

CLASSIFIED DIRECTORY ADVERTISING SERVICES MARKET INQUIRY

Revised remedies proposals

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Introduction

1. As we explained in paragraph 1.5 of our provisional findings, the present inquiry has involved a completely fresh evaluation of the market for classified directory advertising services (CDAS), independent of the work carried out by the Monopolies and Mergers Commission in 1995/96 or by the Office of Fair Trading (OFT) in 2000/01. In considering whether remedial action is appropriate, and if so, what action, we have sought to address the adverse effects on competition identified in our provisional findings, or the detrimental effect on customers arising from them, in accordance with our statutory duty set out in section 134 of the Enterprise Act 2002 (the Act). Our consideration of appropriate remedies has not involved an assessment of which aspects of the Yell undertakings should be retained.
2. On 7 September 2006 we published our proposed remedies. We invited views on the analysis we had undertaken and on our proposals. We then received written responses from the main CDAS providers including a substantial analytical report commissioned by BT from a firm of economic consultants. Non-sensitive versions of parties' responses have been published on the CC website. The Group also held discussions with the main CDAS providers. The Group carefully considered the views and evidence received.
3. As noted in our proposed remedies, we are seeking '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'.¹ In choosing between remedies that are considered to be equally effective in addressing our concerns, we will choose the remedy that imposes the least cost or that is least restrictive.²
4. This paper describes the responses that we received, our assessment of those responses and, in particular, our reasoning in those cases where we have modified our proposals.

Modifications to proposed remedies

5. In the light of new information and analysis arising from responses to the proposed remedies we are considering a number of changes to our proposals. These relate to:
 - (a) second-tier, local directories;
 - (b) themed directories; and
 - (c) volume discounts.
6. Views are invited from interested parties on our revised proposals by 10 November 2006.

Second-tier directories

7. Second-tier directories are directories which may be distributed by a CDAS provider in addition to its main directory, for example providing advertisers with more localized coverage than the main directory in any particular area. Second-tier directories may also be arranged, however, around a particular subject area. We refer to these as

¹Enterprise Act, 2002 section 134(6).

²cf CC3, *Market Investigation References: Competition Commission Guidelines*, paragraph 4.10.

'themed' directories and deal with them in a later section of this paper. With some exceptions, Yell is currently effectively prohibited by the undertakings from publishing second-tier directories.

8. In our remedies proposals³ we considered that Yell should be permitted to publish local, second-tier directories, but that this activity should be subject to the following restrictions:
 - no Yell second-tier directory should have a guaranteed minimum circulation (GMC) of more than 25,000 copies;
 - 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 relevant 'parent' Yell directory; and
 - tying and bundling of main directory advertising and local directory advertising sales should be prohibited.
9. We considered that these restrictions would together effectively address our concerns as regards Yell's potential, in publishing local directories, to use its market power to damage competitors and thus emerging competition, while also imposing the least restriction or costs.
10. Our analysis in the working paper on second tiering, shared with main parties following the publication of the proposed remedies, considered the number of BT and Thomson directories and resulting revenue that would be exposed to effective competition from Yell local directories in cases where:
 - one Yell local second-tier directory could be created within the distribution area of a Yell parent directory; and
 - more than one Yell local second-tier directory could be created within the distribution area of a Yell parent directory.

Effects of a single Yell second-tier directory

11. In this scenario we examined the effects under different assumptions of Yell launching single second-tier directories within the circulation area of its main directories.
12. We first looked at the GMC limit and the potential effect of second-tier directories with smaller and larger GMCs than 25,000. We examined the implication of second-tier directories competing with BT and Thomson directories *of the same or smaller size*. No BT and only one Thomson directory had a lower GMC than 25,000 and could thus be wholly overlapped by a single Yell local directory.
13. We then examined the implications if Yell local directories were able to compete with Thomson or BT directories which had a *larger* GMC than the local directory. In other words, that it could compete viably without necessarily covering the *whole* of the Thomson or BT footprint. We noted that [X] Thomson and one BT directories had a GMC of 1½ times the proposed limit of 25,000 (ie 66 per cent coverage) and that the directories concerned represented less than [X] per cent of either BT's or Thomson's directory revenue. We also looked at the number of Thomson and BT

³Available at www.competition-commission.org.uk/inquiries/ref2005/classdirec/index.htm.

directories that had GMCs up to two (50 per cent coverage) and three times (33 per cent coverage) the proposed limit. In the former case, [X] Thomson directories and seven BT directories, in each case accounting for [X] per cent of both providers' revenue, would be exposed to competition from Yell second-tier directories. We calculated that even under a worst case scenario (that a local directory could compete effectively with a directory three times its size), [X] per cent of Thomson's revenues and [X] per cent of BT's advertising revenue could be exposed to competition from Yell's local directories.

Effect of multiple local directories

14. Next we looked at the possible effect of Yell distributing, within the footprint of a single Yell directory, adjacent local directories which, in combination, would cover *the whole or a substantial part* of a BT or Thomson directory footprint. This possible practice was subsequently referred to by BT as 'honeycombing'.
15. Where the introduction of Yell local directories was restricted to the proposed limit of 20 per cent of the GMC of main Yell directories, the whole of the footprint of six BT and [X] Thomson directories could be overlapped by honeycombed local directories, representing [X] per cent and [X] per cent of BT's and Thomson's respective revenues.
16. Finally, we looked at the number of Thomson/BT directories that could be overlapped by honeycombing, when *relaxing the assumption on total coverage*. In this case we assumed that honeycombed local directories could compete with Thomson/BT directories that were 1½ times their size, thus covering two-thirds of their circulation. On this basis, at the proposed limit of 20 per cent of Yell GMC, [X] Thomson directories could be overlapped and 26 BT directories, representing about [X] per cent of both providers' revenues.

Yell's response

17. Yell told us that circulation of local directories of the order of 40,000 GMC would be appropriate as a circulation of 25,000 was relatively small for a viable local directory. It argued that a higher limit, of 40,000, would make little difference to the competitive situation with BT or Thomson as only three of Thomson's and two of BT's directories had a GMC of 40,000 or less. Yell did not propose that the 20 per cent restriction should be changed.

BT's response

18. In its response to our proposed remedies paper BT argued that we had severely underestimated the likely levels of BT revenue loss and also the seriousness of the resulting impact on the development of BT's CDAS business that could be expected if Yell were to publish second-tier directories. This view was based on research commissioned from a firm of economic consultants. It claimed that the CC's analysis, as set out in its working paper on second tiering, underestimated the *number* of its directories that would be affected and that the criteria we had used to assess whether a second-tier directory would affect a main directory were too narrow. BT said that, in its view, circulation was only one relevant factor. It considered that book types, classifications and types of advertiser were also important.
19. As regards the number of second-tier directories that would be affected, BT considered that while the CC had reviewed honeycombing *within* the footprint of a single Yell directory, it had neglected to include situations where Yell could take

advantage of *adjacent* main directories to produce local directories which, between them, could be used to replicate the distribution area of a BT or Thomson directory.

20. BT went on to argue that the CC had underestimated the degree of overlap that would be necessary for a directory to be affected. BT argued that we had used a 'two-thirds test' (which it inferred from the 1½ times circulation calculation in our working paper on second tiering) but, it argued, a Yell local directory with a GMC of half a BT or Thomson directory could also arguably have an effect.
21. In addition, BT expressed concern regarding the potential effects of Yell cross-selling advertisements in adjacent second-tier directories to main directory advertisers. This strategy could encompass the inclusion in a Yell local directory of free line entries from a wider area than that in which the second-tier directory was distributed, thus reducing the differentiation of a BT directory. BT said that this was another reason for considering the effect of second-tier directories with a footprint of less than two-thirds of a BT or Thomson directory.
22. BT also argued that the CC had not considered the cumulative effect of the maximum circulation limit and the 20 per cent restriction in combination nor the ratio of business to residential distribution points. The latter point was relevant to a situation where Yell might establish a directory footprint in such a way as to target the commercial centre of competitors' directories. Equally, argued BT, Yell could target advertisers over a much wider area than that in which it was distributing its directory. To combat this, it proposed that Yell second-tier directories should be required to have a business to residential distribution point ratio close to the average in UK classified directories.
23. BT concluded that Yell should be prohibited from distributing second-tier directories.
24. Finally, BT argued that, in the event that Yell was not prohibited from distributing second-tier directories, Yell should be prevented from using the Yellow Pages brand in connection with any second-tier directory it is permitted to publish. It argued that the use of the Yellow Pages brand in relation to a second tier of directories was the single biggest factor that could entrench Yell's market power and frustrate the emergence of effective competition. BT also said that we should give consideration to limiting Yell's ability to adopt strategies which could achieve substantially similar effects to use of Yell branding by establishing a firm connection, in the minds of advertisers and users, between the main and second-tier directories. BT submitted that this would include joint marketing, joint selling and distribution in the same poly-bag.
25. In discussion with the CC BT examined two scenarios:
 - in scenario 1 Yell's second-tier directories of 25,000 would expose BT directories three times larger (ie up to a GMC of 75,000) to competition; and
 - in scenario 2 Yell's second-tier directories of 25,000 would expose to competition BT directories with a GMC of twice or less theirs (ie up to a GMC of 50,000).
26. In both cases BT examined the potential impact on its revenues of assuming that a 67 per cent and 50 per cent overlap arising from honeycombing from single main and *adjacent* main directories would expose the relevant BT directories to competition. This latter was the conduct that had been excluded from the CC's original analysis.
27. Under the scenario where a single Yell local directory could expose to competition a BT directory of up to three times its size (75,000) and where honeycombed directories covering half of its footprint would have an effect, it calculated that 56 of

its directories would be exposed to competition, representing [X] per cent of its revenue.

28. Although BT acknowledged that estimating the possible loss of revenue from directories exposed to competition was inherently uncertain, it considered that losing [X] per cent of the revenue from such directories may not be a conservative estimate. BT told us subsequently that a revenue loss as high as [X] per cent of BT revenue exposed to competition by local directories may be lost and that this would have a severe impact on its profitability.
29. BT argued that, if the objective of our proposed remedies was to constrain Yell's market power and protect emerging competition, then it would be more logical to frame the remedy in terms of BT's and Thomson's directory footprints. It recommended that overlap with either a Thomson or BT directory be limited to 30 per cent.
30. To summarize, BT has argued that:
 - Yell could use local directories to target BT's areas of strength, geographically;
 - more directories could be exposed to competition from Yell local directories than our analysis suggests because Yell could take advantage of adjacent main directories to create local directories overlapping the footprints of its competitors;
 - a local directory could damage a BT directory with less than two-thirds coverage of its footprint;
 - a very substantial proportion of its revenues in affected directories (those exposed to competition) could be competed away by local directories;
 - Yell could encourage readers to look to local directories for listings over a wider area, thereby increasing their similarity to BT and Thomson directories, by including free line entries for businesses outside the footprint area unless prohibited;
 - a control based on the footprints of BT and Thomson, rather than Yell, directories would be appropriate; and
 - Yell should be prohibited from using its branding on local directories.

Thomson's response

31. Thomson told us that the architecture of the remedy proposed was one that could work in practice. However, it made two main points regarding the detail of the remedy.
32. First, it argued that the maximum circulation of any one Yell local directory should be set at a level which clearly differentiated it from the existing 'local' directories of the smaller CDAS publishers. It considered that the maximum circulation of any Yell local directory should be 20,000.
33. Second, it argued that the aggregate circulation of local directories in any one area should be set at a level that does not allow Yell either to saturate the area of a competitor's directory or cherry pick the most profitable advertisers within a given area. On this basis it recommended that the aggregate circulation of Yell local directories should not exceed 10 per cent of the main Yell directory's GMC.

34. It supported the use of Yell's directory distribution areas as the reference point for this element of the remedies package as this would provide certainty for Yell's competitors and ease of monitoring by the OFT. Its only concern here was that Yell might manipulate its boundaries to enable it to target its competitors using local directories. Alternatively, if the limit of 10 per cent on Yell's circulation area that it had proposed was not adopted by the CC, it suggested that Yell be prohibited from publishing more than one local directory in any Thomson or BT area.
35. Thomson also argued that GMC was not the appropriate reference point for circulation limits. GMC referred to the *minimum* circulation guaranteed by the publisher. Actual circulation could be in excess of this and was the appropriate reference point.
36. In support of its arguments for tighter restrictions than we had proposed on Yell local directories, it pointed out that [X] of Thomson's revenues arose from directories operating in the footprints of Yell directories which had more than twice the circulation of the equivalent *Thomson Local*. The likelihood was, therefore, that a Yell local directory would compete with Thomson and BT directories with equivalent circulations of between three and four times that of the local directory.
37. Thomson also pointed out that, within the circulation areas of Yell's very large directories such as Glasgow South (which has a GMC of over 500,000), Yell would be able to publish, in compliance with the 20 per cent rule, four adjacent local directories whose combined circulations could amount to around 100,000. Further, like BT, it argued that Yell could publish adjacent local directories from its adjacent main directories which could be used to cover the distribution areas of competitors' directories.

Trinity Mirror's response

38. Trinity Mirror told us that it felt the proposed limitations on local directory circulations were such that local directories would have only a limited impact upon the existing CDAS market. It suggested, however, that local directories could compete far more directly with local newspaper advertising, particularly if the frequency of publication was increased.
39. Trinity Mirror supported the proposed prohibition on tying and bundling but proposed in addition that Yell should be prevented from using its existing brands on local directories. It said that, in its view, requiring Yell not to use its existing brands 'would reduce its ability to import its market power—and the adverse effects on competition—into this new market'.
40. Finally, Trinity Mirror suggested that any local directories should be published by a separate legal entity producing its own accounts. Accounting separation, it argued, would make it far easier for the OFT 'to identify any future breach of competition law, for example a pricing abuse' and allow it to identify any cross-subsidization of the new business.

CC consideration and revised remedy proposal

41. We considered the views and analysis submitted in response to our proposals on second tiering in terms of:
 - (a) the potential exposure of competitors' revenue to competition from Yell's local second-tier directories;

- (b) to what extent the potential exposure to competition is likely to be realized in terms of actual exposure; and
- (c) the extent to which actual exposure to competition from Yell's local second-tier directories is likely to result in revenue loss to competitors.

These considerations are set out below. In summary, we consider that the actual exposure of BT and Thomson revenue to competition from Yell second-tier directories is likely to be relatively small following modification of our proposed restrictions (ie less than 15 per cent) and that the potential loss of this revenue is unlikely to be a high proportion of this exposed turnover.

Potential exposure

- 42. BT considered that the extent of turnover that was exposed to competition from Yell's local directories was likely to be higher than CC estimates due to the view that (a) Yell could take advantage of adjacent main directories to provide a comprehensive overlap of competitors' directories and (b) Yell's local directories would be able to compete with larger BT and Thomson directories than the CC had assumed. In aggregate, BT considered that in its scenario 1 (see paragraph 25), [X] per cent of its turnover could be exposed to competition.
- 43. With regard to the first of the above points we acknowledge the possibility that Yell could, in theory, extensively overlap competitors' directories by launching local directories from adjacent main directories. However, we note that:
 - (a) The number of such viable instances appears to be small—BT identified six directories that might be affected in this manner, accounting for [X] per cent of its revenues in scenario 1.
 - (b) From a users' perspective, use of multiple local directories may be a poor substitute for a single directory reflecting their relevant catchment area.
 - (c) Yell may not wish to use its second-tier allowance to honeycomb in this manner if it precludes more attractive second-tier opportunities. In one scenario suggested to us, for example, Yell would, from its Harrow and West London directories, create four local directories which would overlap BT's Brent directory. These would be local directories centred on Harlesden, Wembley, Brent and Neasden. Creation of the four directories hypothesized by BT would preclude Yell from pursuing what may be more attractive publishing opportunities such as St John's Wood and Maida Vale or Hammersmith and Chiswick.
- 44. With regard to the size of BT and Thomson directories with which Yell local directories would be able to compete, there is, understandably, little empirical evidence. In our provisional findings we concluded that the size or scoping of the publication footprint is an important aspect of differentiation in this market. It is therefore reasonable to assume that the competitive impact on BT and Thomson directory areas will decline significantly with reductions in the GMC of Yell local directories as these become more differentiated from the BT and Thomson directories.
- 45. We note that in the consultant's report on Yell rescoping prepared for BT, the authors consider which of BT's directories may have been affected. It considered that a BT directory was likely to be affected by a Yell rescope if it has more than a [X] per cent geographical area overlap with the relevant Yell directory. By analogy this suggests

that an overlap of less than [~~3~~] per cent from a Yell local is unlikely to have a significant effect.

46. As noted above, Thomson considered that since many of its directories operated in the footprints of Yell directories with more than twice the circulation of the equivalent *Thomson Local*, it was likely that a Yell local directory may compete with a directory three or four times its size. However, we consider that the ability of Thomson directories to co-exist alongside much larger Yell footprints is evidence of successful differentiation rather than effective competition. Thomson is offering, in the main to existing Yell advertisers, a different proposition rather than a direct competitor and, as we have noted in our provisional findings, in general, Yell's prices are not currently constrained by those of its competitors.
47. We acknowledge that Yell local directories might have some competitive impact on BT and Thomson directories that are more than 1½ times their size. In our view, based on considerations outlined above, this impact is likely to decrease with relative size and we consider that there is likely to be little impact on BT and Thomson directories that are more than twice the GMC of Yell local directories given the degree of differentiation that this would entail.
48. In view of the issues and concerns expressed regarding the potential exposure of BT and Thomson's revenue to competition from Yell local directories, the CC considers it appropriate to propose tighter restrictions on second tiering than previously proposed. We consider that this is best achieved through reducing the overall GMC limit rather than reducing the GMC limit of individual directories. We note that the latter limit of 25,000 is already considerably lower than the limit of 35,000 proposed by BT in its response to the remedies notice, albeit with removal of Yell branding, and based on Yell's evidence and the current lack of directories of this size in the market, a GMC of 25,000 would seem to be at the lower end of the viable range for directories.
49. Taking account of the above factors, we consider it appropriate that the proposed limit on the aggregate GMC of second-tier directories published within the footprint of each of Yell's main directories should be reduced from 20 to 15 per cent. The effect of this lower limit on the exposure of BT and Thomson's revenue to competition from Yell's local directories is examined in the next section.
50. With regard to Thomson's observation that actual circulation may be greater than GMC, we note that GMC provides the contractual basis for advertising sales and actual circulation currently fluctuates within a fairly narrow margin of less than 10 per cent above GMC. We consider that GMC provides a better operational basis for our restrictions than actual circulation. However, we also consider that actual circulation of second-tier directories above the normal margin in relation to GMC would be contrary to the good faith undertakings where GMC is constrained by our restrictions.
51. As noted above, Yell could seek to expand the scope of a local directory by providing free line entries to businesses outside its footprint. We consider that this might facilitate local second-tier directories having a more significant impact on BT and Thomson directories as this is a factor that might reduce differentiation between Yell's local directories and BT and Thomson directories. We propose that prohibition of free line entries for businesses located outside the distribution area of the local directory should be part of our proposed restrictions on second tiering.

Actual exposure

52. In our view, the actual exposure of BT and Thomson's revenue to competition from Yell's local directories is likely to fall short of the potential exposure considered above for a variety of reasons such as profitable opportunities for local directories not targeted at competitors (as discussed above), time taken to roll out local directories and limitations on the viability of local directories. We now consider the last of these factors.
53. Yell has indicated to us that a GMC circulation of 25,000 is relatively small for a viable local directory. There are also very few directories of this size in circulation suggesting that the viability and profitability of this size of directory is limited. It appears reasonable to assume that directories with a GMC of less than 20,000 will normally not be sufficiently profitable to pursue.
54. We examined the potential effects of Yell introducing second-tier directories of between 20,000 and 25,000 and assuming that such directories could compete with a main directory up to twice its GMC size (50 per cent coverage) and subject to the proposed limit on the circulation of second-tier directories of 15 per cent of the main directory's GMC. On these assumptions we found that [X] per cent of both BT and Thomson's revenue would be exposed to competition.
55. In view of the above, we consider that our proposed restrictions will result in a relatively small proportion of BT and Thomson's revenue being exposed to competition from Yell's local directories.

Prospective revenue loss

56. BT originally suggested that it may lose [X] per cent and subsequently [X] per cent of revenue exposed to competition from Yell second-tier directories although it also considered that forecasting the level of impact on revenue exposed to competition was likely to be highly uncertain. BT confirmed that it had no relevant empirical data on which to base its suggested level of impact.
57. Whilst acknowledging the uncertainties of forecasting the level of impact, we consider that a loss of [X] per cent or more of revenue exposed to competition is highly unlikely. We note that in calculating revenue exposed to competition we have used comparatively wide criteria. It appears implausible to suggest a revenue loss of [X] per cent or more when, for example, in a number of cases the overlap of Yell directories on the BT directory is no more than 50 per cent or the overlap is achieved by honeycombing rather than a single directory.
58. The suggested loss of revenue also does not appear consistent with the performance of BT's directories against closely matched Yell directories. BT told us that four of its directories had the same footprint of a Yell directory and that nine of its other directories had a 95 per cent overlap. BT supplied us with advertiser penetration data for its directories. The average penetration in the 13 areas where BT has 100 or 95 per cent overlap with Yell is very close to BT's average penetration across all directories ([X] per cent) where typically BT is competing with far larger Yell directories from which it is more differentiated. If BT is able to achieve normal levels of market penetration when its directory sizes are closely matched with Yell and therefore relatively undifferentiated, we do not consider it plausible that BT will lose a substantial proportion of its revenue when BT faces competition from a small Yell directory.

59. In summary, we consider that the potential loss of BT and Thomson revenue is unlikely to be a high proportion of the revenue exposed to competition from Yell local directories. In view of this and the limited revenue likely to be exposed to competition from Yell local directories, we consider that our proposed restrictions on second tiering will be sufficient to prevent Yell from using second-tier directories to undermine emerging CDAS competition.

Other proposals—restrictions based on BT and Thomson footprint

60. BT argued that any control on honeycombing should be set with reference to BT's and Thomson's distribution area such that no more than 30 per cent of the footprint of a BT or Thomson directory would be covered by a Yell local directory.
61. BT provided evidence suggesting that Yell would be able to publish what, in its view, was a number of 'commercially sensible' directories in compliance with a rule limiting the proportion of Yell second-tier directories by reference to the GMC of BT and Thomson directories. BT encountered some difficulty in the methodology of its analysis in relation to the mapping of its directory distribution area borders with those of Thomson. In our view, the evidence provided by BT did not demonstrate that using the GMC of BT and Thomson directories as a reference point would be straightforward to implement or monitor. In fact, monitoring the publication of local Yell directories with respect to overlapping BT and Thomson distribution areas is likely to be fairly complex.
62. As acknowledged by Thomson, a control on Yell set with reference to Yell's distribution areas would provide greater certainty and clarity and would be easier to monitor than a control based on BT and Thomson's distribution areas.
63. We consider that our proposed restrictions would be sufficient to address effectively the detriments we have identified. We therefore continue to propose that Yell's circulation areas are used as the reference point for the GMC restriction.

Other proposals—branding

64. BT and Trinity Mirror argued that Yell should be prevented from using its branding on any second-tier directories. BT also considered that other factors such as joint marketing, joint selling and distribution in the same poly-bag should also be restricted. We considered these proposals carefully but concluded that the restrictions we were proposing would be sufficient to address effectively the detriments we have identified.
65. We have proposed a maximum GMC for Yell second-tier directories that is lower than all but one (Thomson's March directory) of the current directories published by major CDAS providers; we have proposed further tightening of the limit on the proportion of a main directory's GMC that may be represented by Yell second-tier directories in aggregate; we have proposed a prohibition on tying or bundling of advertising sales between main Yell directories and Yell second-tier directories and between Yell second-tier directories. We consider that, in addition to these restrictions, prohibiting Yell from applying its branding to second-tier directories would be more intrusive than is necessary to address the adverse effect on competition.

Themed directories

66. Themed directories or guides, as envisaged by Yell, would contain a limited range of classifications and be focused around a particular subject, such as eating out. They

would not necessarily be delivered direct to households or business addresses but might be distributed by third parties, for example through London hotels in the case of a theatre guide. It was considered unlikely that they would have the same footprint as main directories.

67. Our concern in relation to themed directories can be summarized as follows: if Yell were to launch themed directories which were considered to be potential substitutes for the classified directories of its competitors, this could have the effect of harming other CDAS providers and thus damage emerging competition. In particular, such a practice could undermine the ability of a competing CDAS supplier to overcome the network effect which we identified as a barrier to the establishment of a major CDAS business (see paragraph 6.113 of our provisional findings). Thus our concern in relation to themed directories relates to an effect in the CDAS market and not in any neighbouring market.
68. In the proposed remedies we concluded that similar restrictions should be placed on themed guides as were proposed for other second-tier directories as our competition concerns were, essentially, similar in terms of the potential for Yell to use its market power to damage competitors and thus competition. A themed guide could comprise a material range of classifications which could attract revenue from conventional directories.

The parties' responses

69. Yell told us that themed guides would not be viable at GMCs of 25,000. It gave us the example of a London West End restaurant guide which might have a GMC of 250,000 to 300,000. Yell considered that themed guides addressed a different market to classified directories.
70. Subsequently, Yell noted the Group's concern over the inclusion of particular classifications in themed guides which included, for example, plumbers, builders and drain services. It offered an undertaking to refrain from publishing themed directories which would naturally encompass these classifications without the prior consent of the CC. Yell also proposed a definition of themed guides which emphasized their separate character to classified directories. This was:

'Themed Guide' means a printed periodic guide which:

- Provides in-depth and context based information to consumers including, without limitation, editorial material, mapping, advertorials, third party endorsements, non-classified advertising and classified advertising [a Themed Guide is not intended to provide a comprehensive directory of suppliers of goods and services which are unconnected by a particular theme]; and
- Is distributed either directly or indirectly wholly or mainly to consumers (within the meaning of section 183(1) of the Enterprise Act 2002).

71. Thomson agreed with the CC's proposals, noting that Yell could use the 20 per cent provision in order to produce adjacent themed guides in areas where its main directory had a large GMC or use adjacent main directories to cover an even larger area.
72. BT told us that themed directories would allow Yell to target competitors selectively, in a similar way to using local, second-tier directories but focusing on classifications rather than geographies. A themed guide could allow Yell to target important

classifications in competitors' directories. As a result of losing this advertising, the competitors' directories would become less useful to consumers, which would be reflected in usage levels and hence advertisement response rates.

73. BT also argued that Yell may publish multiple themed guides in an area. Together these could encompass a relatively comprehensive range of classifications and thus, collectively, represent a competitor to BT and Thomson directories.

CC consideration and revised remedies proposals

74. Our main concerns as regards themed directories related to Yell's ability to undermine competition by targeting competitors' advertising revenue.
75. We consider that if themed directories are clearly differentiated, in terms of content, from main directories such that they could be expected to have little impact on the CDAS market then they should fall outside our restrictions on second tiering. If there is a significant degree of overlap with the characteristics of second-tier directories then the publications should fall within our second-tier restrictions.
76. While we note Yell's offer to seek prior permission before producing themed directories encompassing the particular classifications over which the CC may have concerns, we consider that it would be preferable to establish a benchmark against which such proposals could be judged following pre-notification to the OFT. We consider that the test applied by the OFT should be in two parts: qualitative and quantitative.
77. We propose that the qualitative test be the consideration of any proposed Yell themed guide or directory in terms of its compliance with the definition proposed by Yell.
78. As regards a quantitative test, we propose a limit based on classification revenue. Given the enormous variation in the size of and revenue associated with Yell's various classifications, a control simply based on the number of classifications contained in a themed directory would not be effective. Instead, we propose a control based on the proportion of Yell's total revenue represented by the classifications it is proposed would be covered by any themed directory. We propose that the classifications which would be encompassed by any themed directory should represent no more than 10 per cent of revenues in Yell's main directories nationally.
79. We consider that if the classifications contained in any themed directory account for less than 10 per cent of Yell's advertising revenue in *Yellow Pages*, calculated on a national basis, then such directories which also satisfy the qualitative definition should not be subject to our second-tiering restrictions. If a themed directory contains classifications exceeding 10 per cent of advertising revenue, then the publication will be treated as a second-tier directory for the purpose of our restrictions.
80. We have already proposed that tying and bundling between Yell's main and themed directories should be prohibited and have seen no evidence which leads us to alter our view on this.

Volume discounts

81. In our paper on proposed remedies we expressed concerns regarding volume discounts and 'money-back guarantee' pricing. Our concerns related to the possibility of Yell targeting the most profitable customers of its competitors and thereby

weakening developing competition. We explained that we had concerns relating to volume discounts and money-back guarantees 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 compared with a price control with less flexibility. Yell would thus have greater scope to negotiate attractive rates for competitors' customers that it wished to acquire. We also noted that individually negotiated discounts were likely to increase significantly the complexity of monitoring and enforcement. The CC said that it was not minded to permit either volume discounts or money-back guarantee pricing.

The parties' response

82. Yell told us that it thought the prohibition was unnecessary and disproportionate to the concern identified by the CC. It said that a blanket ban was not in the best interests of advertisers as it restricted them from having access to the lower prices they would otherwise enjoy.
83. Yell proposed that if the CC's concern was over individually negotiated discounts, it could permit Yell to publish in its rate card, discount structures that are generic and available to all that meet transparent, specific and objective criteria. It said that such an approach would permit Yell to experiment with new pricing structures such as, for example, cost-per-lead-based advertising, provided that any such new pricing structure adopted would not result in the customer paying a price that was higher than the regulated maximum.
84. BT supported our proposal on volume discounts. It argued that this flexibility would be likely to be exploited by Yell so as to weaken developing competition by discriminating in a targeted manner between different advertising customers. It said that the CC should prohibit all individualized discounts by Yell, including volume discounts.
85. At the remedies hearing we asked BT whether the publication by Yell of generic volume-based discounts would address its concerns as regards individually negotiated prices. BT suggested that any generic volume discount scheme could be designed with particular large clients in mind, given the relatively small number of clients spending more than, say, £5 million or £10 million a year with Yell. The structure of the discount scheme could be tailored to clusters of large-spending clients and would thus, in practice, be bespoke even though presented as generic.
86. Thomson agreed that Yell should be prohibited from offering volume discounts and money-back guarantees on a selective basis. It said that Yell would be likely to use this new flexibility to price discriminate and target its competitors. Thomson also had some reservations on generic schemes.

CC consideration and revised remedy proposals

87. The CC remains concerned that Yell could use individually negotiated prices or discounts to target individual customers of its competitors. It is difficult to see how money-back guarantee or cost-per-lead pricing could be operated other than through individual negotiations with clients in setting up such schemes and/or in assessing fulfilment of performance criteria under the schemes. We note, in particular, that the value per lead will differ widely both between and within industry sectors and a universally applicable rate card for such schemes would therefore be difficult to construct. We also continue to consider that the presence of individually negotiated

prices or discount terms would significantly impair monitoring and enforcement of our measures.

88. We consider that a generic volume discount scheme that was open to all advertisers in all classifications would not provide a significant opportunity for Yell to target individual key customers of competitors. We therefore see no significant reason why we should deny advertisers access to the lower prices that would be likely to arise from such a volume discount scheme. We are not aware that Yell's 'move up' discount, which is in effect a temporary volume discount, has caused any difficulty as regards monitoring or targeted effects and do not foresee that a volume discount with wider application would. In view of these factors, we consider that Yell should be permitted to offer general volume discounts provided that the scheme is published and available to all advertisers and across all classifications.

Our revised remedy proposals

89. In summary, the revisions to our proposals are that:
- (a) the maximum limit on the aggregate circulation of local directories is limited to 15 per cent of the GMC of the Yell directory in which they are distributed;
 - (b) Yell should be prohibited from providing free line entries in its second-tier directories to businesses outside the distribution footprint of the relevant directory;
 - (c) Yell's proposed definition of a themed directory or guide be adopted by the OFT when considering any proposals to publish a themed directory;
 - (d) if the classifications contained in any themed directory proposed account for less than 10 per cent of Yell's advertising revenue in *Yellow Pages*, calculated on a national basis, then such directories are not subject to our second-tiering restrictions if they also satisfy the proposed definition of a themed directory. If a themed directory contains classifications exceeding 10 per cent of advertising revenue then the publication will be treated as a second tier directory for the purpose of our restrictions;
 - (e) Yell is permitted to offer general volume discounts provided that the terms and conditions applying to such a scheme are published and available to all advertisers and across all classifications.