

CLASSIFIED DIRECTORY ADVERTISING SERVICES MARKET INQUIRY

Proposed remedies

Contents

Introduction	3
The provisional findings	3
Framework for the assessment of remedies	5
Consideration of specific proposed remedies	6
Remedy options addressing the cause of the AEC	6
BT proposal—promotion of the generic term ‘classified directories’	7
BT proposal—an information remedy	8
A price cap	8
Reference point	9
The response of the parties	9
CC assessment and proposal	9
Introducing further flexibility to the current structure	10
The ratchet effect	10
Volume discounts and money-back guarantees	11
CC assessment and proposal	11
Choice of index	12
CC assessment and proposal	13
The scope of a price cap	13
Rescoped directories	13
The response of the parties	14
CC assessment and proposal	15
New directories and second tiering	16
The response of the parties	17
CC assessment and proposal	18
Themed guides	22
New types of advertisement	22
The response of the parties	22
CC assessment and proposal	23
The level of a price cap	24
The response of the parties	24
CC assessment and proposal	25
Other provisions	26
Duration of the remedies	28
The response of the parties	28
CC assessment and proposal	29
Relevant customer benefits	29
Summary of CC remedy proposals	30
A price cap	31
Reference point	31
Introducing further flexibility – the ratchet effect and volume discounts	31
Choice of index	31
<i>The scope of a price cap</i>	31
Re-scoped directories	31
New directories and second tiering	32
Themed guides	32
New Types of advertisement	32
The level of a price cap	32

Other provisions.....	32
Duration of the remedies.....	33
Implementation	33
Appendices	34

Introduction

1. On 13 June 2006, the Competition Commission (CC) issued a Notice of Possible Remedies (the Notice), which invited comments on the actions that might be taken by the CC, or recommended for implementation by others, to remedy, mitigate or prevent the adverse effect on competition (AEC), and resulting detrimental effects on customers, as identified in its provisional findings of the same date.

2. This paper presents the results of the CC's consideration of the remedies options it presented in the Notice, and other options that have been suggested to it, in the light of responses to the Notice, further submissions from parties and further CC analysis. These submissions have been posted on the CC's website: <http://www.competition-commission.org.uk/inquiries/ref2005/classdirec/index.htm> A summary of the CC's proposals is set out at the end of the paper (paragraphs 103 to 119). The paper thus sets out the CC's provisional view as to the package of remedies it considers would be effective and proportionate.

3. The CC invites views on the following analysis and proposals, to be provided by 29 September 2006.

The provisional findings

4. In its provisional findings published on 20 June 2006 the CC concluded that there are features of the relevant market, either alone or in combination with each other, that prevent, restrict or distort competition in connection with the supply of classified directory advertising services (CDAS) and hence that there is an adverse effect on competition within the meaning of section 134(6) of the Enterprise Act 2002 (the Act). The provisional findings identified those features in paragraph 8.26. These are listed below:

- The market for major CDAS is highly concentrated: Yell¹ has a market share of around 75 per cent and between them Yell, Thomson² and BT³ have a market share of 99 per cent.
 - The market has been highly concentrated for a number of years. Yell had a market share of over 80 per cent until BT's re-entry in 2002 and between them, Yell and Thomson had a market share of 99 per cent until BT's re-entry. Since it re-entered the market, BT has grown its share substantially.⁴
 - Entry barriers are high and include the network effect referred to below and the need to establish a strong brand identity.
 - The incumbency position of the largest provider is reinforced by the network effects present in the market. Other providers wishing to expand have to build usage in order to attract advertisers. This requires investment, particularly in usage advertising, and acts as a barrier to expansion.
 - Yell has market power and is the price setter in the market.
 - In general, Yell's prices are not constrained by those of its competitors; Yell does not compete on price in any significant way.
5. Paragraph 8.27 of the provisional findings identified the detrimental effect on customers of the features: Yell's prices would be higher than in a well-functioning market were it not for the Yell undertakings.⁵
6. The CC has not, at this stage, reached a final conclusion on the AEC and resulting customer detriment. However, for the purposes of this document, the CC has maintained the working assumption that the features, AEC and resulting customer detriment is unchanged from that outlined in the provisional findings.

¹Yell Group plc.

²Thomson Directories Ltd.

³BT Group plc.

⁴Albeit from a small base.

⁵The undertakings given to the Secretary of State for Trade and Industry by Yell, formerly Castaim, in 2001.

Framework for the assessment of remedies

7. Having identified in its provisional findings a set of features of the markets for the supply of CDAS in the UK that give rise to an AEC, the CC has a duty to consider what, if any, action should be taken to remedy that adverse effect and resulting customer detriment. As well as taking action itself, the CC may recommend that action be taken by others.

8. The CC is required by the Enterprise Act 2002 (the Act) in particular to ‘have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effect on competition’.⁶ Such detrimental effects may affect existing or future customers and be in the form of higher prices, lower quality, less choice or less innovation in relation to goods or services in any market in the UK (whether or not in the market to which the feature or features concerned relate).⁷ The CC notes in its Guidance CC3 (paragraph 4.9): ‘when deciding what is an appropriate remedy, the Commission will consider the effectiveness of different remedies and their associated costs and will have regard to the principle of proportionality’.

9. The CC will also have regard to the effects of any remedial action on any relevant customer benefits within the meaning of section 134(8) of the Act arising from the feature or features of the market concerned. Such benefits comprise lower prices, higher quality or greater choice of goods or services or greater innovation in relation to such goods and services. To qualify within the meaning of section 134(8), the CC should consider that the benefit has accrued as a result (whether wholly or partly) of the features concerned or may be expected to accrue within a reasonable period as

⁶Section 134 (6).

⁷Section 134 (5).

a result would be unlikely to accrue without the feature or features concerned (the assessment of relevant customer benefits is detailed in paragraphs 98 to 102 of this paper).

Consideration of specific proposed remedies

10. This section of the paper discusses the different remedy options set out in the Notice published on 13 June 2006 and those that have been put to us by CDAS providers. For each remedy option and major segment thereof, the CC outlines the remedy as per the Notice, the responses to the Notice and the CC assessment and resulting proposal.

Remedy options addressing the cause of the AEC

11. In the Notice we stated that:

The Group has considered a number of possible remedies to address the AEC including compulsory licensing of the Yellow Pages brand to other CDAS providers; possible restrictions on Yell's consumer advertising; limits on the proportion of addresses to which Yell could distribute directories in any particular area; a break-up option, for example into regional entities. However, the Group does not consider that any of these possible remedies is likely to be effective and/or proportionate in addressing the AEC or the resulting detrimental effect on customers. Accordingly the Group is not minded to give further consideration to these remedies at present but invites comments as to whether such measures may be appropriate.

Our views on these possible remedies have not changed since publication of the Notice.

12. In response to the Notice, further remedy options were proposed by BT which it considered could address causes of the AEC and these options are assessed below.

BT proposal—promotion of the generic term ‘classified directories’

13. BT proposed a remedy that would address what it described as a considerable level of misunderstanding about the term ‘classified directory’. It argued that ‘Yellow Pages’ has become the generic term to describe classified directories. This may cause misunderstanding when an advertiser asks a prospective customer where he found his contact details. The prospective customer may answer ‘Yellow Pages’ even if another classified directory such as BT’s *Phone Book* or a *Thomson Local* was the source. Thus leads generated by Yell’s rivals may be misattributed, lessening the perception of the response provided by Yell’s competitors and damaging Yell’s competitors’ ability to attract business.
14. To address this issue BT proposed that the CC should adopt as a remedy an obligation on CDAS providers to indicate in their marketing material the generic term ‘classified directory’ in addition to the brand name. It said that this could be expected to have a positive impact on consumer awareness in a relatively short period of time.
15. While we understand BT’s concern that the effectiveness of their directory in generating sales leads may thus be under-rated, we do not believe that the suggested requirement would be effective in changing use of language in the way BT desires and we consider that the suggested requirement would be extremely difficult to monitor and enforce. Even if use of language were to change in the manner desired by BT, we consider it unlikely that it would make a significant contribution to addressing the AEC that we have identified. We are therefore not minded to pursue this remedy.

BT proposal—an information remedy

16. BT also proposed an information remedy whereby an independent expert third party would collate information on key performance indicators, such as cost per lead, and make the data available to the market. BT claimed that such a remedy would be likely to mitigate the network effect held by Yell and increase competition in the market because advertisers are likely to be more willing to switch some or all of their volume to alternative suppliers if they have confidence, from an independent survey, that they are likely to obtain better value by switching. BT cited, as a potential model, the Yellow Pages Market Reporter (YPMR), a syndicated market research report produced in the USA.

17. We acknowledge that analogous arrangements for readership or audience measurement have been established in other media and we note that they have generally been created and paid for by media owners and advertisers through their trade associations. We therefore appreciate that an agreed industry benchmark might be useful to CDAS providers but do not feel it would be appropriate for the CC to mandate such an arrangement. We doubt that this would significantly address the AEC we have identified and therefore we doubt it would be an effective remedy. We did not, for example, identify information asymmetry as a feature of the market. We are therefore not minded to pursue this remedy proposal.

A price cap

18. In the Notice the CC said that it was considering the use of a price cap to address the exercise by Yell of its market power, its finding that Yell does not compete on price in any significant way and the customer detriment of higher prices that is expected to result from the AEC. The CC invited responses as to the reference point of a cap, its scope and level and whether there were any other measures that would be needed to ensure the effective application of a price cap remedy.

Reference point

19. A price cap may take as its point of reference particular product prices or a basket of products. Yell's current price cap applies to products, in this case advertisement types. The rate-card price of every advertisement type in each of Yell's directories is specified and Yell may not charge more than this rate. An alternative would be a control which took as its point of reference a 'basket' of advertisements weighted by factors such as the proportion of prior year revenue that each type accounted for.
20. A basket control would allow Yell greater flexibility to set prices according to customers' elasticities of demand. It would enable Yell to charge some advertisers more for a particular advertisement type provided that it charged others less such that the average price of advertisements did not exceed the capped level.

The response of the parties

21. Yell told us that it 'does not believe that a "basket" approach is desirable' though it did state that any future price control 'should be formulated in terms which enable it to operate its rate card more flexibly'. It also favoured simplicity in any price control arrangement.
22. Thomson told us that were there to be a 'safeguard cap there would be little to recommend the complexity of a tariff basket'.
23. BT was strongly against a basket control. It argued that this would facilitate targeted conduct by Yell [X].

CC assessment and proposal

24. We noted that there was no enthusiasm from any of the main CDAS providers for a price control mechanism based on a basket of products. There was a preference for

continuation of a price control applying to individual advertisement types. Although a basket may be preferable for regulated monopolies, its use on an incumbent facing emerging competition may not be beneficial.⁸ The greater flexibility that a basket mechanism would give to Yell would enable it to target price-sensitive customers of its competitors and so undermine emerging competition. It would also enable it to target less price sensitive Yell customers with price increases. We noted too that a basket control introduces greater complexity, making it more difficult for customers and the OFT to monitor compliance.

25. Having regard to the respective advantages and disadvantages of the alternative models of price regulation we therefore propose that price controls should continue to apply to advertisement types rather than through a basket mechanism. We have noted also the preferences of the three main parties for a price control in the form of the current structure as opposed to a basket structure.

Introducing further flexibility to the current structure

26. In its response to our Notice, Yell made a number of proposals which, in the context of continuing the current structure of price controls, it considered would allow it to operate its rate card more flexibly both to compete more effectively and to bring benefits to advertisers. We now consider these.

The ratchet effect

27. Yell noted that the current control operated with reference to the previous rates in its rate card. If, for example, under the current control, it were to lower rates in a directory by more than RPI-6 per cent, the resultant rate would become the benchmark for the following year: Yell could not recoup any of what it described as

⁸See, for example, Price Discrimination, competition and Regulation, Mark Armstrong and John Vickers, *Journal of Industrial Economics*, Vol.41 (Dec., 1993), pp. 335–359.

the 'surplus discount' that it had allowed and this might act as a disincentive to reducing prices. The CC referred to this in paragraph 6.12 of the provisional findings.

28. Thus, for example, a control might require that the maximum rate for an advertisement type fall by £50 per year. The maximum might be £1,000 in year 1, £950 in year 2 and £900 in year 3. Under current arrangements, if Yell were to charge £850 in year 2, this would serve as the base for year 3 resulting in a maximum rate in year 3 of £800: hence the ratchet effect. Removing the ratchet would allow it to return to a rate up to £900 in year 3. Yell has asked for the ratchet effect to be removed.

Volume discounts and money-back guarantees

29. Yell told us that it would like the commercial flexibility to be able to negotiate volume discounts with major advertisers without having to notify these to the OFT as was currently required by the undertakings. Yell also told us that it would like the flexibility to offer a 'money-back guarantee' whereby selected advertisers would be entitled to a refund of the cost of their advertisement if a pre-agreed response level was not met.

CC assessment and proposal

30. In assessing Yell's proposals for increased flexibility, the advantage to selected individual advertisers of such proposals of lower prices or discounts needs to be set against the possibility that Yell may target the most profitable customers of its competitors and thereby weaken developing competition. Increased flexibility may also make monitoring and enforcement of the price control significantly more difficult.
31. We consider that removing the ratchet effect would also remove a disincentive to reduce prices but would not provide significant scope for targeting particular

customers, by offering low prices to its competitors' customers and higher prices to less price sensitive customers of its own. Although this proposal may increase the complexity of monitoring, on balance, the Group is minded to permit the removal of the ratchet effect.

32. On volume discounts and money-back guarantees, the CC has greater concerns regarding the potentially increased scope for price discrimination to the extent that these arrangements would be subject to individual negotiation and would provide Yell with relatively more discretion as compared to a price control with less flexibility. In the case of money back guarantees, for example, the number of responses that would trigger a refund would need to be negotiated on an individual advertiser basis. Advertisers using another CDAS provider's product could be targeted with particularly attractive terms. Such arrangements are also likely to increase significantly the complexity of monitoring and enforcement. Consequently we are not minded to permit these elements of flexibility.

Choice of index

33. We considered whether it remained appropriate to use, as in the current undertakings, the Retail Price Index (RPI) or whether other general measures of inflation, like RPIX⁹ or the Consumer Price Index (CPI), or an index of relevant industry input costs such as that for paper and pulp (PPI), would be more appropriate. We received no submissions from parties on this issue.
34. CPI is used by the Government to set the Bank of England's inflation targets, though RPI is still used as the index for calculating increases to pensions and state benefits and remains a key benchmark for wage settlements and general business usage.

⁹RPI minus mortgage interest payments.

CC assessment and proposal

35. Indices of industry input costs such as PPI would be more relevant if the remedy was intended to address Yell's margins rather than its prices. In this case, the remedy is intended to address the lack of constraint on Yell's prices and as such a consumer price index would provide a more suitable and reliable basis for any price control than a specific index of input costs. We consider that RPI continues to be an appropriate choice for such an index, being better understood than other indices. Further, we see no clear advantage in adopting an alternative. Were Yell to experience exceptional and sustained increases in its input costs and were this not to be reflected in the consumer inflation index, it would still be open to Yell to approach the OFT in order to seek a variation to the control.

The scope of a price cap

36. In our Notice we invited comments on the scope of a price cap, for example how new products, such as rescoped or new directories, should be incorporated in any price cap arrangements. Below, we describe issues relevant to rescoping of directories, then issues relevant to new directories, such as local directories and themed guides and finally issues relating to new types of advertisement.

Rescoped directories

37. When Yell rescopes one of its directories, typically splitting an area covered by one directory into two, the maximum rates it may charge advertisers in each of the new directories is governed by a formula in the current undertakings based on rates charged in the five directories with Guaranteed Minimum Circulations (GMCs) immediately greater than the new directory and the five immediately lower. The maximum rate that Yell may charge advertisers who wish to advertise in both new directories is not expressly provided for in the current undertakings. However, the CC considers that the amount that may be charged is governed by the good faith

provisions in the current undertakings which provide that ‘on the basis of a like-for-like comparison, prices paid for advertisements in Classified Directories published by Yell decline, relative to the RPI, by at least 6 per cent each year’. Thus an advertiser wishing to achieve the same coverage that was obtainable through the original directory would pay, post the rescope, the rate in force immediately prior to the rescope, after application of the RPI–6 per cent control, to advertise in the two new directories.

38. We were told that Yell has, in practice, applied rates on this basis. It describes this as its composite rate.

The response of the parties

39. Yell told us that it considered that the current formula for calculating the maximum rate that it may charge in directories that had been rescoped had been straightforward to apply and that it had seen no evidence in the CC’s provisional findings suggesting that application of the present formula was having any adverse effect on competition. Accordingly, Yell would not be in favour of a change in approach and saw no reason for any such change.
40. BT argued that Yell’s re-scoping had gone beyond the purpose of responding to changes in the locality, such as the opening of a shopping centre or expansion of residential areas. It argued that Yell’s re-scoping has meant that Yell’s directories more closely match the distribution areas of both Thomson and BT directories and that this erodes a competitive point of difference that they have enjoyed previously. [REDACTED] It argued for restrictions on Yell’s re-scoping activity, for example a limit on the total number of directories that Yell could publish of [REDACTED] and a minimum GMC for re-scoped directories of [REDACTED].

41. Thomson noted the competitive effects on its business of Yell's re-scoping, and in particular the effects on pricing. Thomson has told us that Yell's re-scoping undermines its competitive positioning relative to Yell's generally larger directories and this, coupled with the price control, puts downward pressure on Thomson's prices.

CC assessment and proposal

42. We recognize that Yell may wish, in satisfying the needs of its customers and for other legitimate commercial reasons, to alter the footprint of its directories from time to time. However, we consider that it remains necessary to have provisions that regulate Yell's conduct in respect of re-scoping as, without such provisions, Yell would be able to circumvent the price-cap remedy. Absent any restrictions on prices to be charged in newly re-scoped directories, Yell could increase rates in such directories.
43. We therefore propose that the price cap remedy should contain a provision setting maximum prices that Yell may charge in new directories created as a result of rescoping. We have found no persuasive reasons to depart from the current formula, with which Yell, its customers and the industry are familiar. We note also that the current formulation is relatively simple to apply and therefore to monitor.
44. We consider that an express provision should be included in the remedy that sets the maximum rate that Yell may charge an advertiser who has placed an advertisement in the directories resulting from a rescoping exercise. The effect would be that an advertiser who placed the same advertisement in such new directories to achieve the same coverage as prior to rescoping would pay no more than he would have done absent the rescope.

New directories and second tiering

45. Yell is currently prohibited by the undertakings from distributing directories with overlapping distribution areas. This would include lower circulation directories distributed within the area covered by their main directories. Such distribution is sometimes referred to as second tiering. In our provisional findings we said that ‘On balance we do not consider that the evidence submitted to date enables us to form an expectation at this stage in our inquiry that the publication by Yell of additional small directories would prevent, restrict or distort competition or give rise to a detrimental effect on customers’ (paragraph 43).

46. Following the provisional findings, we have received further views from parties concerning the possible detrimental effect of Yell introducing second tier directories. We have also considered whether, having regard to Yell’s market power, it is necessary to include a remedy restricting Yell’s conduct in this respect.

47. Yell told us that it would like to produce second tier directories within areas where it publishes its current directories. These would cover towns or villages inside the distribution areas of its main directories.

48. Yell showed us market research indicating that such directories would be popular with both advertisers and users. It said that producing such directories would enable it to offer businesses a new platform for advertising at a lower cost of advertising than the main directory as a result of the lower GMCs such directories would have. It showed us the results of market research undertaken by FDS International Ltd. in connection with this project which described the product as being focused on locations with [✂] households.

The response of the parties

49. Yell told us that it saw no reason why such directories would require price regulation as local market conditions would determine their pricing. It told us that any concerns on the part of competing suppliers of printed CDAS with respect to Yell's future strategy in supplying second tier directories could be addressed using the extensive powers available under the Competition Act 1998 and the Act.
50. A respondent [redacted] told us that it was strongly against the removal of the current prohibition. It told us that Yell had the incentive and the ability to launch second-tier directories to [redacted]. Given the fundamental importance of the protection of [redacted] competition, the respondent considered that it was essential that the remedies package should include a prohibition on second tiering by Yell.
51. The respondent [redacted] referred the CC to the 1996 MMC report conclusion that BT *Yellow Pages*' publication of second tier directories was 'a step being taken for the purposes of maintaining the monopoly'. The respondent [redacted] said that 'Nothing, fundamentally, has changed in this regard'.
52. [redacted]
53. The respondent [redacted] proposed a series of constraints on Yell in the event that the CC decided not to prohibit second tiering. These included a maximum limit of [redacted] households and [redacted] businesses to be covered by any local directory; a prohibition on cross-selling or combined offers with *Yellow Pages*, *Business Pages* or Yell.com; prevention of the application of *Yellow Pages* branding; a prohibition on delivering a local product in the same packaging as other Yell products; and the creation of a separate legal entity with responsibility for local directory publishing with a separate Profit and Loss account and independently audited.

54. A respondent [REDACTED] was similarly opposed to the ban on Yell second tiering being lifted. It told us that second tiering could reasonably be expected to give rise to an adverse effect on competition. The respondent [REDACTED] considered that if Yell were permitted to publish second tier directories, Yell could pursue the same predatory strategy today as it did ten years ago. The respondent [REDACTED] also referred us to the MMC's conclusion at that time that BT Yellow Pages would use the local *Yellow Pages* directories in a predatory fashion, and told us that there had been no change in circumstances that would warrant the CC taking a different view in the current inquiry. [REDACTED].
55. A respondent [REDACTED]¹⁰ suggested that if Yell were free to engage in second tiering it could introduce 'spoiler' directories in any area where a new entrant was seeking to challenge it, while maintaining its established directories and their related revenues. It told us that, on balance, second tiering would be likely to have a negative impact on competition. It recommended that the CC maintain the prohibition on second tiering by Yell.

CC assessment and proposal

56. In its provisional findings the CC found that there was a 'deficit of competition' in the CDAS market, resulting from the features identified, including Yell's market power and incumbency position and high barriers to entry.
57. Although small and local directories are currently supplied, by a range of providers, in many parts of the country, we recognize that there may, as Yell has claimed, be unmet demand in the market that the particular directories it envisages may satisfy. However, we considered whether, in permitting second tiering without restriction, Yell

¹⁰[REDACTED]

would be able to exercise its market power and the effect this might have on competition.

58. We consider that there is a significant risk that publication of a large number of second tier directories by Yell will have a material adverse impact on the businesses of competitors. Furthermore this impact may be significantly greater than any negative effect on the revenues of Yell's main directories. Yell's sales management would have the incentive and ability to minimize the revenue loss of Yell's main directories; moreover, the characteristics of competitors' directories may be more vulnerable to the introduction of local publications. We recognized also that the proposals that Yell has shown us illustrate the intentions of Yell's current management to produce directories with limited GMCs. However, if the current restriction was lifted entirely, Yell would be able to publish directories with much larger GMCs and on a scale that could have a considerably greater impact on competitors, than a series of low GMC local directories, by more closely matching their footprints. It could also provide scope for avoidance of the price control on the main directories.
59. We considered whether powers under the Competition Act 1998 and the Act would be sufficient to address any competition concerns arising from second tiering by Yell. As noted in paragraph 49, Yell had told us that they would be.
60. As the CC explained in paragraph 8.26 of the provisional findings, it considers that there is a 'deficit of competition' in the CDAS market. Competition Act powers may be used to respond to anti-competitive effects arising from second tiering by Yell, once a breach of the Competition Act has been established. However, having regard to the features and deficit in competition identified, the CC considers that there should be

certain restrictions on Yell publishing second tier directories which are aimed at addressing particular concerns.

61. We therefore propose that the prohibition on Yell publishing second-tier directories is relaxed but that certain restrictions aimed at addressing our concerns should apply. These include a limit on the maximum GMC of any Yell second tier directory.

62. The table below shows, for different possible GMC thresholds, the number of BT and Thomson directories with circulations below that threshold, as well as the number of Thomson and BT directories with a circulation which is less than twice that threshold; the assumption being that if a Yell second tier directory had a circulation of half of the equivalent BT or Thomson directory, the impact on Thomson and BT's sales is likely to be relatively small. At a level of 25,000, fewer than 5 per cent of Thomson and BT's directories would have a circulation of less than twice that of the maximum authorised. At a level of 40,000, by contrast, about 20 per cent of Thomson and BT's directories would be below twice the maximum.

	<u>Maximum GMC</u>					
	<u>20,000</u>	<u>25,000</u>	<u>30,000</u>	<u>40,000</u>	<u>50,000</u>	<u>60,000</u>
Number of Thomson directories with a lower GMC	1	1	2	3	6	10
Number of BT directories with a lower GMC	0	0	1	2	7	13
Number of Thomson directories with GMC of less than twice the maximum	3	6	10	32	57	85
Number of BT directories with GMC of less than twice the maximum	2	7	13	36	64	88

Source: CC calculations

63. We propose that the maximum GMC for any Yell second tier directory be limited to 25,000 to ensure that the directories are 'local' and not directly targeted at the catchment areas of Thomson or BT directories. The smallest directory published by

Thomson or BT is Thomson's March directory with a circulation of 16,000. The average GMC of Thomson's directories is 130,000. BT's average GMC is 126,000.

64. We do not propose that Yell's proposed local directories should be subject to a price cap.
65. Additionally, we considered that a restriction should be placed on the combined circulations of local directories distributed within the footprint of each of Yell's current directories, to prevent Yell from covering the footprint of a competitor or one of its own main directories with several local directories. Were Yell able to engage in conduct of this kind it could have a major impact on its competitors and provide scope for circumventing the price control. We propose that the aggregate GMC of second-tier directories published within the footprint of each of Yell's directories should not exceed 20 per cent of the GMC of the main directory. On the basis of Yell's average GMC for a main directory of about 230,000 and a GMC of circa 25,000 for a local directory, this would imply a maximum of two local directories for each average main directory footprint.
66. We consider that these restrictions will address our concerns as regards Yell's potential to use its market power to damage competitors and thus competition, while allowing it to satisfy the unmet demand that it states it has identified.
67. We considered other possible restrictions that could address our concerns. We considered whether restrictions might be placed on the making of special offers to advertisers in the main directory in order to encourage them to advertise, additionally, in the local directory. We were concerned that Yell might bundle the local directory with the main directory, offering a combined price lower than the price of the two

products if sold separately, or tie the sale of the two products, making the availability of one conditional on the purchase of the other.

68. We propose that tying or bundling of main directory and local directory advertising be prohibited. Yell should not be able to require that one product could not be purchased unless the other one was. And it should not be permitted to offer a price for both products which was less than the aggregate price for both products. We further propose that price tying or bundling between different local directories should be prohibited.

Themed guides

69. Yell has also said that it would like the freedom to publish themed 'guides', [REDACTED].
70. We have a concern about such guides which is analogous to that regarding the introduction of second tier directories, and we consider that such guides should fall within the restriction outlined above for the introduction of local directories.

New types of advertisement

71. Under the current arrangements, new types of advertisement are not subject to the price control in their first year of introduction. For example, when Yell introduced colour advertising it did so at a much higher rate than black and white advertisements [REDACTED]. This premium and therefore the price of colour advertisements was not subject to the price control in the first year of their introduction but was subsequently. In our Notice we invited views on how new products, which would include new types of advertisement, should be incorporated within the price cap arrangements.

The response of the parties

72. Yell did not comment specifically on new types of advertisements.

73. Thomson argued in general that, in the event that the CC were to retain some form of price cap, it should not apply to new products, at least in their year of introduction. On colour advertising, it told us that [✂].
74. BT told us that it believed there were two main strategies that a CDAS provider could adopt on colour. The first was to try to establish a directory which contained a large amount of colour advertising on the basis that this would improve usage. [✂] The alternative was a strategy to charge a significant premium for colour so that an advertiser who chose to pay this premium obtained greater prominence than other advertisers placing mono advertisements. It said that this latter strategy was clearly Yell's approach. BT said that it was not appropriate for the CC to determine which of two viable competitive strategies Yell should use. It also pointed out that requiring Yell to adopt the former strategy would eliminate one of the points of differentiation between BT's products and Yell's.

CC assessment and proposal

75. We do not propose a separate price cap on Yell's colour advertisements nor on other new types of advertisement which it may develop, in their year of introduction. We cannot predict what new products Yell may develop in the future and do not propose that every new product that it is considering launching should be evaluated by the OFT beforehand. The price control we are proposing will apply to any such new advertisement types following their introduction and we believe this will provide an adequate safeguard.
76. We further believe that the Good Faith provisions that we are proposing will provide an effective safeguard against avoidance of the price control through, for example, changes in the sizes of advertisement types offered by Yell.

The level of a price cap

77. We found that in general, Yell's prices are not constrained by those of its competitors, the majority of Yell's advertisement prices were constrained by the price cap rather than its competitors' prices and that Yell does not compete on price in any significant way. A price cap would provide a constraint on prices. We considered whether the constraint should be lower than the general level of price inflation and also whether there should be any adjustment to particular prices or premiums by way of a one-off or glide path adjustment.

The response of the parties

78. Yell told us that its master rate card, as submitted to the OFT, contained rates for directories publishing up to 31 March 2008. These rates are governed by the RPI-6 per cent control currently prevailing. Yell told us that amending its rates prior to that time would be impractical. Yell also told us that it would be prepared to give the CC a binding commitment to the effect that rates published in the master rate card which had already been notified to the OFT would not be subject to any increases.

79. Yell said that if the CC considered that a price cap was necessary after March 2008, to address concerns that prices to some of Yell's advertisers might increase, then the level of the price cap should be set to ensure that prices would not increase in real terms. It therefore argued that the price cap after March 2008 should be set at RPI.

80. Yell stated that the CC had not concluded that Yell's current prices were too high and as such, any remedy should not have the effect of continuing to reduce Yell's rates. It also noted the CC's provisional findings on Yell's current and forecast ROCE. It claimed that there was no justification for a price cap at a level leading to further price decreases in real terms.

81. BT said that a 'safeguard' price cap should be one constraining Yell's rates in nominal terms: ie RPI-RPI. It claimed that such a price cap would incentivise Yell to make cost savings but would also eliminate the scope for Yell to raise its charges to customers with a very high willingness to pay. It claimed that a more severe control would harm BT's CDAS business.
82. Thomson submitted that the price cap had served its purpose and that fierce competition now existed in the CDAS market. It argued that the price cap should be lifted. However, were a price cap to be imposed on Yell, it should be set at RPI to allow smaller competitors at least to recover increases in costs.

CC assessment and proposal

83. On the basis of our provisional findings, we do consider it necessary to impose a price cap. Without this, Yell would be able to set prices higher than in a well-functioning market. In the absence of other appropriate remedies to address the AEC and resulting detriments, a price cap is an effective and proportionate remedy.
84. As noted earlier (paragraph 80), Yell's view is that as the CC had not stated a provisional finding of excess profitability, then there is no basis for requiring a price cap that runs below the general level of inflation. We do not share this view as a general proposition because a well-functioning market may exhibit low price inflation for a variety of reasons other than erosion of high profitability, e.g. competing away current or anticipated efficiency or innovation gains or circumstances of high cash generation.
85. Appendix 1 considers Yell's ongoing productivity performance and financial projections it has supplied to the CC. For the reasons outlined in Appendix 1, these projections appear to be conservative. [REDACTED] We believe that in a well-functioning

CDAS market, as a result of continuing efficiencies and high cash generation it would be expected that output prices for CDAS would rise by less than the general level of inflation in future, albeit not necessarily for a prolonged period or to the extent of RPI-6 per cent. However, we also acknowledge that, over time, growth of the Internet may halt and reverse growth in the printed directories market, putting upward pressure on unit costs and downward pressure on profitability.

86. The CC, in its provisional findings, concluded that in the absence of the cap Yell's prices would be higher than in a well-functioning market. Were an RPI-6 per cent formula to continue to apply to rates in its directories published up until 31 March 2008, (which, as explained in paragraph 78, is the practical consequence of the current price control) the starting point for any new control would be prices lower than they are currently. Most directories would have one further cycle of reductions after the likely implementation date of a remedies package resulting from this inquiry and, some, two further cycles. We believe that the further reductions resulting from the continuing effect of the current price control, followed by a constraint on future price increases restricted to RPI would be broadly consistent with the outcome of a well-functioning market.
87. In view of the above considerations and the undertaking offered by Yell, we propose that the price control should continue at RPI-6 per cent for directories currently scheduled to be published up to and including 31 March 2008, and at RPI for directories thereafter.

Other provisions

Publication of a rate card

88. Under the current Yell undertakings, Yell is required to publish a comprehensive rate card for all editions that it intends to publish between the dates set out in that rate

card. Because of our proposals regarding the ratchet effect, Yell's actual rate card may differ from the maximum rate that it is permitted to charge under the price control: its 'ceiling' rate. We propose that Yell be required to publish its ceiling rates as well as its rate card. This seems to be a straightforward means of enabling advertisers to establish that they are not being asked to pay more than the maximum permitted by the cap.

Preparation and availability of accounts.

89. Yell is currently required to publish accounts for its printed directory business and to make these available to the OFT and anyone who requests them. It is further required to publish in its annual accounts information on its printed directory business. It is required to publish the turnover of its printed directory business segmented between its classified directory business and its business directory business and segmented information on the operating profits and net assets of its printed directory business.
90. We have been told by the OFT that publication of these accounts has been helpful in understanding the way the undertakings have affected Yell and the CDAS market. We propose that a requirement to publish and make available separate accounts for Yell's printed directory business should be included in the remedy package.

Good Faith

91. The current Yell undertakings include a Good Faith provision. This provides a useful safeguard against the possibility that changes may take place in the way that Yell does business that could lessen the effectiveness of the remedy. We propose that a Good Faith provision is included in our package of remedies.

Duration of the remedies

92. In the Notice we stated that while it appears likely that BT will become a stronger competitor, the pace of its future growth was unclear, and the extent to which its future presence will become a significant constraint on Yell's prices was uncertain. We stated that we expect that advertising on the Internet will increase in the future, and that CDAS advertising may decrease. We stated that in these circumstances it may be appropriate to recommend that a review is undertaken by the OFT of any remedies which are applied. We invited comments on whether it was desirable to recommend a review of remedies after a specified period or rely on the OFT's general duty to monitor remedies and review their application in the light of changing circumstances.

The response of the parties

93. Yell argued that the CC should specify the duration of any remedies and direct that the undertakings should then terminate without the need for further review. It suggested that the date for cessation should be specified with reference to directories published in any particular Yell financial year, and gave as an example directories published in the year ending 31 March 2010.

94. BT told us that the need for a remedies package would fall away [redacted]. It said that the future development of BT's CDAS business was innately uncertain though it said that it was committed to investment and expansion and that it might be appropriate to provide for some form of review by the OFT which would be triggered by a range of criteria identified by the CC.

95. Thomson told us that increasing competition in the market was such that a review of any remedies should take place before five years, and said that any form of continuing price control should be reviewed by the OFT within one year. It told us that

the negative impact on its print business of any form of price control involving price reductions or price freezes would quickly be felt.

CC assessment and proposal

96. We accept that the CDAS market is changing and that the continuing growth of BT, in particular, may herald a more competitive environment in which any price control would no longer be required. However, we remain concerned that although BT is well resourced and has certain advantages with respect to this market, its future progress and the development of other competitive constraints are uncertain, and therefore the AEC and resulting detriment may remain in existence beyond a termination date that the CC may prescribe. The CC is therefore minded to recommend that the remedy package should be reviewed by the OFT after a period of three years from the implementation date of the remedies. We note that review prior to this date may result in insufficient time for a clear picture of changing circumstances to emerge.
97. We recommend that the OFT review should consider whether to cancel the package of remedial measures or allow them to continue for a further period based on evidence regarding the emergence of competitive constraints on Yell. In this context the OFT may wish to consider indicators that include whether prices are at or below cap levels, the evolution of market shares and the size of the CDAS market relative to comparable classified advertising on the Internet.

Relevant customer benefits

98. The Act enables the CC when deciding the question of remedies to have particular regard to the effect of any remedial action on any relevant customer benefits of the feature or features of the market concerned (see paragraph 9).

99. The CC guidance (CC3) gives examples of potential customer benefits. A high level of concentration, for example, might enable economies of scale to be obtained that would not be available if there were a number of firms in the market. To be a relevant customer benefit, any such economies would need to be substantially passed on as lower prices.
100. In its provisional findings, the CC concluded that the CDAS market was highly concentrated and has been highly concentrated for a number of years. The CC also concluded that Yell's prices would be higher than in a well-functioning market, were it not for the undertakings. Concentration has not, therefore, led to a customer benefit of lower prices.
101. The CC found also that the incumbency position of the largest provider is reinforced by the network effects that are present in this market. It might be possible to argue that these network effects result in higher quality of the Yell product although we have not received any submissions from parties suggesting that any such benefit is significant. We note, however, that the proposed measures would not disrupt this network effect.
102. We therefore conclude that there are no significant, relevant customer benefits which would result in modifying our choice and/or design of proposed remedies.

Summary of CC remedy proposals

103. The CC's proposals on remedies are listed below in summary form and should be interpreted in conjunction with the details provided in earlier sections.

A price cap

Reference point

104. We propose that Yell's prices should be subject to a price cap and that this should apply to advertisement types rather than a basket of products.

Introducing further flexibility—the ratchet effect and volume discounts

105. The CC proposes that the ratchet effect be removed.
106. The CC proposes to prohibit volume discounts and money back guarantees.

Choice of index

107. The RPI should be the basis of the price control that we are proposing.

The scope of a price cap

Re-scoped directories

108. We propose that a price cap remedy should continue to have an associated provision setting maximum prices that Yell may charge in new directories created as a result of re-scoping.
109. We propose that an express provision should be included in the remedy that sets the maximum rate that Yell may charge an advertiser who has placed an advertisement in the directories resulting from a rescoping exercise so that an advertiser who placed the same advertisement in the new directories to achieve the same coverage as prior to re-scoping would pay no more than he would have done to absent the rescope.

New directories and second tiering

110. We propose that the maximum GMC for any Yell local directory be limited to 25,000. We also propose that the aggregate GMC of second tier directories published within the footprint of each of Yell's directories should not exceed 20% of the GMC of the associated directory.
111. We also propose that tying or bundling of main directory advertising and local directory advertising sales be prohibited.

Themed guides

112. We propose that themed guides fall within the restrictions applying to local directories.

New Types of advertisement

113. We propose that the price control will apply to rates for new advertisement types following the year of their introduction.

The level of a price cap

114. We propose that the price control should continue at RPI-6 per cent for main directories to be published up to and including 31 March 2008 and at RPI thereafter.

Other provisions

115. We propose that Yell publishes accounts for its printed directory business and makes these available to the OFT and anyone who requests them.
116. We propose that Yell publish its rate cards and the ceiling rates that it is permitted to charge under the price control.

117. We propose that a Good Faith provision is included in our package of remedies.

Duration of the remedies

118. We propose to recommend that the remedy package should be reviewed by the OFT after a period of three years from the implementation date of the remedies. At such time, the OFT should consider whether or not the package of remedial measures should be terminated or continue for a further period, according to the changes in competition in the market.

119. We do not consider that it is necessary to recommend the taking of action by others to address the AEC.

Implementation

120. At present the CC is considering whether the measures should be implemented through undertakings by Yell or an order. The CC notes that as many of the measures represent continuation, in modified form, of current arrangements, short implementation timescales may, in general, be appropriate. We are considering whether transitional provisions are necessary.

Yell's efficiency gains and profitability

1. This appendix discusses Yell's prospective efficiency gains and profitability as context for considering the appropriate level of any price control.

Efficiency gains

2. Yell has made significant efficiency gains in the past, particularly as regards sales and order processing costs. Between 2001 and 2005, for example, the number of advertisements published in Yell's directories increased substantially. However, the number of staff engaged in selling and processing these advertisements did not increase at the same rate. As a result, the number of advertisements processed per head of sales staff and staff in general increased, as is shown in Table 1.

TABLE 1 [REDACTED]

3. [REDACTED]

Yell's prospective profitability

4. The CC found that Yell's profitability had been high for a five-year period to March 2005, both compared with its cost of capital and when its return on sales was compared with other companies. However, it was not possible to conclude from the available evidence whether Yell's profits at the end of the period were in excess of its WACC. It noted, however, that because of the constraints imposed on Yell by the undertakings, profitability measurement was unlikely to capture the extent of Yell's market power.

5. Yell supplied us with forecasts of its revenue and profitability, modelling three price cap scenarios: RPI-0 per cent, RPI-3 per cent and RPI-6 per cent. Yell told us that all three scenarios are the same to 2008 because all the rate card prices had been set under RPI-6 per cent for directories published to March 2008.

The detail of the forecasts

6. [REDACTED]

Scenario 1—RPI-6

7. Table 2 shows revenues and profitability to 2011 under the RPI-6 per cent price cap scenario, together with the key ratios ARPA, retention rates, new advertisers and total advertiser numbers.

TABLE 2 [REDACTED]

8. [REDACTED]

[REDACTED]

9. [REDACTED]

10. [REDACTED]¹¹

11. [REDACTED]¹²

12. [REDACTED]

Analysis

13. [REDACTED]

¹¹[REDACTED]
¹²[REDACTED]

14. [✂]

15. [✂]

16. [✂]

[✂]

17. [✂]

18. [✂]

[✂]

19. [✂]

[✂]

20. [✂]

21. [✂]

FIGURE 2

[✂]

22. A high degree of uncertainty is inevitable in forecasts stretching five years ahead.

[✂]