
Further submission following the report by the Competition Commission (CC) on the proposed merger of Carlton Communications PLC and Granada PLC

A report under section 125(4) of the Fair Trading Act 1973 of the Chairman's advice dated 7 November 2003, to the Secretary of State for Trade and Industry under section 88(2) of the Act

In this submission the Office of Fair Trading advises under section 88(2) of the Fair Trading Act 1973 (the Act) on the outcome of the negotiations with Granada plc (Granada) and Carlton Communications plc (Carlton).

BACKGROUND

The background details of the reference to the CC and its subsequent conclusions and recommendations were set out in the OFT's advice of 18 September. You announced on 7 October that you had accepted the conclusions and recommendations of the CC. Your officials wrote requesting the OFT, in concert with the Independent Television Commission (ITC) and Office of Communications (Ofcom), to seek certain undertakings from both Carlton and Granada and, in doing so, to have regard to the concerns raised in the OFT's 18 September advice concerning detailed implementation of the CRR remedy. On 27 October we published a draft set of undertakings for consultation.

THE UNDERTAKINGS

Further to your request and in concert with the ITC and Ofcom, we have negotiated with Carlton and Granada. They have agreed to give undertakings in the form you requested that we obtain. A signed copy of those undertakings is attached to this submission.

To address the detriments identified by the Competition Commission in relation to the ITV networking arrangements that might adversely affect other ITV regional licensees, Carlton and Granada have agreed to a package of safeguards proposed by the ITC – or to any similar measures that the ITC sees fit – and should accept any licence conditions that the ITC chose to propose in relation to them. This package of safeguards is as follows:

- the Network Council should be convened at least twice a year to allow the other

licensees to register their views and understand the overall direction of the broadcasting and programme strategy;

- increases in other licensees' contributions to the network programme budget should be capped at the rate of inflation, save for exceptional events;
- Carlton and Granada should not make the commissioning or broadcasting of a programme conditional on using its own licensees for programme compliance (the process which ensures that the programmes screened on ITV conform to the various standards that the ITC has laid down);
- the other ITV regional licensees should continue to receive 'clean' broadcast feeds from the network;
- if Ulster TV's local programming obligations changed as a result of devolution in Northern Ireland, it should be offered the same opt-out terms as Scottish TV; and
- the number of network hours commissioned from the other ITV regional licensees should be reported annually so that Ofcom would be able to keep the position under review.

To address the identified adverse effects of the merger in relation to the loss of choice of a sales house through which the other ITV licensees could sell their TV advertising airtime, Carlton and Granada have undertaken that Scottish Media Group (SMG), Ulster TV and Channel TV should have the option to carry forward, for the duration of the companies' respective licences, the terms currently in effect between each of them and Carlton's or Granada's sales houses. Carlton and Granada have also agreed to accept any licence conditions that the ITC chooses to propose in relation to this undertaking.

To address the adverse effects of the merger in relation to future competition between Carlton and Granada for the sale of advertising airtime, Carlton and Granada have agreed to a contract rights renewal remedy (the CRR remedy). The CRR remedy gives all advertisers and media buyers that currently have a contract with Carlton and Granada the fallback option of renewing the terms of their 2003 contracts without change for the duration of the remedy, except that where a contract specified a share of broadcast provision, this share will vary in direct proportion to ITV's share of commercial impacts (effectively, its share of total TV advertising), subject to a cap at the initial share. The revised share of broadcast would be calculated against the base level of impacts in 2002, weighted by the mix of demographic and regional impacts actually purchased. The protection can be rolled forward so that a subsequent year's contract becomes the base set of contractual terms, subject to mutual agreement. Further, the CRR remedy is supplemented by nine additional undertakings:

- advertisers may switch between media buyers subject to the merged entity's approval which cannot be unreasonably withheld
- lapsed advertisers have the right to renew the terms of their most recent contract in force since 2000

- rights do not expire if advertisers chose to move away from ITV for a period during the life of the remedy
- line-by-line advertisers acquiring another advertiser have the choice of applying the acquirer's 2003 terms (subject to any risk of over-trading) or the weighted average of the acquirer's and the acquired's 2003 terms, or of rolling forward separately the acquirer's and the acquired's 2003 terms
- where two media buyers merge, their protected contract will be the weighted average of the two, or they have the option of rolling forward each contract separately
- the remedy will cover the airtime sale in the 2003 contracts, which included sales on behalf of SMG, Ulster TV and Channel TV, as well as, in some cases, ITV2 and ITV News
- Carlton and Granada will accept any changes to their licence conditions stipulated by the ITC relating to the conditional selling of ITV2 or any other channels
- there will be a wholly independent adjudicator (or a small panel), selected by the ITC and funded by Carlton and Granada, to resolve certain disputes arising under the CRR remedy, and
- Carlton and Granada have undertaken to make no material changes to the current airtime sales system for the duration of the remedy.

The concerns raised in the OFT's 18 September advice concerning detailed implementation of the CRR remedy have been addressed so far as possible in the undertakings.

- We have been able to define more precisely those aspects of the CRR remedy that were ambiguous in the CC Report, but which are fundamental to implementation of the CRR remedy.
- We have been able to describe more fully the role of the adjudicator. This includes the process to be followed, the standard to be applied in determining disputes, the scope of remedies, and the legal implications of a binding adjudicator process. We have also sought to provide sufficient resources for the adjudicator to be effective and have provided for reserve positions in the event that adjudication of a dispute is not resolved before the end of an existing contract.
- Carlton and Granada have given undertakings in relation to the sale by them of airtime on behalf of Regional Channel 3 licensees in which they do not have an interest, such as SMG.
- In relation to timing, we have been able to negotiate these undertakings within the timetable that you set.

The consultation on the draft undertakings generated 45 responses. Material amendments to the undertakings have been made in the light of helpful comments made by consultees. We have not accepted every comment made during that

consultation process (in particular where they were mutually inconsistent or where the comments were not related to the adverse effects of the merger). However, the consultation raised six points that have not been incorporated into the undertakings but which warrant specific comment.

- It has been suggested by some consultees that clause 3 of the undertakings should be expanded to allow other Channel 3 licencees that are parties to airtime sales agreements with Carlton or Granada greater freedom to renegotiate provisions of these agreements. Such representations however rely on matters that were not identified as a detriment by the CC. We have not therefore incorporated these suggestions.
- A number of consultees have argued that clause 7 of the draft undertakings is too rigid in that it effectively 'locks in' the ITV premium. They have suggested that we allow advertisers and media buyers greater flexibility in contract renegotiation. We have not included this point on the grounds that implementation of the CRR remedy to address the detriment identified by the CC requires only that contracts for the purchase of airtime be rolled over – not that they all be renegotiated. Moreover, this 'lock in' effect was recognised by the CC as a consequence of the CRR remedy.
- Many consultees argued that the terms 'fair and reasonable' and 'material' in clause 10(b) should be more closely defined in the undertakings. We do not believe that it is possible to develop these definitions beyond the level in the undertakings. First, the undertakings endeavour to capture the 'spirit' of the CC's recommendations. Second, insofar as further interpretation of these terms is required, we have concluded that this is a matter for the adjudicator given the wide range of possible issues that may arise. Quite simply, these undertakings cannot provide specifically for every eventuality. As we indicated in our advice of 18 September, this may give rise to some uncertainty as to the scope of the undertakings.
- Consultees have questioned what would happen if an advertiser under an umbrella contract with a media buyer moved to a media buyer that has a line-by-line deal with Carlton and/or Granada. In these circumstances, the advertiser would not be able to claim the benefit of any previously agreed terms.¹ It is true that this specific situation is not covered by the undertakings. We have not been able to identify any meaningful provision to deal with this situation beyond the general obligation on Carlton and Granada to offer always fair and reasonable terms to advertisers seeking to move. The question of whether terms offered by Carlton and Granada are fair and reasonable is subject to review by the adjudicator.
- In relation to Annex 1, it has been suggested to us that the operation of the share of broadcast cap and weighting mechanism should operate so that the share of broadcast commitment is first capped and then weighted. In contrast, Annex 1 weights the demographics first and then applies the share of broadcast cap. This is important where a share of broadcast commitment in a media buyer's or advertiser's contract corresponds to a range of demographics. In this case, it would appear more

¹ This is in contrast to the reverse situation where advertisers that bought airtime under a line-by-line agreement can take the benefit of that contract with them if they switch to a media buyer that has an umbrella agreement with Carlton and/or Granada.

appropriate to apply the share of broadcast cap to Carlton's and Granada's performance across the entire range of demographics rather than for performance in individual demographics. This approach more closely corresponds to the way in which advertising airtime is actually sold. Moreover, this approach also ensures that the merged Carlton and Granada will have an incentive to invest in all parts of its schedule, and not only in relation to specific demographics.

- Also in relation to Annex 1, we have been urged to change the base year for the share of broadcast commitment calculations from 2002 to either 2000 or 2001. We have not adopted these suggestions for two reasons. First, the CC report recommends use of 2002 as the base year. Second, since the aim of the CRR remedy is to allow advertisers buying airtime to rely on their contract negotiated in a pre-merger situation, it seems to us right that the base year should be the last full calendar year immediately preceding these undertakings.

CONCLUSION

The undertakings that you asked the OFT to seek have therefore been obtained. The OFT recommends that, if you accept the attached undertakings, they be published in accordance with s88(2A) of the Act in due course.