

ITV Micro-regions

Provisional Decision and Consultation

June 2011

OFT1336

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SUMMARY

1. The Office of Fair Trading ('OFT') has received representations from an advertiser and an MP asking it to consider intervening in relation to ITV's proposals to modify the geographic basis on which it sells ITV1 advertising airtime by merging three pairs of micro-regions. Originally scheduled for 1 January 2011, these proposed changes have been deferred by ITV management and are now planned for 1 January 2012.
2. The OFT has considered the matter in relation to its duty to monitor the merger undertakings ('the undertakings') given by Carlton and Granada in 2003 in connection with their proposed merger ('the merger') to form ITV plc (ITV). The undertakings are sometimes also referred to as the Contract Rights Renewal (CRR) undertakings.
3. Clause 10(h) of the undertakings states:

'Carlton and Granada agree that they shall not change their Current Airtime Sales System without the consent of the OFT in a way that materially alters the basis on and the way in which they offer Commercial Airtime for sale'.¹
4. The OFT has considered the meaning of this undertaking and has obtained commercially confidential information from ITV to enable it to reach a provisional decision in relation to ITV's proposals. The OFT notes that its views on the interpretation of the undertaking could have implications for future mergers of micro-regions. The OFT is therefore publishing this provisional decision to enable interested parties to submit responses before the OFT reaches a final decision. Any responses received will be taken into account in the final decision.
5. The OFT's provisional view is that it does not consider ITV's plans will materially alter the basis on which ITV offers Commercial Airtime for sale. The OFT also does not regard the change as constituting a material

¹The definition of Commercial Airtime and CASS in the undertakings is set out below.

alteration to the Current Airtime Sales System (CASS). The OFT notes that regional advertisers are protected by other clauses in the undertakings which require ITV to offer fair and reasonable terms. The OFT considers that ITV's plans are therefore compatible with the undertakings.

6. The rest of this document sets out the OFT's analysis and reasons for this provisional decision and invites interested parties to submit any representations by 4pm on Wednesday 6 July 2011

7. Representations should be sent to:

Adam Maxfield
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London
EC4Y 8JX

or by email to adam.maxfield@oft.gsi.gov.uk.

Responses should reach the OFT by 4pm on Wednesday 6 July 2011

Data use statement for responses

8. Personal data received in response to this provisional decision will be processed in accordance with the Data Protection Act 1998. All information received (including personal data) is subject to Part 9 of the Enterprise Act 2002. We may choose to refer to comments received in response to this provisional decision in future publications. In deciding whether to do so, we will have regard for the need for the fair and lawful processing of any personal data, and the need for excluding from publication as far as that is practicable, any information relating to the private affairs of an individual or any commercial information relating to a business which, if published, would or might, in our opinion, significantly harm the individual's interests, or, as the case may be, the legitimate business interests of that business. If you consider that your response

contains such information, that information should be marked 'confidential information' and an explanation given as to why you consider it is confidential.

9. Please note that information provided in response to this provisional decision, including personal information, may be the subject of requests from the public for information under the Freedom of Information Act 2000 (FOIA). In considering such requests for information we will take full account of any reasons provided by respondents in support of confidentiality, the Data Protection Act 1998 and our obligations under Part 9 of the Enterprise Act 2002 before reaching a decision on whether we can release such information under the FOIA.
10. If you are replying by email, these provisions override any standard confidentiality disclaimer that is generated by your organisation's IT system.

ITV's Proposals to combine Micro-regions

11. ITV wrote to a number of regional advertisers in September 2010 to inform them that ITV proposed to merge each of the following pairs of micro-regions with effect from January 2011:
 - Anglia North and South
 - Meridian Kent and Sussex
 - Tyne Tees Bilddale and Pontop.
12. In response to this announcement the OFT received representations from one advertiser² and one MP³ asking the OFT to intervene.

² Mr Graham Robb, Senior Partner, Recognition Marketing and PR, Darlington

³ Mr James Wharton, MP for Stockton South

13. The advertiser, Mr Graham Robb, was concerned that ITV's plans were 'unfair, unjust and will severely impact on the smaller businesses in the Tyne Tees region'. He considered that 'ITV has a monopoly on local television advertising' and felt that [ITV's] 'unilateral decision constituted unfair business practice with a public asset' which 'would have the effect of pricing small and medium sized businesses off our screens'. He considered that the changes would force local businesses 'to advertise in areas of the North that are inappropriate and will result in costs going up by 180 per cent'.
14. James Wharton MP, writing in a representative capacity, was concerned that 'ITV's proposed changes to the sale of advertising will affect the ability of businesses to purchase local television advertising in future'. He believed that the Carlton-Granada merger undertakings might prohibit these changes without the OFT's consent.
15. ITV informed the OFT early in October 2010 that its management had decided to defer implementation of the changes until the end of 2011.

The undertakings

16. The undertakings were given to the Secretary of State for Trade and Industry by Carlton and Granada in 2003 following a finding by the Competition Commission (CC) that the proposed merger may operate against the public interest.⁴
17. They were designed to ensure, among other things, that ITV was unable to exploit its enhanced market position to change the system under which television advertising airtime was sold to the advantage of the merged entity.⁵ The undertakings contain various provisions designed to protect advertisers.

⁴ Carlton Communications Plc and Granada plc, a report on the proposed merger, Cm5952, October 2003 (CC 2003 report).

⁵ See for example paragraph 1.10 of the CC 2003 report cited above.

18. The Secretary of State transferred ultimate responsibility for these undertakings to the CC in 2004 via regulations made under the Enterprise Act 2002.⁶

Enforcement

19. The OFT is required to keep under review the carrying out of the undertakings.⁷ Both the OFT and the CC are empowered to take enforcement action in the event of a breach of the undertakings. Affected third parties can also apply to the court for enforcement.⁸
20. The OFT also has power to give written directions to ITV under clause 21 of the undertakings (a) to take such steps as may be specified or described in the directions for the purpose of carrying out or securing compliance with the undertakings; or (b) to do or refrain from doing anything so specified or described which they might be required by the undertakings to do or to refrain from doing. ITV shall comply with such written directions as the OFT gives.

Variation of the undertakings

21. The OFT is under a duty from time to time to consider whether, by reason of any change of circumstances, the undertakings are no longer appropriate and either the parties can be released from them or they need to be varied or superseded by new undertakings. If it appears to the OFT that ITV can be released from them or that the undertakings need to be varied or superseded, it may give such advice to the CC as it thinks proper in the circumstances.⁹

⁶ The Enterprise Act 2002 (Enforcement Undertakings and Orders) Order 2004 (SI 2004/2181).

⁷ Schedule 24, paragraph 16 Enterprise Act 2002 and section 88(4) of the Fair Trading Act 1973 ('FTA').

⁸ Section 94(4) of the Enterprise Act 2002.

⁹ Schedule 24, paragraph 16 Enterprise Act 2002 and section 88(4) FTA.

22. The OFT conducted such a review and gave advice to the CC in May 2009.¹⁰ This identified a relevant change in circumstances by way of changes in the delivery of the Channel 3¹¹ programme schedule (in particular the development of a High Definition channel and a potential time shifted (+ 1) channel) together with the erosion of Channel 3's market position.
23. The CC subsequently conducted a review of certain aspects of the CRR undertakings. Its final report was published in June 2010.¹² The CC decided that the undertakings should be retained but varied to change the definition of Channel 3 in the undertakings to include ITV1 + 1 and ITV1 HD.¹³ The CC accepted revised undertakings which are published on its website.
24. Clause 10(h) was not modified following the CC's review in this process although the CC expressed a view in response to ITV's claim that it acted as an 'operational straightjacket' which restricted its ability to rationalise micro-regions (see below, paragraph 27 and following).

Clause 10(h) of the undertakings

25. Clause 10(h) states:

Carlton and Granada agree that they shall not change their Current Airtime Sales System without the consent of the OFT in a way that

¹⁰ See Review of the Contract Rights Renewal Undertakings, OFT Advice to the Competition Commission, May 2009 (OFT1084).

¹¹ We use the term Channel 3 instead of ITV1 for the broadcast channel to avoid possible confusion between the name of the channel and ITV plc. The CC use the term ITV1.

¹² The CC's final report is currently available at: www.competition-commission.org.uk/rep_pub/reports/2010/557ITV.htm

¹³ One reason given for the variation was that the previous text was regarded as having an unintended consequence of deterring ITV from launching ITV HD and ITV1 + 1 (see paragraphs 6.29-30, 6.59 and 7.2 of the above CC report)

materially alters the basis on and the way in which they offer Commercial Airtime for sale.

26. Under the undertakings:

- 'Commercial Airtime' means the television transmission time that a television channel may sell to third parties to show advertisements in relation to the Regional Channel 3 Services provided by Licensees.
- 'Current Airtime Sales System' ('CASS') means the features and processes currently used by Carlton and Granada in relation to the sale of Commercial Airtime. This includes: the use of SAP (defined below), the sale of Commercial Impacts in all regions by all demographic audiences, specific time periods, time length factors and day part definitions as currently sold by Carlton and Granada, and the current limited sale of 'specials' outside contracts for the sale of Commercial Airtime between Carlton or Granada and Advertisers and Media Buyers.
- 'Station Average Price' or 'SAP' means a benchmark price for delivery of a specific target audience. It is defined for each target audience and for each region sold.
- 'Commercial Impact' means the viewing by one member of the target audience of an advertisement (including an interactive advertisement), as currently measured by BARB (the Broadcasters' Audience Research Board).

27. In the course of its review, the CC sought evidence on the burdens imposed by the undertakings. ITV drew the CC's attention to clause 10(h) which it considered might restrict its ability to make changes to the micro-regions.

28. The CC said that the operational constraints upon ITV resulted from the detailed requirements of the undertakings as they relate to the CASS. If ITV was uncertain as to whether a change was likely to be material it

could seek guidance from the Adjudicator,¹⁴ Ofcom or the OFT prior to making a particular commercial decision and, if necessary, could seek the OFT's consent.¹⁵

29. The CC went on to say:

'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. We consider that the rationalization of micro-regions, the example of an operational cost submitted by ITV, is not prevented by the CRR Undertakings.'

30. The CC summarised the position in paragraph 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'.

31. The CC decided not to attribute relevant ITV costs of maintaining micro-regions to their calculation of the burdens imposed by the CRR

¹⁴ The Office of the Adjudicator was established to provide guidance on the CRR remedy and to adjudicate on individual contractual disputes. Further information is available on its website at: www.adjudicator-crr.org.uk.

¹⁵ paragraph 6.53 of the CC 2003 report.

undertakings, although it accepted that ITV might have opted not to make such changes to the micro-regions given its interpretation of the undertakings.¹⁶

ITV's Views

32. ITV did not approach the OFT for consent prior to announcing its plans in September 2010, or its revised plans in October 2010. ITV told the OFT that it had sought an opinion from Counsel about the interpretation of clause 10(h) and had noted the remarks made by the CC as cited above, together with similar remarks made in the CC's earlier provisional decision.
33. ITV said that all six of these micro-regions fall within the scope of broadcasting licenses that were controlled by Granada prior to the merger. ITV noted that the purpose of the merger remedy was to address concerns about the enhanced market position of a merged Carlton/Granada¹⁷ and has argued that since Granada could have made these changes without the merger, such changes should logically fall outside the scope of the merger remedy.
34. ITV considered that the clause 10(h) was included as an anti-avoidance clause to prevent ITV acting on its enhanced market position by changing the airtime sales system. As such the framework for considering it should be the entirety of the CASS.
35. ITV considered that the CC report had focused on competition concerns in London (where Carlton and Granada had geographically overlapping franchises) and to a lesser extent competition between other regions. The CC had not considered micro-regions, as 'no competition concern resulted from the merger' in relation to micro-region sales - there was no competition between the merging parties in relation to micro-region sales.

¹⁶ Ibid. paragraph 6.51.

¹⁷ It cited paragraph 1.10 of the CC 2003 report.

36. ITV told the OFT that even if the micro-region changes did fall within the scope of the undertakings, it did not regard its plans as a material alteration to CASS and did not consider that the OFT's consent was required for the change pursuant to clause 10(h).
37. Further, ITV told the OFT that these changes were a necessary part of its plan to meet its commitment to regionalise ITV1 + 1 and ITV HD as fully as possible within the technical and cost constraints which arise as a consequence of limited transponder capacity for digital satellite (DSAT) and excessive build costs for digital terrestrial (DTT) transmission. The changes (it said) would play a key role in assisting ITV to further regionalise the ITV1 + 1 channel and a high definition version of ITV1 on the DTT platform¹⁸ and via DSAT.¹⁹ This would result in greater opportunities for advertisers as well as offering additional services to viewers.
38. Finally, ITV told the OFT that it considered it likely that all of the advertisers affected by the closures would have protected contracts – they would therefore benefit from the protections that the undertakings provide for all ITV1 advertisers (see later), including access to the Adjudicator in the event of any contractual dispute.

OFT Analysis

39. The OFT has been asked by complainants to consider whether ITV's proposed changes are permitted under the undertakings.

¹⁸ Ofcom research at the end of Q2 2010 found that 73.2 per cent of UK homes had at least one TV set capable of receiving DTT broadcasts, either directly or via a set top box.

<http://stakeholders.ofcom.org.uk/market-data-research/tv-research/dtv/dtu-q2-2010/>

¹⁹ ITV told us there are currently 28 regional variations of ITV1 and that due to cost and lack of availability of DSAT capacity it is impossible for such a large number to be broadcast on DSAT and DTT and provide ITV1 + 1 and ITV HD. Absent action of the kind envisaged it would not be possible, for capacity reasons, to offer the ITV1, ITV1 + 1 and ITV HD channels in the number of variations that viewers would expect.

40. The OFT has considered the purpose of clause 10(h) and how it should be interpreted. We have also considered various aspects of the impact of the proposals to form a view as to whether they should be regarded as material in the context of the undertakings. We have considered and will discuss in turn:

- the meaning of clause 10(h)
- the value of advertising affected
- the number of advertisers affected
- the protections available to advertisers under the undertakings.

The purpose and meaning of clause 10(h)

41. The primary purpose of the undertakings was to protect advertisers and media buyers from the imposition of worse commercial terms by a strengthened and unified ITV sales house.²⁰ The undertakings do so by giving advertisers and media buyers the right to roll over their existing 'protected' contracts and at the same time the right to amend their share of broadcast commitments in line with ITV1's share of commercial impacts with no worsening of any other contractual terms. Any firm which does not have a protected contract has the guaranteed right to purchase advertising on fair and reasonable terms. In the event of a dispute about contract terms, the Adjudicator can be invited to determine the outcome and the parties will be bound by his decision.

42. In the light of these contractual protections for advertisers and media buyers, the OFT considers that the practical purpose of clause 10(h) was to ensure that ITV did not change the CASS, to its own advantage, in a way which undermined the operation of the CRR undertakings.²¹ Thus, for example, the OFT considers the clause prevents ITV from changing the

²⁰ Rival commercial broadcasters are protected indirectly by protecting the buyers of airtime.

²¹ Paragraph 2.132 of the 2003 CC report.

concepts such as SAP and Share of Commercial Impacts which form the cornerstone of airtime sales contracts. The clause also prevents the substantive introduction of alternative selling systems or a significant increase in the use of individually negotiated 'Specials', to which CRR protections do not apply.

43. The potential impact of the merger on micro-regional advertising does not feature prominently in the CC 2003 report. It was raised by COI Communications ('COI') which noted that, under the pre-merger arrangements, 'in some instances, parts of regions could be targeted on ITV; an example of this was the Central South micro region of Central TV. As an advertiser, COI had consistently used this ITV facility for certain advertising campaigns. Its fear was that, under a single ITV, there would no longer be the incentive for ITV to compete for airtime sales down to this level, and it would certainly wish to see safeguards to protect this valuable marketing option.'²²
44. Other parties made submissions to the CC about the potential impact on advertising airtime sales but concerns related to the potential impact at a larger, regional level.
45. J Sainsbury plc expressed concerns that the merged entity might erode ITV's 'regionality'. They argued that a more powerful national ITV would be in a better position to reduce its commitments to regional programming and advertising. This could lead to both higher pricing for regional campaigns and reduced access to quality programmes which, in turn, might reduce the opportunity to advertise in distinct regional markets.²³
46. A large advertiser (not identified by the CC) expressed concerns that the merger may reduce the availability of regional slots as a result of regions being combined. It argued that a possible consequence of the merger could be the exercise of greater market power by the merged entity in

²² Paragraph 7.132.

²³ 7.192ff.

regional advertising leading to regions being combined. This, in turn, would reduce choice or increase prices for advertisers who wished to pursue a particular regional focus. The example cited is that the merged group could decide to sell more of its advertising slots for peak periods and key programmes on a national basis; this would reduce the availability of regional slots.²⁴

47. The CC report indicates that the undertakings were intended to ensure that the existing regions and demographics would continue to be served by the merged entity: 'Our view is that the remedy should be supported by additional undertakings to prevent material changes to the current airtime sales system, such as a commitment to maintain the use of SAP for the duration of the remedy and to **retain all regions and demographics** that the parties currently sell'²⁵ [our emphasis].
48. However, this concern relates to the continued retention of existing regions, not micro-regions. The market structure and the network of regional licenses are explained in chapter 3 of the CC report (see particularly figure 3.1). This reflects the division of areas into specific regions in the Broadcasting Act 1990.²⁶ While the report suggests that that the merging of advertising regions may be a cause of concern, we consider it unlikely that the CC envisaged that the undertakings would prevent changes at the micro-regional level. Indeed, the undertakings permit ITV to make **non-material** alterations to the basis on and the way in which ITV offers Commercial Airtime for sale without breaching the undertakings and without needing to seek consent.

²⁴ See 7.204 - third bullet.

²⁵ Paragraph 2.157. Later, at 2.173, it describes the effect of the undertakings as maintaining the 'key features' of the current arrangements for selling airtime.

²⁶ Section 14(2) of the Broadcasting Act 1990: 'Subject to subsection (5), Channel 3 shall be structured on a regional basis, with each of the services comprised within it ('Channel 3 services') being provided for such area in the United Kingdom as the Commission may determine in the case of that service.' The Commission is the ITC.

The value of advertising affected

49. In the OFT's view, the primary meaning of 'material' is with respect to any alteration to the CASS. We have nevertheless also considered whether the changes might have a material effect in relation to the value of advertising and the number of advertisers affected.
50. As the CC has noted, ITV sells the vast majority of its advertising airtime on a national or regional basis, reflecting demand. ITV told the OFT that the total value of advertising sold on a micro-regional basis to the six micro-regions that it is planned to merge into three units accounted for [less than three per cent]²⁷ of all ITV1 regional advertising sold and [less than 0.5 per cent] of all ITV1 advertising in each of the three years 2007-2009. The value of advertising that is affected by the proposals does not appear material in the context of the CASS within the meaning of clause 10(h).

The number of advertisers affected

51. The OFT asked ITV to provide details of the number of advertisers who had purchased advertising in one micro-region without purchasing advertising in the neighbouring micro-region. These advertisers would potentially be most affected by the planned changes.
52. ITV told the OFT that the number of advertisers purchasing on a micro-regional basis in 2009 was [between 15 and 50] in each micro-region. These numbers are relatively small and do not appear material in the context of the CASS – there were well over 2,000 different advertisers on ITV1 in each of the last three years.

The protections available to advertisers under the undertakings

53. ITV told the OFT that it considered it likely that all of the advertisers affected by the closures would have protected contracts. The OFT notes

²⁷ The exact figures in paragraphs 49 and 51 have been redacted for reasons of commercial sensitivity.

that any existing advertisers without protected contracts and any new advertisers or media buyers would be able to purchase regional advertising on fair and reasonable terms by virtue of other provisions in the undertakings (see paragraph 41).

54. While the OFT appreciates that this will not, in some cases, be the audience that these advertisers would prefer to purchase, we do not consider the undertakings were intended to prevent commercial rationalisations of the type planned by ITV. The OFT therefore considers that to the extent that individual advertisers will be affected by the plans there are appropriate safeguards within the undertakings which will mitigate the impact on the advertisers' commercial interests by ensuring they are able to obtain fair and reasonable terms for the purchase of regional advertising.
55. The OFT has no role in the renegotiation of any such commercial contacts which is a matter for the parties concerned. The OFT notes, however, that the Adjudicator is empowered by the undertakings to resolve any disputes that might arise.
56. On the basis of the above analysis, the OFT's provisional decision is that the ITV proposals do not change the CCAS in a way which materially alters the basis and way in which ITV offers Commercial Airtime for sale.
57. In reaching its provisional decision, the OFT did not verify and therefore did not rely on ITV's representation that changes were necessary because of limited transponder capacity and that it was no longer commercially viable for ITV to provide full regionality on all platforms.
58. To the extent that any party submits that the proposals amount to material changes to the CASS and that consent should not be granted, the OFT is providing the opportunity to make representations as to whether or not, and on what basis, the OFT should or should not grant consent within the meaning of clause 10(h).

OFT's Provisional Decision

59. The OFT's provisional view is that it does not find ITV's plans to merge three pairs of micro-regions to be a material alteration to the current airtime sales system within the meaning of clause 10(h) of the undertakings. The reasons are:

- the OFT does not consider clause 10(h) was intended to prevent changes to the sub-regional sales areas as the focus of the clause is the whole of the CASS, embracing the fundamental nature of sales contracts to which the CRR remedy applies (see paragraph 41)
- the OFT also does not find the planned changes to be material under clause 10(h) when considered either in terms of the value of the advertising affected, or the number of advertisers in the context of the CASS
- the OFT notes that the impact on those firms which are affected will be mitigated by a guarantee in the undertakings of access to fair and reasonable terms for regional advertising. The Adjudicator is also empowered to resolve any disputes that arise about such terms
- the OFT notes that future buyers of regional advertising airtime, and any current buyers that lack protected contacts will also be guaranteed to be able to purchase such airtime on fair and reasonable terms.

Next steps

60. The OFT invites comments on its analysis and provisional decision by 4pm on Wednesday 6 July 2011.

61. The OFT will consider all responses received and will publish a summary of these alongside its final decision.