertakings.<sup>4</sup> ITV argued that significant changes in the market for the sale of television advertising airtime had occurred since the CRR Undertakings had been put in place and that these changes made it appropriate for ITV to be released from the CRR Undertakings.
- 1.5 After considering the matter under its prioritization principles, the OFT, with assistance from Ofcom, began its review on 30 January 2008.<sup>5</sup> The OFT published a consultation document setting out its preliminary views on 15 January 2009.<sup>6</sup> On 29 May 2009, in exercise of its powers under Schedule 24, paragraph 16, of the Act, the OFT published its advice (the OFT's advice) that changes of circumstance since 2003 meant that the CC should review the CRR Undertakings and consider variations to them.<sup>7</sup> Ofcom published its submission to the OFT and the CC in April 2010

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<sup>1</sup>The merger in 2003 was referred to the CC under the merger provisions of the FTA. The FTA was based on a public interest test. The CC now takes its decisions using a 'substantial lessening of competition' (SLC) test under the merger provisions of the Act.

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

<sup>3</sup>In 2003, the ITV1 channel was known as ITV. We have used ITV1 throughout this report when referring to the ITV1 channel.

<sup>4</sup>Specifically, clauses 5 to 11 and Annex 1 which relate to the sale of commercial airtime, clauses 12 to 18 and Annexes 2 and 3 which relate to adjudication, and clauses 23 to 25 which relate to the interpretation of words and expressions used in the Undertakings. The Undertakings also have provisions in clauses 2 to 4 in relation to other Regional Channel 3 Services licensees, but these are outside the scope of this review.

<sup>5</sup>As set out by the OFT during its review, 'Ofcom will provide written opinions in confidence to the OFT at key stages of the review. The OFT will reach its own view, having considered the views of Ofcom and all of the evidence available to it. The OFT will be responsible for drafting the final text of any recommendations made.' *CRR review: Frequently asked questions*, Question 10: [www.of.gov.uk/shared\\_of/register\\_of\\_orders\\_and\\_undertaki/CRR-review/CRR-review-FAQs.pdf](http://www.of.gov.uk/shared_of/register_of_orders_and_undertaki/CRR-review/CRR-review-FAQs.pdf).

<sup>6</sup>*Review of the Contract Rights Renewal Undertakings: An OFT consultation*, January 2009: [www.of.gov.uk/shared\\_of/register\\_of\\_orders\\_and\\_undertaki/CRR-review/oft1050con.pdf](http://www.of.gov.uk/shared_of/register_of_orders_and_undertaki/CRR-review/oft1050con.pdf).

<sup>7</sup>A redacted version of the OFT's advice has been published on the CC's website. Its advice to the CC is contained in paragraphs 2.1 to 2.3. A summary of the OFT's advice was published by the OFT on 29 May 2009 and the OFT's full advice was published on 11 June 2009. All references in this document to the OFT's advice refer to the OFT's full advice published on 11 June 2009.

(Ofcom's submission) following a Freedom of Information request.<sup>8</sup> Ofcom's submission, dated 2 June 2009, was taken into account by the OFT in reaching its recommendations.

- 1.6 The OFT recommended that, if the CRR remedy were retained in any form, the CC should change the definition of ITV1 to reflect new means of delivering ITV1's programming such as +1 and HD channels. The OFT also recommended that the CC should give further consideration to whether the decline in ITV1's market position meant that the remedy could be varied to impose fewer costs and distortions than the remedy in its current form but still provide effective protection against the remaining detrimental effects of the merger arising from ITV's strength in 'mass audience' programming.
- 1.7 Ofcom recommended that, given the distortion to ITV's incentives to invest in HD and time-shifted variants of ITV1, the definition of ITV1 in the Undertakings should be broadened. Ofcom also said that there was a strong case for easing the burden of CRR regulation on ITV1 where market forces could provide a credible constraint on ITV's pricing. However, it added that concerns remained such that the CC may wish to consider implementing safeguards to protect advertisers dependent on ITV1 for the quick delivery of mass audiences.<sup>9</sup>

### ***Jurisdiction***

- 1.8 Section 88(4) of the FTA provides that the OFT has a duty to consider whether, by reason of any changes of circumstance, existing undertakings are no longer appropriate and either the relevant parties can be released from the undertakings or the undertakings need to be varied or superseded.
- 1.9 If the OFT concludes that change may be required to the existing undertakings, it provides advice to the CC regarding the changes of circumstance. Under the Act, power to supersede, vary or release undertakings under section 88 of the FTA passed from the Secretary of State to the CC, subject to the designation of the relevant undertakings by the Secretary of State.<sup>10</sup> The Undertakings were so designated in 2004.<sup>11</sup>
- 1.10 The power of the CC to supersede, vary or release undertakings given under the FTA is exercisable in the same circumstances and under the same terms and conditions as the power of the Secretary of State under the FTA. There are no other relevant provisions in the Act and there is no further guidance in the Explanatory Notes to the Act to set out the CC's powers in relation to undertakings given under the FTA. Accordingly, the framework for the review of the CRR Undertakings is governed by the provisions of the FTA relating to variation and release of undertakings.

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<sup>8</sup>Review of the Contract Rights Renewal Undertakings: Evidence to the OFT and CC following the request for release from undertakings given by Carlton Communications Plc and Granada Plc (now ITV Plc) pursuant to section 88 of the Fair Trading Act 1973, 2 June 2009: [www.ofcom.org.uk/tv/ifi/tvlicensing/contract\\_rights\\_renewal/report.pdf](http://www.ofcom.org.uk/tv/ifi/tvlicensing/contract_rights_renewal/report.pdf).

<sup>9</sup>Ofcom's recommendations are contained in paragraphs 8.23 to 8.30 of its submission.

<sup>10</sup>The relevant provisions are found in paragraph 16(3) of [Schedule 24](#) to the Act.

<sup>11</sup>The Undertakings were designated for the purposes of Schedule 24, paragraph 16(1) of the Act in [The Enterprise Act 2002 \(Enforcement Undertakings and Orders\) Order 2004](#) (SI 2004/2181).

## **Conduct of the review**

- 1.11 The CC and the OFT have published an MOU on the variation and termination of merger, monopoly and market undertakings and orders under the FTA and the Act.<sup>12</sup> The MOU sets out the processes that the CC will follow when considering the variation or release of undertakings or orders.
- 1.12 In this review, as set out in the MOU, we reviewed the OFT's advice and considered whether sufficient information and analysis was made available to allow us to reach a decision.<sup>13</sup> We identified a number of areas in which we required further information to be able to validate the information and analysis given to us. Although we have no formal powers to gather information in a review of undertakings, we sought information from, and engaged with, ITV and various third parties (other commercial broadcasters, media agencies, advertisers, the Adjudicator, Ofcom and trade associations). Appendix B sets out further details of the conduct of our review.
- 1.13 Due to the expected complexity of this review, both the OFT and the CC departed in some ways from the process set out in the MOU, providing considerably greater interaction with ITV and third parties than would normally be the case. In particular:
- (a) the OFT consulted on its provisional view and published its final advice at the same time as sending its advice to the CC, giving ITV the opportunity to comment on it;
  - (b) the Chairman of the CC appointed a separate Group of CC members to conduct the review;
  - (c) we took into account further representations from ITV and third parties;
  - (d) we published and consulted on three separate provisional documents: we published our [Provisional Decision as to Changes of Circumstance](#) (the Provisional Decision) alongside a [Notice of Possible Variations](#) (the Notice) on 15 September 2009; and we published our [Provisional Decision on Remedy Variations](#) (the Provisional Remedies Decision) on 19 January 2010. We also published and consulted on a [revised remedy proposal from ITV](#) (RPA Mark 2) on 24 February 2010; and
  - (e) we held a hearing and a number of staff meetings with ITV to discuss possible variations to the Undertakings.

## **Structure of this report**

- 1.14 In this report we set out our final decision on whether to supersede, vary or release the CRR Undertakings. The remainder of the report is structured as follows:
- Section 2 Background
  - Section 3 The 2003 report
  - Section 4 Our approach to considering changes of circumstance
  - Section 5 Assessment of changes in the enhanced market position of ITV1
  - Section 6 Assessment of costs of the CRR Undertakings
  - Section 7 Conclusions as to changes of circumstance

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<sup>12</sup>*Memorandum of understanding between the Office of Fair Trading and the Competition Commission on the variation and termination of merger, monopoly and market undertakings and orders under the Fair Trading Act 1973 and the Enterprise Act 2002, Version 1*, 17 February 2009.

<sup>13</sup>MOU, paragraph 30.

## 2. Background

2.1 In this section, we provide some background on the UK advertising sector and describe how television airtime is bought and sold.

### *The UK advertising sector*

2.2 In 2008, around £17.3 billion<sup>14</sup> was spent on media advertising in the UK, the equivalent of 1.2 per cent of Gross Domestic Product. In this section we describe the various categories of advertising and different advertising media.

### *Categories of advertising*

2.3 Advertising is categorized as either 'classified' or 'display' based on how it has traditionally been organized and presented in print media. These two categories of advertising perform different functions:

(a) Classified advertising directs consumers seeking to make a purchase to sellers with relevant products or services to offer. 'Classified' advertisements are typically grouped by media owners into categories or 'classifications' (for example, job vacancies, property or cars for sale). Classified advertising accounts for around one-third of all UK advertising expenditure.<sup>15</sup>

(b) Display advertising aims to attract consumers' attention while they browse or watch other content. 'Display' advertising is not grouped by classification. Instead, display advertisers often seek to advertise close to content which is likely to appeal to their target audience. Display advertising accounts for around two-thirds of all UK advertising expenditure.<sup>16</sup>

### *Advertising media*

2.4 The share of advertising expenditure by medium from 2000 to 2008 is shown in Figure 1.

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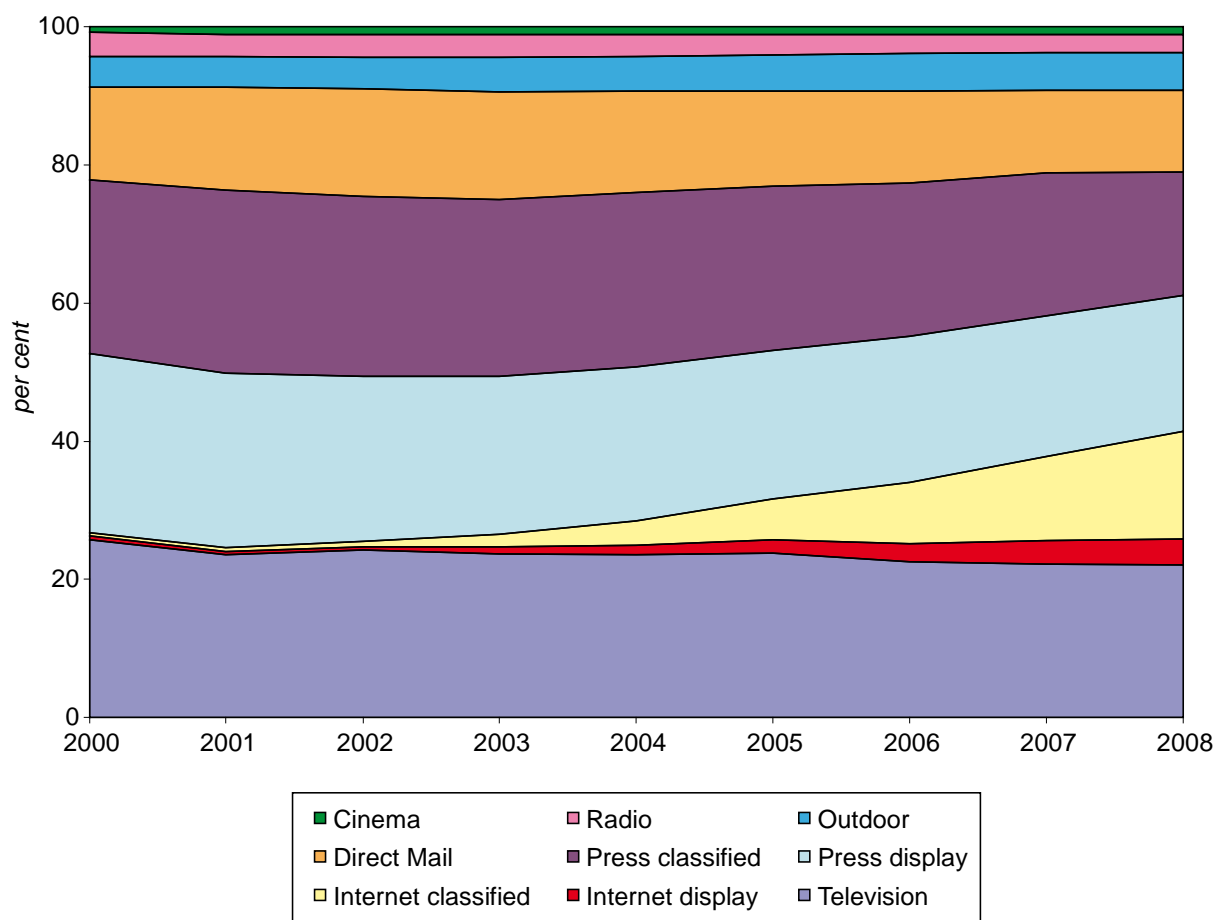
<sup>14</sup>The Advertising Association, *Advertising Statistics Yearbook 2009*, p14. Excludes advertising production costs.

<sup>15</sup>This comprises £2.7 billion of 'internet classified' and £3.1 billion of 'press classified' as a proportion of total expenditure (£17.32 billion). Source: *Advertising Statistics Yearbook 2009*, pp14 & 184.

<sup>16</sup>This assumes that direct mail is treated as display advertising.

FIGURE 1

Share of advertising expenditure by medium, 2000 to 2008



Source: Advertising Statistics Yearbook, 2009, CC analysis.

- 2.5 Figure 1 shows that, between 2003 and 2008, television advertising's share of all advertising expenditure in the UK declined from 23.6 to 22.1 per cent and the share of press advertising (classified and display) fell from 48.4 to 37.6 per cent. Over the same period, the share of Internet advertising (classified and display) increased from 2.9 to 19.3 per cent.
- 2.6 Total advertising expenditure figures for 2009 that are directly comparable with the data behind Figure 1 are not yet available. Figures from WARC suggest, however, that in 2009 total expenditure on Internet advertising overtook by a small margin total expenditure on television advertising.<sup>17</sup>
- 2.7 Television advertising is categorized as display advertising. Conversely, 80 per cent of Internet advertising is categorized as classified, of which nearly three-quarters is 'paid search'.<sup>18,19</sup> Further, Internet advertising is interactive: the consumer may link to

<sup>17</sup>The 2009 figures from WARC for total advertising expenditure do not include Directory advertising expenditure (which has been included in previous years). In order to estimate total advertising expenditure for 2009 that is comparable with the data behind Figure 1, we added in an estimate for directory advertising expenditure. Using this estimated total, we calculated the shares of television advertising expenditure and Internet advertising expenditure as 22.7 and 22.8 per cent respectively.

<sup>18</sup>Advertising Statistics Yearbook 2009, p184. Display advertising accounts for around 20 per cent of Internet advertising expenditure.

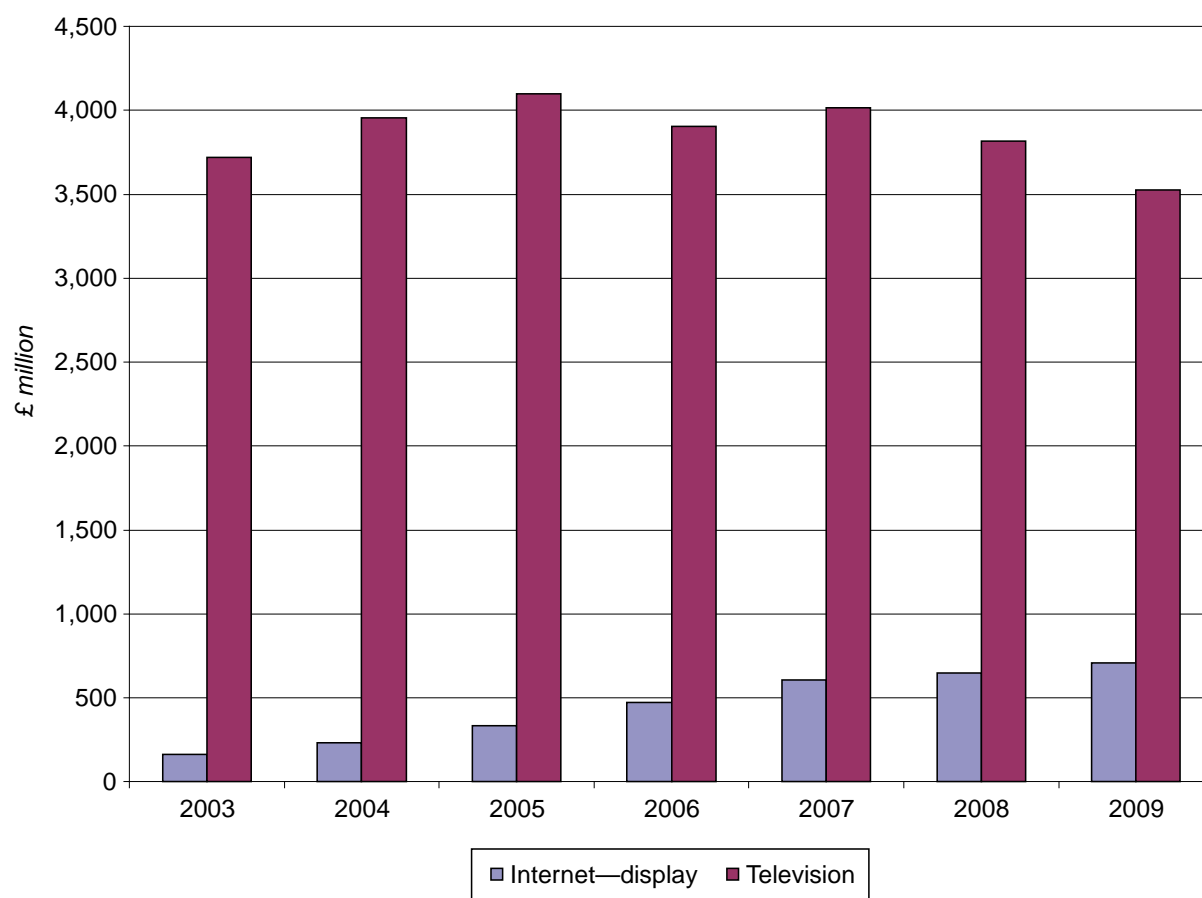
<sup>19</sup>Paid search advertising involves an advertiser bidding online for key words in order to gain prominence in the list of results retrieved by a search engine. It is categorized as classified advertising by the Advertising Association.

an advertiser's website to access further information, compare offers from different sellers and even complete a transaction.

2.8 Given these differences between television and Internet advertising, the type of Internet advertising that is closest in nature to television advertising is Internet display advertising. Figure 2 shows television advertising expenditure compared with Internet display advertising expenditure between 2003 and 2009.<sup>20</sup> It shows that, although Internet display advertising expenditure more than trebled between 2003 and 2009 from £166 million to £709 million, it amounted to only one-fifth of television advertising expenditure in 2009.<sup>21</sup>

FIGURE 2

**Television and Internet display advertising expenditure, 2003 to 2009**



Source: *Advertising Statistics Yearbook, 2009*; *Internet Advertising Bureau Online adspend study, 2009*, CC analysis.

**How television airtime is bought and sold**

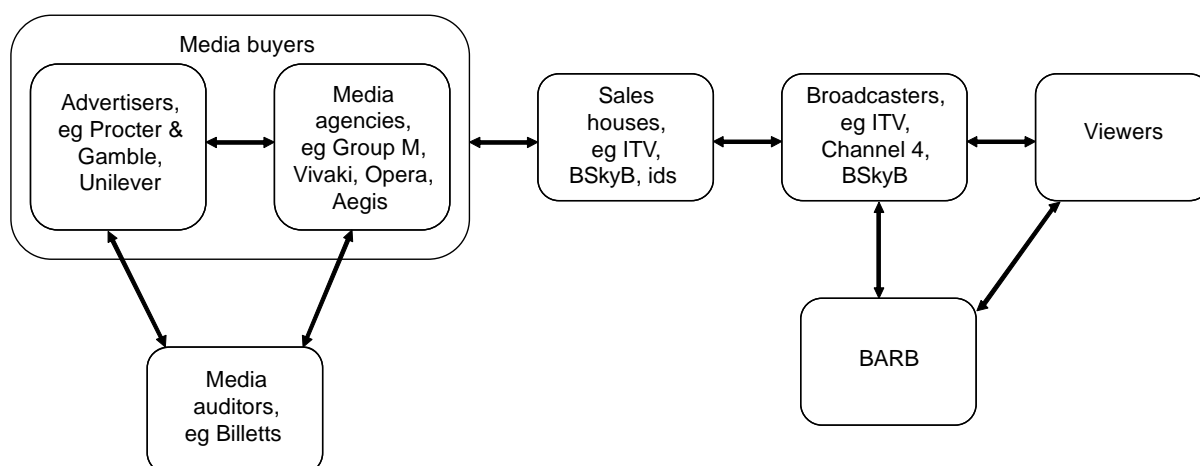
2.9 Figure 3 provides an overview of the various stakeholders in the television advertising supply chain. The role of each of these different stakeholders is described briefly below.

<sup>20</sup>Online advertising expenditure figures for 2009 have been sourced from *Internet Advertising Bureau Online adspend study, 2009*. These figures were used by the Advertising Association in its *Advertising Statistics Yearbook 2009*.

<sup>21</sup>*Advertising Statistics Yearbook 2009*, p184.

FIGURE 3

### The television advertising supply chain



Source: CC based on Ofcom material.

Note: Arrows indicate interaction within the supply chain.

- 2.10 *Advertisers:* The advertising process is initiated by an advertiser.<sup>22</sup> The vast majority of advertisers use media agencies to negotiate terms on their behalf although some, including Procter & Gamble, negotiate terms directly with ITV and other sales houses.
- 2.11 *Media agencies:* Media agencies are employed by advertisers to provide a range of services, including negotiating the terms on which television airtime is purchased from sales houses and booking airtime in line with an advertiser's media plan.
- 2.12 *Media buyers:* We use the term 'media buyers' to include both media agencies acting on behalf of advertisers and advertisers acting on their own behalf.
- 2.13 *Sales houses:* Television advertising airtime is generally sold on behalf of broadcasters by sales houses. Sales houses are responsible for managing the relationship with media buyers and negotiating contract terms and conditions. The larger broadcasters and channel providers such as ITV, Channel 4, Five, BSkyB and Virgin Media Television have their own sales houses.<sup>23</sup> Smaller broadcasters often contract to sell some or all of their airtime through one or other of these sales houses.
- 2.14 *Broadcasters:* Broadcasters show advertisements on their television channels. Working with a sales house, broadcasters determine the schedule for their channels, where to include advertisement breaks and the length and number of those advertisement breaks.<sup>24</sup>
- 2.15 *Media auditors:* Media auditors are employed by advertisers to assess the buying efficiency of media agencies.

<sup>22</sup>Typically a business producing goods and services, but also includes public bodies such as the Government's Central Office of Information (COI), the UK's largest advertiser.

<sup>23</sup>ids is the advertising sales house for Virgin Media Television, UKTV, Virginmedia.com and Virgin Mobile. It is wholly owned by Virgin Media.

<sup>24</sup>Subject to regulations, including the Code on the Scheduling of Television Advertising (COSTA).

- 2.16 *BARB*: BARB (Broadcasters' Audience Research Board) is the primary provider of television audience measurement in the UK. It covers all channels broadcasting across all platforms—terrestrial, satellite and cable in both analogue and digital.<sup>25</sup>

### *Negotiations between media buyers and sales houses*

- 2.17 In this section, we discuss the process which underlies the negotiations between media buyers and sales houses for the sale of television advertising airtime. We consider separately negotiations over contractual terms and conditions and the purchase of airtime for individual campaigns booked during the year.

#### *Contract negotiations*

- 2.18 Contracts for the sale of television advertising airtime are typically negotiated between sales houses and media buyers on an annual basis. Negotiations tend to take place between October and December (the 'deal season') prior to the start of the new advertising year in January.<sup>26</sup> Because ITV is the largest provider of commercial airtime, media buyers are keen to resolve their deals with ITV prior to finalizing their commitments to other broadcasters.
- 2.19 The main types of contracts agreed are:
- (a) *Umbrella contracts*: A contract between a sales house and a media agency which sets out the terms at which that media agency can buy airtime on behalf of any of its advertising clients. These contracts generally specify the overall discount granted to the media agency, which the media agency then allocates among its clients. These umbrella contracts may also include provisions for specific advertising clients for whom terms are negotiated on a 'line-by-line' basis. Umbrella contracts accounted for [⌘] per cent of ITV1's revenue in 2009.
  - (b) *Line-by-line contracts*: In these contracts, advertisers, or media agencies on advertisers' behalf, agree their own specific terms. Some media agencies offer line-by-line contracts to all their advertising clients.
- 2.20 Media buyers may negotiate a variety of airtime pricing arrangements. These may include fixed price deals, based, say, on the cost per thousand of the target audience reached, or, more commonly, a discount off Station Average Price (SAP).<sup>27</sup> The vast majority of contracts specify a SOB commitment<sup>28</sup> from a media buyer in exchange for a discount off SAP. Contracts also contain other terms relating to how advertisements are delivered (for example, access to particular dayparts and programme breaks—see paragraph 2.22).
- 2.21 A media buyer's contract with a sales house may specify the discount to which individual advertisers are entitled, the overall discount which the agency has negotiated, or a mixture of the two. In some cases, media agencies negotiate what are called 'value pots' or 'pool value' arrangements. Under these deals, typically struck in exchange for agreeing additional elements within a contract, media agencies are entitled to additional airtime ('value') which they may distribute between their clients

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<sup>25</sup>BARB is jointly funded by BBC, ITV, Channel 4, Five, BSkyB, and the IPA. More detail is available on BARB's website at [www.barb.co.uk](http://www.barb.co.uk).

<sup>26</sup>However, negotiations could take place during other periods of the year and may cover periods other than one year.

<sup>27</sup>The discount is applied to SAP. This price is not known (although it can be estimated) until after an advertisement has been shown. Appendix C provides further explanation of SAP and discounts.

<sup>28</sup>SOB commitment is the proportion of a media buyer's television advertising expenditure that it commits to spending with a particular sales house. This commitment is specified in the contract between the media agency and the sales house.

at their discretion or as otherwise specified in line-by-line agreements. Pool value deals pre-existed CRR and are in place with media owners other than ITV.<sup>29</sup> However, some media agencies told us that these kinds of arrangements have become more common than they were in the past.

2.22 Contracts also tend to cover a wide range of other terms, which may be very specific. These include:

- (a) *Daypart allocations*: a media buyer may want to specify the delivery of airtime in particular times of the day.<sup>30</sup>
- (b) *Weekly strike-weight tolerance*: a media buyer may want to set parameters for how an advertising campaign is spread over its duration, for example by specifying a minimum spread of ratings per week.
- (c) *Position in break*: this refers to specific positions within an advertising break, eg first advertisement, centre advertisement. It is generally believed that advertisements that are broadcast either first or last in a break are more effective than advertisements in the middle of the break. Therefore a media buyer may try to include a minimum number of first-in-break and last-in-break spots.
- (d) *Programme requests*: television advertising schedules are initially generated by broadcasters' computer systems. However, a media buyer may seek to secure the opportunity for a certain degree of programme selection.<sup>31</sup>
- (e) *Access to specials*: throughout the year, certain of the most popular programmes on a channel are designated as 'specials'. The number of specials to which a media buyer will have access and the premium the media buyer will pay are usually negotiated as part of annual contracts.
- (f) *Advance booking terms*: contracts specify when media buyers can be expected to incur late booking fees. Some contracts will include specific terms allowing amendment of terms for selected late bookings.
- (g) *Other terms and conditions*: these include payment terms.<sup>32</sup>

2.23 During the deal season, a media buyer cannot know the objectives of all individual campaigns it will need to run during the following year. It must therefore take a view on its likely advertising needs. For a media agency, these needs are based on its portfolio of advertising clients and vary from year to year as its clients' needs, or its portfolio of clients, changes.

#### *Individual campaigns*

2.24 Throughout the year there are negotiations between sales houses and media buyers regarding airtime schedules for individual campaigns. These discussions are governed by the terms of a media buyer's contract with each sales house (see paragraphs 2.18 to 2.23).

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<sup>29</sup>For example, there was a pool value deal between [X] and [a broadcaster] from 2003, and we were told by media agencies that pool value deals are in place with other sales houses.

<sup>30</sup>Different dayparts have different audience characteristics whose attractiveness will vary between media buyers. Media buyers' daypart requirements are reflected in their contracts and is one of the factors that affects the overall discount. Standard dayparts are as follows: Breakfast time 0600–0859; Daytime 0900–1729; Peak 1730–2259 (Early peak: 1730–1959 and Late peak: 2000–2259); Post peak 2300–2429; Night time 2430–0559.

<sup>31</sup>Nearly all programme requests are subject to caveats allowing the broadcaster to optimize airtime.

<sup>32</sup>Typically the agreement will reference the sales house's standard terms and conditions.

- 2.25 Media buyers construct media plans for individual campaigns that they believe are most likely to deliver each campaign's objectives. These will be expressed in terms of required coverage<sup>33</sup> and frequency<sup>34</sup> of the audience to be targeted, the campaign budget and the campaign's timing. In some cases, this may involve a burst of advertising designed to reach as large a proportion of the target audience as possible within the shortest possible time; in other cases, it may involve a steady flow of advertisements over a longer period of time. Media plans set out the number of impacts/television ratings (TVRs)<sup>35</sup> that each channel must provide in order to meet the advertisers' coverage and frequency objectives.
- 2.26 Television audiences typically comprise a mix of different demographic groups which are identified by age, gender and socio-economic status.<sup>36</sup> An advertiser's 'true' target audience may not correspond exactly to the audiences traded by a sales house, in which case the media buyer will select the traded audience which represents the closest fit with the target audience required.<sup>37</sup>
- 2.27 Whilst advertisers purchase impacts against a particular demographic, their advertisements may actually be seen by a wider audience, and media buyers may receive, but not pay for, impacts which are not those relating to the demographic that they have bought.<sup>38</sup>
- 2.28 Prior to the advance booking deadline,<sup>39</sup> a media buyer commits to an amount of expenditure based on an expectation of impacts among the audience targeted. In addition, the media buyer makes specific requests (for example, particular programme requests) as provided for in its contract.
- 2.29 Once the advance booking deadline has passed, sales houses use computer systems to aggregate the demands and requirements of media buyers. Sales houses allocate advertising airtime based on a pattern that optimizes their inventory to reflect the polarization of audiences; this process is known as optimization. ITV told us that, although its optimization process would often align with media buyers' requests to have particular campaigns broadcast in a particular programme, a media buyer could not be guaranteed that this would be so.<sup>40</sup>
- 2.30 Reoptimization occurs continually to accommodate late bookings and to take account of changes in the broadcast schedule, anticipated changes to SAP and expected audience. The schedule for a media buyer's campaign is sent back to the media buyer, who checks it against its contract (for example, to see if the schedule is in line with the agreed proportion of dayparts and position in breaks). In addition, it checks the schedule against the campaign objectives (for example, the proportion of a target audience delivered at the start of a campaign). Following this, further negotiation between the media buyer and sales house about positioning of advertisements may

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<sup>33</sup>Coverage is the proportion of the target audience viewing the advertisement at least once over the campaign period. 'Reach' is always expressed in terms of 1+ coverage. See Appendix C for further details.

<sup>34</sup>Frequency is the proportion of the campaign's target audience that has seen the advertisement at least a particular number of times over the campaign period. For example, 4+ coverage of 50 implies that 50 per cent of the target audience has seen the advertisement four or more times during the campaign. See Appendix C for further details.

<sup>35</sup>An impact is a single viewing of a television advertisement by a member of the target audience. TVRs are the number of impacts achieved expressed as a percentage of the target audience.

<sup>36</sup>For example, a distinction can be made between broad categories such as 'Adults', 'Men', 'Children' etc. The 'Adults' demographic could then be further divided into 'ABC1 Adults' or 'Adult Men', '16-34' etc. Different demographic groupings are not necessarily mutually exclusive, eg the '16-34 Men' demographic is a subset of 'Adult Men' and also a subset of '16-34 Adults'.

<sup>37</sup>ITV trades 15 demographics: Adults, ABC1 Adults, 16-24 Adults, 16-34 Adults, Men, ABC1 Men, 16-34 Men, Women, ABC1 Women, 16-34 Women, ABC1 Housewives, 16-54 Housewives, Housewives, Housewives with Children and Children.

<sup>38</sup>This effect is sometimes referred to as 'spillover'.

<sup>39</sup>For ITV the advance booking deadline is typically two months before transmission of the advertisement.

<sup>40</sup>However, a small number of contracts contain unqualified guarantees of access to breaks in particular programmes.

occur until both are in agreement. The sales house usually has the final say on these campaign-by-campaign decisions because the broadcaster's optimization process generally overrides the vast majority of specific contractual terms (as described in paragraph 2.29).

- 2.31 In the month after the advertisement has been transmitted, a reconciliation will take place between the number of impacts/TVRs anticipated and those actually delivered. If, in a particular month, a sales house does not deliver the expected number of impacts, it is considered to have overtraded (or under-delivered) and must deliver extra impacts for the media buyer in a future month.<sup>41</sup> In contrast, if more impacts were achieved for the media buyer than agreed, the sales house will have under-traded (over-delivered), and can deliver fewer impacts for the media buyer than previously planned in a future month.

### 3. The 2003 report

- 3.1 In this section, we set out the CC's findings from the 2003 report. We begin with some background on Carlton and Granada and then set out the CC's findings in terms of competition between Carlton and Granada; constraints on ITV1<sup>42</sup> provided by other commercial channels and media buyers; and the adverse effects that the CC expected would have arisen from the merger absent remedial action. We then describe the CRR Undertakings.

#### ***Carlton and Granada***

- 3.2 In 2003, Carlton and Granada between them owned companies that operated 11 of the 15 Channel 3 regional licences: Carlton operated four regional licences, including the weekday London licence (Carlton Broadcasting Limited (Carlton TV)), and Granada operated seven regional licences, including the weekend London licence (London Weekend Television Ltd (LWT)).<sup>43</sup>
- 3.3 There were three other holders of Channel 3 regional licences:
- (a) Scottish Media Group (SMG), which operated the two licences covering Scotland (Scottish Television Ltd and Grampian Television Limited). Granada was SMG's largest shareholder with a 16.9 per cent share;
  - (b) Ulster Television plc (Ulster TV), which operated the licence covering Northern Ireland; and
  - (c) Channel Television Ltd (Channel TV), which operated the licence covering the Channel Islands.
- 3.4 Granada's sales house sold television airtime for its own regional licensees as well as national airtime<sup>44</sup> for Ulster TV and Channel TV. Carlton's sales house, in addition to selling television airtime for its own regional licensees, sold national airtime on behalf of SMG.

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<sup>41</sup>Overtrading essentially means that individual advertisers are receiving less than their 'agreed share of impacts' in that month. This means that the sales house owes a 'deal debt' to advertisers/media agencies. If this is carried over into the following month, the sales house will face an increased difficulty in delivering all its discount commitments in that month. Sales houses therefore seek to ensure that deal debt does not occur.

<sup>42</sup>As noted in the second footnote to paragraph 1.2, in 2003, the ITV1 channel was known as ITV. We have used ITV1 throughout this report when referring to the ITV1 channel. However, in this section, where referring to quotations taken from the 2003 report, we have used ITV.

<sup>43</sup>2003 report, paragraph 2.32 and Figure 3.1.

<sup>44</sup>Airtime sold across all or a large proportion of ITV's regions.

- 3.5 In 2003, Carlton and Granada jointly owned ITV2, which was ITV's only digital channel at the time of the merger.<sup>45</sup>

### ***Competition between Carlton and Granada***

- 3.6 The CC examined the extent of competition between Carlton and Granada. It found that Carlton and Granada 'each had a strong incentive to maximize the advertising spend committed to it in exchange for discounts, and that there was a degree of apparent price discrimination between customers'.<sup>46</sup>
- 3.7 The CC said that it 'did not accept the parties' argument that—because of the ITV regional structure, and the fixed supply of impacts—the scope for competition [between Carlton and Granada] was minimal'.<sup>47</sup> The CC found that 'a significant amount of the advertising placed with the parties [Carlton and Granada] was aimed at the same target audiences (albeit in different proportions)'. The CC added that 'London was the primary focus of competition within ITV', with the potential to switch advertising between Carlton TV and LWT. However, it also said that 'some switching was possible between ITV licensees in other regions' and that 'advertisers might be willing to accept a lower level of coverage in one region in return for higher coverage in another, or might choose to carry out test marketing in one region rather than another, if the difference in relative prices was sufficiently great'.<sup>48</sup> The CC was also told that 'because most advertisers are seeking to mount national campaigns and so are in the market for impacts in all of the other ITV regions that the parties sell, the competition in London influences prices that are achieved elsewhere, and so "ripples out" through the UK as a whole'.<sup>49</sup>
- 3.8 Competition between Carlton and Granada was, in the CC's view in 2003, able to constrain prices charged to media buyers. In particular, it limited the advertising budget commitment that could be demanded for a given level of discount. The CC found that 'Carlton's and Granada's ability individually to increase revenues and SAP was undoubtedly constrained by the fixed supply of impacts'. However, it found that as a result of the merger, media buyers would no longer be able 'to play one sales house off against the other' during a sales round, or respond to a price increase by either sales house in one sales round by switching to the other sales house in the next sales round.<sup>50</sup>

### ***Constraints on ITV1***

- 3.9 The CC considered the extent of competition between ITV1 and other commercial channels (those that carry advertising; not the BBC channels). The CC noted that analysis provided by Carlton and Granada, in which other commercial channels appeared capable of providing equivalent levels of coverage with and without ITV1, 'appeared technically correct'. However, the CC stated that 'whilst other commercial channels were an important price constraint on ITV, they would not be sufficiently close substitutes to prevent the merged entity from insisting on an increase in [SOB] commitment for a given level of discount following the removal of competition

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<sup>45</sup>Carlton owned 44 per cent and Granada owned 56 per cent.

<sup>46</sup>2003 report, paragraph 2.125.

<sup>47</sup>2003 report, paragraph 2.125.

<sup>48</sup>2003 report, paragraphs 2.126 and 2.127.

<sup>49</sup>2003 report, paragraph 2.98.

<sup>50</sup>2003 report, paragraph 2.125.

between Carlton and Granada'.<sup>51</sup> The CC identified the following reasons for this finding:<sup>52</sup>

- (a) *ITV1's unique features*, in terms of 'elements of its performance which no other commercial channels, either individually or jointly, could match'. These elements included ITV1's 'peak-time schedule, delivering audiences of over 10 million on a weekly and sometimes daily basis' and that ITV1's 'prime-time programming was significantly more popular than anyone else's, apart from the BBC's'. This particular element gave ITV1 the unique ability to 'deliver large audiences to advertisers quickly and in ways which enhanced the effect of their slots';
- (b) *barriers to switching for at least some advertisers*, in the form of 'the difficulty of purchasing sufficient spots to achieve the required coverage, and the likelihood of a lower sales uplift without ITV';
- (c) *some advertisers and media agencies said that they would find marginal switching unattractive*, because 'the merged entity might respond with punitive reductions in discount'; and
- (d) *a lack of countervailing buyer power*, as 'all large media buyers must reach an agreement with ITV' in order to compete effectively with other media buyers.

### **Adverse effects**

3.10 The CC concluded that the merger would have 'an adverse effect on future competition for the sale of advertising airtime and so might be expected to operate against the public interest. This adverse effect would centre on the enhanced market position of a merged Carlton/Granada'. The CC found that:

this [adverse effect] might manifest itself in a number of ways, including in particular the parties' ability, post-merger, to:

- (a) insist on terms that were generally less attractive to advertisers or media buyers. This might include demanding a greater level of commitment, however expressed, of advertisers' and/or media buyers' television advertising budgets for a given level of discount off the SAP, or obliging the advertisers or media buyers to accept worse terms and in particular reduced discounts;
- (b) enhance the degree of price discrimination; and/or
- (c) change the system under which television advertising airtime is sold to the advantage of the merged entity.<sup>53</sup>

### **The CRR Undertakings**

3.11 The CC recommended that, for the proposed merger to be allowed to proceed, the CRR remedy, initially proposed by Carlton and Granada, should be put in place.<sup>54</sup>

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<sup>51</sup>2003 report, paragraph 2.128.

<sup>52</sup>2003 report, paragraphs 2.128, 2.129 and 2.131.

<sup>53</sup>2003 report, paragraph 2.132.

<sup>54</sup>2003 report, paragraph 2.173.

- 3.12 The CRR Undertakings set out the CRR remedy in relation to ITV1 (see Appendix A). In summary, the CRR Undertakings:
- (a) give all existing customers of ITV1 the option of renewing the terms of their pre-merger contracts: these contracts are known as 'protected contracts' in the Undertakings;
  - (b) allow customers of ITV1 to negotiate different contract terms and to choose to nominate any new contract as a 'protected contract': ITV is required to offer any variation to existing contracts for ITV1 on fair and reasonable terms;<sup>55</sup>
  - (c) set out the audience ratchet mechanism (ARM): this mechanism provides for any SOB commitment to ITV1 specified in a protected contract to vary in direct proportion to ITV1's SOCI<sup>56</sup> in the 'base year',<sup>57</sup> weighted by the contracted mix of demographics, regions and specific time periods and subject to a cap of the SOB commitment specified in the protected contract. In the event that ITV1's SOCI, which has in fact fallen since 2003,<sup>58</sup> were to increase in future years, ITV would apply the ARM calculation and propose a SOB commitment in direct proportion to the increase in SOCI up to the cap of the SOB commitment in each media buyer's protected contract. If an agency decided not to increase its SOB commitment in line with the proposal, it would be required to renegotiate the whole of its contract for ITV1 airtime with ITV;
  - (d) prohibit ITV from changing its CASS without the consent of the OFT in a way that materially alters the basis on which, and the way in which, it offers Commercial Airtime for sale;<sup>59</sup> and
  - (e) established an independent Office of the Adjudicator (the Adjudicator). The Adjudicator's primary role is to rule on contractual disputes arising between ITV and customers in relation to whether variations to protected contracts for ITV1 are fair and reasonable. The Adjudicator is funded by Ofcom which is, in turn, fully reimbursed by ITV.

3.13 The CC stated in 2003 that it expected the CRR remedy to be in place for a minimum of three years.<sup>60</sup>

#### 4. Our approach to considering changes of circumstance

4.1 As described in paragraphs 1.8 to 1.10, we are required to consider whether, as a result of any changes of circumstance, the CRR Undertakings are no longer appropriate and either ITV can be released from them or they should be varied or superseded. In making this evaluation, we considered:

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<sup>55</sup>All protected contracts in existence at 1 November 2003 were presumed to be 'fair and reasonable'.

<sup>56</sup>SOCI is the share of commercial impacts. It is expressed by sales house and by target audience.

<sup>57</sup>See the Undertakings, definition of 'base year'.

<sup>58</sup>See paragraph 5.23.

<sup>59</sup>CASS is defined as '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 ...'—the Undertakings, paragraph 25.

<sup>60</sup>2003 report, paragraph 2.149.

- (a) whether the enhanced market position of ITV1, created by the merger between Carlton and Granada, has changed since the 2003 report, and if so, the nature of any such change (see Section 5);<sup>61</sup>
  - (b) whether CRR has created significant costs (see Section 6);
  - (c) whether any remedy that is needed to address ITV1's enhanced market position arising from the merger can be effective while imposing lower costs on ITV (see Section 8); and
  - (d) in light of any costs attributable to any effective remedy, whether that remedy is disproportionate to the adverse effects created by ITV1's enhanced market position (see Section 8).
- 4.2 In considering the enhanced market position of ITV1 arising from the merger, we used the conclusions of the 2003 report as our starting point and assessed whether and, if so, how the aspects identified in the 2003 report have changed. This is different from a general assessment of any market power ITV might currently hold in relation to ITV1 airtime, especially since Carlton and Granada may have held some market power pre-merger.
- 4.3 As set out in paragraphs 3.6 to 3.10, the CC's adverse finding in the 2003 report was based upon the pre-merger constraints that Carlton and Granada placed on one another, and the insufficient constraints on ITV1 provided post-merger either by other commercial channels or by media buyers. We cannot update the CC's assessment of the competition between Carlton and Granada since they no longer exist as independent commercial entities; we have assumed that the competition lost between Carlton and Granada at the time of the merger is as described in the 2003 report.
- 4.4 The statutory scope of our review is narrow and, in reviewing undertakings, we have more limited statutory powers than we do in merger inquiries or market investigations. We are required to examine only whether there have been changes of circumstance from the 2003 report such that the CRR Undertakings should be released, varied or superseded. Certain matters which have been raised in the course of the review therefore fall outside the scope of our review:
- (a) consideration of whether CRR should be expanded to address third parties' views that ITV might have market power in relation to its digital channels (ie ITV's channels excluding ITV1);
  - (b) concerns expressed to us regarding possible 'conditional selling' of television airtime on the ITV family of channels.<sup>62</sup> In particular, we were told that media agencies and ITV tend to negotiate on the basis of the ITV family of channels rather than each individual ITV channel. Although the CRR Undertakings apply to ITV1 only, they do not provide an explicit constraint on conditional selling by ITV. However, the Adjudicator's guidance specifies that ITV1 airtime should be sold on a stand-alone basis.<sup>63</sup> Rules regarding conditional selling, alongside rules requiring Public Service Broadcasters (PSBs) to sell all their advertising airtime,

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<sup>61</sup>Throughout this report, where we refer to the 'enhanced market position of ITV1' we are referring to the enhanced market position created by the merger between Carlton and Granada, as described in the 2003 report.

<sup>62</sup>'Conditional selling' occurs when a broadcaster requires that an advertiser/buyer who wishes to purchase airtime on one channel buys another of the broadcaster's products as a pre-condition of the sale.

<sup>63</sup>The Undertakings apply to ITV1 only. ITV must make a "fair and reasonable" offer on ITV1 as a standalone contract if requested. This applies to CRR, contract variations and new contracts. ITV can propose a bundled offer-but the buyer does not have to accept this if they only want an ITV1 deal or if they want separate deals for ITV1 and ITV digital. ITV cannot only offer fair and reasonable terms on ITV1 conditional on accepting terms on ITV digital. Whilst ITV is within its rights to offer a bundled ITV family deal, it cannot demand this.' Adjudicator's *Guidance on the CRR remedy*: [www.adjudicator-crr.org.uk/enquiries.htm](http://www.adjudicator-crr.org.uk/enquiries.htm).

are covered by the Airtime Sales Rules.<sup>64</sup> Ofcom began a consultation on the Airtime Sales Rules (ASR) in March 2010;<sup>65</sup>

- (c) aspects of the Undertakings other than the CRR remedy which were not referred to us in the OFT's advice;<sup>66</sup> and
- (d) wider competition issues in relation to television airtime sales (see paragraphs 9.3 to 9.8).

## 5. Assessment of changes in the enhanced market position of ITV1

5.1 In this section we examine whether, and to what extent, the enhanced market position of ITV1 has changed from that described in the 2003 report. We look at changes since 2003 in the constraints on ITV1 from other commercial channels and from media buyers. We consider possible changes in:

- (a) the television industry (see paragraphs 5.3 to 5.10);
- (b) the relevant market (see paragraphs 5.11 to 5.18);
- (c) certain market indicators: SOCI, share of NAR<sup>67</sup> and the ITV1 premium (see paragraphs 5.19 to 5.30);
- (d) the ability of individual advertising campaigns to be switched from ITV1 (see paragraphs 5.31 to 5.105);
- (e) the ability of media agencies to switch SOB commitment from ITV1 (see paragraphs 5.106 to 5.155); and
- (f) the likelihood of entry and expansion (see paragraphs 5.156 to 5.162).

5.2 We conclude with a summary of our assessment (see paragraphs 5.163 to 5.168).

### ***Changes in the television industry***

5.3 There have been significant and continuing changes in the television industry in the past seven years. In particular, the number and availability of television channels have increased through the advent of digital broadcasting and the increased penetration of digital television in UK households.<sup>68</sup>

5.4 The penetration of digital television has increased from 52.1 per cent of households in 2003 to 91.4 per cent at the end of 2009.<sup>69</sup> This change has been driven by the success of Digital Terrestrial Television (DTT), satellite, cable and other digital

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<sup>64</sup>These rules state that media buyers must be able to purchase airtime on one channel without being required to purchase airtime on other channels. They came into effect from 1 December 2003 and are enforceable by Ofcom via the licence conditions which apply to holders of broadcasting licences. The rules are available at:

[www.ofcom.org.uk/tv/ifi/guidance/ITV\\_airtime\\_sales/Airtime\\_sales\\_rules/](http://www.ofcom.org.uk/tv/ifi/guidance/ITV_airtime_sales/Airtime_sales_rules/).

<sup>65</sup>[www.ofcom.org.uk/media/news/2010/03/nr\\_20100329a](http://www.ofcom.org.uk/media/news/2010/03/nr_20100329a).

<sup>66</sup>OFT's advice, paragraph 3.9.

<sup>67</sup>NAR is total advertising revenue, less agency fees and commission.

<sup>68</sup>Viewers buy television reception equipment to access analogue and digital television channels and services. Viewers will normally have a choice between different digital television platforms, as well as the television services available on those platforms. Thus, viewers may decide just to buy reception equipment to access free-to-air content on a particular platform (ie a retail platform access service) and/or may also decide to pay subscription and/or pay-per-view fees to access additional content (ie a retail content service).

<sup>69</sup>Ofcom, *The Communications Market: Digital Progress Report, Digital TV, Q4, 2009*.

[www.ofcom.org.uk/research/tv/reports/dtv/dtv\\_2009\\_q4/dtv\\_2009\\_q4.pdf](http://www.ofcom.org.uk/research/tv/reports/dtv/dtv_2009_q4/dtv_2009_q4.pdf).

platforms, demand for which has been augmented by the launch of a large number of new channels.

- 5.5 The increased penetration of digital television and the increase in the number of channels available have led to increased fragmentation of audiences across channels. In 2003, the digital-only channels<sup>70</sup> attracted 23.6 per cent of viewing; this figure had risen to 42.1 per cent by 2009.<sup>71</sup> The number of channels broadcasting in the UK increased from 294 in 2003 to 495 at the end of 2008.<sup>72</sup> Digital-only channels have included new free-to-air channels launched by ITV (ITV3 and ITV4), as well as a range of new channels launched by other broadcasters, including time-shifted channels (eg Channel4+1).
- 5.6 Other significant changes in the television industry since 2003 include the increased availability of video on demand (VOD) services<sup>73</sup> and personal video recorders (PVRs). Both VOD services and PVRs have made it easier for consumers to watch a programme at a time of their choosing. Changes in the technical quality of television transmission have also occurred since 2003, in particular with the increased availability of HD programming.
- 5.7 We have taken these broad changes in the television industry into account when considering the change in the constraints on ITV1 since 2003.

#### *Future changes in the television industry*

- 5.8 During our review, we were told of a number of future changes in the industry that, it was suggested, might increase the constraints on ITV1.
- 5.9 One of these changes is digital switchover (DSO). The DSO process, which began in 2008, will switch all analogue television services to digital by 2012. By the end of March 2010, around 24 per cent of UK households were in areas where the analogue signal had been switched off.<sup>74</sup> The proportion of homes with digital television will continue to increase until DSO is completed. In particular, as the 8.6 per cent of households currently without access to digital television take up digital television, there will be a further effect in shifting viewing to other digital channels. However, in our view, DSO, although a major change in the television industry, is unlikely to have a significant further effect on the constraints on ITV1 given that, by the end of 2009, over 90 per cent of UK households could already receive digital television signals (see paragraph 5.4).
- 5.10 Other possible changes in the television industry that were mentioned to us include mergers between sales houses,<sup>75</sup> a prolonged recession shrinking the market for television advertising<sup>76</sup> and reviews of the way in which public service broadcasting is

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<sup>70</sup>The channels other than BBC1, BBC2, ITV1, Channel4/S4C and Five.

<sup>71</sup>Source: BARB: [www.barb.co.uk/facts/annualShareOfViewing?\\_s=4](http://www.barb.co.uk/facts/annualShareOfViewing?_s=4). Figure for 2009 includes C4+1 viewing figures.

<sup>72</sup>Ofcom, *Communications Market Report 2009* (August): [www.ofcom.org.uk/research/cm/cmr09/cmr09.pdf](http://www.ofcom.org.uk/research/cm/cmr09/cmr09.pdf).

<sup>73</sup>VOD services are available not just on home computers but on televisions and other devices such as games consoles and mobile phones. VOD services include those provided by the broadcasters themselves, such as the BBC's iPlayer, as well as those provided by platform owners, such as Virgin Media, and aggregator services, such as Arqiva's SeeSaw.

<sup>74</sup>*Airtime Sales Review Consultation*, Ofcom, 29 March 2010, paragraph 4.11: [www.ofcom.org.uk/consult/condocs/asr/asrcondoc.pdf](http://www.ofcom.org.uk/consult/condocs/asr/asrcondoc.pdf).

<sup>75</sup>Some consolidation of sales houses occurred during the course of our review, but these were not on a scale likely to have a material effect on our conclusions. For example, Sky Media took over airtime sales for MTV's television brands from Viacom Brand Solutions in November 2009.

<sup>76</sup>It was not clear how prolonged the effect of the economic recession on television advertising expenditure would be or whether this would have any greater effect on ITV than on any other sales house.

financed.<sup>77</sup> Although we recognized the importance of such possible changes to the industry as a whole, the impact of these events, were they to occur, on the constraints on ITV1 was too uncertain to consider as part of this review.

### ***Changes in the relevant market***

- 5.11 In 2003, the CC concluded that the relevant market for the purpose of assessing the merger between Carlton and Granada was all television advertising in the UK.<sup>78</sup> In particular, the CC found that advertising on television was in a different market from advertising in other media because the difference between these types of advertising ‘created a substantial degree of independence in the pricing of television advertising compared with the pricing of advertising in other media (press, outdoor, radio, Internet and cinema)’.<sup>79</sup>
- 5.12 In this section, we assess whether the relevant market has changed since 2003. We note that, as set out in our guidelines, market definition is a framework within which to analyse the changes in the constraints on ITV1 since 2003, rather than an end in itself.<sup>80</sup>

#### *ITV’s views*

- 5.13 In its submissions to the OFT, ITV’s view was that there was a single market for television advertising in which all traded demographics were substitutable. ITV said that television advertising and Internet display advertising were converging towards a single market, but that it was not necessary to conclude on this matter for the purposes of the CRR review because in its view the evidence showed that ITV1 was sufficiently substitutable on the narrower market definition of television advertising.
- 5.14 Following publication of our Provisional Decision, ITV submitted that, because we had provisionally found that ITV1 was not sufficiently substitutable, it was necessary to conclude on whether the market was broader than television advertising. ITV said that Internet advertising, in particular Internet display advertising, had increasingly become a constraining factor on the television advertising market and that the constraint was such that Internet display advertising, and possibly Internet search advertising, ‘may now form part of the same relevant market as television advertising’. ITV told us that Internet operators like Google were able to offer both display and search advertising which was attractive to advertisers. ITV referred to a study by the Internet Advertising Bureau (IAB) which showed that online advertising had surpassed television advertising to become the largest advertising sector in the UK.<sup>81</sup>
- 5.15 ITV also told us that, as advertisers were able to substitute between different demographics, the varying constraints on different demographics were not relevant in assessing ITV1’s overall pricing constraints. Specifically, ITV told us that if there was a broad market for all demographics, it was not necessary for all demographics (or for all campaign types within demographics) to be fully substitutable in order for ITV1 pricing to be constrained overall.

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<sup>77</sup>The Digital Britain report was published during our review and included proposals for alternative funding models for public service broadcasting. However, it was unclear how many of the proposals in the report would be implemented. See [www.culture.gov.uk/images/publications/digitalbritain-finalreport-jun09.pdf](http://www.culture.gov.uk/images/publications/digitalbritain-finalreport-jun09.pdf).

<sup>78</sup>2003 report, paragraphs 2.88 & 2.89.

<sup>79</sup>2003 report, paragraph 2.85.

<sup>80</sup>Merger References: Competition Commission Guidelines, June 2003, CC2, paragraph 2.2.

<sup>81</sup>ITV told us that the IAB’s report, in conjunction with PricewaterhouseCoopers, estimated that Internet advertising accounted for 23.5 per cent (£1,752 million) of the total (gross) advertising expenditure in the first half of 2009, while television advertising accounted for 21.9 per cent. See [www.iabuk.net/en/1/adspendgrows300909.mxs](http://www.iabuk.net/en/1/adspendgrows300909.mxs).

## Our assessment

5.16 We found that, despite various changes in the television industry (see paragraphs 5.3 to 5.7) and in the advertising expenditure by media (see paragraphs 2.4 to 2.8) since 2003:

(a) The relevant product market remains no wider than television advertising:

- (i) As described in paragraphs 2.7 and 2.8, there has been a rapid growth of Internet advertising expenditure since 2003. However, the bulk of this growth has been in Internet *classified* advertising. Internet *display* advertising, which is closest in nature to television advertising, has increased from 1.1 per cent of total advertising expenditure in 2003 to only 4.6 per cent in 2009, significantly less than television advertising's estimated 22.7 per cent share of expenditure.<sup>82,83</sup> Although there is likely to be continued growth in Internet display advertising in the future, we could not rely on such growth constraining television advertising in the foreseeable future.
- (ii) Figures on the growth in Internet display advertising do not reveal whether Internet display advertising is a substitute or a complement to television advertising. Advertisers and media agencies said that they did not regard Internet advertising as a substitute for television advertising, although it was potentially a complementary product in delivering certain types of campaigns. We have not seen any evidence that suggests that the sale of television advertising is constrained by Internet display advertising.<sup>84</sup>

(b) The relevant product market remains no narrower than television advertising:

- (i) Digital channels are now available to the vast majority of households on different platforms (via DTT, satellite and cable platforms—see paragraph 5.4). In our view, it continues to be appropriate not to segment the market for television advertising by platform.
- (ii) We recognize that there continues to be a degree of substitutability between the airtime bought under at least some different demographics.<sup>85</sup> For the purposes of this review we found that, on balance, it remains appropriate to define a single product market for all demographics. However, in our view varying constraints within demographics are a relevant consideration in assessing the constraints on ITV1. In particular, we recognize that the airtime traded by broadcasters is differentiated by demographics and that we need to examine any implications that this differentiation may have for the competitive constraints on ITV1 (for example, the relative constraints on ITV1 for a broad demographic such as 'Housewives' compared with a narrower demographic, such as '16–34 Men').

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<sup>82</sup>See *The Advertising Statistics Yearbook 2009*, Table 3.1.1, p14, and Table 16.2, p184. See also our discussion of the figures for 2009 in paragraph 2.6.

<sup>83</sup>Based on the estimates in the IAB report, referred to by ITV, display advertising accounted for only £316.5 million (18 per cent) of a total Internet advertising expenditure of £1,752 million in the first half of 2009. This amounts to around 4 per cent of the total (gross) advertising expenditure in the first half of 2009.

<sup>84</sup>This view was also reached by Ofcom in its submission (paragraph 1.11) and in its *Airtime Sales Rules Review, Consultation*, 29 March 2010:

[www.ofcom.org.uk/consult/condocs/asr/asrcondoc.pdf](http://www.ofcom.org.uk/consult/condocs/asr/asrcondoc.pdf). Ofcom noted that the situation could change in the future.

<sup>85</sup>In particular, many demographics overlap. For example, '16–34 Men' is a subset of a number of other demographics including 'Men', 'Adults' and '16–34 Adults'.

- 5.17 We found that the relevant geographic market remains the UK. There continues to be sufficient substitutability between regions to support the finding of a national market despite some advertisers having specific regional advertising requirements.
- 5.18 For the reasons discussed in paragraphs 5.16 and 5.17, we therefore undertake our assessment of changes in the enhanced market position of ITV1 since 2003 within the market for television advertising in the UK.

### **Changes in certain market indicators**

5.19 The 2003 report looked at three market indicators as part of its competitive assessment of ITV1's enhanced market position post-merger:

- (a) ITV1's SOCI;
- (b) ITV1's share of NAR; and
- (c) the ITV1 premium.

5.20 In this section, we examine the change in these market indicators since 2003 to inform our assessment of the change in ITV1's enhanced market position. We note that market shares need careful interpretation given the differentiated nature of television airtime on different channels (see paragraph 5.16(b)(ii)).

### *ITV1's share of commercial impacts*

5.21 The 2003 report noted that ITV1's SOCI for Adults<sup>86</sup> was 43.5 per cent in 2003 and that of the next largest competitor, Channel 4, was 16.6 per cent.<sup>87</sup>

5.22 Table 1 and Figures 4 and 5 show the changes in SOCI for Adults between 2003 and 2009.

TABLE 1 **SOCI for Adults, 2003, 2008 and 2009**

	<i>per cent</i>		
	<i>First six months of 2003*</i>	<i>Full year 2008</i>	<i>Full year 2009</i>
ITV1	43.5	30.0	28.4
ITV Digital	1.9	8.8	9.5
Channel 4 (including S4C)	16.6	13.4	12.3
Five	11.0	8.5	8.1
GMTV	2.8	2.2	2.1
Other channels	<u>24.2</u>	<u>37.0</u>	<u>39.7</u>
Total	100.0	100.0	100.0

Source: 2003 report, Table 5.10; ITV.

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\*Figures for first six months of 2003 taken from 2003 report, Table 5.10. Figures for ITV Digital were not provided in the 2003 report but have been included based on data from ITV.  
 Note: Figures may not sum due to rounding.

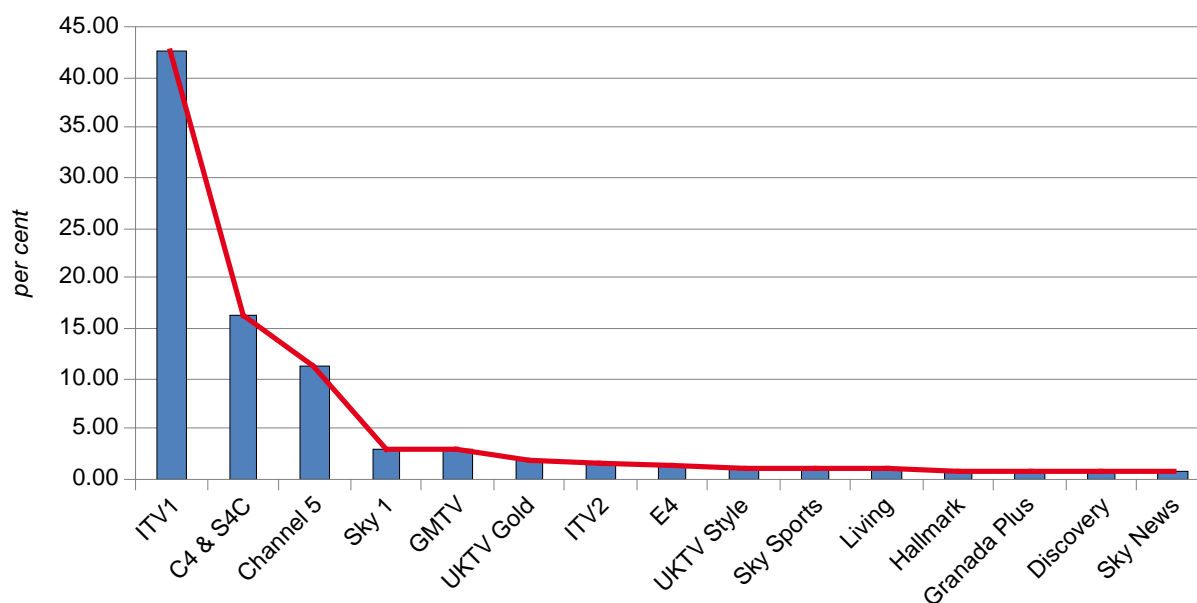
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<sup>86</sup>Individuals aged 16 and over.

<sup>87</sup>2003 report, paragraph 5.39. The 2003 report did not look at Carlton's and Granada's SOCI separately. Figures were for the first six months of 2003 only. Channel 4 figure includes S4C's SOCI.

FIGURE 4

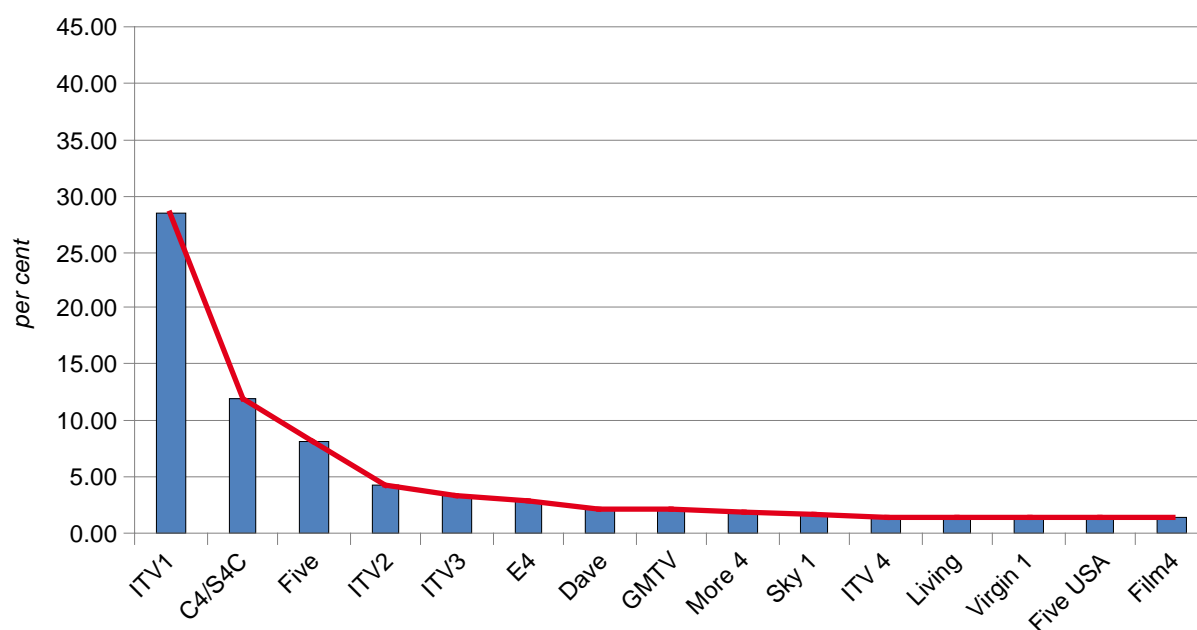
**Top 15 commercial channels based on Adult SOCI, 2003**



Source: Ofcom, from BARB data.

FIGURE 5

**Top 15 commercial channels based on Adult SOCI, 2009**



Source: Ofcom, from BARB data.

5.23 Table 1 shows that, since 2003, ITV1's SOCI for Adults has fallen from 43.5 to 28.4 per cent in 2009,<sup>88</sup> but ITV1 remains by far the single largest commercial channel in terms of SOCI (as also shown in Figures 4 and 5). Channel 4 is the next

<sup>88</sup>ITV1's SOCI has declined across all demographics since 2003.

largest channel, with a SOCI for Adults of 12.3 per cent—less than half that of ITV1. The decline in ITV1’s SOCI of 15.1 percentage points since 2003 has been distributed to a range of other channels, including ITV’s digital-only channels (which have increased by 7.6 percentage points since 2003)<sup>89</sup> and digital channels launched by other broadcasters (which have increased by 15.5 percentage points since 2003). In aggregate, these other channels have taken a significant proportion of ITV1’s SOCI, even though individually each of these channels has relatively few viewers, as shown in Figures 4 and 5.

### *ITV1’s share of net advertising revenue*

5.24 The 2003 report noted that ITV1’s share of NAR was 51.2 per cent in 2003 and that Carlton and Granada had shares of NAR of 23.5 per cent and 27.7 per cent respectively. The next largest competitor, Channel 4, had a share of NAR of 20.4 per cent.<sup>90</sup>

5.25 Table 2 sets out changes in ITV1’s share of NAR between 2003 and 2009. We note that any decrease in NAR might be partly attributable to the CRR remedy itself because the ARM allows media buyers to withdraw SOB commitment to ITV1 in direct proportion to the decline in ITV1’s SOCI.

TABLE 2 **Share of NAR, 2003, 2008 and 2008**

	<i>per cent</i>		
	<i>First six months of 2003*</i>	<i>Full year 2008</i>	<i>Full year 2009</i>
ITV1	51.2	39.3	38.4
ITV Digital	0.9	6.8	8.2
Channel 4 (including S4C)	20.4	19.2	19.1
Five	7.7	7.8	6.7
GMTV	1.7	1.7	1.8
Other channels	<u>18.2</u>	<u>25.2</u>	<u>25.9</u>
Total	100.0	100.0	100.0

Source: 2003 report, Table 5.10; ITV.

\*Figures for first six months of 2003 taken from 2003 report, Table 5.10.

Note: Figures may not sum due to rounding.

5.26 Table 2 shows that since 2003, ITV1’s share of NAR fell from 51.2 per cent in 2003 to 38.4 per cent in 2009.<sup>91</sup> ITV1 remained by far the single largest commercial channel in terms of share of NAR with Channel 4 the next largest channel with a share of NAR of 19.1 per cent in 2009, just under half that of ITV1’s share of NAR. As with SOCI, the fall in ITV1’s share of NAR of 12.8 percentage points has been distributed to a range of other channels, which include ITV’s digital-only channels (for which share of NAR increased by 7.3 percentage points)<sup>92</sup> and digital channels launched by other broadcasters (for which share of NAR increased by 7.7 percentage points). Whilst these other channels, collectively, have taken a significant proportion of ITV1’s lost SOCI, they account for a smaller proportion of NAR than of SOCI. This indicates that the other channels have not been able to generate as much revenue per impact as ITV1.

<sup>89</sup>The ‘Adult’ SOCI of the ITV family (ie ITV1 and ITV’s digital-only channels) fell from 45.4 per cent in 2003 to 37.9 per cent in 2009.

<sup>90</sup>2003 report, Table 5.10, figures were for the first six months of 2003 only. Channel 4 figure includes share of NAR for S4C.

<sup>91</sup>ITV1’s share of NAR remained higher than either Carlton’s or Granada’s share of NAR in the first six months of 2003 (which were 23.5 and 27.7 per cent respectively—see paragraph 5.24).

<sup>92</sup>Overall ITV’s share of NAR (excluding GMTV) fell from 52.1 per cent in 2003 to 46.6 per cent in 2009.

## *The ITV1 premium*

- 5.27 Commercial channels are said to trade at a premium when the share of NAR divided by SOCI for a particular demographic is greater than 1. A premium indicates that the price of advertising (ie the price of an impact) on a particular demographic on a particular channel is above the average for all channels. It can also indicate that there are other qualitative aspects that media buyers value in advertising on a particular channel which are not fully captured by SOCI.
- 5.28 ITV1's premium has increased from 1.18 in the first six months of 2003 to 1.28 in 2008 and 1.34 in 2009.<sup>93</sup> This increase has occurred despite the proportionate relationship between ITV1's SOCI and media buyers' SOB commitment to ITV1 specified in the ARM formula.<sup>94</sup> This suggests that media buyers have not, in fact, reduced their SOB commitment by as much as the reduction in ITV1's SOCI.
- 5.29 ITV said that the ITV1 'premium' was not a useful method for measuring how price had changed since 2003 because it used two unrelated metrics—share of NAR (derived against all demographics sold) and 'Adult' SOCI (impacts available against a single demographic). ITV said that it was not feasible to create a meaningful metric because information on impacts traded by demographic was not available. ITV also said that any calculation should be based on share of NAR lagged one year behind SOCI because of the annual deal round.
- 5.30 We note that ITV referred to the ratio between ITV1's share of NAR and its SOCI (which is what we have termed the 'ITV1 premium') in its 2009 preliminary results presentation<sup>95</sup> and that ITV said that it was not feasible to look at the ITV1 premium by demographic. We also noted that, even using a lagged premium (the ratio of share of NAR to 'Adult' SOCI from the previous year), ITV's premium would have increased from 1.18 in 2003 to 1.28 in 2009.<sup>96</sup>

## ***Changes in the ability of individual campaigns to be switched from ITV1***

- 5.31 As set out in paragraph 3.9, the 2003 report found that there were insufficient constraints on ITV1 from other commercial channels, highlighting a number of ITV1's unique features and barriers to switching.
- 5.32 In this section we consider:
- (a) coverage analyses<sup>97</sup> and the potential limitations of such analyses (see paragraphs 5.33 to 5.48);
  - (b) ITV1's unique ability to deliver large audiences to advertisers and the relevance of doing so (see paragraphs 5.49 to 5.65);
  - (c) ITV1's other unique features and barriers to switching, which need to be taken into account when assessing the effective ability of advertising campaigns to be switched from ITV1 (see paragraphs 5.66 to 5.95):

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<sup>93</sup>See ITV investor presentation, *Platform for change: ITV plc 2009 Preliminary Results*, 3 March 2010, p8: [www.itvplc.com/files/presentation/31497/FINAL\\_PRESENTATION.pdf](http://www.itvplc.com/files/presentation/31497/FINAL_PRESENTATION.pdf)

<sup>94</sup>The 2003 report did not look at Carlton's and Granada's premiums separately.

<sup>95</sup>ITV investor presentation, *Platform for change: ITV plc 2009 Preliminary Results*, 3 March 2010, p8: [www.itvplc.com/files/presentation/31497/FINAL\\_PRESENTATION.pdf](http://www.itvplc.com/files/presentation/31497/FINAL_PRESENTATION.pdf)

<sup>96</sup>The 2003 figure is calculated by dividing ITV1's 2003 share of NAR in Table 2 by its 2002 SOCI (43.5 per cent) in Table 5.10 of the 2003 report. The 2009 figure is calculated by dividing ITV1's 2009 share of NAR in Table 2 by its 2008 SOCI in Table 1.

<sup>97</sup>See explanation in paragraph 5.33.

- (i) the likelihood of advertisers obtaining a lower sales uplift without ITV1;<sup>98</sup>
  - (ii) the difficulty of purchasing sufficient advertising spots to achieve the required coverage without ITV1; and
  - (iii) other features of ITV1, such as light viewers and wastage; and
- (d) evidence of switching by individual advertisers since 2003 (see paragraphs 5.96 to 5.99).

We conclude with our assessment of the changes since 2003 in the ability of individual advertising campaigns to be switched from ITV1 (see paragraphs 5.100 to 5.105).

### *Coverage analyses*

- 5.33 In 2003, the CC examined analysis by Carlton and Granada that sought to demonstrate that, for a given level of expenditure, a media buyer could expect to achieve a similar degree of coverage and/or frequency for a given campaign by using either a mix of commercial channels which included ITV1, or a mix from which ITV1 was excluded. The analysis demonstrated that equivalent levels of 1+ and 4+ cover could be achieved with and without ITV1 in relation to some, but not all, demographics<sup>99</sup> (we have referred to this type of analysis as ‘coverage analysis’).<sup>100</sup> The analysis examined coverage (1+ cover), so as to give an indication of the proportion of the target audience reached, and frequency (4+ cover), so as to give an indication of the level of repeat viewings. The ability for a campaign to obtain equivalent coverage and frequency with or without ITV1 was due to the lower price of advertising on other channels which meant that a greater number of TVRs<sup>101</sup> could be bought when ITV1 was excluded from the channel mix, despite other channels’ less efficient delivery of impacts.
- 5.34 The 2003 report found that ‘the coverage analysis carried out by the parties [Carlton and Granada], demonstrating equivalent levels of coverage with and without ITV, appeared technically correct’, but that there were barriers to switching and unique features of ITV1 that limited the substitutability of ITV1 for at least some advertisers (see paragraph 3.9).<sup>102</sup>
- 5.35 In the 2003 report, no comparison was made between the loss of coverage from excluding Carlton or Granada separately and the loss of coverage from excluding the whole of ITV1.
- 5.36 Both ITV and third parties submitted coverage analyses during this review. In this section, we summarize the results of these analyses and our assessment of them. A full description of ITV’s and third parties’ coverage analyses is set out in Appendix D.

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<sup>98</sup>‘Sales uplift’ is the term used by ITV to refer to the increase in sales that an advertiser gains through advertising its products or services.

<sup>99</sup>The exceptions were ‘ABC1 Adults’, ‘Adults’ and ‘Housewives’, where excluding ITV1 led to a decline in 1+ cover of between one and three percentage points.

<sup>100</sup>Any assessment of ITV1 substitutability and of any change in this substitutability over time needs to take into account aspects that are not captured by these analyses (see paragraph 5.45). For this reason, we have referred to these analyses as ‘coverage analyses’ rather than ‘substitutability analyses’, which was the term used by ITV.

<sup>101</sup>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 per cent of the target group. Thus, a 30-second advertisement in a programme that reaches 25 per cent of a particular demographic group delivers 25 TVRs. For further details, see Appendix C.

<sup>102</sup>2003 report, paragraphs 2.128 and 5.111.

## *ITV's coverage analyses*

- 5.37 ITV's coverage analyses were based on two different methodological approaches:
- (a) First, ITV conducted coverage analyses using media planning software (software-based coverage analysis). ITV took a number of different hypothetical campaigns and distributed TVRs among the available viewing audience and in proportion to each channel's SOCI. It then calculated the total cost of each campaign. To assess the effect of removing ITV1 from each hypothetical campaign schedule, ITV reallocated TVRs away from ITV1 in proportion to the other channels' SOCI, assuming the same budget and same price of impacts on all channels. ITV assessed the resulting changes in coverage and frequency. This approach was the same as that used for submissions to the CC by Carlton and Granada in 2003 and allowed comparisons to be drawn between 2003 and 2008/09.
  - (b) Second, ITV conducted coverage analyses using manual reallocation of advertising spots (manual coverage analysis). ITV asked a media auditor, [X], to examine a number of actual campaigns and to reallocate the advertising spots from ITV1 to other channels, assuming the same budget. The media auditor used media planning best practice to reallocate spots from ITV1 to other commercial channels<sup>103</sup> and examined the resulting coverage and frequency for scenarios with and without ITV1. Coverage analysis using this methodology was not conducted in 2003.
- 5.38 Using both methodologies, ITV tested campaigns with differing campaign objectives in terms of required ratings, durations and seasonal timings. ITV also undertook coverage analyses for an individual campaign after taking into account the effect on the price of impacts on ITV1 and other commercial channels of switching (a) £30 million and (b) £205 million away from ITV1.<sup>104</sup> In ITV's view, £30 million was the correct benchmark for any assessment of switching behaviour (see paragraph 5.112), and the £205 million figure was to test an 'extreme' scenario.
- 5.39 ITV's coverage analyses were used to provide three different assessments:
- (a) A 'snapshot' analysis, in which ITV examined the change in coverage and frequency for individual campaigns of different sizes and durations across a range of demographics conducted with and without ITV1 in 2007/08/09. ITV conducted this analysis using both its software-based and manual methodologies. ITV submitted that these analyses showed that media buyers could achieve their campaign objectives without ITV1. It found that, when ITV1 was omitted from schedules, there was no longer deterioration in coverage for the majority of campaign types across all demographics, except the 'Housewives' demographic. It also found that frequency increased for all demographics and all campaign types when ITV1 was omitted.
  - (b) A comparison between the results of the coverage analyses for a range of individual campaigns with and without ITV1 in 2003 and 2009. ITV was able to conduct this assessment using only the software-based methodology, as it did not have comparable manual coverage analyses for 2003. ITV said that the comparison between 2003 and 2009 showed that for every demographic the degree of reliance on ITV1 was significantly less in 2009 than in 2003.

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<sup>103</sup>The media auditor stated that this was to avoid too many advertisements on the same channel, avoid using rarely-used channels and be consistent with channels' sales policies. We comment on this approach in Appendix D.

<sup>104</sup>ITV used £30 million based on its critical loss type analysis and £205 million based on the [X] implied by ITV's customer survey. We explain ITV's critical loss type analysis and survey of media buyers in paragraphs 5.111 and 5.112.

- (c) A comparison between the results of the coverage analyses with and without each of Carlton and Granada in 2003 with the results of the coverage analyses with and without ITV1 in both 2003 and 2009. This comparison was conducted using only the software-based methodology. ITV submitted that the results of this comparison showed that the increase since 2003 in the ability of media buyers to achieve their coverage and frequency objectives without ITV1 was sufficient to erode completely the effect of the merger between Carlton and Granada. In particular, ITV said that the results showed that, across all of ITV1's major traded audiences, advertisers had less dependence on ITV1 today than they had on either Carlton or Granada pre-merger.<sup>105</sup>

#### *Third parties' coverage analyses*

5.40 A number of third parties also undertook both software-based and manual coverage analyses (including software-based analyses of actual campaigns). Almost all third party analyses were conducted on the basis of a 'snapshot' analysis of the change in the coverage and frequency for an individual campaign conducted with and without ITV1 in 2007/08/09.

5.41 Third party evidence showed that:

- (a) Removing ITV1 from the schedule led to deterioration in 1+ cover for some demographics. The most affected demographics were the main broad demographics that ITV1 sells—'Housewives', 'Adults' and 'ABC1 Adults'—and, to a lesser extent and to varying degrees, the next three most important demographics—'ABC1 Men', '16–34 Adults' and 'Housewives with Children'.<sup>106</sup> These six demographics comprise [X] per cent of ITV1's net revenue.<sup>107</sup>
- (b) If ITV1 was not used for a campaign, this tended to increase frequency, with 4+ cover increasing in nearly all scenarios.
- (c) There were some demographics for which neither coverage nor frequency decreased for most campaigns when ITV1 was omitted. These included 'Children' and 'Men'.

- *ITV's views on third parties' coverage analyses*

5.42 ITV criticized third parties' coverage analyses on two main grounds:

- (a) Third parties' coverage analyses, because they were all based on a snapshot of coverage with and without ITV1 in 2007/08/09, did not distinguish between the market position of ITV1 and the enhanced market position of ITV1 attributable to the merger. In ITV's view, these analyses were therefore irrelevant to the issue that we are required to address in this review.
- (b) Most third parties' coverage analyses were based on actual campaign data which were non-representative, biased or out of date or adopted biased methodologies. ITV told us that, once biased or methodologically flawed coverage analyses of third parties were removed, there was an increase in frequency for all demographics and all campaign types when ITV1 was omitted and there was no

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<sup>105</sup>As set out in Appendix D, ITV also conducted the analysis by comparing ITV1 with a de-merged Carlton and Granada in 2009. ITV found that this analysis also showed that advertisers would have no greater reliance on ITV1 as a whole than they would have on either a demerged Carlton or a demerged Granada.

<sup>106</sup>More detail is provided in Appendix D.

<sup>107</sup>Revenue net of agency commission.

deterioration in coverage for the majority of campaign types across all demographics, except the 'Housewives' demographic.

5.43 In considering the weight that should be attached to any reduction in 1+ cover, ITV told us that:

- (a) The reduction in coverage for the 'Housewives' demographic was smaller than the reductions in coverage in certain demographics (notably 'ABC1 Adults') when Channel 4 was omitted. ITV argued that this meant that ITV1 airtime was at least as substitutable as Channel 4's airtime.
- (b) Advertisers are interested in both reach and frequency.<sup>108</sup> ITV said that an increase in frequency when ITV1 was omitted was a positive benefit that was likely to more than offset the reduction in 1+ cover when ITV1 was omitted.

#### *Our assessment of coverage analyses*

5.44 ITV attributed significant importance to its coverage analyses. Third parties, partly at the request of the OFT, therefore responded with their own analyses. Having reviewed a considerable amount of evidence from ITV and third parties (see Appendix D), we agreed with the findings in the 2003 report that the approaches 'appeared to be technically correct'. Coverage analysis can tell us whether, based on the assumptions underpinning the analysis, a campaign could, in principle, be conducted without ITV1. However, in our view, and as set out in the 2003 report, coverage analyses cannot be used as a complete assessment of the substitutability of ITV1 or the change in its enhanced market position since 2003. In particular, this type of analysis shows what customers could do in the event of a price increase, but may not be indicative of what they would do in practice. Where such analyses suggest that impacts on ITV1 are not required to meet campaign objectives, they raise the question as to why media buyers continue to advertise on ITV1, especially given that impacts on ITV1 are at a premium to those on other channels. If impacts on ITV1 were not required by advertisers to achieve their campaign objectives, we would have expected advertisers to have switched away from ITV1. We consider actual switching by individual advertisers since 2003 in paragraphs 5.96 to 5.99.

5.45 We identified a number of further limitations with the coverage analyses (which were also identified in 2003):

- (a) Coverage analyses assume that each impact for a given demographic is of the same value to the advertiser, regardless of the programme with which it is associated, the channel on which it is shown or the time at which it is shown. As highlighted in paragraph 5.28, the premium attached to impacts on ITV1 has increased since 2003, suggesting that ITV1 continues to offer additional benefits to advertisers relative to other commercial channels. We discuss the importance of these aspects in relation to the relative size of ITV1's audience and the ability of ITV to generate a higher sales uplift for advertisers in paragraphs 5.49 to 5.65 and 5.68 to 5.73.
- (b) Coverage analyses focus on coverage and frequency objectives and do not take into account other important campaign parameters or contractual requirements,

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<sup>108</sup>ITV told us that, if advertisers were interested only in reach, advertising campaigns would be run on an entirely different basis with advertisements shown simultaneously on multiple channels (an approach known as 'road-blocking'). In addition, ITV said that greater contractual certainty would be sought over campaign spot placement.

including daypart splits and positions in break. In addition, software-based coverage analyses do not consider the existence of:

- (i) clashes of the same type of advertisements within breaks;
- (ii) limitations on the number of spots required on other commercial channels in order to deliver the same number of ratings; and
- (iii) the availability of inventory on other commercial channels.

We discuss the importance of these limitations in paragraphs 5.74 to 5.88. We noted that manual coverage analyses attempt to overcome some of these limitations but these analyses are themselves subject to limitations, in particular the degree of discretion and subjectivity involved in the reallocation of ITV1 spots. In addition, manual coverage analyses are not available for 2003 to help assess the change in ITV1's enhanced market position.

- (c) Coverage analyses may not reflect media buyers' actual ability to switch some expenditure away from ITV1 because they cannot take into account the nature of annual negotiations which determine SOB commitments and discounts. We discuss the ease of switching SOB commitment in paragraphs 5.108 to 5.155.
- (d) Coverage analyses do not incorporate the dynamic effects of reactions to changes in price following any switching. We discuss this in the context of switching SOB commitment in paragraphs 5.108 to 5.155.

5.46 We considered how the coverage analyses could be most appropriately used to assess the change in ITV1's enhanced market position since 2003. We placed most weight on those analyses that examined the differences in the coverage and frequency achievable without ITV1 between 2003 and 2007/08/09. As almost all third parties' coverage analyses were snapshot approaches, this meant that we focused on ITV's coverage analyses described in paragraphs 5.39(b) and (c). We found that:

- (a) ITV's comparison of the results of coverage analyses for Carlton and Granada in 2003 with those for ITV1 in 2003 and 2009 was, in principle, the most appropriate of those conducted to inform our assessment of changes in the enhanced market position of ITV1. However, we found that ITV's quantification of the merger effect in 2003 did not fully reflect the conclusions reached by the CC in 2003. In particular, the merger effect in ITV's coverage analysis for Carlton and Granada in 2003 suggested that there was a small loss of 1+ cover for only three demographics ('Adults', 'Housewives' and 'Housewives with Children');<sup>109</sup> the conclusions in the 2003 report,<sup>110</sup> on the other hand, listed a number of factors beyond coverage analysis which formed the basis for finding an enhanced market position of ITV1 post-merger and suggested a much wider merger effect.<sup>111</sup>
- (b) ITV's comparison between software-based coverage analysis for ITV1 as a whole in 2003 and ITV1 as a whole in 2009 showed that campaigns were able to get closer to their coverage and frequency objectives without ITV1 in 2009 than in 2003.

5.47 Although we acknowledged that snapshot approaches did not address the issue of the change in ITV1's enhanced market position since 2003, we examined such

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<sup>109</sup> Appendix D explains why the coverage analysis generates a small merger effect.

<sup>110</sup> See paragraph 3.9.

<sup>111</sup> We consider the other factors and ITV's views on these factors throughout the rest of Section 5.

analyses submitted by ITV and third parties to provide a sense-check on the sensitivity of the results to different assumptions. We did not agree with ITV's claim that most of the third parties' coverage analyses were non-representative, biased or out of date (see Appendix D). The results of third parties' coverage analyses were based on different assumptions to those of ITV and suggested that media buyers would not necessarily be able to achieve the same level of 1+ cover without ITV1, particularly in ITV1's most important demographics (see paragraph 5.41). These analyses illustrated that different assumptions underpinning coverage analyses can lead to quite different results.<sup>112</sup>

5.48 We noted ITV's points (see paragraph 5.43) about the weight that should be attached to a reduction in 1+ cover:

(a) We placed little weight on ITV's coverage analysis comparing the omission of ITV1 with the omission of Channel 4. Such a comparison does not provide any indication as to the change in ITV1's enhanced market position since 2003: it does not examine changes from 2003 and it focuses on the extent to which campaign objectives could be achieved without Channel 4, which has no bearing on the substitutability of ITV1.

(b) Evidence from third parties suggested that campaign goals vary for each campaign (such that gains in frequency may benefit some advertisers whereas falls in coverage may be critical for other advertisers) and that only a small drop in coverage had an important effect on sales.<sup>113</sup> As it was not clear what relative weight should be attached to coverage and frequency, we found that it was not appropriate for us to weigh up losses in coverage with gains in frequency.

### *ITV1's large audiences*

5.49 In the 2003 report, the CC found that ITV1's 'peak-time schedule, delivering audiences of over 10 million on a weekly and sometimes daily basis, contrasted with viewing figures on other commercial channels which rarely rose above 3 or 4 million for an individual programme and were typically much lower'. The CC noted that in 2002, ITV1 broadcast 877 'shows' drawing audiences of over 5 million viewers compared with only 58 shows on Channel 4. In addition, the CC found that 933 of the top 1,000 'best-rating' programmes on commercial television in 2002 were shown on ITV1.<sup>114</sup> The CC found that ITV1 had the unique ability to 'deliver large audiences to advertisers quickly and in ways which enhanced the effect of their slots'. The CC was concerned that 'the merged entity would be able to exploit this advantage more effectively than Carlton and Granada could separately'.<sup>115</sup>

5.50 The 2003 report also noted that contracts between media buyers and ITV1 included detailed clauses specifying which impacts would be available to the media buyer.

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<sup>112</sup>See Appendix D for details of the different assumptions used by third parties.

<sup>113</sup>See [OFT's advice](#), paragraph 5.50, where two examples are provided:

- (i) [redacted] used econometric analysis to estimate the effects on sales from a drop in its target coverage levels due to removal of ITV1 based on a campaign run in January 2008. It found that sales would fall by 7.4 per cent without ITV1; and
- (ii) [redacted] noted that in a pitch for a client worth £50 million, the differential in claimed coverage between the successful and unsuccessful pitching agencies was 2.8 per cent.

ITV disputed both of these points: first, on the basis that the econometric analysis would be unlikely to provide definitive proof of ITV1's contribution to sales; and second, on the basis that coverage optimization is not a key driver in media agency pitch adjudication.

<sup>114</sup>2003 report, paragraph 5.102. Different episodes of the same series are counted as different shows.

<sup>115</sup>2003 report, paragraph 2.131.

This included the proportion of advertisements shown at peak time, the amount of access they have to specials or to specific programmes such as *Coronation Street*.<sup>116</sup>

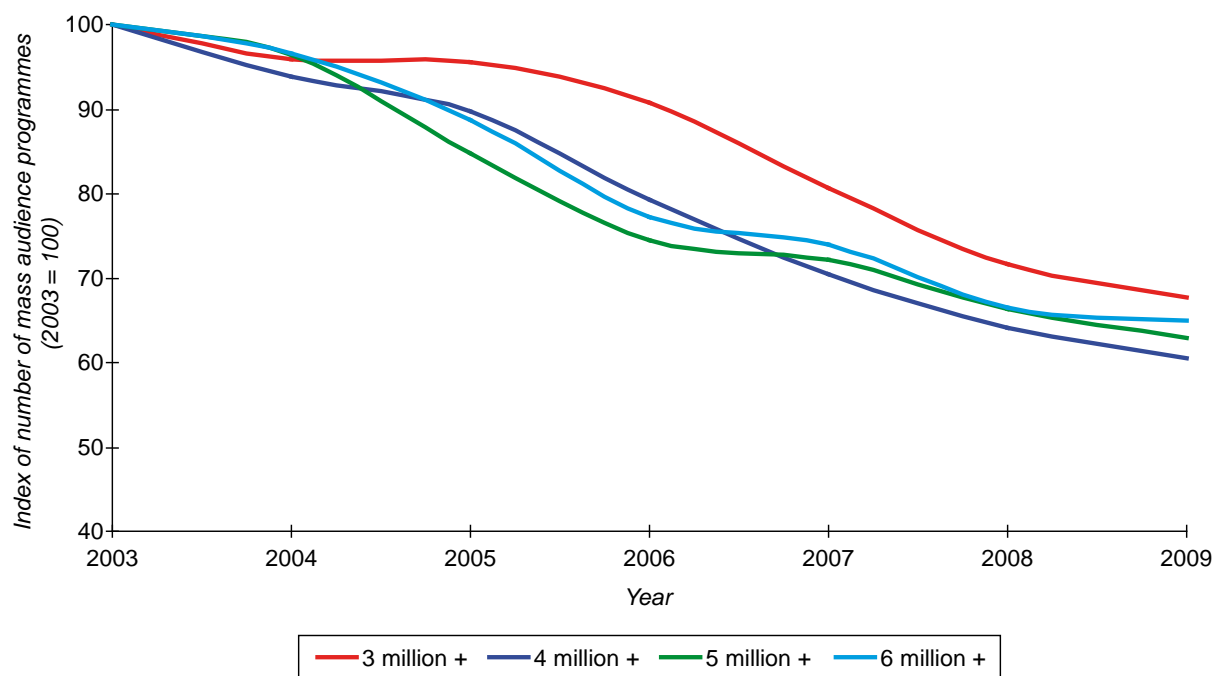
5.51 Given the CC's concern in 2003 regarding ITV1's unique ability to attract large audiences, we examined changes in ITV1's share of programmes delivering large audiences since 2003. We assess first in paragraphs 5.52 to 5.57 whether this unique ability still exists and then consider in paragraphs 5.58 to 5.65 whether this continues to be relevant in giving ITV1 an enhanced market position.

*Changes in ITV1's ability to deliver large audiences since 2003*

5.52 Figures 6 and 7 show the change in the number of large audiences (for audiences of over 3, 4, 5 or 6 million) on all commercial channels, and the change in ITV1's share of large audience programmes on commercial channels between 2003 and 2009.

FIGURE 6

**Number of large audience programmes on commercial channels, 2003 to 2009**

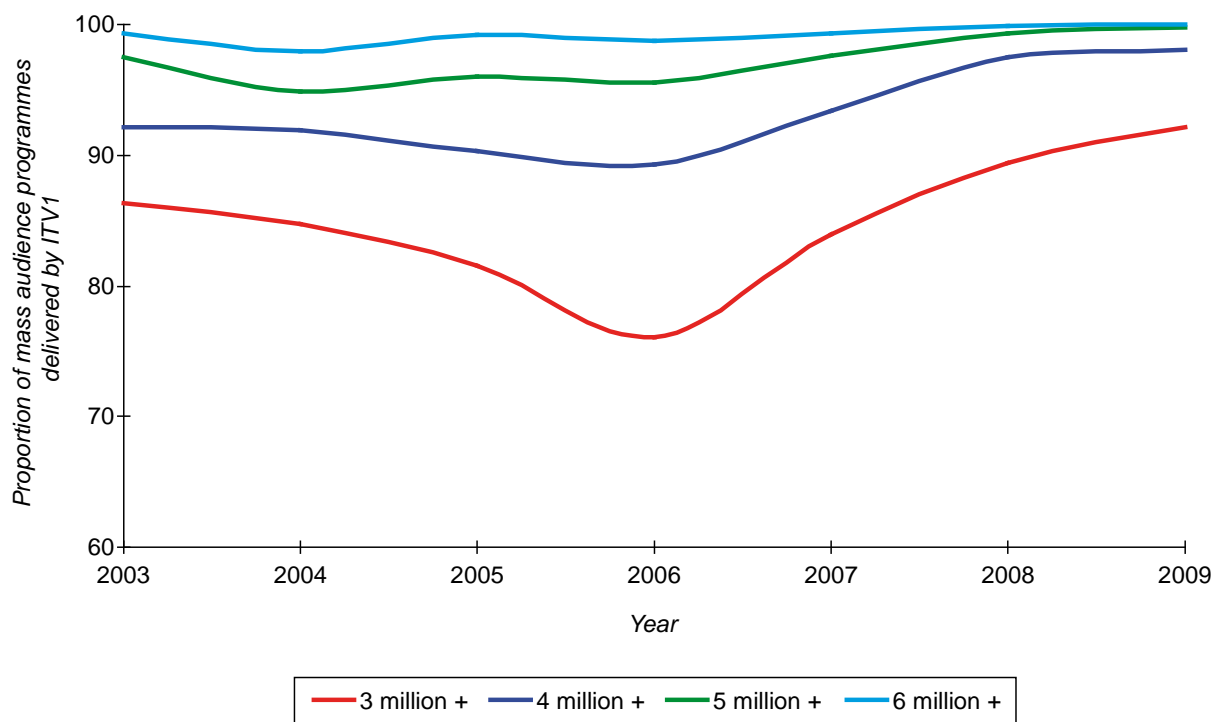


Source: Office of the Adjudicator based on BARB/DSS data.

<sup>116</sup>2003 report, paragraph 5.135.

FIGURE 7

**ITV1's share of large audience programmes on commercial channels, 2003 to 2009**



Source: Office of the Adjudicator based on BARB/DSS data.

5.53 Figure 6 shows that the overall number of programmes delivering audiences in excess of 3, 4, 5 or 6 million on commercial channels declined by around 30 to 40 per cent between 2003 and 2009.<sup>117</sup> Figure 7 shows that during this period ITV1's share of programmes delivering audiences in excess of 4, 5 or 6 million on commercial channels remained above 90 per cent, while its share of programmes delivering audiences in excess of 3 million fell to less than 80 per cent in 2006 but rose again to above 90 per cent in 2009. In addition, in 2009, ITV1 accounted for 982 of the top 1,000 most watched programmes on commercial television for all adults, compared with 995 in 2003 and 933 in 2002.<sup>118</sup>

- *ITV's views*

5.54 ITV submitted that these figures on ITV1's large audience programmes were misleading. ITV said that:

(a) The absolute size of ITV1's audience was not a relevant test in assessing substitutability and, even if it was, ITV1's ability to deliver large audiences had, in fact, declined since 2003:

(i) In 2003, ITV1's average peak audience was 7.16 million viewers and its average viewing figure for its programmes in the top 1,000 most-watched programmes (ie 995 programmes) was 9.6 million viewers (with its lowest-

<sup>117</sup>OFT's advice, paragraph 5.19. Figures updated with 2009 data.

<sup>118</sup>Source: Ofcom.

rated top 1,000 programme delivering 6.3 million viewers and its highest-rated programme generating 19.4 million viewers).

- (ii) In 2009, ITV1's average peak audience was 5.45 million viewers and its average viewing figure for its programmes in the top 1,000 most-watched programmes (ie 982 programmes) was 6.9 million viewers (a range of 4.3 million to 18.3 million viewers).

(b) ITV said that the relevant consideration was ITV1's relative ability to deliver advertisers' campaign objectives. This was a function of the relative size of ITV1's audiences versus audiences on *all other* commercial channels, rather than ITV1's absolute audience delivery for individual programmes. ITV submitted that in 2003, ITV1's average peak time audience was 1.08 times that of all other commercial channels combined (7.16 million on ITV1 versus 6.60 million viewers on all other commercial channels); by 2009, this multiple was 0.60 (5.45 million on ITV1 versus 9.01 million viewers on all other commercial channels). Table 3 shows these figures as well as those for Channel 4, Five and the top 20 commercial channels excluding ITV1. ITV said that these figures demonstrated that all other broadcasters combined were now capable of delivering higher numbers of impacts in peak time than ITV1. ITV added that the trend in these figures would continue over the next five years.

TABLE 3 Average numbers of viewers during peak time (19.30–22.30), 2003 to 2009

	<i>million viewers</i>		
	2003	2008	2009
ITV1	7.16	5.44	5.45
Channel 4 (including S4C)	1.98	1.83	1.69
Five	1.31	1.15	1.15
All commercial channels excluding ITV1	6.60	8.66	9.01
Top 20 commercial channels excluding ITV1	5.30	6.49	6.91

Source: ITV.

Note: Audiences for +1 channels included with parent channels. 'All other commercial channels' and 'top 20 commercial channels' exclude ITV1 but include ITV's digital channels.

- *Our assessment*

5.55 We noted that the argument relating to the decline in ITV1's ability to deliver large audiences was also raised in 2003.<sup>119</sup> We found that the increase in digital television had led to a fragmentation of audiences across channels, such that audience sizes of the most popular individual programmes on commercial television had declined significantly in the period between 2003 and 2009. This implied that a 'large audience' programme in 2009 would provide a smaller audience than a 'large audience' programme in 2003. However, during this time audience sizes for the most popular individual programmes had declined across all commercial channels, such that ITV1 had retained its relative advantage in delivering large audiences. In particular, ITV1 had largely maintained its high share of the top 1,000 programmes and its share of programmes with audiences of over 3, 4, 5 or 6 million (see paragraphs 5.52 and 5.53).

5.56 We noted ITV's comparison of the relative average peak-time audience of ITV1 and all other commercial channels in 2003 and 2009 (see paragraph 5.54 and Table 3).

<sup>119</sup>2003 report, paragraph 5.102.

We thought it relevant, however, to look at comparisons between ITV1 and individual channels which are its closest competitors in terms of audience size. These closest competitors are likely to provide the most significant competitive constraints given that media buyers said that rapid access to large audiences was important (see paragraphs 5.59 and 5.60). We note that, although ITV1's average peak-time audience had declined from 3.62 times that of Channel 4 and 5.45 times that of Five in 2003 to 3.22 times that of Channel 4 and 4.74 times that of Five in 2009 (see Table 3), ITV1's average peak-time audience in 2009 was still significantly larger than any individual competing channel. The comparison provided by ITV, and the comparison relative to the top 20 commercial channels excluding ITV1, illustrated that, in order to match the size of ITV1's large audiences, a media buyer would still need to advertise on several other commercial channels in 2009, albeit fewer than in 2003.

- 5.57 For the reasons discussed in paragraphs 6.55 and 6.56, we found that ITV1's unique ability to deliver large audiences had not been significantly eroded since 2003.

*Changes in the relevance of ITV1's ability to reach large audiences*

- *ITV's views*

- 5.58 ITV submitted that any advantage in 'mass audience' programming was irrelevant in determining the substitutability of ITV1 because:

(a) Media buyers attach value to ITV1's 'mass audience airtime' because it is 'desirable'; this does not mean it is 'necessary' to achieve advertisers' objectives:

- (i) ITV submitted that its coverage analyses showed that advertisers could achieve their campaign objectives for fast coverage at high levels without using ITV1 (in terms of both the week-on-week speed of build and campaigns of short durations with high TVR requirements).<sup>120</sup> The media auditor's manual coverage analysis in April 2008 for a 400 TVR campaign over four weeks targeted at the 'ABC1 Adult' demographic found that omitting ITV1 would only require an additional 296 spots for a total of 3,008 spots (an increase of 10 per cent). ITV added that there were relatively few campaigns<sup>121</sup> which required coverage to be built over a short period of time.<sup>122</sup>
- (ii) ITV told us that sales houses did not sell spots in programmes; they sold impacts, subject to broad quality parameters from the media buyers and optimization by the sales house. ITV noted that, although its optimization process often aligned with media buyers' requests, advertisers had no contractual entitlement to access specific programmes other than through a limited amount of airtime currently contracted as specials (in 2008, specials accounted for [x%] to [x%] per cent of ITV1's revenue); this was at odds with any claim by the media buyers that access to specific large audience programmes was necessary.

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<sup>120</sup>The results of these coverage analyses are summarized in Appendix D.

<sup>121</sup>ITV defined a 'short term, fast build campaign' as one run for one week or less at levels of TVRs higher than the average (60 TVRs). ITV found that a significant proportion [x%] per cent of such campaigns were run at between 60 and 100 TVRs and the vast majority [x%] per cent were run at less than 150 TVRs. ITV noted that campaigns running at more than 150 TVRs in a week accounted for only a small proportion [x%] per cent of campaigns and [x%] per cent of ITV1's total advertising revenue.

<sup>122</sup> ITV also provided coverage analyses for fast-build campaigns by comparing coverage and frequency with and without Channel 4. We have placed little weight on these analyses in our assessment of the change in the enhanced market position of ITV1 for the same reason as set out in paragraph 5.48.

(b) ITV1's ability to deliver large audiences does not necessarily assist it in delivering coverage: advertisements in several medium-sized programmes have a much higher probability of delivering increased 1+ coverage than advertisements in two programmes with large audiences on ITV1 because programmes with large audiences (such as *Coronation Street*, *Emmerdale* and *The X Factor*) tend to deliver the same viewers again and again. ITV told us that in 2008 41 per cent of ITV1's impacts were delivered from just eight programmes, with 22 per cent of impacts coming from *Emmerdale* and *Coronation Street* alone.<sup>123</sup>

- *Third parties' views*

5.59 Media buyers said that ITV1's unique ability to provide large audiences remained important in enabling them to achieve coverage and that this was especially important for fast-build and time-critical campaigns (for example, campaigns promoting fast-moving consumer goods and newspapers, retailers with particular promotions, product launches and rebranding). Other third parties said that almost all advertisers required ITV1 for fast build at some stage, and particularly at the initial stages of a longer campaign.<sup>124</sup>

5.60 Third parties said that a larger number of spots were required to obtain the same coverage without ITV1. In contrast to the media auditor's analysis for ITV (see paragraph 5.58), [redacted] suggested that a campaign that originally ran over 1,202 spots to reach 255 TVRs in the 'ABC1 Adults' demographic would require almost 2,000 more spots to replace ITV1.<sup>125</sup>

- *Our assessment*

5.61 We found that ITV1's ability to reach large audiences was still important to media buyers. In our view, media buyers' actual behaviour in relation to advertising on ITV1 is more informative than coverage analyses which predict how they could behave.

5.62 We found that media buyers continued to value ITV1's ability to deliver large audiences, particularly for fast-build and time-critical campaigns. We noted that, despite ITV's views in paragraph 5.58(a), media buyers' claims were supported to some extent by ITV's own coverage analyses which showed that, in some demographics, campaign objectives requiring large numbers of impacts to be delivered over a short period of time could be met more effectively with ITV1 than without ITV1. In particular, this related to those campaigns targeted at 'Housewives' or 'Adults' and with a campaign objective focused on maximizing 1+ coverage (see Appendix D).

5.63 We considered why ITV1's large audiences are seen as so important by media buyers despite the results of ITV's coverage analysis. We found that, because ITV1 is able to offer programmes with higher coverage than any other commercial channel, the existence of ITV1's large audience programmes in a campaign schedule is likely to deliver a campaign's coverage objectives more quickly than on other commercial channels. In addition, ITV1's large audiences allow a media buyer to meet its campaign objectives with fewer spots on fewer channels and without dealing with as many sales houses on each campaign (see paragraphs 5.56 and 5.60).

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<sup>123</sup>These eight programmes were *Coronation Street*, *Emmerdale*, *This Morning*, *The Bill*, *Midsomer Murders*, *Loose Women*, *Jeremy Kyle* and *Goldenballs*.

<sup>124</sup>OFT's advice, paragraph 5.110 and 5.53.

<sup>125</sup>OFT's advice, paragraph 5.67.

- 5.64 We noted that the argument relating to the overlap of audiences in ITV1's large audience programmes was also raised in 2003 (see paragraph 5.58(b)).<sup>126</sup> We disagreed that audience overlap would undermine ITV1's advantage in delivering large audiences. Based on the figures in paragraph 5.58(b), we noted that nearly 60 per cent of ITV1's impacts are delivered by programmes other than the eight mentioned by ITV (those not mentioned included *The X Factor* and *Ant & Dec's Saturday Night Takeaway*, although ITV said that these programmes would also have a high degree of overlap with the other eight programmes). Further, evidence from media buyers suggested that any problem regarding audience overlap is, at least to some extent, addressed in the discussion that takes place between a media buyer and a sales house once the initial schedules have been released. A media buyer would generally not want to have its advertisement shown repeatedly in the same programme. In each campaign schedule, a media buyer may, however, want spots in particular large audience programmes in order to help deliver the campaign's objectives.
- 5.65 Even though access to large audience programmes is not guaranteed in contracts, we found that such programmes remain important to media buyers. As in 2003, media buyers continue to have a number of contractual requirements relating to access to certain programmes and they also continue to purchase 'specials'. We would expect media buyers to ensure that such contractual terms are met. The contracts of media buyers with ITV1 and the views expressed by media buyers during this review suggest that the importance of these contractual aspects has not changed significantly since 2003 (see paragraph 8.34).

#### *ITV1's other unique features and barriers to switching*

- 5.66 In this section we examine three factors identified in the 2003 report:
- (a) the likelihood of advertisers obtaining a lower sales uplift without ITV1;
  - (b) the difficulty in purchasing sufficient spots to achieve the required coverage; and
  - (c) other features of ITV1.
- 5.67 We consider whether these factors are still sufficiently important today to mean that there remain barriers to switching or unique features of ITV1.

#### *The likelihood of advertisers obtaining a lower sales uplift without ITV1*

- 5.68 In 2003, the CC found that advertisers might generate a higher sales uplift when using ITV1 instead of other channels. The 2003 report noted that media buyers had drawn attention to:
- (a) ITV1 having the bulk of programmes with the highest audiences on commercial television;
  - (b) ITV1 being particularly suited to event-driven advertising (for example, due to viewers responding more strongly to advertisements screened during high-profile programmes, advertisements on ITV1 conferring status in the minds of viewers,

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<sup>126</sup>2003 report, paragraph 5.102. The CC was told that *Coronation Street* and *Emmerdale* accounted for half of the top 1,000 shows.

and advertising on ITV1 enhancing a product's appeal to multiple retailers).<sup>127</sup> Media buyers had said that qualitative differences meant that coverage was not the only measure of a campaign's success and that other measures meant that ITV1 was more valuable than other channels.<sup>128</sup>

5.69 We have considered in paragraphs 5.49 to 5.65 whether the size of audiences ITV1 delivers has become less important since 2003. In this section, we consider whether there has been any change in the 'quality' of impacts on ITV1 such that they may no longer generate a better response than other commercial channels' impacts in terms of advertisers' sales. We examined a range of evidence from ITV and third parties in relation to this issue (see Appendix E for further details).

- *ITV's views*

5.70 Through its sales and marketing communications to media buyers since 2003, ITV has continued to suggest that ITV1 viewers engage in ways such that other channels may be an imperfect substitute for ITV1 even if they replicate its coverage. In its submissions to this review, however, ITV stated that the research underlying these arguments was not robust and that its marketing material used the results arising from this research that were most helpful to its sales arguments. ITV told us that there was no qualitative difference in how engaged or immersed viewers were with ITV1 programming or advertising relative to programming and advertising on other channels.

5.71 ITV submitted that the evidence from third parties (see paragraph 5.72 and Appendix E) was not sufficiently robust to support the proposition that ITV1's airtime was of a higher quality than airtime delivered on other commercial channels.

- *Third parties' views*

5.72 Media buyers argued that ITV1's impacts continued to generate above-average responses as a result of greater levels of consumer engagement:

(a) Some media agencies said that they could measure the degree to which consumers 'engaged' with particular programmes and from this could infer the extent to which advertising messages transmitted within those programmes would be absorbed, recalled and acted upon.

(b) Some advertisers said that they were able to measure additional sales generated as a result of an advertising campaign though they did not attempt to examine why or how these effects were achieved.

(c) Media buyers also noted a number of subjective reasons for using ITV1:

- (i) many advertisers still had an 'emotional' attachment to ITV1 (and Channel 4);
- (ii) being seen on ITV1 conferred status on the advertisement;
- (iii) large multiple retailers demanded that their suppliers advertised on ITV1 in order to drive 'footfall';

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<sup>127</sup>2003 report, paragraphs 2.121 and 5.137. The CC also noted the TV Works research conducted by TNS (see 2003 report, paragraph 5.138).

<sup>128</sup>2003 report, paragraph 5.120.

- (iv) the affinity between the advertisers' customer base and ITV1's audience meant that targeting was more effective on ITV1;
- (v) different programming environments made the different channels more or less suitable for certain advertisers. For example, [§§] noted that ITV1 had a 'safer' environment, whereas Channel 4, Sky and Virgin Media Television were more 'edgy' with more adult content than ITV1; and
- (vi) advertisers had been historically 'educated by media agencies on how best to run television advertising campaigns, in particular, in respect to the importance of ITV1 (and Channel 4) in their channel mix'.<sup>129</sup>

- *Our assessment*

5.73 We considered the relative 'quality' of impacts on ITV1 compared with other commercial channels and their possible impact on achieving campaign objectives. We noted that the relative 'quality' of impacts on ITV1 compared with other channels is different from the general importance of 'quality' terms and conditions across all broadcasters (such as position in break, access to centre breaks, etc), which we discuss in paragraphs 5.134 to 5.137. No third party was able to demonstrate unambiguously that a greater engagement with advertisements on particular programmes on ITV1 than on other commercial channels leads to a greater propensity to purchase products or services (see Appendix E). However, we found that there continues to be a widespread belief among media buyers that there is a qualitative difference between impacts on ITV1 and those on other commercial channels (see paragraph 5.72). In large part, this seems to be derived from ITV1's unique ability to deliver large audiences (see paragraphs 5.49 to 5.65). The increase in the premium on ITV1 (see paragraph 5.28) also suggests that the value attached to impacts on ITV1 may have increased since 2003.

*Difficulty in purchasing sufficient spots to achieve the required coverage*

5.74 In the 2003 report, the CC found that a barrier to switching (and a factor undermining coverage analysis) was created by the difficulty of purchasing sufficient spots on other commercial channels in order to achieve an advertiser's required coverage.<sup>130</sup> This finding was based on evidence from media buyers that:

- (a) Channel 4 restricted the volume of advertising airtime available to both individual campaigns and individual advertisers running multiple campaigns, and it was highly unusual for any campaign to achieve more than 50 TVRs in a week on Channel 4. Other commercial channels also had a limited number of spots available for each demographic, particularly broad demographics (for example, Channel 4 and BSkyB did not sell broad demographics such as 'Adults' or 'Housewives'), and this determined how TVRs were purchased.
- (b) There were restrictions on the number of centre breaks, positions in breaks, and the number of similar advertisements in the same break (for example, avoiding two car advertisements in the same break). These limited substantial switching from ITV1 to other commercial channels.

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<sup>129</sup>OFT's advice, paragraphs 5.100 and 5.101.

<sup>130</sup>2003 report, paragraph 2.128.

The CC found that these limits had the effect of (i) increasing repeat viewings of advertisements (wastage) and (ii) increasing the price of impacts on other commercial channels.<sup>131</sup>

5.75 In this section, we first consider whether these factors, which created the CC's concerns regarding capacity constraints in 2003, have changed since 2003. We then consider the effects of any such capacity constraints.<sup>132</sup>

- *Inventory constraints imposed by other commercial channels*

5.76 ITV submitted that 'while Channel 4 states it will not accept more than 50 Adult TVRs on the channel in a single week, in practice Channel 4 frequently breaches this policy'. ITV also said that such sales policies were taken into account in the manual coverage analysis it had submitted and that its software-based coverage analyses did not require it to breach 50 TVRs in a single week on Channel 4.

5.77 Channel 4 told us that it did not have an official sales policy that set a cap on a single campaign not delivering more than 50 TVRs in a week but in general TVR commitments were constrained by availability and efficiency of airtime. In addition, practical constraints raised in response to this review by broadcasters other than Channel 4 related to their ability to deliver large audiences and achieve similar coverage and frequency to that which could be achieved with ITV1; they did not relate to sales policies.<sup>133</sup>

5.78 We found that evidence on other broadcasters' sales policies suggests that they are no longer a practical constraint on switching.

- *In-break clashes and other constraints*

5.79 ITV told us that broadcasters could optimize to avoid in-break clashes and that there were enough available breaks to avoid such clashes.<sup>134</sup> ITV submitted that there were no constraints at a particular time of year because broadcasters sold TVRs not spots and price adjusted to manage additional demand.

5.80 Media buyers said that problems still existed due to clashes with other competing brands, advertisers' own restrictions on which channels they would allow their advertisement to be shown, and regulatory restrictions (eg on foods high in salt and sugar). Third parties also noted that there were practical difficulties in finding and obtaining the necessary replacement spots (especially for campaigns running with high weekly levels of TVRs and/or on particular days or during certain periods, such as Christmas).<sup>135</sup>

5.81 We found that, as in 2003, broadcasters try to ensure that products of the same type are not advertised in the same break. Although we recognize ITV's point that optimization can help to mitigate this issue, the issue of in-break clashes and the methods broadcasters use to overcome such clashes has not changed since 2003. Whilst there may be a large number of advertisement breaks on other commercial

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<sup>131</sup> 2003 report, paragraphs 2.122, 5.120, 5.122, 5.123 and 5.132.

<sup>132</sup> We consider wastage in paragraph 5.92.

<sup>133</sup> We have already discussed the issue of large audiences and ability to meet coverage objectives without ITV1 in paragraphs 5.49 to 5.65.

<sup>134</sup> ITV submitted that, even if Channel 4 had, for example, twice the number of car advertisements it usually had on average, there would be 12 possible breaks for each advertisement to be broadcast just in peak time—before any optimization took place.

<sup>135</sup> OFT's advice, paragraphs 5.70 and 5.75.

channels, replicating ITV1's coverage requires more spots on other channels due to the smaller audiences those other channels can deliver (see paragraphs 5.49 to 5.57). We found that only a relatively small number of programmes can compete with the size of audience that ITV1 delivers and in-break clashes are therefore more likely to be a concern for media buyers on other commercial channels.

- *Effects of capacity constraints*

- 5.82 ITV said that, if demand increased either across the market as a whole, or for a particular channel, this would lead to a corresponding increase in the price per impact, ie media buyers would receive fewer impacts for the same amount of revenue committed. ITV argued that the key constraint on switching was therefore the change in relative prices that would occur post-switching.
- 5.83 ITV submitted analysis that showed that due to the annual growth of impacts in the market, £182 million could move away from ITV1 in 2008 without causing any year-on-year increase in the price of impacts for other broadcasters.<sup>136</sup> ITV also examined switching in the event that prices were affected by switching. It pointed to its coverage analysis after £30 million and £205 million of switching as evidence for this. ITV asked a media auditor to assess the likely changes in SAP after £30 million and £205 million of switching. In the £205 million scenario, it found that SAP would fall by 15 per cent on ITV1, and rise by between 12 and 16 per cent on Channel 4 and 7 to 11 per cent on Five, depending on the demographic.
- 5.84 ITV argued that most media buyers would not simply be increasing their existing SOB commitments when switching expenditure to other commercial channels; they would also expect to receive better terms and conditions on those other commercial channels as a result of any increased SOB commitment.
- 5.85 Media buyers produced broadly similar estimates to ITV of the effect on price of moving expenditure to other channels. [X] suggested that moving £300 million out of ITV1 would cause prices on other main channels to inflate by around 15 per cent; and [X] said that if £205 million were distributed across the other channels according to their shares of NAR, it would result in an 11 per cent increase in prices.
- 5.86 We found that ITV's assessment of the amount of switching that could take place given year-on-year growth in impacts did not capture how prices would actually change following switching. In particular, we noted two effects on the price of airtime on ITV1 and other commercial channels following switching from ITV1:
- (a) First, an increase in revenue on other commercial channels would lead to an increase in the price of airtime on those other commercial channels due to the SAP mechanism. By the same mechanism, the reduction in revenue on ITV1 would lead to a decrease in price of ITV1 airtime. This outcome would also be affected by any annual growth in impacts in the market overall and across different channels. Any fall in the price of ITV1 airtime might lead some media buyers to switch to ITV1.
- (b) Second, as described by ITV in paragraph 5.84, a media buyer would be able to negotiate better terms and conditions, and in particular a higher discount, on other commercial channels if it were to increase its SOB commitments to those

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<sup>136</sup>This analysis assumes that expenditure is redistributed consistent with any different rates of growth of impacts across each channel.

channels. Conversely, reductions in a media buyer's SOB commitment to ITV1 might lead to worse terms on ITV1.

5.87 The net effect of these two factors is dynamic and uncertain; it depends upon the sensitivity of media buyers to changes in price of airtime on ITV1 and other commercial channels and the extent to which media buyers are able to negotiate better terms and conditions. We discuss the ability of media buyers to switch SOB commitment in paragraphs 5.108 to 5.155.

- *Our conclusion on capacity issues*

5.88 Taking all the capacity issues in paragraphs 5.74 to 5.87 into account, we found that, on balance, media buyers are unlikely to be prevented from switching individual campaigns to other commercial channels due to capacity constraints alone. However, there are important price effects following any switching which are uncertain and will be the outcome of a combination of changes in the SAP of airtime and negotiated changes to discounts.

#### *Other features of ITV1*

5.89 In the 2003 report, third parties suggested that other unique features of ITV1 might prevent effective substitution of ITV1. In particular, these third parties stated that reaching a large proportion of 'light viewers' (those viewers who do not watch television often) in a short time period without ITV1 may be difficult; they also stated that the lower number of spots needed to achieve required coverage on ITV1 ensured that viewers did not see advertisements too many times and become irritated ('wastage').<sup>137,138</sup>

5.90 In this section, we consider whether these two unique features have changed since 2003. We also consider other unique features raised during the review.

- *Light viewers*

5.91 ITV1's share of all light viewers declined from 19 per cent in 2003 to 13 per cent in 2009.<sup>139</sup> Media buyers no longer seemed to attach weight to ITV1's advantage in reaching light viewers. For example, two media agencies, [X] and [X], said that the focus on light viewers might be outdated, given that it was unclear to what extent this category of viewers was responsive to television advertising.<sup>140</sup>

- *Wastage*

5.92 Some third parties argued that, if ITV1 were to be omitted from a campaign, there would be 'wasted' impacts, where frequency was higher than that targeted in a campaign's objectives. Most coverage analyses submitted by ITV and third parties showed that excluding ITV1 from campaigns resulted in higher levels of frequency (see Appendix D).<sup>141</sup> ITV said that higher levels of frequency could not necessarily be considered to be 'wastage'. In our view, these additional impacts are only 'wasted'

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<sup>137</sup>2003 report, paragraphs 1.9 and 5.137.

<sup>138</sup>Light viewers are those individuals whose weekly viewing hours fall into the lowest percentile of all viewing and are the most difficult to reach via a television advertising campaign.

<sup>139</sup>OFT's advice, paragraph 5.88. The figures provided are on the basis of the third of the total television audience that watch the least amount of television.

<sup>140</sup>OFT's advice, paragraph 5.90.

<sup>141</sup>OFT's advice, paragraph 5.62.

impacts for a media buyer if the value the media buyer places on the extra impacts is outweighed by the cost of buying airtime. This will depend on each campaign's specific objectives.

- *Other features raised during the review*

5.93 Other unique features of ITV1 were also raised during the course of this review:

(a) *Spillover effects.* Some media buyers suggested that 'spillover' effects, which arise when an advertisement bought under a particular demographic is viewed by a wider audience (particularly if shown in a large audience programme), were a significant consideration for media buyers when planning campaigns.<sup>142</sup>

(b) *Regional advertising benefits.* Some third parties suggested that ITV1 offered a unique benefit of regional advertising and allowed advertisers to use regional advertising for test campaigns.<sup>143</sup>

5.94 No evidence was provided to suggest that such effects are either merger specific or have become more important since 2003. In addition, neither spillover effects nor the loss of regional advertising benefits were considered to be significant issues in the CC's conclusions in the 2003 report.

- *Our assessment of other features of ITV1*

5.95 Based on paragraphs 5.91 to 5.94, compared with the 2003 report we no longer attach significant weight to the following as unique features of ITV1: light viewers, limited wastage, spillover effects and regional advertising benefits.

#### *Evidence of switching by individual advertisers since 2003*

5.96 We looked at whether there were examples of advertisers that had switched campaigns away from ITV1 since 2003, suggesting greater substitutability of ITV1. Ofcom, in its submission, said that 'examples of switching have been observed and we have no reason to believe that these examples could not be replicated more widely'.<sup>144</sup>

5.97 ITV presented some evidence to suggest that some advertisers had successfully switched all expenditure away from ITV1 since 2003.<sup>145,146</sup> The two most significant examples submitted by ITV—[§] and [§]—had reduced advertising expenditure on ITV1 for certain campaigns in the past but both continued to advertise on ITV1.<sup>147</sup>

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<sup>142</sup>OFT's advice, paragraph 5.57.

<sup>143</sup>OFT's advice, paragraphs 5.104–5.106.

<sup>144</sup>Ofcom's submission, paragraph 1.15.

<sup>145</sup>ITV identified the following as companies which had switched all spend away from ITV1 to other channels since 2003: [§]. ITV said that for [§] the cost of advertising on ITV1 was a reason for switching. Other reasons given are related to the ability to target a particular audience. ITV also provided figures on the reduction in spend with ITV1 by the [§] sectors as evidence that ITV1 is no longer necessary to the particular issue of achieving quick coverage. The fact that [§] had not used ITV1 in its most recent campaign was said to be evidence that advertising on ITV1 is not essential for new product launches.

<sup>146</sup>ITV noted that it was able to provide data only on advertisers that had entirely ceased to advertise on ITV1 and did not have data on marginal switching on an individual advertiser basis. However, it said that, in aggregate, switching had occurred (see paragraph 5.114).

<sup>147</sup>[§] told the OFT that it had not switched away from ITV1, but that its focus in 2007 on promoting its [§] product, aimed at young men, meant that for this period more of its expenditure was with other channels that were more effective in reaching this target audience. [§] told the OFT that it continued to advertise with ITV1—particularly during event programming—and that ITV1 remained essential to achieving the reach it wanted.

- 5.98 ITV argued that the extent of historic switching was not relevant to considering whether the CRR Undertakings should be varied or terminated. It said that the relevant issue was switching behaviour in the event that ITV were to demand that media buyers pay more for ITV airtime than they would have had to pay absent the merger (ie rates higher than those achievable under CRR). ITV also said that it would not be possible to link historic switching to changes in prices for advertising on ITV1 holding all other prices constant, given annual changes in media buyers' SOB commitments on other commercial channels and fundamental changes in the supply of impacts over the period that CRR had been in place.

*Our assessment*

- 5.99 ITV identified only a few examples of switching by individual advertisers (see paragraph 5.97). We agree with ITV that the level of switching observed since 2003 is affected by the existence of the CRR Undertakings. In particular, CRR allows media buyers to withdraw expenditure from ITV1 in proportion to the reduction in SOCI, should they wish to do so. However, if there had been a significant amount of switching since 2003, this would support ITV's contention that ITV1 was more substitutable than in 2003 and its enhanced market position had been eroded. We consider the potential for media agencies to switch SOB commitment absent CRR in paragraphs 5.108 to 5.155.

*Conclusion on the ability of individual advertising campaigns to be switched from ITV1*

- 5.100 Although ITV placed considerable weight on its coverage analyses, we found that such analyses cannot be used as a complete assessment of the substitutability of ITV1 or the change in its enhanced market position since 2003. In particular, such analyses examine only what media buyers could do in the event of a price increase on ITV1 and not what they would do in practice.
- 5.101 We found that ITV's coverage analyses suggested that equivalent levels of coverage and frequency are more likely to be delivered without ITV1 in 2009 than in 2003. However, we noted that a number of the snapshot approaches provided by third parties illustrated that different assumptions underpinning coverage analyses can lead to quite different results. In particular, some of these analyses and ITV's analysis for the 'Housewives' demographic illustrated that there are some campaigns for which media buyers could not achieve the same level of 1+ coverage without ITV1.
- 5.102 When we examined what had happened in practice, we found little evidence of advertisers switching expenditure away from ITV1. We found that the results of the coverage analyses were undermined by ITV1's continuing unique ability to deliver impacts in a way that advertisers demand. This unique ability is primarily based on ITV1's ability to reach large audiences relative to other commercial channels. We found that, although audience sizes of the most popular programmes have declined since 2003, ITV1 had largely retained its relative advantage in delivering large audiences. In our view, this advantage continues to be relevant because it allows media buyers to meet their coverage objectives for certain campaigns (notably those fast-build and time-critical campaigns) that cannot be met by using other commercial channels; it allows a campaign's coverage objectives to be delivered more quickly than on other commercial channels; and it allows a media buyer to meet campaign objectives with fewer spots on fewer channels and without negotiating with as many sales houses on each campaign.

- 5.103 We also found that media buyers continue to believe that there is a qualitative difference between impacts on ITV1 and those on other commercial channels. In large part, this seems to be derived from ITV1's unique ability to deliver large audiences, but many media buyers cited other 'qualitative' factors. The increase in the premium on ITV1 also suggests that the value attached to impacts on ITV1 may have increased since 2003.
- 5.104 Third parties still had some concerns regarding capacity constraints on other commercial channels, particularly in relation to obtaining impacts during suitable peak time programmes. Although we found that such constraints were unlikely on their own to prevent switching, we noted that the price effect following switching is uncertain. We return to this issue when we consider the ability of media agencies to switch SOB commitment in paragraphs 5.108 to 5.155.
- 5.105 Some barriers to switching or unique features of ITV1 identified in the 2003 report have changed since 2003. In particular, compared with the 2003 report, we no longer attach significant weight to the following as unique features of ITV1: light viewers, limited wastage, spillover effects and regional advertising benefits.

### ***Changes in the ability of media agencies to switch SOB commitment from ITV1***

- 5.106 As set out in paragraph 3.9, the 2003 report found that there were insufficient constraints on ITV1 from media buyers. In particular, the 2003 report highlighted difficulties in marginal switching and a lack of countervailing buyer power.
- 5.107 In this section we therefore consider whether these two factors have changed since 2003 such that we would expect media buyers to switch some expenditure from ITV1 in the event of a worsening of terms. We consider:
- (a) whether difficulties in switching SOB commitment have reduced since 2003. Having considered in paragraphs 5.31 to 5.105 changes to the potential for media buyers to omit ITV1 on an individual campaign basis, we consider how media agencies would try to incorporate any potential substitutability of ITV1 into their annual deal negotiations over ITV1 airtime;<sup>148</sup> and
- (b) the consolidation of media agencies since 2003.

We conclude with our assessment.

### ***Difficulties in switching SOB commitment***

- 5.108 In reaching its conclusions in 2003, the CC noted in the 2003 report that 'some advertisers and media buyers told us of their fears that this [marginal switching] could be unattractive, because the merged entity might respond with punitive reductions in discount'.<sup>149</sup> The 2003 report noted that 'all large media buyers must reach an agreement with ITV, because they are assessed by their actual and potential customers on their ability to achieve good terms from ITV in relation to the market, rather than in absolute terms'.<sup>150</sup> The CC identified three ways in which the enhanced market position of ITV1 might manifest itself post-merger: (a) insistence on worse contractual terms; (b) enhanced degree of price discrimination; and (c) changes to the airtime sales system (see paragraph 3.10).

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<sup>148</sup>Since the vast majority of ITV1's airtime is bought through agencies, we focus on media agencies in our discussion.

<sup>149</sup>2003 report, paragraph 2.128.

<sup>150</sup>2003 report, paragraph 2.129.

5.109 ITV's (and third parties') coverage analyses showed that not all campaigns can be switched away from ITV1 because some campaign objectives can only be met effectively with ITV1. In the light of these analyses, it is unlikely to be a credible threat for a media agency to move *all* expenditure out of ITV1 given that at least some campaigns may require ITV1. We consider next whether a media agency would switch some of its SOB commitment away from ITV1 in response to a price increase on ITV1. This depends on how price sensitive the media agency is to ITV1 airtime, and whether ITV would be able to worsen the media agency's terms for its SOB commitment remaining on ITV1 or whether price discrimination remains possible. We consider price discrimination separately in paragraphs 5.138 to 5.146.

#### *ITV's views*

5.110 ITV submitted that there was now sufficient expenditure within media agencies' SOB commitments that did not rely on ITV1 that media agencies would be able to switch expenditure to other commercial channels or to other media following an increase in price of ITV1 airtime.

5.111 ITV engaged a market research firm to conduct a survey of media buyers so as to understand how they would behave if ITV were to attempt to extract a 5 to 10 per cent higher expenditure commitment to ITV1 (this would be a proxy for a 5 to 10 per cent price rise) (see Appendix G for further details).

5.112 ITV used its survey of media buyers to derive the amount of 'marginal' switching (reduction in SOB commitment) that would be required in order to constrain it from being able profitably to increase its prices (the 'critical loss') and compare this figure with the amount of switching that would be expected to occur in response to the price rise (the 'actual loss'):

(a) ITV's survey found that, although 74 per cent of respondents stated that ITV1 was essential to their media mix, more than two-thirds (69 per cent) of those respondents who stated that ITV1 was essential said that they would switch some or all of their expenditure away from ITV1 in response to an attempt to extract a 5 to 10 per cent higher expenditure commitment to ITV1.

(b) Based on the survey responses, if ITV were to attempt to extract a 5 to 10 per cent higher expenditure commitment to ITV1 from its customers, £[redacted] million of expenditure switching away from ITV1 would be sufficient to offset the revenue gains to ITV from media buyers paying increased prices on ITV1 (the critical loss).<sup>151</sup>

(c) ITV used the survey results to calculate that approximately [redacted] per cent of ITV1's revenue would be lost if ITV were to demand a 5 per cent increase in expenditure on ITV1 from media buyers. This amounted to approximately £[redacted] million a year, of which £[redacted] million would be diverted to non-ITV1 television channels (the actual loss).

(d) ITV said that its survey demonstrated that the actual loss from switching of media buyers' SOB commitment would be greater than the critical loss. ITV said that even a small revenue loss would inhibit it from raising prices because, in the

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<sup>151</sup>Of this £[redacted] million, £[redacted] million would switch to other media and £[redacted] million would switch to other television channels.

short to medium term, its costs were fixed and so any reduction in revenue would not be offset by cost savings.<sup>152</sup>

- 5.113 ITV submitted that the results of its coverage analyses supported the results of its survey because they showed that, even after £30 million of expenditure had left ITV1, advertisers could continue to meet their campaign objectives.<sup>153,154</sup> ITV also used its coverage analysis to assess the demographics and campaign types where advertisers could achieve their campaign objectives without ITV1. It said that the only expenditure that it identified that could be said to rely on ITV1 was for the 'Housewives' demographic, which accounted for [3%] per cent of total advertiser expenditure on ITV1 in 2008.<sup>155</sup>
- 5.114 ITV said that, as the CRR Undertakings ensured that media buyers never had to pay more for ITV1 airtime than they would have paid absent the merger, no market data existed to assess properly whether ITV1 could successfully demand a higher expenditure commitment if the CRR remedy was removed. Nevertheless, ITV said that over the five-year period between 2004 and 2008, advertisers had moved a total of over £415 million out of ITV1, without any capacity constraints.
- 5.115 ITV also submitted that the revenue that media agencies could remove from ITV's digital channels was directly relevant to understanding the extent of leverage that media agencies could exercise in negotiations. Specifically, any increase in SOB commitment on ITV1 airtime that ITV may be able to extract from media agencies could be outweighed by the media agency 'punishing' ITV by removing some or all of its SOB commitment from ITV's digital channels.
- 5.116 In considering the extent of negotiations since CRR was introduced, ITV said that limited negotiations around SOB commitments was due to the behaviour of media agencies. ITV told us that media agencies had no incentive to enter into negotiations to amend their existing deals to reduce SOB commitments beyond that allowed under the CRR ratchet. In particular, ITV said that media agencies had adapted their business models since 2003 to take advantage of CRR and were reluctant to see CRR abolished because it would disrupt their businesses.
- 5.117 ITV told us that terms and conditions (terms other than discounts, as described by media buyers in paragraph 5.121(b)) were 'not remotely as important to ITV's customers as SOB commitments and discounts'. ITV said that under their current contracts, media buyers did not have an absolute entitlement to receive such terms and that ITV could not in any event deliver them in aggregate. Nevertheless, ITV said that these terms were contractual terms which must be met over the course of the year and ITV could not therefore deny access to such terms (for example, access to centre breaks), although they were subject to optimization. ITV added that, to the extent that any other 'levers' exist, they were not currently protected by CRR.

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<sup>152</sup>OFT's advice, paragraph 5.122.

<sup>153</sup>Specifically, the results showed that there was a reduction in 1+ coverage for Housewives and Adults when omitting ITV1, whilst 1+ and 4+ coverage for other demographics increased when omitting ITV1.

<sup>154</sup>Again, ITV submitted that coverage analysis for Channel 4, after switching of £30 million from Channel 4, was relevant to the assessment. In our view, this assessment carries little weight, for the reasons set out in paragraph 5.48.

<sup>155</sup>ITV said that advertisers were not reliant on the 'Housewives' demographic because a wider market definition was appropriate.

### *Third parties' views*

5.118 Third parties did not accept ITV's survey results. They said that the survey overlooked the complexity of negotiations and that it was not representative, in particular, in terms of the level of seniority of respondents.

5.119 The OFT, in its advice, said that:

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.<sup>156</sup>

Ofcom also said that it was not able to verify whether the individuals surveyed were those responsible for making purchasing decisions on a day-to-day basis.<sup>157</sup>

5.120 Third parties said that advertising campaigns which required ITV1 were those that particularly relied on large audience programmes for their ability to deliver fast reach and coverage. Some third parties argued that a very wide range of advertisers required ITV1 for fast build at some stage (see paragraph 5.59).

5.121 Media buyers continued to express concerns over ITV's reaction to marginal switching (reductions in SOB commitment). In particular, media buyers referred to continued concerns regarding:

- (a) Reduced discounts on the SOB remaining with ITV1 after switching. Media agencies regarded maintaining discount on ITV1 as critical in competing with other media agencies.<sup>158</sup> For example, one media agency [X] said that any change in its ITV1 discount would fundamentally affect its business.
- (b) Worsening of other contractual terms and conditions—for example, access to particular programmes or specials, centre breaks and position in break; and delays in deals being signed creating difficulties in guaranteeing advertisers access to ITV1 from 1 January, which is particularly crucial for some advertisers. Media buyers told us that these quality terms were important (see paragraph 8.34). In particular, they told us that broadcasters' performance on 'quality' terms was evaluated by media auditors alongside performance on price. In addition, other terms and conditions, such as 'value pot' arrangements and late booking arrangements, were seen as important aspects of media buyers' contracts. We were also told that ITV could use its optimization override clause, refuse to amend schedules, implement late fees that had been previously waived, and deny access to airtime in particular programmes.

5.122 Having reviewed a range of evidence, including examples of switching, Ofcom, in its submission, said that there was still uncertainty about the size of the group which could switch away from ITV1. Ofcom said that 'during the course of the review, very

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<sup>156</sup>OFT's advice, boxed paragraph after paragraph 5.125.

<sup>157</sup>Ofcom's submission, paragraphs 5.82-5.83 and A5.276.

<sup>158</sup>See, for example, [OFT's advice](#), paragraph 5.145.

little evidence was provided which would enable us to quantify precisely how much spend is represented by this group ... Evidence provided by ITV suggests that only a small amount of revenue need switch before a price increase would become unprofitable for ITV. On this basis, we consider that the evidence supports the overall view that sufficient switching could occur such that ITV would be constrained in its ability to raise prices'. Ofcom also said that 'concerns have also been raised about the ability for media buyers and advertisers to switch away any spend (even if its [sic] substitutable spend) due to barriers to switching, although evidence on these barriers to switching remains limited and anecdotal'.<sup>159</sup>

- 5.123 The OFT, in its advice, found 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'.<sup>160</sup>

#### *Our assessment*

- 5.124 We consider first ITV's survey, critical loss type analysis and assessment of 'reliant' expenditure. We then consider media buyers' claims in paragraph 5.121 by assessing whether switching some SOB commitment is plausible given the relationship between SOB commitment and contractual terms (discounts and other terms and conditions).
- 5.125 We found that ITV's survey did not adequately capture the complex nature of the negotiations that take place between ITV and media buyers (see paragraphs 5.126 to 5.137). In addition, we found that ITV's survey results were not robust and that the critical loss type analysis based on the survey was unreliable for estimating the extent to which actual switching from ITV1 would be sufficient to prevent ITV worsening terms for media buyers (see Appendix G). In particular, we found that:
- (a) The survey sample was not representative as most of the respondents to the survey were not responsible for making advertising buying decisions and the sample size was small. We therefore found that we could not rely on the results of the survey to estimate the expected extent of switching in response to a price increase across all media buyers (the 'actual loss' in the critical loss analysis).
  - (b) ITV's calculation of the 'critical loss' of £[~~8~~] million was conducted using the responses to the survey on the assumption that television advertising has high fixed costs and low marginal costs. It was not derived using financial information related to ITV1 and only took into account the critical loss in relation to the media buyers in the survey sample.<sup>161</sup>
- 5.126 We noted a number of concerns with the coverage analysis approach (see paragraphs 5.44 to 5.48). In particular, we did not find that this approach reflected how media agencies would actually react. Evidence from media buyers, although largely qualitative (see paragraph 5.119), suggested that the expenditure classified by ITV as 'reliant' expenditure on ITV1 (expenditure that was not substitutable) was important even if there were other parts of their expenditure on ITV1 which could potentially be switched. We also found that the amount of 'non-reliant' expenditure, which ITV suggested was important, would not necessarily equate to expenditure that could

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<sup>159</sup>Ofcom's submission, paragraphs 1.6 and 5.82 to 5.84.

<sup>160</sup>OFT's advice, paragraph 5.150.

<sup>161</sup>ITV told us that the results obtained covered buying points accounting for 75 per cent of ITV1's revenues.

switch from ITV1 because of the link between SOB commitments and discounts and other terms in annual negotiations. Any worsening of terms on the SOB commitment remaining on ITV1 may in turn render any attempts to switch ‘non-reliant’ expenditure unprofitable for the media buyer.

5.127 We considered ITV’s argument that media buyers might be able to use ITV’s digital channels as a negotiating tool to prevent ITV from worsening terms on ITV1. We did not find this argument to be persuasive. We found that any ability for media buyers to switch from ITV’s digital channels would be unlikely to prevent ITV from exercising an enhanced market position on ITV1. First, we saw no evidence that threats to switch from ITV’s digital channels had led to significantly better terms on ITV1. Second, as ITV1 and ITV’s digital channels have separate SOB commitments and associated discounts, we would not expect threats to switch from ITV digital channels to affect discounts for ITV1 airtime.

5.128 We agreed with ITV that expenditure moved to other channels since 2003 (see paragraph 5.114) was done within the protection of CRR so did not necessarily reflect what expenditure might move absent CRR. Although we noted that media buyers had, under CRR, been able to move expenditure to other channels, we wanted to understand whether, absent any remedial action, there would still be concerns regarding punitive responses from ITV, as described in the 2003 report. To do this, we examined cases where media buyers had tried to reduce their SOB commitment by more than the ARM allowance as this would be beyond some of the protection provided by CRR. We were interested in whether such reductions had led to difficulties in negotiating terms with ITV. We also considered the nature of disputes that had been raised since CRR was in place and considered negotiations under CRR more generally.

5.129 We found that, in general, any reduction in the SOB commitment a media agency is willing to make to a broadcaster will lead to a renegotiation regarding the discounts and other contractual terms that apply to the remaining SOB commitment (see paragraph 5.84). There are two ways in which a media buyer might find its terms changed in response to an attempt to reduce SOB commitments: (a) reduced discounts and (b) worse terms and conditions.

- *Discounts*

5.130 For any broadcaster, media buyers will tend to offer a ‘buyout’ rate if they wish to reduce their SOB commitment—ie the amount by which the media buyer is prepared to reduce its discount on its remaining expenditure in return for a lower SOB commitment.<sup>162</sup> As media agencies usually need at least some of ITV1’s airtime and need to maintain a competitive price on ITV1 in order to retain advertiser clients, any discount reductions are unattractive (see paragraphs 5.62 and 5.121). This means that, absent CRR, ITV would be in a strong negotiating position if a media agency were to try to reduce its SOB commitment.

5.131 We found that there had been limited negotiation by media buyers beyond the reduction in SOB commitments allowed by the CRR remedy. We noted ITV’s reasons in paragraph 5.115 for this lack of negotiation and discuss them in paragraphs 6.41 to 6.48. We identified two cases which went before the Adjudicator where media agencies wished to reduce their SOB commitments by more than the amount required by the ARM. These cases are summarized in Appendix H. In each case,

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<sup>162</sup>Similarly there are ‘buy-in’ rates when media buyers wish to increase their SOB commitment and ITV is expected to give them higher discounts in return.

ITV's and the media agency's notions of what constituted a fair and reasonable 'buyout' price were very different. In one case, the Adjudicator was unable to rule for procedural reasons; in the other, the Adjudicator considered that the buyout terms offered by ITV were not fair and reasonable.

5.132 In the latter case, ITV required a significant reduction in discount in response to the proposed reduction in SOB commitment that would have led to an increase in the effective price of the advertising that remained with ITV1. As a result, this would release a relatively small amount of money that could be spent with other channels and the media agency would be likely to have been significantly disadvantaged by switching.

5.133 For the reasons set out in paragraphs 5.130 to 5.132, we found that, absent CRR, reductions in SOB commitment on ITV1 would be likely to lead to a reduction in discount which would act as a deterrent to switching for media agencies because they need to maintain discounts on ITV1 in order to compete for advertising clients.

- *Other contractual terms*

5.134 We noted that media buyers believed there to be a wide range of levers that ITV could use in relation to contractual terms on ITV1 other than discounts. Absent appropriate remedies, media buyers were concerned that these contractual terms might be worsened during annual negotiations.

5.135 The worsening of contractual terms might include less access to peak times, fewer centre breaks, worse positions in breaks and reduced programme access. It might also include worse terms in relation to late booking flexibility. At present, many of these aspects are protected by CRR. It is apparent from media agencies' contracts, which specify such terms in great detail, and the evidence from media agencies (see paragraph 8.34) that these terms form an important part of negotiations and are an important factor in media auditors' assessment models. Although media buyers do not have an absolute entitlement to such terms, they will want to ensure that as much as possible of their contractual terms are delivered.

5.136 In addition, we were told that ITV had considerable bargaining leverage over a media buyer during campaign schedule discussions (for example, by refusing to amend schedules, implementing late fees that had been previously waived, and demanding premiums where they had not previously existed). These aspects may be particularly important at certain times of the year if, for example, any clients are trying to promote their products for the Christmas period. As noted in Appendix H, disputes have occurred in the past over ITV's policy on day-to-day trading for ITV1 airtime, particularly the price offered for 'burst' campaigns (two disputes) and late booking penalties (three disputes).

5.137 Based on paragraphs 5.134 to 5.136, we found that, absent CRR, reductions in SOB commitment on ITV1 would be likely to lead to a worsening of terms and conditions, many of which are seen as important to media buyers. We found that this would act as a deterrent to switching.

*Price discrimination*

5.138 Our assessment in paragraphs 5.124 to 5.137 is on the basis that ITV would worsen terms to *all* media buyers. If ITV were able to enhance the degree of price discrimination between media buyers, price rises would be targeted at those customers that

were relatively price insensitive and the critical loss analysis would become less relevant.

5.139 In 2003, the CC was concerned that, post-merger, ITV might enhance the degree of price discrimination in relation to airtime on ITV1. The CC identified that the deals between media agencies and ITV were ‘highly complex, substantially different from one another, and not easily comparable’.<sup>163</sup> With regard to pre-existing price discrimination, it said ‘we are unsure whether ... this indicates the existence of systemic price discrimination’.<sup>164</sup> However, it also stated: ‘there is at least some ability to discriminate between media buyers, based on their negotiating skills’.<sup>165</sup>

- *ITV's views*

5.140 ITV argued that, ‘to the extent that Carlton or Granada had the ability to price discriminate pre-merger, this was outside the scope of a merger consideration’. Based on its interpretation of the 2003 report, ITV submitted that the ability for ITV to enhance the degree of price discrimination in relation to ITV1 airtime was significantly less of a concern than ITV’s potential ability to extract higher prices for ITV1 across all media buyers. ITV further noted that the CRR Undertakings did not include an obligation that changes to ITV1 prices were non-discriminatory.

5.141 ITV said that changes since 2003 in the way advertisers and media agencies operated had increased transparency at individual advertiser and agency levels and reduced the scope for price discrimination. As a result, ITV said that its ability to price discriminate was no greater than the ability either Carlton or Granada had pre-merger. The changes since 2003 included:

- (a) an increase in the proportion of advertisers using media auditors (up from 37 per cent of advertisers in 2003 to 41 per cent in 2009) with media agency remuneration linked to the audit process, giving greater transparency;
- (b) advertisers frequently testing the market in order to gain greater visibility of the deals available from different media agencies; and
- (c) consolidation of media agencies, generating greater transparency of advertisers’ requirements within each media agency.

5.142 ITV also told us that it would not be able to price discriminate successfully in relation to ITV1 airtime because the three conditions which were necessary for it to do so would not be met:

- (a) First, ITV said that certain advertisers must ‘need’ ITV1 for at least some part of their airtime and have an inability to substitute away from ITV1. ITV told us that, on the basis of the coverage analyses described in paragraphs 5.37 and 5.58, this condition would not be met.
- (b) Second, ITV must be able to identify those advertisers that needed ITV1, and/or their ‘reliant’ expenditure. ITV said that this condition would not be met because media buyers were easily able to mask their true requirements on a campaign by campaign basis. ITV submitted that during the deal season it had no knowledge of how a media buyer’s SOB commitment would translate into absolute

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<sup>163</sup>2003 report, paragraph 5.74.

<sup>164</sup>2003 report, paragraph 2.181.

<sup>165</sup>2003 report, paragraph 5.76.

expenditure and no visibility of what demographics would be purchased or how this would translate into individual advertisers' requirements as these could shift substantially year on year.<sup>166</sup> Moreover, ITV submitted that individual campaigns could be 'disguised' by buying more than one traded demographic.

- (c) Third, ITV must have a mechanism for successfully extracting the reliant expenditure from those advertisers that needed ITV1 without incurring a punishment that outweighed the increased revenue gained from price discriminating. ITV argued that this condition would not be met because under a media agency deal advertisers' reliant expenditure was aggregated alongside non-reliant expenditure, such that the media agency could punish ITV by removing non-reliant expenditure from ITV1.

- *Our assessment*

5.143 Although the 2003 report did not weight the different adverse effects identified, we are inclined to agree with ITV that an enhanced degree of price discrimination is likely to have been less of concern than a worsening of terms across all media buyers.

5.144 We noted ITV's points regarding the increased transparency between advertisers and media agencies (see paragraph 5.141). However, we were not convinced that the factors cited by ITV would be significant in reducing the enhanced ability for ITV to price discriminate in relation to ITV1 airtime:

(a) ITV1's ability to enhance the degree of price discrimination against media buyers would be reduced only if media buyers could better detect differences in ITV's offers for ITV1 airtime and ultimately react to any such difference by switching from ITV1. We first note that there has only been a small increase in the use of media auditors between 2003 and 2009. More generally, we note that ITV's first and second arguments (see paragraph 5.141(a) and (b)) involve an increased transparency to advertisers of the relative deals available to them across media agencies. As such, this may help advertisers to detect and punish through switching any price discrimination applied by media agencies against advertisers, but has no effect on the ability of advertisers to detect and punish any price discrimination applied by ITV in relation to ITV1 airtime. Where competition between media agencies for advertising clients is intense, any price discrimination by media agencies against advertisers would be prevented.

(b) As regards the consolidation of media agencies (see paragraph 5.141(c)), we noted that this involves an increased transparency to media agencies of advertisers' preferences. As such, this may help media agencies to price discriminate against advertisers and does not help to assess any change in the enhanced ability for ITV to price discriminate against media buyers in relation to ITV1 airtime.

5.145 We did not agree with ITV's view that price discrimination was not possible. We note that SOB commitments and discounts are negotiated with each individual media buyer and that there are many individually negotiated terms. This facilitates price discrimination. With regard to ITV's three conditions set out in paragraph 5.142:

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<sup>166</sup>In particular, ITV noted the following factors that affected a media buyer's reaction to price changes: ITV1's relative value compared with other broadcasters, how hard other broadcasters were negotiating in a particular year, and the agency's client base and that client base's valuation of ITV1 airtime.

- (a) We have already considered the coverage analysis in paragraphs 5.44 to 5.48 and the ability of media buyers to switch some SOB commitment from ITV1. For the reasons given in paragraph 5.126, we do not agree with ITV's contention that media buyers have no 'need' to use ITV1.
- (b) Although we recognize that it is not possible to predict precisely the expenditure by demographic during a year, experience of a media agency's behaviour in the past in response to suggested and actual price changes on ITV1 allows ITV to consider how that media agency is likely to react to proposed changes in the price of ITV1 airtime. Past experience is also likely to give information to ITV on the specific identity and needs of advertisers contracting with each media agency. We do not therefore agree with ITV's proposition that it is impossible to identify those advertisers which need ITV1.
- (c) Although we accept that umbrella deals may to some extent limit the ability of ITV to target particular advertisers, our review of contractual terms suggest that these are sufficiently complex and bespoke to some advertisers that mechanisms are likely to exist for ITV to discriminate against advertisers.

5.146 For the reasons discussed in paragraphs 5.143 to 5.145, we found that ITV's ability to enhance the degree of price discrimination in relation to ITV1 airtime had not diminished since 2003.<sup>167</sup>

### *Consolidation of media agencies*

5.147 In the 2003 report, the CC found that the market share of even the largest media agency was smaller than that of ITV1. The CC also said that all large media agencies must reach an agreement with ITV in relation to ITV1 airtime in order to compete effectively for advertisers.<sup>168</sup>

5.148 ITV said that since 2003 ITV1 had become a much less important part of media agencies' business as the share of the top three media agencies' budget going to ITV1 had fallen significantly, while the same media agencies were responsible for almost twice as much of ITV1's revenue compared with 2003. As a result, ITV submitted that media buyers had less dependence on ITV1 in 2009 than they had on either Carlton or Granada pre-merger.

- *Our assessment*

5.149 We found that since 2003 there has been consolidation of media agencies (see Appendix F). In addition, some media agencies now trade together without having formally merged their businesses. In particular, we found that in 2003 the top three media agencies' share of ITV1's total revenue was [X] per cent but by 2009 this had doubled to [X] per cent.

5.150 However, in our view, media agencies are not necessarily less dependent on ITV1 than they were in 2003. Increased concentration of media agencies does not necessarily imply countervailing buyer power; this depends on whether media agencies can credibly threaten to switch some expenditure away from ITV1, which we have discussed in paragraphs 5.108 to 5.146.

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<sup>167</sup>We noted that Ofcom, in paragraph 1.16 of its submission, said that 'we have concerns that ITV may be able to target and set excessive prices for impacts which are necessary to deliver fast mass cover, e.g. peak time impacts'.

<sup>168</sup>2003 report, paragraph 2.129.

### *Our conclusion on the ability of media agencies to switch SOB commitment from ITV1*

- 5.151 We found that ITV's advantage in negotiations with media buyers had not been eroded materially since 2003. Although we received conflicting evidence from ITV and media buyers, it was clear to us that at least some advertising campaigns still require ITV1.
- 5.152 We found that switching some SOB commitment is likely to be deterred because, given the prevalence of SOB deals, any reduction in expenditure on ITV1 could be expected to affect the discount and hence the price a media buyer pays for its remaining SOB commitment to ITV1. Although we cannot observe whether switching some SOB commitment would be possible without CRR, the evidence from the relevant case decided by the Adjudicator is consistent with our assessment that ITV has the incentive and the means to discourage media agencies from reducing their SOB commitments on ITV1 (see paragraphs 5.131 and 5.132).
- 5.153 In addition, there are a wide range of contractual terms other than discounts which are important to media buyers and which ITV could worsen in response to a proposed reduction in SOB commitment (see paragraphs 5.134 and 5.135). Although we cannot observe whether switching some SOB commitment would lead to such problems without CRR, evidence from disputes and negotiations between ITV and media agencies suggests that these have been an issue even under the protection of CRR (see paragraph 5.136).
- 5.154 We also found in paragraphs 5.143 to 5.146 that price discrimination remains possible.
- 5.155 For these reasons, we conclude that switching some SOB commitment would continue to be difficult absent an effective remedy. The increased concentration of media agencies since 2003 had not, in our view, led to countervailing buyer power.

### ***Changes in the likelihood of entry or expansion***

- 5.156 An attempt by ITV to worsen terms to media buyers may be ineffective if there were a credible threat of entry or expansion by competing commercial channels. The 2003 report did not contain an assessment of the likelihood of entry or expansion. In this section, we consider whether the possibility of expansion or entry is sufficient to constrain ITV1's enhanced market position.

#### *ITV's views*

- 5.157 ITV submitted that in 2003 it was difficult for new channels to get access to spectrum that was capable of delivering substantial new levels of reach and frequency. It added that this had now changed: a new entrant with sufficient funding could, in theory, invest similar amounts in peak-time programming and attract similar-sized large audiences to ITV1. ITV told us that the television market included companies which were part of large corporate groups with access to significant resources (for example, RTL and BSkyB) that could be invested in 'mass audience' programming if it were profitable for them to do so.
- 5.158 ITV said that, as many of ITV1's 'mass audience' programmes were delivered by independent production companies, other broadcasters would be free to purchase the rights to such programming and broadcast the programming immediately. ITV

said that the programmes that had moved from ITV1 to smaller channels had not necessarily lost audiences.<sup>169</sup>

- 5.159 ITV said that competition in the television advertising market was centred on broadcasters' relative abilities to deliver reach and frequency via impacts across campaign durations rather than delivering viewers for specific programmes. It was for this reason that other broadcasters had chosen not to invest in 'mass audience' programming and instead had chosen to optimize coverage delivery in different ways (for example, Channel 4 had focused its programme investment on narrower, more targeted audiences).

#### *Our assessment*

- 5.160 We agree that since 2003 the growth in multi-channel television has made it easier to launch new channels and that many broadcasters have adopted different programme investment strategies from ITV1 to deliver impacts to advertisers. However, as set out in paragraphs 5.100 to 5.105, ITV1's enhanced market position arises from its unique ability to deliver large audiences and thus generate coverage in a short period of time. In order for other broadcasters to deliver similar coverage and frequency over short campaign durations, they would need to be able to provide the sort of large audience programmes that could compete with ITV1.
- 5.161 We acknowledge that the television industry includes large group companies with access to significant financial resources that could purchase popular programmes from production companies. In our view, however, based on experience since 2003, any such expansion or entry would not be timely, likely or sufficient to act as a competitive constraint on ITV1. In particular:
- (a) It would take considerable time for other broadcasters to create the brand and reputation with which to generate audience sizes that are able to compete with ITV1's programmes. In addition, the success of entry or expansion is dependent on, among other things, the position of a channel in the electronic programme guide (EPG) and the availability of a channel across different platforms. None of the new channels that have been launched since 2003 have yet been able to deliver the size of audiences achieved by ITV1.
  - (b) Any entry or expansion is unlikely to be of sufficient scale or scope to generate audience sizes that are consistently able to compete with ITV1's large audience programmes. In this respect, we note that the evidence shows that in the period since 2003, despite some popular programmes transferring to smaller channels, ITV1 has continued to retain an advantage in delivering large audience programmes.
- 5.162 We therefore found that there is little likelihood of other commercial broadcasters entering or expanding to such an extent as to be able to compete with ITV1 in attracting large audiences. Entry or expansion would not therefore act as a competitive constraint on ITV1.

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<sup>169</sup>When *Home and Away* moved from ITV1 to Five in 2001, its viewing figures fell by around 40 per cent in multi-channel homes. However, ITV said that there was a gap of over a year between *Home and Away* finishing on ITV1 and starting on Five which led to the regular audience diminishing. ITV also said that when *Richard and Judy* moved to Channel 4, its average audience increased from 1.4 million in the last six months on ITV1 to 1.7 million viewers in the first six months on Channel 4.

## ***Conclusion on the change in ITV1's enhanced market position***

- 5.163 Since 2003 there have been significant changes in the television industry and ITV1's share of NAR and SOCI have declined. The ratio of ITV1's share of NAR to its SOCI, the ITV1 premium, has, however, increased from 1.18 in 2003 to 1.34 in 2009 despite the operation of CRR.
- 5.164 The results of ITV's coverage analyses suggest that significantly more campaigns could be run effectively without ITV1 in 2009 than in 2003 and that excluding ITV1 would compromise the effectiveness of the other campaigns to a lesser extent now than in 2003. On the other hand, the coverage analysis showed that for certain campaigns (in particular, fast-build and time-critical campaigns) in certain demographics (notably 'Housewives' and 'Adults') media buyers would not generally be able to achieve the same level of 1+ coverage without ITV1.
- 5.165 In any case, in our view coverage analyses cannot provide a complete picture of the substitutability of ITV1. In particular, they do not capture certain unique features of ITV1. We found that since 2003 ITV1 has largely retained its ability to reach large audiences although the absolute size of its audiences has declined. ITV1's large audiences allow media buyers to meet a campaign's coverage objectives more efficiently than on other commercial channels because fewer spots are required and coverage can be achieved more quickly given the coverage of such large audience programmes. This most affects those campaigns that require impacts to be delivered in a shorter period of time. In addition, media buyers have also continued to believe that ITV1 is able to offer other unique benefits in terms of the 'quality' of the impacts it provides.
- 5.166 In our view, the difficulties in switching some SOB commitment have not been significantly reduced. Most advertising is bought through media agencies and in our view these agencies need to be able to purchase ITV1 airtime at competitive prices (relative to other media agencies) in order to attract and retain clients. As a result, we do not consider that a media agency can threaten credibly to withdraw all its business from ITV1. Moreover, in our view, media buyers who seek to reduce their SOB commitment are likely to be offered significantly less favourable terms on the expenditure remaining on ITV1. As a result, whether or not individual campaigns could be switched away from ITV1, the likelihood of such switching would still have insufficient constraining effect on ITV. The increased concentration of media agencies since 2003 has not resulted in countervailing buyer power.
- 5.167 We concluded that ITV1's enhanced market position was still sufficiently strong that absent appropriate remedies it would have an adverse effect on media buyers. This adverse effect might manifest itself through the three ways described in the 2003 report. In particular, we are concerned that, absent an effective remedy, ITV might be able to worsen terms overall through seeking higher SOB commitments, reducing discounts or worsening terms and conditions. If ITV used its enhanced market position to increase SOB commitments from media buyers, this would reduce the amount advertisers would spend on other commercial broadcasters.
- 5.168 We concluded that it would not be appropriate to release ITV from the CRR Undertakings. We concluded, however, that we should consider varying the CRR Undertakings in light of the changes of circumstance that we have outlined.

## 6. Assessment of costs of the CRR Undertakings

- 6.1 Given our conclusion in Section 5 that a remedy is still required to address the adverse effects of the merger, we next consider whether CRR has created significant costs that might be mitigated through a variation to the CRR Undertakings.<sup>170</sup>
- 6.2 Third parties did not identify any significant costs arising from the CRR Undertakings. Indeed, most third parties believed it was appropriate for CRR to stay in place with only minor variations to the Undertakings.<sup>171</sup> In particular, ISBA told us that ‘CRR is widely held within competition regulation as an excellent example of an effective and proportionate intervention. Nor has it generated any significant unintended or second-order effects’.
- 6.3 ITV attributed a number of costs to the CRR remedy, primarily in the form of unintended incentives created by the ARM and by ITV’s inability to react to changing demand due to media buyers relying on their historic protected contracts. ITV submitted a quantitative assessment by consultants OC&C of those costs incurred by ITV that it considered should be attributed to CRR. OC&C’s report estimated these costs using both a ‘top-down’ approach and a ‘bottom-up’ approach.<sup>172</sup>
- 6.4 We use the term ‘costs’ in the same way as ITV. However, these ‘costs’ include not only costs incurred but also, in many cases, revenue forgone. We note that CRR was designed to restrict ITV from increasing its revenue through exercising the enhanced market position created by the merger between Carlton and Granada.
- 6.5 In this section, we consider the costs identified by ITV and form a view as to whether, and to what extent, these ‘costs’ are costs that are likely to have resulted from, or been exacerbated by, CRR.

### **Top-down approach to assessing costs**

- 6.6 OC&C’s top-down approach was based on a comparison of ITV1’s returns on programming investment over the period 1995 to 2008 with that of ITV1’s ‘closest commercial competitor’, Channel 4.<sup>173</sup> OC&C found that between 1995 and 2003 both broadcasters had a similar rate of decline in this measure of ‘programming efficiency’ but that ITV1 had lost ground to Channel 4 since the introduction of CRR. OC&C noted that some of the difference in programming efficiency between ITV1 and Channel 4 would have been attributable to ITV1 being unable to take advantage of ‘dynamic efficiencies’ due to CRR and that ‘some of the gap may also be due to poor programming decisions taken on the part of ITV’. As it could not disentangle these effects, OC&C assumed that a range of between [x] and [x] per cent of the gap in returns on programming investment between Channel 4 and ITV was due to CRR. Based on these ranges, OC&C estimated that the current total lost revenue to ITV of CRR was in the range £[x]–£[x] million in 2008/09, giving a mid-point estimate of £[x] million. OC&C said that, given the nature of dynamic inefficiencies, it would expect this estimate of lost revenue to increase the longer CRR is maintained.

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<sup>170</sup>For a discussion of the risks associated with behavioural remedies, see *Merger Remedies: Competition Commission Guidelines*, November 2008, CC8, pp25-26.

<sup>171</sup>OFT’s advice, paragraph 1.10.

<sup>172</sup>These approaches are explained in paragraphs 6.6 and 6.12 to 6.15.

<sup>173</sup>OC&C focused on ITV1’s and Channel 4’s ratio of programme expenditure to its share of NAR (ie share of NAR per pound invested in programmes), indexing each channel’s ratio to 2003 in order to show the relative performance of Channel 4 and ITV1 in terms of ‘programming efficiency’.

## *Our assessment*

- 6.7 We consider whether the top-down approach could provide a meaningful guide as to the costs of CRR.
- 6.8 We consider first whether the methodology used by OC&C is appropriate. We note that the metric adopted by OC&C is only one way of looking at 'programming efficiency'. In the past, for example, ITV has used the ratio of share of programme expenditure to share of audience as an indicator of programming efficiency.<sup>174</sup> We also note that OC&C's analysis did not make any assumptions about what would have happened to Channel 4 and ITV1 absent CRR, and in particular that, prior to 2003, Channel 4's programming efficiency was already beginning to improve relative to ITV1's.
- 6.9 We next consider the extent to which CRR might have been the cause of any differences in programming efficiency between ITV1 and Channel 4. We note that OC&C recognized that it was uncertain what proportion of the difference in programming efficiency between ITV1 and Channel 4 was due to CRR or due to ITV's 'poor programming decisions' on ITV1 over the period 2003 to 2008. We found that we could not meaningfully disentangle the effects of CRR from other effects on the efficiency of programming investment and note that there was no basis for OC&C's estimates that between [x] and [x] per cent of the gap was attributable to CRR.
- 6.10 We note further that differences in programming efficiency would be likely to occur absent CRR. We would expect to see differences between any broadcasters' programming efficiency over time due to a wide range of factors that influence strategies and the outcomes of those strategies. In particular, differences in programming efficiency between Channel 4 and ITV1 might easily arise absent CRR. Channel 4 and ITV1 have, and have always had, different structures, different strategies and different public service broadcasting remits. Channel 4 has 'a specific remit for innovation, educative programming and distinctiveness'; the ITV1 network, on the other hand, is the UK's largest commercial television channel with 'additional responsibility for the provision of regional news, current affairs and other regional programming'.<sup>175</sup> Such different remits would be bound to lead to differences in programming efficiency at particular points in time.
- 6.11 Based on paragraphs 6.7 to 6.10, we found that the top-down analysis did not provide a reliable basis on which to assess the costs to ITV of CRR.

## ***Bottom-up approach to assessing costs***

- 6.12 The bottom-up approach identified specific 'costs' to ITV of CRR. ITV submitted that OC&C did not evaluate every potential inefficiency resulting from CRR but focused on those costs that were clearly linked to CRR in some way and that lent themselves to some degree of quantification. ITV submitted that some of the unidentified or unquantifiable costs may be significant and that as a result the cost estimates provided by OC&C were likely to underestimate the actual costs due to CRR.<sup>176</sup> ITV submitted that OC&C used best endeavours to quantify the costs with a reasonable degree of

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<sup>174</sup>See, for example, ITV investor *Site Visit*, 21 June 2006, p38: [www.itvplc.com/investors/presentations/?year=2006](http://www.itvplc.com/investors/presentations/?year=2006). On this basis, ITV1 was performing significantly better than Channel 4 in 2005, in contrast to the metric adopted by OC&C.

<sup>175</sup>See Ofcom, *Public Service Broadcasting: Annual Report 2009*, 21 July 2009, p10: [www.ofcom.org.uk/tv/psb\\_review/annrep/psb09/psbrpt.pdf](http://www.ofcom.org.uk/tv/psb_review/annrep/psb09/psbrpt.pdf).

<sup>176</sup>As an example of such costs, ITV noted the costs associated with ITV's inability to deliver dynamic efficiencies (in terms of commissioning and scheduling) across its full family of digital channels as a result of CRR.

certainty, and adopted a conservative approach when there was a high degree of uncertainty.

- 6.13 OC&C estimated the quantifiable costs due to CRR in total amounted to between £[x] million and £[x] million in 2008/09 (giving a mid-range estimate of £[x] million) which OC&C said were directly attributable to ‘dynamic inefficiencies’ resulting from CRR. OC&C submitted that CRR had a material negative impact on ITV’s business and that, in particular, the ‘dynamic inefficiencies’ that resulted directly from CRR were significant and amounted to at least £[x] million in 2008/09. It also expected the size of these costs to increase year on year. When these costs were considered alongside ITV1’s total profit in 2008 (£[x]), ITV said that CRR was not a proportionate remedy and should not be maintained.
- 6.14 OC&C identified ‘costs’ to ITV arising from CRR in relation to:<sup>177</sup>
- (a) the effect of the ARM in creating distorted incentives for ITV (£[x]–£[x] million);
  - (b) the role of protected contracts in creating deal debt (£[x]–£[x] million);
  - (c) operational constraints (£[x]–£[x] million); and
  - (d) regulatory risk and uncertainty (not quantifiable).
- 6.15 In addition, OC&C estimated administrative costs of CRR (such as the costs of the Office of the Adjudicator and ITV’s compliance costs) to ITV of £[x] million a year.
- 6.16 To evaluate the ‘costs’ in the bottom-up approach, we assess in paragraphs 6.17 to 6.57 the extent to which each ‘cost’ should be attributed to CRR. ITV argued that we did not understand OC&C’s methodology of examining only a certain proportion of overall costs that could be attributed to CRR. However, we noted that OC&C’s assessment of costs in the bottom-up approach, in contrast to the top-down approach (which assumed a range of [x] to [x] per cent) did not make an assumption as to the proportion of each cost estimate which should be attributed to CRR.<sup>178</sup> Our approach is based on an assessment of whether the cost estimates provided by OC&C can be attributed to CRR. Where we find that other factors are likely to have played a significant role in creating the costs, we make a judgement, based on evidence from ITV and third parties, as to the relative importance of CRR in generating those costs. We did not find it feasible to estimate the precise percentage of each cost that should be attributed to CRR, but we express a view on the likely role of CRR in creating these costs (see paragraph 6.60).

### *The effect of the ARM in creating distorted incentives for ITV*

#### *ITV views and OC&C’s analysis*

- 6.17 ITV submitted that, because the ARM was based on SOCI, ITV was incentivized to maximize ITV1’s SOCI rather than focus on a range of factors: coverage and frequency, quality of programming, ability to deliver viewers in key demographics, average programme viewings and other qualitative terms (for example, access to position in break). ITV submitted that this had led to outcomes that were inconsistent with the demands of advertisers and audiences. These outcomes included:

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<sup>177</sup>Figures may not sum to the total of £[x]–£[x] million due to rounding.

<sup>178</sup>With the possible exception of the cost relating to the misalignment of programming expenditure (£[x] million), in which ITV assumed that some of the gap could be closed absent CRR. However, this percentage in part reflects the difference between programming expenditure and NAR that would be expected to occur in each month.

- (a) Making programming decisions to maximize SOCI rather than aligning with advertisers' demand (in particular, focusing on daytime rather than peak-time impacts). OC&C estimated the revenue forgone of these programming decisions at £[redacted]–£[redacted] million.<sup>179</sup> Appendix I provides further detail of the breakdown of OC&C's estimates of revenue forgone.
- (b) Not investing in ITV1+1 and ITV1 HD services.<sup>180</sup> ITV said that, because the current definition of ITV1 in the Undertakings related to the 'Regional Channel 3 Services' licence and not to ITV1's programme schedule, ITV1's SOCI used in the ARM would not include impacts delivered by an ITV1 HD service<sup>181</sup> or an ITV1+1 service.<sup>182</sup> ITV was therefore not incentivized to provide these services. OC&C estimated that this generated profits forgone of £[redacted] million in relation to an ITV1+1 service.

### *Third parties' views*

- 6.18 Third parties said that the choice of ITV1's programme schedule had been driven by factors other than CRR, such as a general aversion to risk that applied pre-merger as well as in recent years. A few third parties agreed that, while the CRR remedy encouraged ITV to produce programmes and schedules that would deliver high audience levels for ITV1, it might also discourage innovation and experimentation.<sup>183, 184</sup>

### *2003 report*

- 6.19 The 2003 report noted that 'the parties fully expected that the ratchet element of the CRR mechanism would incentivize the merged entity to maximize its investment in the ITV1 schedule because customers' share of broadcasting commitments would fall automatically if ITV1's share of commercials impacts was to decline'.<sup>185</sup>
- 6.20 The parties also said that CRR 'would enable the merged entity to achieve the benefits of the proposed merger'. Such benefits were:

better—less dysfunctional—decision-making, reflected, particularly, in better programme placement within the schedule and in more effective and timely negotiating for rights to sporting events and acquired programmes. This should flow through into better programme quality and more choice for viewers—and should be welcomed by those who advertise on ITV.<sup>186</sup>

- 6.21 ITV said that these statements in the 2003 report were solely based on the benefits that could be achieved by resolving [redacted]. ITV added that the statements failed to recognize the unanticipated consequences that CRR has since had on programme

<sup>179</sup>This comprises costs A(i) to (v) in Appendix I.

<sup>180</sup>ITV also said that other broadcasters had been incentivized to launch +1 and HD channels because they could reduce ITV1's SOCI and derive additional SOB as a result.

<sup>181</sup>On 2 April 2010, ITV launched ITV1 HD. This service is available on Freesat, Freeview, Sky and Virgin. The Freeview HD service is rolling out across the UK and will reach up to 60 per cent of the UK by the end of 2010 and 98.5 per cent by the end of DSO. See ITV's press release:

[www.itv.com/presscentre/pressreleases/programme/pressreleases/itv1hdto launchinapril/default.html](http://www.itv.com/presscentre/pressreleases/programme/pressreleases/itv1hdto launchinapril/default.html).

<sup>182</sup>Also impacts on ITV1 broadcast on satellite and cable platforms are not technically included in the definition of ITV but have been counted in the ARM to date.

<sup>183</sup>OFT's advice, paragraph 6.30.

<sup>184</sup>A number of third parties also made the same observation as ITV in relation to the incentives for other broadcasters to launch new free-to-air channels, particularly +1 channels, that assist in reducing ITV1's SOCI. OFT's advice, paragraph 6.33.

<sup>185</sup>2003 report, paragraph 6.64.

<sup>186</sup>2003 report, paragraphs 6.68 and 2.134.

incentives because it has not operated as a fallback option. ITV also said that it did not anticipate that CRR would remain in place indefinitely.

#### *Our assessment*

- *Programming decisions*

- 6.22 We consider first the extent to which the ARM in principle creates incentives for ITV to behave in a way that is inconsistent with advertisers' demands and then consider whether CRR has, in practice, influenced ITV's strategy for ITV1 (and in particular its programming decisions) since 2003.
- 6.23 In relation to the incentives created by the ARM and their compatibility with advertisers' demands, we recognize that SOCI does not capture all the aspects that advertisers might take into account when deciding how and where to advertise their products and services. However, we note that in 2003 the parties did not consider that the ARM would disincentivize ITV from investing in the ITV1 schedule. We found that CRR has not, in principle, significantly distorted ITV's decision-making in relation to ITV1. ITV remains incentivized to deliver what advertisers want in order to maximize profits. Increasing or maintaining SOCI can be achieved through a number of different programming approaches, but ultimately broadcasters increase their SOCI through producing good-quality programmes that appeal to audiences. Although the ARM allows media buyers to reduce their SOB commitment in direct proportion to reductions in ITV1's SOCI, it is not a one-way ratchet and subsequent improvements in ITV1's SOCI could be expected to lead to increases in SOB commitment up to the cap in protected contracts (see paragraph 3.11).
- 6.24 Consequently, in our view, ITV faces a choice of programming strategies similar to any other broadcaster, including whether to invest in daytime or peak-time programmes; short-term or long-term growth strategies; and high-risk or low-risk programmes. Not all programming decisions taken by broadcasters can be expected to be successful. In particular, as recognized by OC&C, ITV may have made some 'poor programming decisions' during this period.
- 6.25 We next consider how CRR has, in practice, influenced ITV's strategy for ITV1 since 2003. After the merger, ITV may have adopted a strategy of maximizing ITV1's short-term SOCI but investor presentations from the time suggest that priorities for ITV1 were wide ranging and included revitalizing the ITV1 schedule, delivering savings to shareholders and seeking to minimize the cost burden of ITV1's PSB obligations.<sup>187</sup>
- 6.26 In September 2007, ITV announced a change of strategy. ITV's new strategy was to be content led, adopting a longer-term perspective, despite the costs that ITV told us such a strategy would generate because of the incentives created by CRR to maximize SOCI. The new strategy focused on launching a new peak-time schedule with more 60-minute drama at 9pm, fewer repeats, more comedy and more football. It also included a focus on new commissioned content. This strategy was aimed at increasing ITV's share of 'light viewers' and 'ABC1 Adults', rather than ITV1's SOCI.<sup>188</sup>
- 6.27 ITV told us that it [redacted]. ITV said that [redacted]. However, we found that such a position was not consistent with investor presentations made at the time the strategy was

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<sup>187</sup>See, for example, ITV investor presentation *Site Visit*, 21 June 2006: [www.itvplc.com/investors/presentations/?year=2006](http://www.itvplc.com/investors/presentations/?year=2006).

<sup>188</sup>See, for example, investor presentations made at the time, including *ITV: The next 5 years: content-led recovery*, 12 September 2007.

launched by the then ITV Chairman and Chief Executive, Michael Grade. In particular, these presentations refer to the strategy being 'not reliant on a regulatory fix' and making 'no assumptions on CRR relief'. Instead the strategy was about making 'existing assets work harder and better together'.<sup>189</sup>

6.28 In our view, any decisions on strategy and programming are adopted for a wide range of reasons. Although we recognize that CRR may have had a part to play in the decisions ITV has taken since 2003, we found that, at most, only a small proportion of the revenue forgone which ITV attributed to the ARM was likely to be attributable to CRR.<sup>190</sup> We consider the likely size of this cost in paragraph 6.60.

- *Incentives for ITV to invest in ITV1+1 and ITV1 HD services*

6.29 We agreed with ITV that the definition of ITV1 in the Undertakings has reduced the incentive for ITV to invest in ITV1+1 and ITV1 HD services. Impacts delivered through these services would not count towards ITV1's SOCI in the ARM calculation. ITV would therefore be penalized by any reduction in impacts on ITV1 following the launch of an ITV1+1 or ITV1 HD service because media buyers would be able to reduce their SOB commitments in line with the reduction in ITV1's SOCI.

6.30 We found that the current definition of ITV1 in the CRR Undertakings, which does not include ITV1+1 or ITV1 HD, has led to an unintended effect that could be directly attributed to CRR.<sup>191</sup>

### *The role of protected contracts in creating deal debt*

#### *ITV views and OC&C's analysis*

6.31 ITV submitted that, absent CRR, it would negotiate new contracts with media buyers during the deal season so as to match the expected supply of TV airtime (based on expected schedule performance) to advertisers' demand.

6.32 ITV submitted that the existence of protected contracts under CRR had reduced the amount of negotiation over contractual terms. ITV told us that, although the big media agencies typically entered into some form of annual negotiation and generally re-protected their new contracts, this tended to focus on part of the contract and not the whole such that many agencies' core deals remained under 2003 terms.

6.33 ITV submitted that protected contracts had created an additional cost to ITV in negotiating with media agencies in that it had created 'windfall' gains for media agencies. In particular, ITV said that: (a) media agencies could avoid transaction costs by not negotiating; (b) umbrella contracts had allowed media agencies to manage demand changes from advertising clients without needing to renegotiate with ITV; and (c) media agencies were given complete certainty as to their ITV1 discount year on year, which had made it easier for them to 'broker' the discount obtained from broadcasters between the advertising clients within their umbrella deals.

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<sup>189</sup> *ITV: The next 5 years: content-led recovery*, 12 September 2007, p4: [www.itvplc.com/files/presentation/2171/StrategyUpdate07.pdf](http://www.itvplc.com/files/presentation/2171/StrategyUpdate07.pdf).

<sup>190</sup> We also identified two specific issues with the reliability of OC&C's estimate of the revenue forgone (see Appendix I).

<sup>191</sup> We considered ITV's point that CRR had had a similar distorting effect on other broadcasters' incentives to invest in new channels so as to reduce ITV1's SOCI. Based on our assessment of the uncertainty of the effect of +1 channels in terms of cannibalization and net effect on SOCI for each broadcaster (see Appendix K), we considered that such effects were likely to be secondary to the effects on the broadcaster's own SOCI.

6.34 ITV said that this inability to negotiate had led to significant deal debt problems.<sup>192</sup> As a consequence of the accumulation of deal debt and in order to prevent further deal debt accumulating, OC&C estimated that ITV had consistently [redacted] for [redacted] rights, which would attract a particular audience to generate a large volume of impacts in a particular way. In total, OC&C calculated that the effect of [redacted] for [redacted] rights was between £[redacted] and £[redacted] million a year in 2008/09:

(a) OC&C estimated that ITV [redacted] by £[redacted] million for the rights to [redacted]. This estimate was based on an ITV board paper on the case for [redacted] acquisition which included a line item of £[redacted] million defined as [redacted]. OC&C said that, absent CRR, ITV would not have had specifically to acquire rights for the purpose of clearing deal debt and its maximum willingness to pay for [redacted] would have been £[redacted] million lower.

(b) In addition, OC&C said that the effect of [redacted] for [redacted] rights being caused by CRR was likely to apply equally across the full range of ITV1's other [redacted] rights. OC&C estimated that, in relation to other [redacted] rights, this generated an additional annual cost to ITV of £[redacted] million.<sup>193</sup>

### *Third parties' views*

6.35 In relation to incentives for media buyers to negotiate, a number of third parties suggested that CRR may be inhibiting dynamism in the media buyer market. These third parties argued that to depart from their existing protected contract—for example, to change their channel profile, target audiences, trading parameters and so on—necessitated renegotiation which was a potentially protracted process. They also argued that if a media buyer involved the Adjudicator to decide on fair and reasonable terms, it risked reprisals from ITV. They said that the status quo therefore represented a safe option and was the path of least resistance.<sup>194</sup>

6.36 There were mixed views on the extent of contract negotiations. Some media buyers considered that the CRR remedy had increased the complexity of contract negotiations, with agreements becoming more legalistic. One third party 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 for other channels.<sup>195</sup>

6.37 In its submission, Ofcom said that 'media buyers do not appear willing to exert their negotiating power. Ofcom believes that the CRR remedy has affected the way in which contracts are negotiated and may have reduced incentives to move away from existing protected contracts (for instance, by moving more money out of ITV1 than is provided for under the ratchet)'.<sup>196</sup>

6.38 The OFT, in its advice, found that '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

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<sup>192</sup>ITV told us that this inability to negotiate led to significant deal debt problems of about £[redacted] million in 2006. This deal debt disappeared the following year. ITV submitted that this was largely due to (a) improved performance in impacts in 2006 and 2007, especially Formula 1 coverage with the arrival of Lewis Hamilton, Liverpool in the UEFA Champions League final and England in the Rugby World Cup final, and (b) some major customers [redacted].

<sup>193</sup>In addition, OC&C noted that the effect (of [redacted] per cent of the value of [redacted] rights being attributable to [redacted] caused by CRR) was likely to apply equally across the full range of ITV1's other [redacted] rights. OC&C submitted that it conservatively applied only [redacted] per cent of this effect (ie only [redacted] per cent of the value) to other [redacted] rights, generating an additional annual cost to ITV of £[redacted] million.

<sup>194</sup>OFT's advice, paragraph 6.21.

<sup>195</sup>OFT's advice, paragraphs 6.23 & 6.24.

<sup>196</sup>Ofcom's submission, paragraph 1.18.

has prevented ITV adjusting to changes in the demand and supply of different demographics'.<sup>197</sup>

- 6.39 In relation to the effect of any lack of contract negotiations, third parties did not believe that CRR was preventing ITV from honouring its contracts. Many third parties pointed out that 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 reducing their expenditure commitments to the full extent provided by the ARM. Another suggested that 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.<sup>198</sup>

#### *2003 report*

- 6.40 The 2003 report noted that the parties said that 'the right to renew a contract based on the terms of the CRR mechanism would not prevent customers from negotiating different deals if they wanted to do so. It would simply establish for each customer a minimum entitlement'.<sup>199</sup>

#### *Our assessment*

- 6.41 To assess the costs which ITV attributed to protected contracts, we consider first the extent to which CRR has created costs for ITV by limiting negotiations between ITV and media buyers. We then consider the possible attribution to CRR of deal debt that had arisen since 2003. Finally, in this section we consider whether any [X] for [X] rights can be attributed to the need to remove deal debt.
- 6.42 The CRR Undertakings protected all aspects of contracts at the time of the Carlton and Granada merger. This 'protected contract' is a fall-back right and media buyers are entitled to negotiate a variation to this contract or an entirely new contract.<sup>200</sup> The CRR Undertakings also entitle media buyers to agree with ITV that any new or replacement contract, or any variation to a protected contract, becomes the media buyer's 'protected contract', which it is entitled to fall back on.<sup>201</sup> Depending on the approach of each individual media buyer, they may hold a protected contract dating back to 2003, or they may have reprotected the contract in any subsequent year. Table 4 sets out the distribution of protected contracts by value and by volume.

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<sup>197</sup>OFT's advice, boxed paragraph after paragraph 6.37.

<sup>198</sup>OFT's advice, paragraph 6.37.

<sup>199</sup>2003 report, paragraph 6.65.

<sup>200</sup>The Undertakings, paragraph 6. See also Ofcom's *Technical Background Guide to Advertisers and Buyers' rights under the CRR remedy*. Any variations to a protected contract, or any new contract for ITV1 airtime, must be made on fair and reasonable terms:

[www.ofcom.org.uk/tv/ifi/guidance/ITV\\_airtime\\_sales/tech\\_crr/crr\\_remedy\\_pdf.pdf](http://www.ofcom.org.uk/tv/ifi/guidance/ITV_airtime_sales/tech_crr/crr_remedy_pdf.pdf).

<sup>201</sup>The Undertakings, paragraph 10(e). Ofcom's *Technical Background Guide to Advertisers and Buyers' rights under the CRR remedy*: [www.ofcom.org.uk/tv/ifi/guidance/ITV\\_airtime\\_sales/tech\\_crr/crr\\_remedy\\_pdf.pdf](http://www.ofcom.org.uk/tv/ifi/guidance/ITV_airtime_sales/tech_crr/crr_remedy_pdf.pdf).

TABLE 4 Distribution by year of number and value of outstanding protected contracts (as at July 2009)

	<i>per cent</i>	
	<i>Distribution of contracts by gross revenue</i>	<i>Distribution of contracts by volume of contracts</i>
2003	1	19
2004	2	12
2005	4	13
2006	7	16
2007	7	17
2008	<u>79</u>	<u>23</u>
Total	100	100

Source: ITV.

6.43 Table 4 shows that, in July 2009, 79 per cent of ITV1’s contracts by value and 23 per cent by volume were protected against the current contract. Only 3 per cent by value and 31 per cent by volume were protected against the 2003 or 2004 contracts.

6.44 Table 5 shows the percentage of contracts by value that have been renegotiated each year since 2003. Renegotiation may occur without the contract being re-protected (see paragraph 6.42) and Table 5 does not capture the extent of re-negotiation.

TABLE 5 Distribution by year of value of contracts renegotiated each year (as at July 2009)

	<i>per cent</i>		
	<i>Not renegotiated</i>	<i>Renegotiated</i>	<i>Dormant*</i>
2004	6	92	2
2005	39	59	2
2006	33	64	3
2007	23	74	3
2008	36	60	4
Average 2004–2008	27	70	3

Source: ITV.

\*Refers to media buyers that bought ITV1 airtime the preceding year but neither renegotiated their contracts nor took their CRR offer that year.

Note: Figures may not sum due to rounding.

6.45 Table 5 shows that, on average between 2004 and 2008, 70 per cent of contracts by value were renegotiated each year and 27 per cent of contracts were rolled over due to CRR. A greater percentage of contracts by value were renegotiated each year than were rolled over.

6.46 We contrasted ITV’s arguments regarding the lack of negotiation with the value of contracts that had been renegotiated year on year and reprotected to the current contract. In our view, CRR had not prevented negotiations occurring. We accepted that some media buyers had retained relatively dated contracts as their protected contracts, but we found that these media buyers, although seemingly large in number, accounted for a small proportion of ITV1’s gross revenue. The extent of negotiations that has taken place on each contract is not clear to us because it has been difficult to ascertain the precise terms changed and the value that is placed on those terms by both media buyers and ITV. However, absent CRR, we would only expect significant changes in contractual terms year on year if media agencies changed their client base significantly or their existing clients’ demands changed significantly. We found that, if media buyers choose to roll over protected contracts, it

is likely that ITV has not offered terms that are as attractive as pre-merger. A key purpose of the CRR Undertakings was to prevent ITV worsening terms for ITV1 airtime from those pre-merger; ITV is not restricted by CRR from making offers to media buyers in order to negotiate away deal debt.

- 6.47 We considered ITV's concerns regarding possible 'windfall gains' to media agencies which might mean that media agencies would require more attractive offers from ITV to induce them to relinquish their protected contracts. We did not agree that these concerns were well founded. We would expect advertisers to switch between media agencies if they were unhappy with the discount being offered by that media agency. We see 'brokering' using 'pool value' both as a natural corollary of umbrella deals and as one of the ways in which media agencies compete with each other. We noted that 'pool value' was part of media agency negotiations with broadcasters before the CRR Undertakings were put in place and is also used in negotiations with other broadcasters.
- 6.48 We found in paragraphs 6.41 to 6.47 that CRR did not appear to have significantly hindered negotiations between media buyers and ITV. Nevertheless, we considered the extent to which any deal debt on ITV1 since 2003 could be attributed to difficulties in ITV negotiating with media agencies due to protected contracts. We noted that deal debt is a natural phenomenon in the market for TV advertising airtime. All sales houses face deal debt when they are unable to deliver sufficient ratings to match the ratings sold. Indeed, issues with deal debt were present in the market for television airtime before CRR was put in place.<sup>202</sup> It was therefore unclear to us that CRR was likely to be the main cause, or even a major cause, of the deal debt faced by ITV in 2004 and 2005. Further, we found that, in the event that deal debt was allowed to accrue, it should be able to be negotiated away in the normal course of business. We noted that when ITV built up deal debt in 2006, it was able to [REDACTED].<sup>203</sup>
- 6.49 We next considered OC&C's estimate of the cost of protected contracts. OC&C estimated the cost of protected contracts by examining the amount ITV had paid for [REDACTED] rights, notably [REDACTED] in order to help address deal debt:
- (a) We recognized that £[REDACTED] million of the bid for the rights to [REDACTED] was attributed to [REDACTED]. However, as set out above, we found the contribution of CRR to deal debt to be uncertain. Further, we noted that ITV paid £[REDACTED] million for the rights to [REDACTED]. The overall bid price was based on ITV's view of the price needed to win the contract. The board paper shows that the highest bid scenario put forward to ITV's board was £[REDACTED] million. It was not clear to us that the [REDACTED] could be attributed to CRR. In particular, the board papers suggested that acquisition of these rights was at least as important for [REDACTED] as it was for removal of deal debt: [REDACTED].<sup>204</sup>
- (b) No evidence was submitted to support the extent to which ITV had [REDACTED] for other [REDACTED] rights, which accounted for £[REDACTED] million of the 'upper bound' estimate of costs.
- 6.50 We found that CRR had not significantly hindered the ability for ITV and media agencies to negotiate and so is likely to have had only a small effect on the creation

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<sup>202</sup>In 2003, in giving evidence to the CC, Granada referred to the extent to which Yorkshire Tyne Tees (YTT) had overtraded. YTT overtraded by £22 million on a turnover of £100 million. ITV said that YTT's overtrading had caused significant instability within the market. See also the commentary in the trade press regarding overtrading by YTT in the mid-1990s, for example *Marketing Week*, 13 September 1996, 'A worried YTTV barks at Laser'.

<sup>203</sup>Most sales houses overcome deal debt through negotiation during the annual deal season. This requires the sales house to offer something in exchange for removal of the deal debt.

<sup>204</sup>ITV investor presentation, *Morgan Stanley TMT Conference 2006*, 15 November 2006:

[www.itvplc.com/files/presentation/2200/MorganStanleyTMT06.pdf](http://www.itvplc.com/files/presentation/2200/MorganStanleyTMT06.pdf).

of any deal debt. We found that the value placed by ITV on the [redacted] contract, and indeed other [redacted] rights, was attributable to a range of factors, of which deal debt was only one. Considering the chain of causation between protected contracts, the amount of negotiation between ITV and media buyers, the creation of deal debt and the removal of deal debt through acquisition of [redacted] rights, it is our view that, at most, only a small proportion of the cost which ITV attributed to protected contracts is likely to be attributable to CRR. We consider the likely size of this cost in paragraph 6.60.

## *Operational constraints*

### *ITV views and OC&C's analysis*

- 6.51 ITV submitted that CRR had acted as an operational straitjacket through clause 10(h) of the CRR Undertakings, which restricted ITV from making changes to the CASS. OC&C noted that, although it had not conducted a full operational review of ITV, one example of the effect of CRR restricting commercially rational changes was the restriction on ITV rationalizing the number of micro-regions sold. ITV added that, in contrast to other broadcasters, if some media buyers were unwilling to amend their contracts to reflect operational changes, ITV would be precluded from making such operational changes. ITV said that, even if minor operational changes could be agreed with all media buyers, the cost to ITV would be significantly higher than it would be to other commercial broadcasters due to CRR. OC&C estimated that such operational changes could generate cost savings to ITV of between £[redacted] million and £[redacted] million a year.

### *Our assessment*

- 6.52 The operational constraints arising from CRR resulted from the detailed requirements of the CRR Undertakings as they relate to the CASS.<sup>205</sup> The CRR Undertakings oblige Carlton and Granada not to 'change their CASS 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'.<sup>206</sup>
- 6.53 If ITV is uncertain as to whether a change is likely to be a 'material' change to the CASS, it can seek guidance from the Adjudicator, Ofcom or the OFT prior to making a particular commercial decision and, if necessary, seek the OFT's consent. Our view is that the definition of CASS, in conjunction with the requirements of the CRR Undertakings for ITV to offer airtime on fair and reasonable terms, provides sufficient flexibility for individual media buyers and ITV to renegotiate mutually satisfactory contractual terms in relation to minor changes to the airtime sales system.<sup>207</sup> We consider that the rationalization of micro-regions, the example of an operational cost submitted by ITV, is not prevented by the CRR Undertakings.<sup>208</sup> We did not therefore find that this cost should be attributed to the CRR Undertakings, although we accepted that ITV may have opted not to make such changes given its interpretation of the CRR Undertakings.

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<sup>205</sup>The [Undertakings](#) contain a comprehensive definition of CASS as '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'—CRR Undertakings, clause 25.

<sup>206</sup>The [Undertakings](#), clause 10(h).

<sup>207</sup>The contract rights roll-over provisions of CRR give protection to media buyers in the event of an unsatisfactory outcome to negotiations, and media buyers would, in any case, have recourse to the adjudication process. Risks that ITV would circumvent CRR are addressed by the provision that such changes do not 'materially alter' the basis on which airtime sales are conducted, without the consent of the OFT.

<sup>208</sup>Indeed ITV sells the vast majority of its ITV1 airtime on the basis of macro regions (see first footnote to paragraph 8.89).

## Regulatory risk and uncertainty

### *ITV views and OC&C's analysis*

- 6.54 OC&C said that CRR introduced regulatory costs to ITV by creating regulatory risk in operational decisions. In particular, OC&C noted that the OFT and the Office of the Adjudicator had the ability to overturn or delay ITV's decisions. OC&C presented an example of ITV's decision in 2007 to [redacted]. OC&C's view was that this decision [redacted]. OC&C submitted that the regulatory uncertainty could have led to ITV forgoing £[redacted]–£[redacted] million profit a year, although it did not include this figure in its estimate of the costs of CRR. ITV added that similar regulatory risk applied to any decision ITV might take in relation to rationalizing micro-regions, particularly if a single micro-region advertiser took a dispute to the Adjudicator.

### *Our assessment*

- 6.55 As with changes to the CASS, we noted that ITV is not precluded from seeking guidance from the Adjudicator, Ofcom or the OFT prior to making commercial decisions. As in paragraph 6.53, our view is also that the requirements of the CRR Undertakings for ITV to offer airtime on fair and reasonable terms provides sufficient flexibility for individual media buyers and ITV to renegotiate mutually satisfactory contractual terms in relation to minor changes to the airtime sales system. We noted that the dispute [redacted]<sup>209</sup> and did not prevent ITV from implementing its proposed changes—ITV was able to [redacted]. In addition, the Adjudicator set out clear guidance on this matter in his *Guidance enquiries*.<sup>210</sup> We have considered the issue of rationalizing micro-regions in paragraph 6.53. No other examples of regulatory uncertainty were submitted to us. We did not find therefore that there was sufficient evidence to support the claim that CRR led to significant costs to ITV associated with regulatory risk and uncertainty.

## Administrative costs

### *ITV views and OC&C's analysis*

- 6.56 OC&C estimated administrative costs of CRR (such as the costs of the Office of the Adjudicator and ITV's compliance costs) to ITV of £[redacted] million a year.

### *Our assessment*

- 6.57 We agreed that the administrative costs of CRR were a relevant cost of CRR that needed to be taken into account in assessing the proportionality of the CRR Undertakings.

### *Our conclusion on the costs which ITV attributed to the CRR Undertakings*

- 6.58 As set out in paragraphs 6.12 to 6.57, we found that the CRR Undertakings had created some costs to ITV.
- 6.59 We found that the current definition of ITV1 in the CRR Undertakings had the direct effect of deterring ITV from providing ITV1+1 and ITV1 HD services. This had created significant profits forgone for ITV.

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<sup>209</sup>[redacted]

<sup>210</sup>*Guidance enquiries*, [redacted]. [www.adjudicator-crr.org.uk/enquiries.htm](http://www.adjudicator-crr.org.uk/enquiries.htm).

6.60 Our assessment of OC&C's evidence did not suggest that the other costs to ITV that it attributed to CRR were significant, although some costs may exist:

(a) For the reasons given in paragraphs 6.22 to 6.28 and 6.41 to 6.50, we found it likely that, at most, only a small proportion of the costs attributed by ITV to the ARM and protected contracts (totalling £[redacted]–£[redacted] million<sup>211</sup>) were attributable to CRR.

(b) For the reasons given in paragraphs 6.52 and 6.53, the operational costs (totalling £[redacted]–£[redacted] million) identified by ITV should not be considered as attributable to CRR.

(c) There was insufficient evidence to support the claim that CRR introduced significant costs to ITV associated with regulatory risk and uncertainty.

(d) There were administrative costs of CRR totalling £[redacted] million.

Overall, we found it likely that, at most, only a small proportion of these costs cited by ITV should be attributed to the CRR Undertakings.

6.61 We noted that some unquantifiable costs may exist (particularly in relation to dynamic costs) but that the size of these was highly uncertain.

6.62 We found that it would be appropriate to consider variations to the CRR Undertakings that might mitigate these costs, whilst retaining an effective remedy.

## 7. Conclusions as to changes of circumstance

7.1 In Section 5, we found that, although ITV1's market position is not as strong as in 2003, ITV1 has retained an enhanced market position as a result of the merger between Carlton and Granada, primarily due to its unique ability to deliver large audiences. We concluded that the changes of circumstance since 2003 did not warrant ITV's release from the CRR Undertakings and that a remedy was still required to address the likelihood that adverse effects would otherwise arise. Nevertheless, we concluded that we should consider variations to the CRR Undertakings to address the changes of circumstance we had identified.

7.2 In Section 6, we found that the CRR remedy had created some costs, primarily in deterring ITV from providing ITV1+1 or ITV1 HD services. We found that, at most, only a small proportion of the costs which ITV had attributed to CRR were likely to be attributable to CRR. Nevertheless, we concluded that we should consider whether ITV1's enhanced market position could be addressed in a way that imposed lower costs on ITV.

7.3 We therefore examine next whether there are appropriate ways to vary the Undertakings to address the following changes of circumstance:

(a) the decline in the market position of ITV1;

(b) unintended incentives for ITV created by the ARM to focus primarily on maximizing ITV1's SOCI;

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<sup>211</sup>This is the sum of £[redacted]–£[redacted] million and £[redacted]–£[redacted] million in paragraph 6.14 less the £[redacted] million relating to the effect of deterring ITV from launching ITV1+1 and ITV1 HD services, which are considered in paragraph 6.59.

(c) unintended disincentives for ITV to provide ITV1+1 and ITV1 HD services as a result of the definition of ITV1 in the Undertakings; and

(d) difficulties for ITV in reacting to changing demand due to protected contracts.

## 8. **Assessment of possible variations to CRR Undertakings**

8.1 In this section we assess possible variations to the CRR Undertakings that might address the changes of circumstance summarized in Section 7. We set out first those variations that we decided not to pursue (paragraphs 8.2 to 8.14). We then consider ITV's proposed Rules for Protection of Advertisers (paragraphs 8.15 to 8.66) before assessing certain amendments ITV proposed in relation to CRR (paragraphs 8.67 to 8.77). We next consider variations that we intend to implement (paragraphs 8.78 to 8.111). Having set out our conclusions on the effectiveness of possible variations (paragraphs 8.112 to 8.117), we consider proportionality (paragraphs 8.118 to 8.133).

### ***Variations that we decided not to pursue***

8.2 In this section we set out the variations to the CRR Undertakings that, on the basis of the responses that we received to our Notice and further analysis, we decided not to pursue. These were variations to:

(a) address ITV's ability to exploit ITV1's advantage in delivering large audiences;

(b) remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms;

(c) address incentives for ITV to focus primarily on maximizing ITV1's SOCI; and

(d) address difficulties for ITV in reacting to changing demand.

### ***Variations to address ITV's ability to exploit ITV1's advantage in delivering large audiences***

8.3 We considered varying the CRR Undertakings to regulate only sales of airtime within large audience programmes or programmes shown during peak time as a proxy for large audience programmes. Such variations could potentially take into account ITV1's advantage in delivering large audiences despite its overall decline in SOCI and share of NAR. In the Notice, we said that this variation would be complex to implement and presented risks of unintended effects.<sup>212</sup>

8.4 There was little support for this variation.<sup>213</sup> Virtually all the responses to the Notice indicated that this variation would be difficult to design and implement, would create a more complex set of rules, and would be uncertain in terms of its effects. ITV submitted that the CC's concerns regarding the complexities of separating the sale of ITV1 airtime into regulated and unregulated parts were well founded. It added that such a variation would require ITV to change its current airtime trading model to avoid being severely curtailed in its ability to optimize its inventory on ITV1.

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<sup>212</sup>Notice, paragraph 9.

<sup>213</sup>For a fuller summary of third party views on the possible variations in this section, see our [website](#).

- 8.5 We therefore found that it was not appropriate to vary the Undertakings specifically to address ITV1's advantage in delivering large audiences.

*Variations to remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms*

- 8.6 We invited views on a variation that would remove advertisers' entitlement to renew existing contract rights but would retain the requirement that ITV should offer ITV1 airtime on 'fair and reasonable' terms. As set out in our guidelines, terms that would be considered 'fair and reasonable' would need to be sufficiently transparent to customers and monitoring agencies to enable effective enforcement.<sup>214</sup> We said that, in our view, a variation based on 'fair and reasonable' terms had a number of significant drawbacks. These included the difficulty of establishing and applying consistently a 'fair and reasonable' test in relation to the pricing of television airtime and the resulting likely increase in the number of disputes. In the Notice, we said that, for these reasons, we were not minded to pursue this variation.<sup>215</sup>
- 8.7 Almost all parties agreed that this variation would be impractical, citing, for instance, the negotiating power that ITV had and the likely increase in disputes arising from the difficulty in defining requirements for ITV1 airtime which were 'fair and reasonable'.
- 8.8 We therefore found that it was not appropriate to vary the Undertakings to remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms.
- 8.9 ITV submitted a proposal, entitled Rules for Protection of Advertisers (RPA), which was based on an obligation on ITV to offer ITV1 airtime on 'fair and reasonable' terms, but was supplemented by a number of other components, including a form of 'price control'. We discuss this proposal separately, in paragraphs 8.15 to 8.66.

*Variations to address incentives for ITV to focus primarily on maximizing ITV1's SOCI*

- 8.10 We considered variations that could address incentives for ITV to focus primarily on maximizing ITV1's SOCI, for example by using an alternative measure of ITV1's market position or by changing the relationship between ITV1's SOCI and media buyers' SOB commitments in the ARM. In the Notice, we suggested that alternative measures or relationships could introduce fresh unintended consequences and may create specification problems relative to SOCI.<sup>216</sup>
- 8.11 ITV agreed with our concerns over such possible variations. Most third parties also saw no reason to adopt a different measure. It was put to us that introducing a new measure would create confusion and opportunities for misunderstanding. There was little support for changing the 1:1 relationship between ITV1's SOCI and media buyers' SOB commitments, nor was there a consensus as to how an alternative relationship should be defined.
- 8.12 We therefore found that it was not appropriate to vary the Undertakings specifically to address incentives for ITV to focus primarily on maximizing ITV1's SOCI.

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<sup>214</sup> *Merger Remedies: Competition Commission Guidelines*, CC8, November 2008, [paragraph 4.17](#).

<sup>215</sup> Notice, paragraph 13.

<sup>216</sup> Notice, paragraph 21. These included a lack of reliable measurement, the need to define a specific time of day or set of programmes and the fact that only one aspect of coverage would be captured.

## *Variations to address difficulties for ITV in reacting to changing demand*

- 8.13 In the Notice we invited views on any variations that could address difficulties for ITV in reacting to changing demand by introducing more flexibility into the negotiations between ITV and media buyers whilst ensuring that the CRR Undertakings continued to address the adverse effects of the merger. We received no proposals from third parties. ITV submitted that, apart from the adoption of a 'fair and reasonable regime' (see ITV's RPA proposal), it was not aware of a variation to CRR that would be likely to deliver greater flexibility in negotiations and an acceptable outcome to such negotiations.
- 8.14 We therefore found that it was not appropriate to vary the Undertakings specifically to address difficulties for ITV in reacting to changing demand.

## ***ITV's proposed Rules for the Protection of Advertisers***

- 8.15 ITV submitted two principal variants of its RPA proposal, both of which we published for consultation on our website:<sup>217</sup>
- (a) *RPA Mark 1.* ITV submitted [RPA Mark 1](#) in October 2009 in response to our Notice. RPA Mark 1 was based on maintaining ITV1's overall weighted average discount and preventing ITV from requiring increased ITV1 SOB commitments from media buyers unless ITV1's SOCI had increased. Media buyers' access to specials would also be maintained on existing terms.<sup>218</sup> These controls were supplemented by requirements on ITV to make offers for ITV1 airtime on 'fair and reasonable' terms and on a non-discriminatory basis. Disputes over offers for ITV1 airtime could be taken to adjudication. We assessed this version of RPA in our [Provisional Remedies Decision](#) and found that it would not be an effective remedy to the adverse effects of the merger. None of the responses to the Provisional Remedies Decision caused us to change our provisional views on RPA Mark 1.
- (b) *RPA Mark 2.* RPA Mark 2 is reproduced in Appendix J. ITV submitted RPA Mark 2 in February 2010 following publication of our Provisional Remedies Decision. It contained a number of differences to RPA Mark 1, including the introduction of thresholds for defining what would be presumed to constitute a 'fair and reasonable' offer and, therefore, which offers for ITV1 airtime could be subject to adjudication. These thresholds were based on two factors: the change proposed in a media buyer's SOB commitment relative to the change in ITV1's SOCI since the previous year's agreement and the size of the proposed reduction in an individual media buyer's discount. In paragraphs 8.23 to 8.44, we set out third parties' views on RPA Mark 2 and ITV's comments on these views. We set out our assessment of RPA Mark 2 in paragraphs 8.45 to 8.59. Following our publication of third parties' views and a letter to ITV in which we set out our provisional views on RPA Mark 2, ITV submitted further amendments to RPA Mark 2 in March 2010 (RPA Mark 2.1). RPA Mark 2.1 is also reproduced in Appendix J. The differences between RPA Mark 2 and RPA Mark 2.1 are described in paragraphs 8.60 and 8.61. We set out our assessment of RPA Mark 2.1 in paragraphs 8.62 to 8.66.

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<sup>217</sup>During its meetings with us and submissions to us, ITV provided a number of small changes to RPA Mark 1 and RPA Mark 2 prior to publication on our website, but, substantively, there were two versions of RPA. Where we use 'RPA' or 'RPA proposal' in this document we are referring to all variants of ITV's remedy proposal.

<sup>218</sup>ITV said that this measure was specifically to address our concerns regarding ITV1's large audiences.

- 8.16 ITV proposed that RPA would replace the CRR Undertakings. The RPA proposal also incorporated changes to the definition of ITV1 in relation to ITV1+1 and ITV1 HD, which we consider further in paragraphs 8.78 to 8.111.

#### *ITV's rationale for its RPA proposal*

- 8.17 ITV told us that its RPA proposal would fully address the specific concerns identified in the Provisional Decision, but in a manner that imposed substantially less distortion (and hence costs) on ITV's business, and hence would be a more proportionate remedy than CRR. ITV said that, although RPA would not give advertisers the same certainty as they were afforded under CRR, such certainty was no longer warranted in light of the changes of circumstance in the market in which ITV1 operated and, in particular, the increased substitutability of ITV1 airtime. ITV also maintained that, even if ITV1's market position had not changed since 2003, CRR was never intended to replace negotiations in the way that it has—it was intended to provide a fall-back option in the event that commercial negotiations failed. ITV said that media buyers did not enjoy any such certainty pre-merger, nor would they do so in any competitive market. In addition, ITV believed that this certainty had itself led to significant distortions in media buyers' behaviour, creating market rigidity which RPA would eliminate (see paragraphs 6.31 to 6.34). Instead, under RPA, ITV said that negotiations would take place between ITV and media buyers in a flexible and dynamic environment.
- 8.18 ITV told us that the constraints of RPA would nevertheless impose material restrictions on ITV's flexibility in negotiations. In particular, ITV said that RPA was designed to address the concerns identified in the Provisional Decision. ITV told us that any residual doubts as to whether such arrangements would, in practice, lead to mutually satisfactory outcomes would be addressed through a revised adjudication process.
- 8.19 ITV said that RPA would not allow media agencies and advertisers to roll over the vast majority of terms and conditions (for example, those relating to 'qualitative' features of airtime such as daypart commitments, position in break, centre breaks, etc) in their current contracts as they can under CRR.<sup>219</sup> ITV said that, in order to ensure that some form of negotiation occurred annually, not all aspects of contracts could be fixed as they were under CRR. ITV suggested that, since SOB and discounts were the two most important aspects of contracts, the least important aspects of contracts (qualitative terms) should no longer be fully protected in order to introduce constrained negotiating flexibility. ITV said that these qualitative terms were not 'remotely as important' to its customers as SOB commitments and discounts.

#### *Key features of ITV's RPA proposal*

- 8.20 ITV's RPA proposal would replace the CRR Undertakings. This would include paragraph 10(h) which obliges ITV not to change the CASS in a way that would materially alter the basis on which airtime sales are made without the consent of the OFT. ITV considered that it was unnecessary to have a specific undertaking that ITV must continue to trade on the basis of SOB commitments or SAP so as to ensure that it did not attempt to circumvent the RPA by changing the trading mechanism. This was because ITV would need to retain these trading parameters in order to comply with agreed SOB commitments. ITV also stated that maintenance of paragraph 10(h) of the Undertakings would not be acceptable to it given the broad-ranging and constraining nature of this requirement.

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<sup>219</sup>Access to specials on current terms was, however, maintained (see paragraph 8.22). RPA Mark 2.1 subsequently introduced a mechanism for maintaining daypart commitments (see paragraph 8.60).

8.21 The definition of ITV1 implied by paragraph 11 of the Undertakings would also be replaced by a new definition that included ITV1+1 and ITV1 HD (see paragraphs 8.78 to 8.111). In addition, ITV said that, since RPA would replace all aspects of CRR and give a revised system of protection, the rights conferred by the CRR Undertakings regarding advertisers which change media agencies or merge with other advertisers and media agencies that merge with other media agencies would no longer be necessary.

8.22 Under RPA Mark 2:<sup>220</sup>

- (a) ITV would be obliged to make a separate stand-alone offer for ITV1 airtime on 'fair and reasonable' terms to all customers.<sup>221</sup>
  - (b) ITV would commit to a form of 'price control' on ITV1 airtime in which it would maintain the overall weighted average contracted discount levels on ITV1 at not less than their current levels. ITV said that, as the discount element of the price control related to aggregate levels of discount, whether ITV met its weighted average contracted discount obligation overall was a matter of general compliance with the RPA rather than a matter for dispute by an individual media agency or advertiser. ITV proposed that its obligations relating to aggregate discounts could be validated after the event by an appropriate body such as Ofcom or an independent auditor appointed by Ofcom.
  - (c) The whole of ITV's offer for ITV1 airtime could be disputed by a media buyer if ITV failed to meet either of two criteria:
    - (i) the proposed change in the SOCI:SOB relationship was not 1:1 or was not in favour of the media buyer;<sup>222</sup> or
    - (ii) the proposed discount was more than a 10 per cent reduction of the previous year's discount.<sup>223</sup>
- Any offer that did not breach either of these two limits would be deemed to be fair and reasonable and could not be taken to adjudication. In the event of adjudication in relation to an offer outside these parameters, ITV would be required to demonstrate that the overall terms of its offer were not unreasonable.
- (d) ITV would commit to maintain media buyers' existing access to ITV1 specials on current terms, subject to content rights.
  - (e) ITV would put in place additional measures that would provide further protection to media buyers when negotiating contracts for ITV1 airtime. These would include:
    - (i) defined periods of time within which ITV would be required to make 'formal offers' to media buyers; and

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<sup>220</sup>Many of the features of RPA Mark 2 were also features of RPA Mark 1. However, there were a number of differences as described in paragraph 8.15(b).

<sup>221</sup>ITV said that, although it considered such an obligation to be unnecessary in light of Ofcom's conditional selling rules, it was willing to offer this obligation in order to avoid the need to consider the effectiveness of Ofcom's rules.

<sup>222</sup>In other words, the offer could be taken to adjudication if ITV sought a fall in SOB commitment that was less than the fall in SOCI; or ITV sought an increase in SOB commitment that was greater than the increase in SOCI.

<sup>223</sup>The 10 per cent reduction was expressed as a percentage of the previous year's discount and not as a percentage of SAP (ie it was not a ten percentage point reduction in discount). It could take place each year. ITV noted that the 10 per cent reduction in discount was a proposed level and that it could be set at a different level.

- (ii) aligning new internal procedures within ITV to ensure compliance with the requirements of RPA.
- (f) Adjudication would be a merits-based assessment on fair and reasonable terms of the whole of ITV's offer for ITV1 airtime. A revised adjudication process would include a mechanism for ITV to appeal to Ofcom in the event that the Adjudicator failed to act in accordance with the requirements of fair process or made a decision that was unreasonable or irrational.

### *Third parties' views on RPA Mark 2*

8.23 Almost all media buyers and broadcasters who submitted views to us said that RPA Mark 2 offered inadequate protection to advertisers and would not address effectively ITV's ability to insist on worse terms for ITV1 airtime. For example, one broadcaster (Five) said:

Although a formal relationship between share of broadcasting commitment and ITV1 SOCI might be retained, the withdrawal of all terms and conditions protected by CRR together with a new ability for ITV to negotiate over discount levels would mean advertisers and agencies would be under pressure to offer larger SOB commitments in order to maintain their existing discount and terms and conditions provisions.

- 8.24 The one exception was a media agency (Walker Media) which differs from its larger competitors in that its business is based on line-by-line rather than umbrella deals. This media agency expressed some reservations about the feasibility of RPA Mark 2 as a sensible replacement for CRR but at the same time was keen for CRR to be lifted. It also said that there was a case for a wider-ranging review of the airtime trading market.
- 8.25 Ofcom noted a number of positive aspects of RPA Mark 2. In particular, it said that 'if workable, the remedy should have a positive impact on the TV advertising sector as it would provide stronger incentives for full annual negotiations compared with what apparently happens under CRR'.<sup>224</sup> It said that, although there would be less certainty for media agencies in each deal round, RPA Mark 2 would improve the incentives facing buyers fundamentally to reassess their requirements for ITV1 airtime each year. However, Ofcom had concerns about how the adjudication process would work under RPA Mark 2 (see paragraph 8.37).
- 8.26 We discuss third parties' views on RPA under the following headings:
- (a) the criteria used to assess whether an ITV offer for ITV1 airtime would not be deemed unreasonable (adjudication thresholds);
  - (b) the extent of protection likely to be afforded by the proposed rules on discounts;
  - (c) the effect of RPA on the negotiation process; and
  - (d) the likely effectiveness of the adjudication process.

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<sup>224</sup>We discuss the extent of annual negotiations in paragraphs 6.41 to 6.47.

### *Adjudication thresholds*

- 8.27 The majority of third parties from whom we heard considered that, in itself, the proposed 1:1 relationship between changes in ITV1's SOCI and SOB commitments, as a threshold for adjudication, was satisfactory.
- 8.28 No third parties told us that the proposed 10 per cent discount reduction threshold for adjudication was fair or reasonable. Instead they told us that a reduction approaching 10 per cent would be very significant indeed.<sup>225</sup> One broadcaster (Five) said that 'advertisers and agencies would be under pressure to offer larger SOB commitments in order to maintain their existing discount and terms and conditions provisions'. In addition, two broadcasters (Five and UKTV) noted the scope for price discrimination that the 10 per cent discount reduction threshold would permit.
- 8.29 Third parties drew attention to the scope that ITV would have to worsen terms for media buyers even within the parameters in which deals would be deemed fair and reasonable (and thus not eligible for adjudication). They said that ITV could for example:
- (a) propose the removal of all of a media buyer's existing quality and other terms and conditions; and/or
  - (b) propose to reduce an individual media agency's discount by up to 10 per cent.
- 8.30 We were told that in both cases the terms offered to a media agency could be significantly worsened without exposing ITV to the risk of being taken to adjudication. Further, the prospect of these terms worsening could incentivize media agencies to accept an increase in SOB commitment in order to maintain the same terms.

### *Discounts*

- 8.31 Third parties were generally sceptical as to whether ITV's proposed control over its weighted average discounts would offer advertisers effective protection. Two main criticisms were levelled at the proposal: that it posed circumvention risks and that the measure lacked transparency.
- 8.32 A number of third parties expressed concerns that the weighted average discount control could be circumvented by ITV in one of the following ways:
- (a) Discounts are set against SAP, which varies depending on audience delivery and overall demand. Concerns were therefore raised that ITV could increase SAP by charging media buyers to buy back the unprotected quality parameters.
  - (b) ITV could manipulate the total discount available through optimization of its inventory against audiences by not allowing advertisements in particular programmes unless media buyers purchased certain, more expensive, audiences.
  - (c) As the discount control is recalibrated each year and calculated on a delivered basis, ITV would be able to under- or overdeliver on discounts.

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<sup>225</sup>One major advertiser ([redacted]) described a 10 per cent reduction in discount as 'a massive loss of value'. Another (Kraft Foods) said that 'a 10% reduction in our current discount would equate to a [redacted]% price increase ... Paying more for the same levels of ITV1 airtime is not fair or reasonable.' Another ([redacted]) said that '... this would have meant a loss of airtime value of around £0.5m to (us) in 2008/09 ... equivalent to the cost of a light and medium weight TV campaign'.

- 8.33 One broadcaster (Five) noted that ‘media buyers would have no transparency about how much discount was in the market so would be bidding “blind” in an auction they could not afford to lose’. Third parties pointed out that the validation exercise would have to be carried out after the event and so was not transparent and that the calculations involved would be complex and prone to error given the wide range of different types of deals.<sup>226</sup>

#### *Effects on the negotiation process*

- 8.34 ITV’s claim that terms and conditions, including ‘quality’ terms such as daypart commitments, first in break, centre breaks etc, were relatively unimportant was strongly refuted by third parties.<sup>227</sup> The IPA told us that its members believed that ITV was ‘fundamentally wrong’ to dismiss the importance of quality terms and commitments. It said that the removal of existing terms and conditions could provide ITV with an opportunity to reduce quality and thus overall value. Media agencies told us that they spent a significant amount of time negotiating quality terms with ITV<sup>228</sup> and that their performance on delivering quality indicators was compared with that of other media agencies. In the analysis tool used by one media auditor (Billett’s ‘Rack’), quality is an integral function of the cost of a campaign. Non-quality terms, such as ‘value pot’ arrangements and late booking fees and penalties, were also cited by third parties as potential sources of negotiation leverage for ITV.
- 8.35 Third parties suggested that ITV would have the incentive and the ability to negotiate higher SOB commitments from media buyers. A major advertiser (Kraft Foods) submitted that RPA Mark 2 would ‘provide ITV with the ability to force higher SOB commitments to maintain contracted discounts.’ A broadcaster (Sky) said that ITV could be expected to leverage from media buyers a SOB commitment which was disproportionately higher than ITV1’s SOCI justified, thus removing the protection over the relationship between SOB and SOCI. Another broadcaster (Five) told us that ‘media buyers would be incentivised to offer larger SOB deals in order to secure as high a level of discount as possible’. Media agencies tended to agree with this, telling us that ‘discount means everything’ ([redacted]) and that ‘if agency umbrella share deals continued to operate it was likely that ITV would be in a strong position to negotiate increases in SOB’ (Walker Media). Some pointed out, however, that, were a media agency to favour ITV1 simply in order to maintain its discounts, this would be discovered and pointed out to advertisers by media auditors.

#### *The adjudication process*

- 8.36 Some third parties submitted that RPA Mark 2 would lead to fewer disputes being taken to adjudication than CRR. Others thought that the volume of disputes being taken to adjudication would increase. Third parties also submitted that disputes taken to adjudication would be complex to deal with. A broadcaster (Five) told us that ‘so many factors currently subject to CRR provisions would become a matter for negotiation that it would be extremely difficult for any outside adjudicator to disentangle all the elements and form a view as to whether an offer made by ITV was fair and

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<sup>226</sup>As one third party ([redacted]) said, ‘... in any one year there are a great many individual contracts that would have to form part of the calculations. These contracts are a mixture of advertiser direct deals, individual line-by-line deals, agency deals, burst deals etc. The calculations necessary to arrive at a weighted average discount would occupy a huge spreadsheet and entail thousands of inputs, making mistakes highly possible.’

<sup>227</sup>One major advertiser ([redacted]) said ‘We disagree entirely with ITV’s assertion that quality is not “remotely as important to ITV’s customers as SOB commitments and discounts”.’ [redacted] and a third ([redacted]) said that it was ‘amazed’ by ITV’s assertion that these terms and conditions were not relevant. It described the statement that they were not as important as SOB commitments as ‘simply not true’.

<sup>228</sup>One third party ([redacted]) told us that it estimated that 40 per cent of its time spent negotiating with ITV related to terms and conditions.

reasonable'. Another broadcaster (Sky) told us that RPA Mark 2 would require a level of supervision and adjudication on a contract-by-contract and term-by-term basis that was totally impractical.

- 8.37 Ofcom told us that the lack of clarity resulting from the absence of guidance on how adjudication would be undertaken under RPA Mark 2 would result in significant difficulties in interpreting RPA Mark 2 and so resolving disputes. It said that under CRR the Adjudicator only has to agree (or disagree) that an offer is fair and reasonable in relation to a protected contract. Under RPA Mark 2 there would be no such backstop against which to compare the current offer. It believed that, as a result, detailed guidance would be needed as to what would constitute a fair and reasonable offer from ITV. If such guidance was impossible to provide, it suggested exploring alternative approaches to adjudication, such as developing a process akin to arbitration.
- 8.38 Third parties also told us that media buyers would be more exposed to brinkmanship tactics by ITV and that any right of appeal for ITV to Ofcom would prolong the adjudication procedure to the disadvantage of media buyers. An advertiser (Kellogg) submitted that 'the commercial leverage that ITV has by not allowing bookings to be made until a dispute is adjudicated on would significantly weaken any adjudication process'. Another advertiser (Kraft Foods) told us that 'the right of appeal enables ITV to use this as a delaying tactic which adds more time pressure to the negotiation process'.
- 8.39 Ofcom said that, in its view, an independent adjudicator with a good understanding of the sector and experience of how television advertising negotiations took place and who was able to develop a good working relationship with both ITV and media buyers was best placed to resolve disputes in a timely manner. Ofcom expressed concerns about ITV's proposal to introduce a right of appeal for ITV to Ofcom because of the risk of undermining the Adjudicator's role and expertise. In particular, Ofcom was concerned that there would be a strong incentive for ITV to appeal any decision which did not give it a favourable outcome. This would significantly prolong the adjudication process and could deter media buyers from referring a dispute for adjudication in the first place. Ofcom also noted that any concerns regarding the way the Adjudicator carried out his duties could be resolved via discussions with the OFT or Ofcom, such that an appeal mechanism was not necessary.

#### *ITV's comments on third parties' views*

- 8.40 In response to third party comments on its RPA Mark 2 proposal, ITV said that many of the statements made by media buyers were untrue and, in certain circumstances, appeared to be deliberately misleading.
- 8.41 ITV said that third parties had put forward no evidence to support their view that the 10 per cent discount reduction threshold was 'a massive figure'. Further, it said that the importance which one agency attributed to discounts supported ITV's contention that terms and conditions were not remotely as important as discounts or SOB and that the aim of agencies was to retain what it described as the 'windfall gains' they had achieved under CRR.
- 8.42 ITV said that the concerns raised by third parties regarding the possible circumvention of the weighted average discount control (see paragraph 8.32) were misleading and incorrect. In particular, ITV said that the discount control was calculated on a contracted basis, not a delivered basis, in order to eliminate the circumvention concerns raised by third parties. ITV also said that compliance with the weighted average discount control was not a matter that was relevant to individual negotiations and that all an individual media buyer needed to know was that an appropriate body

was responsible for monitoring and enforcement. Further, ITV said that the discount calculation under RPA Mark 2 would be more straightforward than the advertiser-specific calculations required under CRR.

- 8.43 ITV also said that third parties had not provided evidence to support their views that 'quality' terms were important. It said that ITV's customers did not have an absolute entitlement to receive these terms and that ITV could not deliver them in aggregate in any case.
- 8.44 Nor, according to ITV, had media agencies provided evidence to support their submissions that the burden of the adjudication process on media agencies was likely to be greater under RPA Mark 2 than under CRR. In particular, ITV argued that, under RPA Mark 2, media buyers would only need to demonstrate that the offer fell outside the specified parameters. ITV said that it expected there to be fewer disputes; if, however, this were not the case, it would be possible to scale up the Adjudicator's resources to meet increased demand. ITV added that it would be incentivized to minimize the number of disputes because the burden of proof under RPA Mark 2 would be on ITV to demonstrate that its offer was not unreasonable and the cost of the Adjudicator's Office would be borne by ITV. ITV said that it was not proposing a right of appeal to Ofcom on the substance of a dispute but to ensure that the Adjudicator followed due process.

### *Our assessment of RPA Mark 2*

- 8.45 As set out in paragraph 5.167, we found that ITV1's enhanced market position was still sufficiently strong that, absent appropriate remedies, adverse effects would occur. As we set out in that paragraph, such adverse effects might arise in one or more of the three ways described in the 2003 report. We consider in paragraphs 8.46 to 8.59 whether RPA Mark 2 provides sufficient protection to media buyers so as to address effectively each of these adverse effects in light of the changes of circumstance identified in Section 5.

#### *The ability of ITV to insist on less attractive terms or to enhance the degree of price discrimination*

- 8.46 The first two ways in which the adverse effect identified in the 2003 report might manifest itself were that the merger may enhance ITV's ability to insist on terms less attractive either to media buyers as a whole or to specific media buyers through enhanced price discrimination. These terms could relate to three contractual aspects of ITV1 airtime: (a) SOB commitment, (b) discounts, and (c) other terms and conditions. We considered how RPA would provide protection in relation to these aspects.
- 8.47 The rules proposed by ITV primarily set the parameters for access to the adjudication process (plus an additional control regarding overall weighted average discounts). We consider first whether it would be possible for adverse effects to arise within the scope of the parameters of RPA Mark 2 without the adjudication process being initiated by media buyers. We then consider the extent to which the adjudication process, when initiated, would provide protection to media buyers.
- 8.48 First, ITV could worsen the terms on which ITV1 airtime is made available to a media buyer without a media buyer being able to challenge the offer through the adjudication process. It could, in particular:

- (a) worsen media buyers' terms and conditions (for example, terms relating to day-part commitments, programme breaks or payment terms) as these are all outside the parameters of adjudication under RPA Mark 2. We disagreed with ITV that such terms and conditions are not important to media buyers (see paragraph 5.135); and
  - (b) reduce an individual media buyer's discount by up to 10 per cent year on year. We noted that media agencies have consistently explained that the discount on ITV1 airtime is an important differentiating factor in competition between media agencies (see paragraph 5.121).
- 8.49 Second, ITV could structure an offer in such a way that, while the media buyer could in principle take a dispute to adjudication, it would not do so in practice. We noted the submissions of many third parties who told us that a media buyer may be under pressure to offer, for example, a larger SOB commitment than would be consistent with the change in ITV1's SOCI in order to retain its discounts and/or its terms and conditions. ITV would be able to leverage the contractual terms outside the parameters of the adjudication process in order to extract a higher SOB commitment from the media buyer. For example, ITV would be able to extract higher SOB commitments by threatening to reduce aspects such as pool value arrangements, payment terms, or discounts by up to 10 per cent. In these circumstances, we were concerned that the media buyer would be likely to commit to a higher SOB rather than accept a lower discount or worse terms and conditions for the same SOB.
- 8.50 As identified in the 2003 report, we found that any increase in SOB commitment to ITV1 would also have an adverse effect on other commercial broadcasters, who would consequently receive a smaller share of media buyers' budgets than they would otherwise.
- 8.51 We were also concerned that other factors may mean that some media buyers would not take a dispute to adjudication:
- (a) Some third parties had said, in relation to CRR, that media buyers were not always willing to take cases to the Adjudicator, primarily because of the fear that ITV had considerable bargaining leverage over a media buyer during campaign schedule discussions (see paragraph 5.136). In particular, the balance of negotiating power between ITV and media buyers would favour ITV, given its enhanced market position in relation to large audiences. We were concerned that those media buyers most reliant on ITV1 would feel least able to bring a dispute, when they would be most in need of protection.<sup>229</sup>
  - (b) RPA Mark 2 provides no effective fallback position for media buyers. We were concerned that ITV should not be able to circumvent the adjudication process by prolonging negotiations in the period leading up to the new year in order to force media buyers to accept unattractive terms before their existing agreements ran out. This would make the adjudication process ineffective and squeeze the time available for media buyers to negotiate with other broadcasters given the importance of agreeing the SOB being committed to ITV1.
- 8.52 We noted media buyers' concerns regarding the weighted average discount control and ITV's claim that these concerns were not valid (see paragraphs 8.32 and 8.42). We found that the overall weighted average discount control would not be a straight-forward calculation, but given the concerns we identified in paragraphs 8.48 and 8.49

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<sup>229</sup>ITV told us that media buyers would not be daunted in taking a dispute to adjudication because they would only have to register a dispute and the burden of proof would be on ITV.

in particular, we did not need to form a view as to whether this particular component of RPA Mark 2 would work in practice.

- 8.53 We next considered whether, in the event that a media buyer chose to take a dispute to adjudication, the proposed adjudication process offered adequate protection against a worsening of terms. In our view, RPA Mark 2 places substantial reliance on the adjudication process. It is therefore critical that the adjudication process should operate effectively to protect media buyers.
- 8.54 Our guidelines state that any remedy based on ‘fair and reasonable terms’ must deal adequately with the circumstances of external customers and must be transparent to customers and monitoring agencies in sufficient detail to enable effective enforcement.<sup>230</sup> In the absence of clear guidance on the basis for adjudication, we anticipate that there would be considerable difficulty for any adjudicator (or appeal mechanism) to weigh the value of SOB commitments, discount and terms and conditions against each other for any given media buyer. Even with such guidance, given the considerable variations in terms between media buyers, the basis for any adjudication under RPA would be likely to be complex.
- 8.55 ITV’s proposed appeal process to Ofcom would add additional risk and costs to the dispute process and would also be likely to lead to extended time frames over which disputes would be resolved. We also noted that Ofcom did not consider such an appeal mechanism to be necessary.

#### *Changes to the airtime sales system*

- 8.56 The third way in which the adverse effect identified by the CC in the 2003 report might manifest itself was that ITV would be able to change the system under which television advertising airtime was sold to its advantage.
- 8.57 As set out in paragraph 8.20, RPA Mark 2 would remove clause 10(h) of the Undertakings which obliges ITV not to change the CASS. We found it difficult, however, to see how ITV could be sure of complying with undertakings varied on the basis of RPA Mark 2 if it were to move away from using the existing trading metrics of SOB commitment and SAP.

#### *Our conclusion on RPA Mark 2*

- 8.58 We identified two key concerns with RPA Mark 2:
- (a) First, ITV would be able to worsen terms to media buyers, particularly in relation to discounts and other terms and conditions, without the possibility of being taken to adjudication. This might also, for example, result in media buyers agreeing to higher SOB commitments in order to retain their previous year’s terms. This would also have an adverse effect on other commercial broadcasters, who would consequently receive a smaller share of media buyers’ budgets than they would otherwise.
  - (b) Second, the proposed adjudication process would be inadequate given the need for guidance on ‘fair and reasonable’ terms, the lack of an effective fallback

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<sup>230</sup> *Merger Remedies: Competition Commission Guidelines*, CC8, November 2008, [paragraph 4.17](#). The discussion relates to fair, reasonable and non-discriminatory terms and access remedies but the principle is applicable to the RPA remedy proposed by ITV.

position for media buyers and the potential risks and delay introduced into the negotiation process in this complex market.

- 8.59 We therefore concluded that RPA Mark 2 would not be able to remedy effectively the adverse effects arising from the merger.

*ITV's further refinements to RPA Mark 2: RPA Mark 2.1*

- 8.60 RPA Mark 2.1 differed in two principal ways from RPA Mark 2:

- (a) ITV invited us to determine an appropriate figure for the previously proposed discount reduction threshold of 10 per cent if we did not believe that 10 per cent was appropriate; and
- (b) ITV proposed that media buyers would be given the right to retain the daypart access rights granted under their current contracts.<sup>231</sup>

- 8.61 Additional differences between RPA Mark 2.1 and RPA Mark 2 included requiring ITV to send media buyers a formal offer on ITV1 airtime at least two weeks before the end of the existing contract; allowing terms of existing contracts to be rolled over until resolution of any dispute; providing an ex-ante mechanism by which Ofcom could monitor the weighted average discount control; and allowing Ofcom to impose fines on ITV if it did not comply with the control (see Appendix J).

*Our assessment of RPA Mark 2.1*

- 8.62 We considered whether ITV's revision to RPA Mark 2, as set out in RPA Mark 2.1, would be an effective remedy to the adverse effects arising from the merger.
- 8.63 We found that, assuming the discount reduction threshold was greater than zero,<sup>232</sup> ITV would still have the ability to reduce individual media buyers' discounts year on year yet remain outside the scope of the adjudication process. ITV would also be able to use the threat of imposing a discount reduction of less than the adjudication threshold to extract a larger SOB commitment from a media buyer than would be implied by any change in ITV1's SOCI. The discount reduction threshold determines the scope of the adjudication process. Lowering the threshold would reduce the year-on-year reductions in discount which could be applied without the adjudication process being available but would place more emphasis on the adjudication process.
- 8.64 We found that, regardless of ITV's proposal on daypart commitments, ITV would still be able to impose year-on-year discount reductions and worsen other terms and conditions. This would be sufficient to enable it to extract higher SOB commitments from media buyers.
- 8.65 We found that ITV's proposed temporary rollover arrangement (see paragraph 8.61) would be likely to extend rather than reduce the risks for media buyers. In particular, any adjudication decision that was unfavourable to the media buyer would necessitate a process of unwinding and recalculating the terms on which airtime was traded between ITV and media agencies, and between media agencies and their clients. This would lessen media buyers' incentives to take a dispute to adjudication

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<sup>231</sup>This protection would involve a formula to adjust existing daypart commitments by the relative proportionate change in dayparts since 2002 so as to ensure that ITV's inventory remained in line with daypart commitments.

<sup>232</sup>We noted that a threshold of zero would result in a position similar in nature to CRR.

in the first place. The prospect of a right of appeal by ITV would further increase these risks and likely delays.

*Our conclusion on RPA Mark 2.1*

- 8.66 Although RPA Mark 2.1 addressed some of the concerns we identified in relation to RPA Mark 2, we concluded that RPA Mark 2.1 did not sufficiently address the two key concerns set out in paragraph 8.58. We therefore concluded that it would not be an effective remedy to the adverse effects arising from the merger.

***ITV's proposed amendments to CRR***

- 8.67 In March 2010, ITV submitted a number of ways in which the current CRR Undertakings might be amended in the event that we concluded that the CRR remedy should be substantially retained. We found that these proposed amendments fell into three categories:

- (a) the adoption of a procedure to permit ITV to appeal to Ofcom following a decision by the Adjudicator. The grounds for appeal would be where the Adjudicator failed to act in accordance with the requirements of a fair process or made a decision that was unreasonable or irrational;
- (b) measures to mitigate or remove the alleged distorting effects of CRR. These concerned issues raised by ITV in relation to the mismatch of supply and demand under protected contracts, operational constraints of CRR and the regulatory risk and uncertainty caused by CRR; and
- (c) matters which did not relate to a change of circumstance but were related to issues of process.

*Our assessment*

*An appeal procedure for ITV*

- 8.68 In paragraph 8.39, we set out that Ofcom did not consider that an appeal mechanism was necessary (either for RPA or for CRR) and that an independent adjudicator was the most appropriate way to achieve an effective and responsive process for resolving disputes.
- 8.69 We were concerned that ITV's proposed right of appeal to Ofcom:
- (a) would be likely to deter media buyers from bringing disputes to adjudication and may thus increase any incentive to rely on their protected contract terms rather than engage in negotiations with ITV;
  - (b) would be likely to increase the cost and complexity of CRR—in particular, the average length of disputes would be expected to increase; and
  - (c) depending on the precise role of the appeal body, it may undermine the role of the Adjudicator by moving the 'real' ground of determination to the appeals process.
- 8.70 Accordingly, we found that the proposal would be unlikely to enhance the effectiveness of the remedy or reduce its costs.

*Measures to address alleged distorting effects of CRR*

- 8.71 These proposals included measures to address what ITV referred to as ‘the mismatch of supply and demand under protected contracts’, aimed at bringing its contractual commitments into line with its actual supply of inventory. They also included measures to address the operational constraints and regulatory risk and uncertainty that ITV said were caused by CRR (see Section 6). We have already examined such alleged distortions in Section 6 and found that, with the exception of the definition of ITV1, only a small proportion of the costs, at most, were attributable to CRR.
- 8.72 There were four proposed amendments that fell into this category. ITV said that:
- (a) The intention of clause 10(h) of the Undertakings, which relates to not changing the CASS, should be clarified to ensure that CRR operates in the way in which it was originally intended (to prevent circumvention of CRR) without unnecessarily constraining ITV operationally, for example changing its micro-regions (see paragraph 6.51).
  - (b) It was necessary to make clear that the Adjudicator’s role in disputes is solely to determine whether the terms offered to a particular media buyer are ‘fair and reasonable’ and is not, for example, ‘to require ITV to continue to invest in particular programming’. ITV said that, in the event that ITV decides not to invest in particular programming, the Adjudicator’s role is to determine whether the revised terms and conditions offered by ITV are ‘fair and reasonable’ in the changed circumstances. (see paragraph 6.54).
  - (c) Clause 10(b)(iii) of the Undertakings on advertisers switching media agencies being automatically included in existing media agency deals, clause 10(f) on mergers between line-by-line advertisers and clause 10(g) on media agency mergers should be clarified to ensure that the existing caveats operate as originally intended. These caveats should prevent a situation arising whereby ITV would be contractually obliged to deliver more inventory than it has available as a direct result of CRR rather than due to any change in ITV1’s performance.
  - (d) The proposed adjustment for daypart commitments under RPA Mark 2.1 (see paragraph 8.60) should be included within CRR to bring daypart commitments back in line with inventory.
- 8.73 We have set out our views in paragraphs 6.52 and 6.53 in relation to possible operational constraints caused by clause 10(h) of the Undertakings and changes to the CASS, and in particular our views on changes to ITV1 micro-regions offered for sale by ITV. It is not clear to us that changes in relation to micro-regions are ‘material’ changes to the CASS. Even if they were considered to be ‘material’, ITV could make such changes with the consent of the OFT under clause 10(h) of the Undertakings. Where ITV wishes to make non-material changes to the CASS which would prevent it from delivering rights protected under CRR, it should offer ‘fair and reasonable’ terms to affected customers. In the event that a customer takes a dispute to adjudication, the Adjudicator will determine whether ITV’s offer is fair and reasonable. Ofcom said that it was not convinced that any changes were required to clause 10(h). We also find that the Undertakings do not need to be revised to reflect this matter. The process is explained in Ofcom’s *Technical Background Guide to Advertisers and Buyers’ rights under the CRR remedy* (Ofcom’s guidance) and the Adjudicator’s *Guidance*

*enquiries* (the Adjudicator's additional guidance).<sup>233</sup> To the extent that any clarification would be helpful, this could be reflected in Ofcom's guidance and/or the Adjudicator's additional guidance.

- 8.74 We have set out our views in paragraph 6.55 in relation to regulatory risk and uncertainty claimed to have been caused by CRR. Ofcom said that changes in regulation may cause uncertainty about ITV's ability to meet protected contracts. Ofcom believed that the interpretation of 'fair and reasonable' should be flexible enough to cover circumstances where ITV may not be able to meet contractual commitments due to changes in regulation. In our view, such issues should be capable of resolution through constructive engagement between ITV and its customers and ultimately, in the event that changes to terms are necessary, ITV should offer a media buyer 'fair and reasonable' revised terms. In the event of a dispute, the Adjudicator would take any changes in regulation into account in arriving at a judgment. The process is explained in the Adjudicator's additional guidance.<sup>234</sup> To the extent that any clarification would be helpful, this could be reflected in Ofcom's guidance and/or the Adjudicator's additional guidance.
- 8.75 Ofcom said that, although it was sympathetic to the view that there should be flexibility in interpreting ITV's contractual position under protected contracts, it did not understand the scale of the problem in relation to ITV's proposed changes in paragraph 8.72(c) or how ITV was proposing to rectify it. In our view, the Undertakings already provide ITV with adequate protection in clauses 10(b)(iii) and 10(f)(i)(cc). If ITV wishes to exercise these clauses it should do so on 'fair and reasonable' terms and in the event of a dispute it would be for the Adjudicator to determine whether ITV had done so. To the extent that any clarification would be helpful, this could be reflected in Ofcom's guidance and/or the Adjudicator's additional guidance.
- 8.76 We have set out our views in paragraphs 6.41 to 6.50 in relation to the role of protected contracts. In our view, it is not necessary or appropriate to add complex daypart calculations to CRR; issues relating to changing demand and supply of daypart commitments should be capable of resolution through constructive engagement between ITV and its customers.

*Matters not relating to changes of circumstance*

- 8.77 ITV submitted a number of proposals for refinements to the CRR Undertakings which we considered would best be dealt with in consultation with Ofcom (and other parties, such as the Adjudicator, as appropriate) rather than through variations to the CRR Undertakings. None of these matters, in our view, related to changes of circumstance. These matters included:
- (a) clarifying the nature and extent of ITV's obligation to supply information to the Adjudicator, currently described in paragraph 21 of the Contracts Rights Renewal Adjudication Scheme (CRR Scheme);<sup>235</sup>
  - (b) clarifying the scope of the Adjudicator's role in providing guidance on the CRR Undertakings and any process by which that guidance is updated over time;

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<sup>233</sup> *Technical background guide to advertisers and buyers' rights under the CRR remedy:*

[www.ofcom.org.uk/tv/ifi/guidance/ITV\\_airtime\\_sales/tech\\_crr/crr\\_remedy\\_pdf.pdf](http://www.ofcom.org.uk/tv/ifi/guidance/ITV_airtime_sales/tech_crr/crr_remedy_pdf.pdf).

*Guidance enquiries*, for example questions 4 and 13: [www.adjudicator-crr.org.uk/enquiries.htm](http://www.adjudicator-crr.org.uk/enquiries.htm).

<sup>234</sup> *Guidance enquiries*, for example questions 4 and 13: [www.adjudicator-crr.org.uk/enquiries.htm](http://www.adjudicator-crr.org.uk/enquiries.htm).

<sup>235</sup> The CRR Scheme is set out in Annex 3 of the Undertakings.

- (c) clarifying clause 10(e) of the Undertakings which specifies the process by which a new contract is designated as a protected contract, so as to prevent media buyers subsequently switching back to a previous protected contract;
- (d) establishing a procedure for making offers to media buyers so as to avoid making offers to those media buyers that do not wish to buy ITV1 airtime; and
- (e) establishing the appropriate extent of consultation over the Adjudicator's costs, currently described in paragraphs 12 and 13 of the CRRA Scheme.

### ***Variations that we intend to implement: redefinition of ITV1***

- 8.78 In Section 6, we found that the definition of ITV1 in the Undertakings had reduced the incentive for ITV to invest in ITV1+1 and ITV1 HD services. Impacts delivered through these services would not count towards ITV1's SOCI in the ARM calculation. ITV would therefore be penalized by any reduction in impacts on ITV1 following the launch of an ITV1+1 or ITV1 HD service because media buyers would be able to reduce their SOB commitments in line with the reduction in ITV1's SOCI. We said that we would examine whether the definition of ITV1 in the Undertakings could be changed to take into account this cost.
- 8.79 In this section, we set out third parties' and ITV's views on this variation. We then set out our assessment of the proposed variation.

#### *Third parties' views*

- 8.80 The majority of the responses we received, particularly from media buyers, supported the proposed variation. However, the smaller broadcasters and their sales houses generally expressed concern that the variation would cause ITV1's SOCI, and thus, potentially, its share of NAR, to increase at the expense of other broadcasters.
- 8.81 Third parties raised a number of specific concerns in relation to this proposed variation, which we discuss in paragraphs 8.82 to 8.85.

#### *Content of ITV1+1 and ITV1 HD*

- 8.82 The majority of third parties commented that the variation should be based on a requirement that ITV1+1 and ITV1 HD services are exact replicas<sup>236</sup> of ITV1 with identical programming and advertisements. Some particular concerns were expressed in relation to this:
- (a) Some broadcasters expressed concern that ITV would not be able to offer an exact replica of ITV1 because there would be difficulties in providing the regional services presently offered by ITV1.
  - (b) One broadcaster ([redacted]) told us that, if ITV could not provide on all platforms the same level of regionalization on ITV1 HD and ITV1+1 as it provided on ITV1, impacts on ITV1+1 and ITV1 HD should not be included in the ARM calculation. Another broadcaster (Sky) said that there would need to be a change to the recording and attribution of viewing for ITV1+1 and ITV1 HD. It said that safe-

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<sup>236</sup>We use 'exact replica' to refer to a 'simulcast' of ITV1 in the case of ITV1 HD, and a 'staggercast' delayed by 1 hour in the case of ITV1+1. We note that in practice there may be circumstances when it may not be feasible for advertisements on an ITV1+1 channel to be identical to ITV1, eg advertisements for a lottery being shown after the lottery has taken place. Such circumstances would need to be taken into account.

guards were necessary to ensure that such viewing was in the first instance correctly recorded by BARB in the appropriate region and then correctly attributed to ITV1's SOCI under the ARM.

- (c) One broadcaster ([REDACTED]) told us that an ITV1+1 channel (and possibly an ITV1 HD service) would not be subject to Ofcom's code of scheduling TV advertising (COSTA) rules and so would be able to broadcast more advertising minutage.

#### *Value of impacts on ITV1+1 and ITV1 HD*

- 8.83 One broadcaster ([REDACTED]) submitted that including ITV1+1 and/or ITV1 HD in the definition of ITV1 would have the effect of forcing media buyers to buy ITV1+1 and/or ITV1 HD as part of their CRR protected contracts with ITV, whether or not they wanted to do so. A media agency ([REDACTED]) questioned whether ITV1+1 and ITV1 HD impacts should be traded at the same price as ITV1. Its view was that impacts delivered by these channels should contribute to the ARM by a factor of 0.5 and their pricing set at a maximum of 50 per cent of that of ITV1 (similar, it said, to the relative price of ITV1 to ITV's digital channels such as ITV2). Another party (ISBA) told us that some protection should be put in place to protect advertisers against ITV leveraging the price of ITV1+1 or ITV1 HD above the price of ITV1 in certain instances. [REDACTED]

#### *Speed of implementation*

- 8.84 Some third parties submitted that any variation to the definition of ITV1 should be phased in over time. One broadcaster ([REDACTED]) proposed a transitional period before impacts from any new channels were included in ITV1's SOCI so as to allow the market to gauge their impact on the distribution of viewing and of commercial impacts. Another broadcaster (Sky) submitted that ITV should only be entitled to monetize additional inventory in the year following its actual delivery (eg in 2011, if launched at the start of 2010), and a media agency ([REDACTED]) submitted that the impacts delivered by ITV1+1 and ITV1 HD should only be included in ITV1's SOCI after one year of transmission.

#### *Effect of launch*

- 8.85 A number of broadcasters were concerned that if ITV counted impacts on the ITV1+1 service towards ITV1's SOCI this would lead to a slower decline in ITV1's SOCI, and consequently its share of NAR, with less revenue becoming available to other broadcasters as a result. These other broadcasters provided estimates of the likely effect on ITV1's SOCI of launching an ITV1+1 service. Estimates were based on those broadcasters' own experience of launching a +1 service and in particular the extent to which viewers of the +1 service were watching it instead of the 'parent' service (so-called cannibalization). This evidence is set out in detail in Appendix K.

#### *ITV's views*

- 8.86 ITV said that, if CRR were to remain or its RPA proposal were to be accepted, the definition of ITV1 should include ITV1+1 and ITV1 HD services. It told us that, 'had these variants of ITV1 existed in 2003, the definition of ITV1 in the Undertakings would have covered them at the time'.
- 8.87 ITV addressed the specific concerns expressed by third parties.

## Content of ITV1+1 and ITV1 HD

- 8.88 ITV noted that ITV1+1 content might differ from ITV1 if those programmes and advertisements were subject to time delay constraints (eg certain live events for which ITV may not hold the rights to a time-delayed transmission). In such circumstances, ITV said that it would transmit a 'blank screen' such that no additional impacts would be delivered (and hence there would be no increase in ITV1's SOCI).
- 8.89 ITV told us that, while it intended the ITV1+1 service to be a delayed simulcast of ITV1, there would also be some differences in regional news programmes and advertisements due to issues of regional news transmission capacity.<sup>237</sup> [X] ITV estimated that, based on ITV1+1 covering [X] as opposed to the existing 15 regional opt-outs on ITV1, [X] per cent of ITV1's NAR would come from sales regions that would not be replicated under the ITV1+1 service.<sup>238</sup>
- 8.90 ITV stated that ITV1 HD was simulcast [X]. ITV recognized that a similar regional issue existed in relation to ITV1 HD as to ITV1+1 because it would cost approximately £[X] million a year to ensure that the 26 micro-regions were replicated and there were substantial capacity restrictions on digital satellite which would also limit ITV's ability to provide full regionality. ITV proposed to launch only two regions initially on ITV1 HD, scaling up over time to provide six regions, replicating the regional structure on ITV1+1.
- 8.91 ITV told us that regional differences between ITV1 and ITV1+1 or ITV1 HD lead to two key issues:
- (a) Those media buyers that have bought impacts in a region that is broadcast on ITV1 but not on ITV1+1 or ITV1 HD would not have any impacts delivered on ITV1+1 and ITV1 HD. However, ITV told us that, because the ARM was calculated on an individual advertiser basis and was weighted by demographic, region and time period, ITV could only count those impacts in regions where an advertiser purchased airtime. ITV told us that this would ensure that ITV would be precluded from counting ITV1+1 or ITV1 HD impacts where the advertiser derived no benefit from them.
  - (b) Those media buyers that have bought impacts in a region that is broadcast on ITV1 and also broadcast on ITV1+1 or ITV1 HD, but across a wider geographic area, will have impacts delivered on ITV1+1 and ITV1 HD outside the region for which the impacts were purchased. ITV told us that it had already put in place a process with BARB whereby new editing rules would be applied by BARB to the 'as run transmission log'<sup>239</sup> that ITV provides to BARB so that only those impacts delivered in the region purchased would be recorded against ITV1's SOCI.
- 8.92 ITV raised a potential concern that media buyers might take advantage of its proposed regional recording system by switching to purchasing all individual micro-regions on ITV1 instead of the wider regions they currently purchased. Unless suitable mechanisms were put in place, such purchasing of many micro-regions

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<sup>237</sup> At present there are 15 regional Channel 3 licences, of which 11 are owned by ITV plc. These 15 regional licences can be further broken down into 26 'micro-regions'. ITV1 airtime may be sold on the basis of either regions or micro-regions, but is more commonly sold on the basis of 'macro regions', which are a combination of particular licence regions sold together as a package to allow regional or national advertisers to coordinate their advertising requirements. Regional news services are provided at the regional level and not the micro-regional level but there are a number of options which allow ITV to broadcast simultaneously to two different sub-regions within one overall programme, such that content may differ for parts of the programme. BARB monitors ITV1's SOCI on the basis of the 26 micro-regions.

<sup>238</sup> This excludes the regions owned by SMG and Ulster, over which ITV plc has no control.

<sup>239</sup> The 'as run transmission log' sets out the programmes and advertisements actually transmitted on ITV1. 'Editing rules' are applied to this information by BARB in creating BARB's viewing data.

would enable media buyers to avoid ITV1+1 or ITV1 HD impacts delivered outside the precise region purchased from being counted towards ITV1's SOCI. ITV suggested that the definition of 'exact replica' would need to clarify that impacts should be counted based on regions purchased by media buyers at a campaign level on ITV1.

#### *Value of impacts on ITV1+1 and ITV1 HD*

- 8.93 ITV told us that it currently sold its ITV2+1 channel on a consolidated basis with ITV2 (ie ITV2 and ITV2+1 are sold as ITV2) [redacted].

#### *Speed of implementation*

- 8.94 ITV told us that there was a natural phasing in of any new channel because it would slowly increase its SOCI over time.

#### *Effect of launch*

- 8.95 ITV said that there was considerable uncertainty regarding the effect on ITV1's SOCI and revenue of launching an ITV1+1 service. ITV provided board papers supporting the case for an ITV1+1 service. These board papers estimated that launching ITV1+1 would lead to a net increase in impacts of [redacted] per cent: an increase of [redacted] per cent derived from the total number of viewers watching ITV1+1 offset by a decrease of [redacted] per cent from viewers transferring from ITV1 to ITV1+1. As noted in Appendix K, ITV estimated that the deterrence from launching ITV1+1 cost ITV £[redacted] million profit a year.
- 8.96 ITV told us that, while an ITV1+1 channel might be expected to have a cannibalistic effect, it might also expand ITV1 viewing (and hence ITV1's SOCI) overall. However, ITV added that an ITV1 HD channel would directly cannibalize the ITV1 channel and there was no evidence to suggest that there would be any expansionary effect. Hence over time one would expect that, absent a variation to CRR, the reduction in ITV1's SOCI and revenue caused by ITV1 HD would be greater than that caused by ITV1+1.

#### *Our assessment*

- 8.97 In this section, we set out our assessment of each of the issues raised by third parties and addressed by ITV.

#### *Content of ITV1+1 and ITV1 HD*

- 8.98 This variation relates only to ITV1+1 and ITV1 HD services: any other alternative ITV1 service (eg ITV player) is outside the scope of this variation.
- 8.99 If impacts on ITV1+1 and ITV1 HD services are to be counted towards ITV1 in the ARM calculation, we consider that they should be an exact replica of ITV1 subject to:
- (a) differences in content between ITV1 and ITV1+1 for those programmes and advertisements that are subject to time delay constraints (eg certain live events for which ITV may not hold the rights to a time-delayed transmission); and
  - (b) differences in regional news programmes and advertisements between ITV1 and ITV1+1 or ITV1 HD.

- 8.100 We did not find that any of the specific issues raised by third parties regarding the content of ITV1+1 and ITV1 HD materially undermined the rationale for this variation.
- 8.101 We noted that the extent of lost regional capability of an ITV1+1 service is likely to account for less than [redacted] per cent of ITV1's NAR. We would expect ITV to offer the same regionality on ITV1+1 and ITV1 if it were commercially attractive to do so. If, however, ITV wanted to [redacted], we considered whether there were suitable recording mechanisms that could be put in place to ensure that media buyers were correctly charged for those impacts and ITV1's SOCI was not overinflated.
- 8.102 BARB told us that the agreed default basis for commercial impact reporting for all regional channels was that impacts were only reported for areas where the impacts were purchased. BARB told us that ITV1+1 impacts would not be published if they were not purchased for that region. BARB noted that the situation was different for ITV1 HD, where some changes to recording techniques would be required to ensure that the same principle applied.
- 8.103 We accepted that ITV's proposed recording process with BARB was capable of ensuring that only those impacts delivered in the desired region would be recorded against ITV1's SOCI. In relation to potential gaming of the system by media buyers, we accepted ITV's point and proposed to address this through drafting of the Undertakings. We would require that impacts should be recorded against ITV1's SOCI in a region if the advertisement was an exact replica of the advertisement on ITV1 in the equivalent geographical area on ITV1+1 and ITV1 HD, even if the advertisement was purchased against a narrower region on ITV1 than on ITV1+1 or ITV1 HD.
- 8.104 We considered that any ambiguity as to whether or not advertising minutage could be varied on ITV1+1 and ITV1 HD would be avoided through a requirement that impacts on those services may count towards ITV1's SOCI only if advertisements on them are exact replicas, subject to the qualifications discussed in paragraphs 8.99 to 8.103.

#### *Value of impacts on ITV1+1 and ITV1 HD*

- 8.105 If the services are to be exact replicas, we consider it most likely that impacts on ITV1+1 and ITV1 HD would be sold on a consolidated basis with ITV1. This approach has been adopted by other sales houses, including [redacted]. We did not find there to be any basis for reducing the weight attributed to ITV1+1 and ITV1 HD impacts in ITV1's SOCI: any basis would be arbitrary and its effect would be uncertain. Moreover, most media buyers appeared content for ITV1+1 and ITV1 HD impacts to be sold on a consolidated basis with ITV1 impacts and priced at the same level.

#### *Speed of implementation*

- 8.106 In our view, the effects of ITV1+1 and ITV1 HD services on ITV1's SOCI would be phased in naturally because of the way in which the ARM calculation works. For example, if ITV1+1 or ITV1 HD were introduced on 1 April, the impacts would count towards ITV1's SOCI for the final three quarters of the year, and would be included on this basis in the ARM calculation for SOB commitment purposes in the following deal year. We therefore find that there is no need for additional phasing requirements.

### *Effect of launch*

- 8.107 If ITV1's SOCI increases following the launch of ITV1+1 or ITV1 HD, some broadcasters would, obviously, lose SOCI.<sup>240</sup> This seems to us to be a normal part of the competitive process. Moreover, not all broadcasters would lose SOCI and we would expect that those broadcasters competing with an ITV1+1 and ITV1 HD service would respond competitively to retain their SOCI.
- 8.108 If ITV1's SOCI were to increase, it is not clear that media buyers would necessarily increase their SOB commitment or increase it to the same extent. If, under a varied CRR, ITV1's SOCI increased as a result of ITV1+1 and ITV1 HD impacts being counted towards ITV1, this would allow ITV to propose that media buyers, if they wished to retain their present discounts, increase their SOB commitments up to the level indicated by the ARM, though subject to the maximum SOB commitment in protected contracts.<sup>241</sup> However, in the event that a media buyer declined to increase its SOB commitment, this would be likely to lead to negotiation between ITV and the media buyer over the appropriate level of discounts to be applied in such circumstances, and so the precise effect on a media buyer's SOB commitment to ITV1 (and thus other broadcasters' share of NAR) is uncertain.

### *Conclusion on changing the definition of ITV1*

- 8.109 We concluded that it is appropriate to vary the definition of ITV1 in the CRR Undertakings. As set out in paragraph 8.87, this variation in relation to ITV1+1 alone is estimated to be worth £[~~30~~] million of profit per year to ITV. The lost profit in relation to ITV1 HD is also likely to be significant.
- 8.110 We noted the possible effect of the proposed variation on ITV1's SOCI and its share of NAR, potentially at the expense of other broadcasters' share of NAR. However, we considered that such effects are part of the normal competitive process and would not arise from the enhanced market position created by the merger.
- 8.111 We did not find that any of the issues raised by third parties led us to conclude that CRR with this variation would not be effective in addressing the adverse effects of the merger (see paragraphs 8.98 to 8.108). We therefore concluded that the CRR Undertakings should be varied in order to:
- (a) redefine ITV1 to include ITV1+1 and ITV1 HD impacts;
  - (b) require that, in order for the impacts to be counted towards ITV1's SOCI in CRR, ITV1+1 and ITV1 HD services be exact replicas of ITV1 except for:
    - (i) differences in content between ITV1 and ITV1+1 for those programmes and advertisements that are subject to time-delay constraints (for example, certain live events for which ITV may not hold the rights to a time-delayed transmission); and
    - (ii) differences in regional news programmes and advertisements between ITV1 and ITV1+1 or ITV1 HD. We would require that impacts should be recorded against ITV1's SOCI in a region if the advertisement is an exact replica of the advertisement on ITV1 in the equivalent geographical area on ITV1+1 and

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<sup>240</sup>We recognize that the introduction of an ITV1 HD service is likely to lead to significantly less incremental impact than the introduction of an ITV1+1 service given that the programmes on ITV1 HD would be shown at the same time as on ITV1. The main effect would therefore be the cannibalization effect.

<sup>241</sup>The 'base year' level: see Annex 1 to the [Undertakings](#).

ITV1 HD, even if the advertisement was purchased against a narrower region on ITV1 than on ITV1+1 or ITV1 HD; and

- (c) allow these changes to take effect once revised undertakings have been accepted. Impacts counted in that year's SOCI would feed into the ARM calculation of CRR in the following year (for example, if ITV1+1 or ITV1 HD were introduced on 1 April, the impacts would count towards ITV1's SOCI for the final three quarters of the year, and would be included on this basis in the ARM calculation for SOB commitment purposes in the following deal year).

### ***Conclusion on effectiveness of possible variations***

- 8.112 We found that CRR has been an effective remedy in addressing the adverse effects identified in the 2003 report. This is supported by third party evidence submitted during our review.
- 8.113 We considered whether any potential relaxation of Ofcom's Airtime Sales Rules<sup>242</sup> relating to withholding airtime from sale and to conditional selling would undermine the effectiveness of the CRR remedy (or any variation to it) and in particular create circumvention risks. Ofcom's review of the Airtime Sales Rules commenced in March 2010 and was being consulted upon at the time of our final report. In these circumstances, we concluded that it would be appropriate for Ofcom to consider and take account of potential circumvention risks in the light of our final report on the CRR Undertakings.
- 8.114 We considered whether there were ways in which the CRR Undertakings could be varied to take into account changes of circumstance whilst retaining the effectiveness of the remedy in addressing the adverse effects of the merger.
- 8.115 We concluded that possible variations to:
- (a) address ITV1's advantage in delivering large audiences;
  - (b) remove elements of CRR while maintaining a requirement on ITV to offer ITV1 airtime on fair and reasonable terms;
  - (c) address incentives for ITV1 to focus primarily on maximizing ITV1's SOCI; and
  - (d) address difficulties for ITV in reacting to changing demand
- would not be effective remedies to the adverse effects of the merger (see paragraphs 8.2 to 8.14).
- 8.116 We concluded that ITV's RPA proposal would not be an effective remedy to the adverse effects of the merger (see paragraphs 8.45 to 8.66).
- 8.117 We concluded that changing the definition of ITV1 in the Undertakings to include ITV1+1 and ITV1 HD would reflect the changes of circumstance and would retain a remedy that is effective in addressing the adverse effects of the merger (see paragraphs 8.97 to 8.111).

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<sup>242</sup>See paragraph 4.4 for an explanation.

## **Proportionality**

- 8.118 Our guidelines state that, in order to be reasonable and proportionate, we will select the least costly remedy that we consider to be effective. If we are choosing between two remedies that are equally effective, we will select the remedy that imposes the least cost or that is least restrictive. We will seek to ensure that no remedy is disproportionate in relation to the scale of the competition problem and its adverse effects.<sup>243</sup>
- 8.119 In paragraphs 8.112 to 8.117 we found that there were two effective remedies: CRR in its current form and CRR with a variation to the definition of ITV1 (CRR as varied).<sup>244</sup> Given the costs of ITV being deterred from providing ITV1+1 and ITV1 HD services (see Section 6), we found that CRR as varied would be less costly and less restrictive than CRR in its current form. We therefore considered whether the costs of CRR as varied would be disproportionate to the size of the adverse effects (the detriment) that would be likely to arise absent a remedy, taking into account the changes of circumstance summarized in Section 7.
- 8.120 In considering the costs which ITV attributed to CRR, we recognized the possibility that there may be unquantified dynamic costs that might also arise from CRR. ITV referred only to the unquantified costs associated with 'ITV's inability to deliver dynamic efficiencies (in terms of commissioning and scheduling) across its full family of digital channels'. We found in paragraphs 6.22 to 6.28 that the ARM is likely to have had only, at most, a small effect on programming decisions. We also noted that there are likely to be unquantified dynamic customer benefits to CRR. In particular, CRR allows media agencies to switch their SOB commitment (up to the level allowed by the ARM without discounts being reduced) from ITV1 to other broadcasters, should they wish to do so. This encourages rivalry in relation to that part of a media buyer's advertising budget, which, absent CRR, would be subject to fewer competitive forces.<sup>245</sup> We concluded that while the size of each of these dynamic effects was uncertain, we had no reason to believe that the costs would outweigh the benefits. In our assessment of proportionality, we therefore focus on those aspects of costs and detriment that we can evaluate with more certainty.

## **Detriment**

- 8.121 In this section, we examine what was said in the 2003 report in relation to the detriment and consider any relevant evidence from this review in order to form a judgment as to the range of detriment that is likely to arise absent a remedy.

### *2003 report*

- 8.122 In relation to the three adverse effects identified by the CC, the 2003 report stated that:<sup>246</sup>

We expected that the overall consequence of these adverse effects would be for Carlton and Granada together to achieve a higher level of revenue than if the merger had not gone ahead. This would be most

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<sup>243</sup>*Merger Remedies: Competition Commission Guidelines, CC8, November 2008, paragraph 1.9.*

<sup>244</sup>ITV said that we should assess whether RPA was an effective remedy, but as we have found it to be ineffective in addressing the adverse effects we have not considered it any further in our proportionality assessment.

<sup>245</sup>As our guidelines set out, 'rivalry has numerous beneficial effects: prices and costs are driven down and innovation and productivity increase, so increasing the quality, and more generally the diversity of choice available to customers'—*Merger References: Competition Commission Guidelines, CC2, June 2003, paragraph 1.21.*

<sup>246</sup>2003 report, paragraph 2.132.

likely to be to the detriment of advertisers and the other commercial broadcasters. An increase of one percentage point in ITV's NAR would reduce the revenue available to other broadcasters by around £17 million.

- 8.123 The 2003 report also discussed the extent of 'contestable revenue' between Carlton and Granada (in other words, the extent of revenue that could be switched between the two sales houses). It found that a media buyer could potentially switch 40 per cent of expenditure from one sales house to the other, and that at least three media buyers had recently varied their London share commitments between Carlton and Granada, with an average movement of 10 per cent of ITV London expenditure.<sup>247</sup>

#### *ITV's views*

- 8.124 ITV submitted that there was limited competition between the two sales houses in ITV regions outside London. ITV noted the evidence in the CC's 2003 report and submitted that 'it seems reasonable to infer that the CC was of the view that the amount of contestable revenue was small—and was certainly less than 10 per cent of ITV NAR and quite possibly less than 5 per cent'. It added that 'in 2002, total ITV NAR was worth around £1.7 billion, so that 5 per cent would have equated to around £85 million'. In response to our Provisional Remedies Decision, ITV submitted that contestable revenue was the amount of revenue that Carlton and Granada competed for in 2003. It said that the merger detriment was the additional revenue that a merged ITV could achieve by increasing the price of this contestable airtime over and above competitive price levels. It said that, therefore, the merger detriment would be a small fraction of the identified contestable revenue—certainly no more than 1 per cent of NAR and likely to be substantially less.

#### *Our assessment*

- 8.125 In paragraph 7.1 we found that a remedy was still required to address the continuing likelihood of adverse effects from the merger. Based on the evidence before us, we could not foresee any future significant changes of circumstance with sufficient certainty to take them into account in our review.
- 8.126 Given the time that has elapsed since the merger, we did not consider it appropriate or feasible to reconduct the analysis of competition between Carlton and Granada from the 2003 report. Despite these difficulties in quantifying the size of the adverse effects, we considered the likely range of detriment.
- 8.127 We disagreed with ITV's view (see paragraph 8.124) that the competition problem was limited to the London regions. The 2003 report set out that the competition concerns, although focused on London, were seen to extend across all the ITV regions.<sup>248</sup> We also found that the £17 million figure quoted in the 2003 report, representing 1 per cent of NAR in 2002, was an illustrative figure; it was not presented as an estimate of detriment.
- 8.128 We therefore considered what a reasonable range of detriment would be. Our experience of the size of adverse effects anticipated on most mergers suggests that

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<sup>247</sup>These estimates were, however, thought to be uncertain. Revenue from the two London licences in 2002 was £[§]—[§] per cent of ITV's NAR.

<sup>248</sup>2003 report, paragraph 2.127.

a price increase of up to 5 per cent is not unusual.<sup>249</sup> In addition, independent work for the OFT has found that in 2008/09 the mean price increase that would have been expected had the OFT not intervened and the merger gone ahead was 8 per cent.<sup>250</sup> We also noted the significant concerns expressed by media buyers (see Section 5) during this review. Based on these concerns and our experience of price increases on mergers, we decided that 5 per cent of NAR would be a reasonable estimate of the detriment. In order to be cautious, we decided to adopt a range of 1 to 5 per cent.

8.129 We took into account the fall in ITV1's general market position between 2003 and 2009 by examining the size of the detriment in relation to ITV1's NAR in 2009 rather than ITV1's NAR in 2003. A range of detriment of 1 to 5 per cent of NAR equates, in 2009, to between approximately £10 million and £50 million.<sup>251</sup>

### *Assessment of proportionality of CRR as varied*

8.130 We considered proportionality by comparing the range of detriment with the range of alleged costs of CRR identified by ITV. Excluding the cost of ITV being deterred from providing ITV1+1 and ITV1 HD services, which would be removed by CRR as varied, ITV's range of costs that it alleged should be attributed to CRR amounted to £[redacted]–£[redacted] million in 2008/09 (see paragraph 6.60). However, we found that this range did not properly take into account that only a part of those costs might be attributable to a varied CRR (or CRR) (see paragraph 6.16).

8.131 We looked at the relative scale of the alleged costs and the lower end of the range of detriment. In order for CRR as varied to generate costs that exceed the lower end of the range of detriment (£10 million), we would need to find it likely that more than [redacted] per cent of the upper bound of the range of alleged costs of £[redacted] million or more than [redacted] per cent of the lower bound of the range of alleged costs of £[redacted] million were attributable to CRR as varied. In paragraph 6.60, we found it likely that, at most, only a small proportion of the costs alleged by ITV were attributable to CRR as varied. We therefore find that the costs of CRR as varied are likely to be smaller than even the lower end of the range of detriment (£10 million).

8.132 We also considered proportionality by examining the changes in detriment and anticipated costs of CRR since the 2003 report. We noted that CRR was proposed by Carlton and Granada in 2003 and was found not to be a disproportionate remedy to the adverse effects of the merger by the CC. Taking into account the proposed variation, in our view the costs of CRR (see Section 6) have not been significantly higher than were expected in 2003.<sup>252</sup> Although we found that the extent of detriment may have fallen to some extent due to the decline in ITV1's share of NAR since 2003 (see paragraph 8.129), there was no evidence to suggest that this decline was sufficient to make CRR as varied disproportionate.

8.133 Based on paragraphs 8.130 to 8.132, we concluded that CRR as varied is not disproportionate to the likely size of the adverse effects.

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<sup>249</sup>See, for example, *Estimated costs to consumers of mergers and market outcomes against which the CC took action between April 2008 and March 2009*. In this document the CC considered a range of cases, including Project Kangaroo, in which the CC assumed an estimate of [0 to 5] per cent price increase (the exact figures were redacted but fell in this range) when the size of the detriment was highly uncertain. Other cases quoted (Stonegate/Deans and BOC/Ineos) had ranges of [0 to 10] per cent (again, figures are redacted) and other cases had even higher anticipated price increases (Nufarm/AH Marks): [www.competition-commission.org.uk/our\\_role/analysis/quantification\\_of\\_cc\\_actions%20.pdf](http://www.competition-commission.org.uk/our_role/analysis/quantification_of_cc_actions%20.pdf).

<sup>250</sup>See, for example, *A Review of OFT's Impact Estimation Methods* (January 2010) by Professor Stephen Davies, which states that recent evaluation work for the OFT suggests that the mean simulated avoided price increase for mergers in 2008/09 was 8 per cent (see paragraph 5.4 of that paper): [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/oft1164.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/oft1164.pdf).

<sup>251</sup>Based on ITV1's NAR of £993 million in 2009. Source: *ITV plc report and accounts 2009*: <http://2009.itv.ar.ry.com/?id=55878>.  
<sup>252</sup>2003 report, paragraphs 2.154 to 2.170.

## 9. Conclusions

- 9.1 For the reasons set out in paragraphs 8.109 to 8.111, we concluded that the CRR Undertakings should be varied so as to change the definition of ITV1 in the Undertakings to include ITV1+1 and ITV1 HD. This variation would reflect the changes of circumstance and would still be an effective remedy in addressing the adverse effects of the merger. We conclude that this remedy is not disproportionate to the adverse effects that are likely to arise in the absence of CRR.
- 9.2 We will consult on revised Undertakings that incorporate this variation.

### **Final observations**

- 9.3 In the [2003 report](#), the CC stated that it had ‘come across a number of features of the market for selling airtime that caused all of us disquiet’. The CC went on to recommend:
- a review of the wider market for selling airtime on commercial television, which would seek to ascertain whether the nature of the deals struck, the trading mechanisms, and the overall structure of the market substantially lessen competition in selling airtime on commercial television, and would identify how the system might be changed to enable it to operate more effectively and competitively.<sup>253</sup>
- 9.4 During the course of this review, a number of third parties said that a wider review of the market was required in order to address a number of characteristics of the market for sale of television airtime which prevent, distort or restrict competition. These characteristics included: SOB deals, media agency umbrella deals and the SAP trading mechanism.
- 9.5 We noted that many of the characteristics identified by third parties were similar to those characteristics of the market identified during the CC’s investigation in 2003. CRR operates in a complex and opaque environment conditioned by the existence of SOB deals, media agency umbrella deals and the SAP trading mechanism. These characteristics of the market continue to have potentially anti-competitive effects. In our view, the way in which television airtime is currently sold has a significant influence on the need to retain a variant of the CRR remedy.<sup>254</sup>
- 9.6 Media agencies also raised concerns regarding possible conditional selling of television airtime on the ITV family of channels (see paragraph 4.4). Ofcom began a consultation on the Airtime Sales Rules in March 2010.
- 9.7 Ofcom, in its submission in June 2009, said that it did not believe that a wider review of the market was appropriate at that time. It recognized, however, that, in due course, a wider review of the television advertising sector may be necessary.<sup>255</sup>
- 9.8 We have now completed our review of CRR and consider that CRR should be kept in place with some variation. However, the scope of our review was to consider the

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<sup>253</sup>[2003 report](#), paragraphs 2.180 to 2.183.

<sup>254</sup>In particular, we found that switching advertising expenditure between sales houses is hindered by media agency umbrella deals and the relationship between SOB commitments and discounts (see paragraph 5.152). We found that the way media agencies conduct their business was more likely to be influenced by these factors than by CRR (see paragraphs 6.41 to 6.47).

<sup>255</sup>*Review of the Contract Rights Renewal Undertakings: Evidence to the OFT and CC following the request for release from undertakings given by Carlton Communications Plc and Granada Plc (now ITV Plc) pursuant to section 88 of the Fair Trading Act 1973*, 2 June 2009, paragraph 1.22: [www.ofcom.org.uk/tv/ifi/tvlicensing/contract\\_rights\\_renewal/report.pdf](http://www.ofcom.org.uk/tv/ifi/tvlicensing/contract_rights_renewal/report.pdf).

ongoing need for the CRR Undertakings within the context of the current operation of the market for television airtime. As a consequence, our review related only to ITV1 and not to other ITV channels or to other sales houses. We were unable to examine or address the ways in which the market as a whole trades television airtime despite the concerns we identified in paragraphs 9.4 and 9.6. As in 2003, we continue to believe it appropriate for there to be a wider review of the market for selling television airtime.