

## Summary of responses to the Notice of possible variations to the undertakings

On 15 September 2009 the CC published its provisional decision into its review of the contract rights renewal (CRR) Undertakings. We also separately issued a Notice of possible variations (the Notice) which explored possible ways in which the CRR Undertakings might be varied.

This paper is a summary of the responses received from third parties in relation to each of the possible variations.

### Limiting the scope of CRR to address only ITV1's advantages in delivering large audiences

1. We invited views on limiting the scope of the CRR Undertakings, for example by regulating sales of airtime within large audience programmes.
2. Parties made the following comments:
  - One media buyer [redacted] believed that it would be possible to 'ring-fence' peak and off-peak airtime sales by arranging for off-peak to be sold by a separate sales house, but found it difficult to envisage a mechanic on which to base peak-only contracts. This might be done by examining existing contracts to try and derive a cost index for each daypart and each audience but recognized that this would be difficult.
  - One party [redacted] thought that it was extremely difficult to imagine a successful segmentation of ITV1's inventory in this way, and even though the most obvious segment might be peak time, this would not be comprehensive. However, even if it were possible to create a comprehensive segmentation, the resultant complexity of contracts would be even more bewildering and any transitional arrangement even more so.
  - One media buyer [redacted] said that splitting ITV1's schedule into regulated and unregulated airtime would make buying airtime more complex.
  - Two parties commented that using peak as a proxy would miss large audience programmes transmitted out of peak (eg World Cup football and rugby) ([redacted], [redacted]) and the fact that not all programmes in peak were mass audience [redacted].
  - One broadcaster<sup>1</sup> [redacted] said that defining 'large audiences' would be difficult as various bases (eg absolute or relative size) could be chosen; using peak as a proxy would not be satisfactory as different channels had different definitions; and if new contracts needed to be negotiated this would offer ITV an opportunity to exploit its market power. It may be possible to develop a weighting system to value peak but this would be very complicated.
  - Another broadcaster [redacted] thought that it was difficult to see how peak-only contracts could be negotiated as there would be no frame of reference since there

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<sup>1</sup>For the purposes of this summary, we have used the term 'broadcaster' to cover broadcasters and sales houses.

were at present no peak-only deals. Any such contracts would allow scope for protected contracts to be 'unpicked'.

- One party [X] said that the ability to judge whether any new terms being proposed were fair and reasonable would, in the absence of any benchmarks, be difficult and highly controversial.
- One broadcaster [X] said that, in essence, the idea of splitting ITV1 airtime into peak and non-peak was sound. It could envisage how the practical difficulties of managing the sales process might be overcome but noted that this variation to the Undertakings could have unintended consequences regarding ITV's incentive to invest in daytime programming, in the event that peak airtime were used as a proxy for 'large audience'.
- One broadcaster [X] said that ITV would be able to leverage its strength in peak to off-peak airtime in the same way as it did with sales of digital channels. Conditional selling of this sort was difficult to prove, particularly since the agencies were reluctant to take ITV to the Adjudicator but there had been continuing reports of conditional selling, as noted in the OA's April 2009 report.
- One party [X] thought it was possible that a divided system of the sort envisaged would grant ITV more opportunities to exploit its market power on an ongoing basis than the current system. ITV may well be able to leverage its large audience market power across to unregulated small audience ITV1 contracts (as well as to digital contracts).
- One party [X] thought that dividing the sale of ITV1 airtime into large and smaller audience parts would represent a major change in the way UK airtime was sold. Such groundbreaking reform would raise the risk of unintended consequences.
- One broadcaster [X] said that broadcasters would be further encouraged to programme to peak, beyond the current incentives to do so, potentially moving some risky content away from peak.
- One broadcaster [X] commented that were peak to be used as a proxy for 'mass audience' delivery, it would be likely to open the door to manipulation of programming and scheduling to the non-regulated off-peak daypart. ITV could also make sales of peak airtime conditional on buying daytime.
- One media buyer [X] said that it would add further complexity to the CRR and one consequence of this would be that ITV would enjoy an advantage in any negotiations and they could exploit any loopholes in the remedy.

### **Removing elements of the CRR while retaining protection of media buyers through a requirement on ITV to offer airtime on fair and reasonable terms**

3. We next invited views on varying the CRR Undertakings such that, while the right of advertisers to roll over contract terms would be removed, the requirement that ITV should deal with its customers on a fair and reasonable basis would be retained, for example in circumstances where an agency wished to reduce its share of broadcast with ITV.
4. Parties made the following points:

- One party [X] warned us against anything which might undermine the positive, performance-based relationship between ITV's audience performance and its ability to drive revenues.
- One media buyer [X] said that there was no effective alternative which would act as a benchmark for what was 'fair and reasonable'.
- One media buyer [X] considered that it would be very complex and leave a lot open to interpretation, hence it would allow ITV to further exploit its market dominance.
- One party [X] thought that a potential outcome of this variation might be that a situation could occur where an agency suffered worse terms but was nevertheless reluctant to register a dispute for fear of retaliatory action by ITV, or due to a lack of comparable legal resource.
- One media buyer [X] said that this would not work without regulation and clearly defined rules of engagement.
- One broadcaster [X] said that ITV would tend to exploit its power by testing the limits of a fair and reasonable regime. The only constraint on ITV in such circumstances would be the prospect of recourse to the Adjudicator who would be making subjective judgements and this would lead to greater market uncertainty.
- One party [X] considered that the adjudicator's role would expand considerably. The adoption of so subjective a dimension as 'fair and reasonable' would lead to media buyers seeking the Adjudicator's input in all substantive negotiations.
- One broadcaster [X] commented that the likely increase in the number of disputes would place an excessive burden on the Adjudicator to micro-adjudicate on the reasonableness of each term of each agency contract.
- One party [X], however, considered that it might not be as challenging as the CC appeared to envisage, as historical terms would still be available as a reference point in the event of a dispute.

### **The definition of ITV1 in the Undertakings**

5. In the Notice we noted that the current definition of ITV1 in the CRR Undertakings related to the 'Regional Channel 3 Services' and not to ITV's programme schedule. This meant that it did not include all methods of delivering the ITV1 programme schedule—and ITV1 high definition (ITV1 HD) or potential time-shifted ITV1 (ITV1+1). We said that we were minded to vary the CRR Undertakings accordingly but invited views on this.
6. Some parties did not object to this possible variation, but made the following points:
  - Several parties commented that the proposal would be acceptable provided that the new services were genuinely simulcast/identical (or substantially the same) in content to ITV1's schedule [X].
  - One party [X] considered that some very time-sensitive advertising might not be as effective on ITV1+1 and that, as a consequence, ITV1+1 impacts might, on

- occasion, be worth less than impacts on ITV1. One media buyer [redacted] suggested that its contribution to ITV1's SOCI should be reduced by 50 per cent.
- Two parties [redacted] commented that there would be a year's delay before any impacts generated by these services would contribute to ITV1's annually-calculated SOCI, and another party [redacted] told us that there would be a significant delay. One of the parties [redacted] added that ITV should only be permitted to monetize these impacts in the year following delivery.
  - One media buyer [redacted] said that only formats or platforms that were measured by BARB should be included in order to ensure that there was a consistent methodology for the measurement of audience and therefore SOCI.
  - One broadcaster [redacted] considered that fewer regional variations would be available on the +1 and HD services and care should be taken by BARB to ensure that audience viewing was measured appropriately and then correctly attributed to ITV1's SOCI under the ratchet, to be overseen by the Adjudicator.
  - Another broadcaster [redacted] said that impacts would need to be sold under the terms specified in the protected contracts and ITV1's regional obligations maintained.
  - One broadcaster [redacted] thought that permitting any ITV1+1 impacts to accrue to ITV1 would confer a not insignificant benefit on ITV, which, judging by the experience of Channel 4's +1 service, could increase its SOCI by 5 per cent, and thereby also increase its SONAR. Another broadcaster [redacted] estimated that this could increase ITV1 impacts by 8 per cent and therefore suggested that ITV1's advertising minutage across the channels be reduced to 5 minutes.
  - One party [redacted] said that any ITV1 definition in any new undertakings should be flexible enough to cope with future developments (eg in distribution), perhaps permitting changes with the agreement of ITV and Ofcom but without recourse to a full review.

7. Some parties were opposed to this variation or had strong reservations for the following reasons:

- One broadcaster [redacted] said that ITV1+1 and HD channels would be separate, secondary channels and so should not be treated as variations of ITV1. Treating them as such would reinforce ITV's ability to charge ITV1-level premiums for the impacts they deliver.
- One broadcaster [redacted] thought that including ITV1+1 and/or HD channels in the ITV schedule would force agencies to buy ITV1+1 and /or ITV HD as part of their CRR protected contracts, whether they wanted to or not.
- One broadcaster [redacted] said that ITV1+1 and possibly an ITV HD channel would not be subject to Ofcom's COSTA advertising minutage rules therefore ITV could benefit from the advantages of selling airtime at ITV1 prices but offer more advertising minutes.
- One broadcaster [redacted] commented that ITV would not be able to deliver the ITV1 schedule fully on all platforms and so neither ITV1+1 nor ITV HD channels would be a full simulcast. The services could not offer the same regional coverage as ITV1, as STV and UTV had not come to an agreement to carry ITV1+1, and Ofcom had only granted TLCS licences for six regional variants of ITV1+1. To replicate the regionalized content of ITV1 for customers receiving TV by satellite

would require additional satellite capacity which ITV was believed not to possess. Unlike ITV1, the HD service would be a single national service with no regional variations.

- One broadcaster [X] thought that there may be a case for including an ITV1 HD channel in CRR but there was no benefit in facilitating the launch of an ITV1+1 channel which would result in an inevitable shift of revenues between the rest of the market and ITV1.
  - Two broadcasters [X] said that the consequence of more impacts being attributed to ITV was that other smaller sales houses would lose revenue share. One of the broadcasters [X] said that ITV1+1 could increase ITV1's impacts by as much as 10 per cent. Other estimates of the increase in impacts that would accrue to ITV1 were potentially up to 20 per cent (based on historical market performance) depending on factors including relative positioning in the electronic programme guide [X]. Another broadcaster [X] calculated that the effect of the variation would be a net gain of 8.3 per cent in anticipated revenues.
  - One broadcaster [X] said that sales houses were under enormous pressure to compete with ITV's negotiating power and were looking to merge with other sales houses to boost their 'market weight', as illustrated by the recent merger between the Sky and Viacom sales houses. This will lead to even less choice for advertisers.
  - One broadcaster [X] said that the variation should not be permitted to either service because of the power that ITV commanded in the market.
8. If the variation went ahead, two broadcasters requested that there should be a phased introduction, so the market can gauge its impact on the distribution of viewing and of commercial impacts [X] and because it would protect broadcasters from the detrimental effects of the change [X].

### **Using an alternative measure of ITV1's market share in the ARM**

9. The Notice invited views on possible alternative measures of ITV1's market share which could be used in the Audience Ratchet Mechanism (ARM) than SOCI. These included peak SOCI (SOCI relating to the peak period) or share of commercial viewing (SOCV) which is share of viewing rather than impacts.
10. Parties made the following points:
- One party [X] thought that introducing a new, parallel, measure would create confusion, create opportunity for misunderstanding and replace the objectivity of a single metric with the subjectivity of multiple metrics chosen by seller (and buyer) alike purely on the basis of painting the best (or worst) case.
  - One broadcaster [X] considered that applying a new measure would present difficulties in the transition of contracts and that there would be a risk that ITV would be able to exploit its market power. A standard mechanism for translating SOCI to SOCV could be a way of avoiding this but agreeing the mechanism could introduce new complexities.
  - One broadcaster [X] said that focusing on SOCV could incentivize broadcasters to focus on demographics with particular commercial drop-out profiles at the expense of other audiences, and could lead to ITV moving advertising minutage

from high-rating programmes in an effort to decrease commercial inventory, thus inflating ITV's Station Average Price (SAP).

- Another broadcaster [X] said that there was considerable risk of new distortions being introduced if the ARM formula was based on peak SOCI rather than all SOCI and broadcasters would be forced to compete even more strongly in peak time. To base the ARM on share of viewing rather than SOCI would introduce a major disconnect in the relationship between ITV and its advertisers.
  - One broadcaster [X] thought that adjusting the ratchet by mixing up the present currencies of SOCI and SONAR with pricing based on commercial viewing would undermine the CRR.
  - Another broadcaster [X] said that there had been no significant unintended effects of the ARM based on SOCI. ITV1 had not been focusing on generating impacts where it was cheapest to do so, in off-peak dayparts: the proportion of impacts in off-peak relative to peak had barely shifted from 2003. ITV would have made the same decisions irrespective of CRR; for example, ITV introduced the Friday episode of *Coronation Street* before CRR was introduced.
11. One media buyer [X] indicated that it would be prepared to consider a remedy that enabled the market to re-establish an investment relationship with ITV1's SOCV (as opposed to SOCI) with 2009 set as the new base level.
12. One party [X] commented on the following alternative measures: share of viewing (SOV) and share of top programmes:
- Basing the ARM on SOV might be considered fairer to ITV in the sense that ITV1 was, like other terrestrial channels, disadvantaged by the current advertising rules relative to multi-channel channels as it was subject to more restrictive advertising minutage requirements. However, advertisers bought airtime in order to have their advertisements seen by viewers (higher programme viewing was largely irrelevant if not translated into higher impacts). As such, SOV was less reflective of what advertisers were buying than SOCI.
  - The ARM could be based on ITV1's share of top programmes, measured as ITV1's proportion of the top 1,000 individual programmes or the top 100 best episodes or some combination of both. The benefit of this is that the ARM would be based on ITV1's strength in mass audience programmes. However, one potential downside was that ITV might lose SOCI but maintain its share of mass audience programmes (as had occurred recently). In this situation, agencies might wish to reduce SOB but be unable to do so under this alternative measure.

### **Changing the ARM formulation**

13. We invited views on a variation in which the ARM would be changed so that, in the event that ITV1's SOCI fell, ITV's customers would be entitled to a lower automatic reduction in SOB commitment to ITV1 than under the present formulation.
14. Parties made the following points:
- One party [X] said that different media buyers were likely to have different views on what they considered to be fair and reasonable. In assessing their desired level of commitment to ITV1, some media buyers might place more weight on ITV1's overall SOCI and others on ITV1's share of mass audience programmes. Over the

last couple of years ITV1 had lost overall SOCI but maintained or grown its share of mass audience programmes. However, there was no guarantee that this pattern would continue. It would be difficult to be confident that any alternative to the current 1:1 ratio would be a fairer approach. The safest course of action would be to err on the side of caution and provide agencies and advertisers with the right to remove more rather than less from ITV1, ie maintain the current 1:1 ratio.

- One party [X] considered that absent any relevant evidence this would be an arbitrary variation whose only purpose would be to allow ITV to forgo less revenue as its audience declined, to the disadvantage of advertisers.
- One media buyer [X] thought that while ITV1's SOCI had been declining, this was not reflected in the ARM calculation until the following deal year. This suggested that media buyers should be entitled to dis-invest out of ITV1 by more than the decline in ITV1's SOCI.
- One media buyer [X] said that there were no good arguments for a lower reduction in SOB versus ITV1's decline in SOCI, or indeed an increased reduction.
- One broadcaster [X] commented that this proposal would significantly increase complexity, adding more confusion and conflict to the market. Varying the ratio in ITV1's favour would only increase ITV1's rates and market share, at the expense of other broadcasters.
- Another broadcaster [X] thought that there were no compelling arguments for reducing the proportion of revenue that advertisers could extract from their ITV1 contracts for any given reduction in SOCI. The only effect of doing this would be that more revenue would be committed to ITV1 by media buyers and such a change would not address any incentives that ITV1 had to maximize SOCI.
- One broadcaster [X] said that reducing the rate at which advertisers could withdraw expenditure, relative to ITV1's SOCI, would materially undermine the protection that the remedy was intended to afford.
- Another broadcaster [X] stated that the ability to withdraw expenditure from ITV1 as its SOCI fell went to the core of the protection believed necessary at the creation of the merged ITV and therefore this protection must be retained.

### **The difficulties for ITV in reacting to changing demand**

15. We invited views on whether there were ways in which the CRR Undertakings could be varied so as to introduce more flexibility into the negotiations between ITV and media buyers whilst ensuring that the CRR Undertakings continued to address the adverse effects of the merger.
16. Parties made the following points:
  - One media buyer [X] said that there was no evidence that there was a need for greater flexibility in the negotiation process, which had operated successfully over a number of years during which there had been significant changes in demand.
  - One party [X] was not aware of any such difficulties from advertisers/agencies.
  - One party [X] noted that CRR did not prevent contractual variations and that rolling over previous terms was only a fallback. There were doubts that introducing

greater flexibility into CRR would produce materially greater market dynamism unless accompanied by wider changes to how the market operated.

- One broadcaster [X] thought that greater flexibility would be likely to introduce greater complexity, have unintended effects and would not necessarily deliver significant benefit to the market. For example, there could be issues agreeing a definition over what should be considered a 'minor' change.
- Another broadcaster [X] said that there was scope for greater flexibility in the way CRR worked. Individual advertisers who had a line-by-line contract with ITV might take a 'holiday' from advertising on ITV1 while retaining their contract rights so that they could return to them in the future. However, agencies with agency deals were not able to take a similar holiday on behalf of such clients as they had to deliver share of broadcast deals in order to protect their CRR protected contracts. This had the effect of incentivizing agencies to persuade some clients to buy ITV1 when they might otherwise not want to, in order to make up any loss in their SOB commitment caused by other advertisers exercising their right to take a holiday. Agencies ought to have the right to reduce their SOB commitment to ITV1 in direct relation to the holidays taken by any of their clients without this affecting their contracts.
- One media buyer [X] thought that in order to introduce more flexibility into the negotiation process there needed to be scope for buyers sensibly to reduce their SOB below the level indicated by the ARM. To stop ITV responding negatively, the resulting loss of value (known as the 'buy-out') would be equal to the increase in discount it would be entitled to (known as the 'buy-in') under its most recent agreement with ITV1. Buyers who favoured a lower investment in ITV for less favourable pricing could choose this option.

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