

Summary

1. On 24 May 2007 the Secretary of State for Trade and Industry, now the Secretary of State for Business, Enterprise and Regulatory Reform, referred the acquisition by British Sky Broadcasting plc (BSkyB) of 17.9 per cent of the shares in ITV plc (ITV) to the Competition Commission (CC) for investigation and report. The reference was made under section 45(2) of the Enterprise Act 2002 (the Act). This followed the Secretary of State's intervention notice dated 26 February 2007 and the reports of the Office of Fair Trading (OFT) and the Office of Communications (Ofcom) to the Secretary of State of 27 April 2007 under sections 44 and 44A of the Act respectively. Following an extension to our timetable, we are required to report to the Secretary of State by 2 January 2008. This was the first reference to be made under Chapter 2 of Part 3 of the Act (Public Interest Cases).
2. The media sector includes film, radio and television production and broadcasting; aspects of telecommunications; advertising; publishing; and the retailing of audio-visual appliances and DVDs. The Communications Act 2003 (CA 2003) established Ofcom as the independent regulator and competition authority for the UK communications industries with responsibilities across television, radio, telecommunications and wireless. We focused primarily on television, although we recognized the importance of the broader media sector, particularly in our discussion of plurality issues.
3. The industry is characterized by significant and rapid changes in technology and consumer demand. For many years, viewers received three terrestrial channels: BBC1, BBC2 and ITV. Channel Four Television Corporation (Channel 4) was launched in 1982 and Channel 5 Broadcasting Limited (Five) in 1997. Multi-channel television using satellite or cable technologies was introduced in the early 1980s, offering many more television channels to viewers. Traditionally television was

broadcast using an analogue signal. However, digital technology started to be introduced in the late 1990s, using spectrum capacity more efficiently and facilitating better picture quality. DTV Services Limited's (DTVSL's) free-to-air (FTA) service, branded as Freeview, was relaunched in October 2002 and has since grown very rapidly. By the end of March 2007, there were 8.4 million digital terrestrial television (DTT)-only homes, around 8.0 million satellite subscription homes, and 3.1 million cable subscription homes. The analogue service is being phased out region by region across the UK between 2008 and 2012. Digitization is facilitating the convergence of the television, telecommunications and Internet sectors, and leading to the development of a range of new services and delivery platforms including, for example, mobile television and high-definition television (HDTV).

4. There are two basic business models available to television broadcasters: FTA and pay-TV. The major analogue FTA television services are BBC1, BBC2, ITV1, Channel 4 and Five. DTT is available through a set-top box and carries around 40 FTA channels. Around 200 channels are available FTA to owners of BSkyB satellite dishes through the 'Freesat from Sky' service. The BBC has also announced its intention, together with some commercial broadcasters including ITV, of launching a 'Freesat' service. Commercial broadcasters of FTA services rely primarily on advertising and sponsorship for their funding.
5. Pay-TV retailers include BSkyB, Virgin Media Inc (Virgin Media) and the newer entrants such as BT Vision, Tiscali SpA (Tiscali) and Top Up TV Ltd (Top Up TV). Pay-TV retailers typically offer alternative packages of 'basic' channels, with 'premium' channels (such as sports or movie channels) offered singly or in small packages, usually as an optional extra. Pay-TV is available on DTT, digital satellite (DSat), cable, and the newer platforms (broadband and mobile). Pay-TV retailers rely

primarily on subscription fees for their funding; subscribers pay monthly fees to view encrypted channels.

6. Current service and technical developments include the offer of bundled services; video on demand (VoD); HDTV; and a range of services including personal video recorders (PVRs). New distribution platforms include mobile television and broadband television (either in the form of Internet Protocol Television (IPTV) or television-over-the-Internet).
7. BSkyB is a leading broadcaster of sports, movies, entertainment and news. It was formed in 1990 from the merger of Sky Television plc and British Satellite Broadcasting Limited. BSkyB's largest shareholder is News UK Nominees Ltd (ultimately owned by News Corporation) which owns 39.1 per cent of BSkyB.
8. BSkyB acquires programming to broadcast on its own channels and supplies channels on a wholesale basis to other broadcasters. It also retails channels (both its own and those of third parties) to subscribers. BSkyB currently makes three of its channels available FTA via the UK DTT platform as part of the branded Freeview offering and has a 20 per cent stake in DTVSL. BSkyB produces a limited amount of its own content. Around three-quarters of BSkyB's revenue is derived from subscriptions. Advertising makes up a small proportion of its revenues.
9. ITV (and its predecessors) has been the UK's largest commercial broadcaster for more than 50 years. ITV was created from the merger of Carlton Communications plc (Carlton) and Granada plc (Granada) in February 2004 and is quoted on the London Stock Exchange. It is a producer of content through ITV Productions and a broadcaster of FTA content. It also has a 40 per cent stake in Independent Television

News Limited (ITN) and a 20 per cent stake in DTVSL. Around three-quarters of its revenue is derived from advertising.

10. On 17 November 2006 BSkyB announced that it had bought 696 million shares in ITV, amounting to 17.9 per cent of ITV's issued share capital. BSkyB paid 135p per share, a total of £940 million, for its stake. We formed the view that BSkyB, through its acquisition of a stake in ITV, was looking to preserve the possibility of participating in any future bid for ITV. We thought it unlikely that BSkyB would have chosen to invest in ITV purely as an investment vehicle.
11. We looked at whether BSkyB had acquired the ability materially to influence policy relevant to the behaviour of ITV in the marketplace. We took the policy of a company in this context to mean the management of its business, in particular in relation to its competitive conduct, including the strategic direction of a company and its ability to define and achieve medium-term objectives. In assessing whether BSkyB had acquired material influence as a result of the acquisition, we did not take account of the possibility of a BSkyB director being appointed to the ITV board, nor of BSkyB increasing its shareholding, subject to remaining within the 20 per cent limit imposed by the provisions of CA 2003.
12. We found that the size of BSkyB's holding both in absolute and relative terms was such that on the basis of past voting patterns it would be likely to be able to block special resolutions proposed by ITV's management. ITV's future strategy, published on 12 September 2007, focused on a three- to five-year plan for content-led growth funded through gains in efficiency and the disposal of remaining non-core assets. Nevertheless, given the dynamic environment in which ITV operates, we found that the board might well find it necessary to make major investments requiring external funding over the next two to three years. BSkyB's ability to block a special resolution

could effectively rule out some of ITV's strategic options by limiting ITV's ability to raise funds. BSkyB's importance and stature as an industry player, together with its position as the largest shareholder, would give additional weight to its views. This could encourage the board to accommodate BSkyB's views to avoid conflict. We concluded that BSkyB had acquired material influence. The turnover test under section 23(1) of the Act was satisfied and we concluded that a relevant merger situation had been created.

Assessment of competitive effects

13. We concluded that, had the acquisition not occurred, we would expect ITV to remain independent. We therefore assessed the competitive effects of the acquisition against an independent ITV.

Audiovisual services

14. We concluded that at current prices, ITV and BSkyB operate within a UK market for all-TV which included both pay-TV and FTA services. The all-TV market was highly differentiated and dynamic and we conducted our analysis of the impact of the acquisition not only by assessing the impact on the whole market under current competitive conditions, but also by looking at possible future constraints in pay-TV.
15. We looked at the strength of the existing and future constraints on BSkyB in the market for all-TV, assessing the constraint from other pay-TV operators and from the FTA offer in the absence of the acquisition. We found that within pay-TV, services offered over cable and DSat platforms were close competitors. Although services offered over the IPTV platform provided a certain level of competitive constraint within an all-TV market, it was not clear to us that these players would be able to acquire significant market share within the next few years.

16. We found that FTA services posed a constraint to BSkyB's offer and that the BBC and ITV were both key to the strength of the FTA offer. Channel 4 and Five also made a significant contribution. BSkyB's business model relies on the ability to persuade consumers to pay for the content available in its packages, rather than opt for freely-available services. We concluded that, given the competitive constraint of the FTA offer on BSkyB's services, and the importance of ITV within the FTA offer, BSkyB would have the incentive to influence ITV's strategy in such a way as to minimize the constraint it offered to BSkyB.
17. We did not find that entry or expansion would be likely to constrain the parties and hence mitigate BSkyB's incentive to influence ITV's strategy.
18. We looked at the impact of the acquisition on current competitive constraints. We thought it likely that BSkyB would influence ITV's strategy. We identified several examples of the ways in which this might happen:
 - (a) BSkyB could seek to influence investment in content production and commissioning. Given its interests as a competitor and despite its interests as a shareholder, BSkyB would have the incentive to reduce ITV's investment in content in order to reduce the competitive constraint of FTA on BSkyB. Further, ITV could seek to acquire rights to existing content (such as sports rights) in order to improve the quality of its offer. If ITV sought to raise additional finance to support such an acquisition, BSkyB would have an incentive to seek to disrupt this.
 - (b) FTA broadcasters are likely to need to invest significantly to obtain additional spectrum from Ofcom to launch an HDTV offer. BSkyB would have an incentive to seek to influence ITV's ability to raise funds to participate in any spectrum auction.
 - (c) BSkyB could attempt to influence the course of any future transactions involving ITV to weaken the constraint that FTA services would otherwise provide. It might,

for example, disrupt an acquisition of ITV that might otherwise strengthen ITV's competitive position, or encourage the acquisition of ITV by another buyer who might act in BSkyB's interests.

19. BSkyB might also be able to exercise indirect influence due to its industry knowledge and standing. BSkyB would have an incentive, for example, to disrupt the planned launch of ITV's Freesat service with the BBC, particularly in relation to the broadcast of HD channels.
20. We concluded that, as a result of the acquisition, there was likely to be a substantial lessening of competition (SLC) arising from a loss of rivalry in the all-TV market between ITV and BSkyB. This may be expected to result in a reduction in quality, a reduction in innovation, or an increase in the price of audiovisual services within the all-TV market, compared with the levels that there would have been absent the acquisition.
21. We looked at the possible impact of the acquisition on future competitive constraints. We did not form an expectation that ITV would develop a pay-TV offer, or strengthen a competitor's existing offer. We concluded that there was unlikely to be an SLC arising from a loss of potential rivalry from a pay-TV offer developed or strengthened by ITV.

Joint bidding for sports rights

22. The acquisition may lead to BSkyB influencing investment in ITV's strategy in relation to sports rights (see paragraph 18(a)). We concluded that the acquisition was not likely to lead to an SLC arising from either a reduction in joint bidding between ITV and third parties, or from increased joint bidding between ITV and BSkyB for sports rights.

Advertising

23. We concluded that the effects of the acquisition could be assessed within a UK market for television advertising.
24. Although third parties raised a number of concerns in this market, we did not believe that any of the mechanisms could be expected to result in an SLC. The Contracts Rights Renewal remedy (CRR) currently prevents ITV from raising prices for sales of advertising on ITV1, and we saw no evidence to suggest that the parties would have the power to raise prices for advertising on the remaining channels that they offer. We also found that the nature of the influence obtained by BSkyB as a result of the acquisition would be unlikely to facilitate the types of anti-competitive behaviour described by third parties.

National television news programme supply

25. We concluded that the effects of the acquisition could be assessed within a UK market for the wholesale provision of television news.
26. We looked at the impact of the acquisition on the wholesale supply of news programming resulting from the indirect link between BSkyB and ITN (in which ITV has a 40 per cent stake). Channel 4 appeared to be the most concerned about its future news provision, in part because of its high-quality specification for its news services.
27. We considered the potential mechanisms through which competition could be reduced between Sky News and ITN. We thought it unlikely that the ownership link between BSkyB and ITV would lead Sky News to compete less aggressively with ITN given the size of BSkyB's stake, the non-strategic nature of wholesale news provision, the fact that no relevant contracts will come up for renewal before 2010

and the presence of countervailing incentives for both companies. Nor did we expect the acquisition to increase the likelihood of coordination between ITN and Sky News.

28. We concluded that the acquisition was unlikely to result in an SLC arising from a loss of rivalry in the wholesale provision of national television news.

Provisional conclusions on the SLC test

29. We therefore concluded that BSkyB's acquisition of a 17.9 per cent stake in ITV was likely to result in an SLC arising from a loss of rivalry in the all-TV market between ITV and BSkyB.

Plurality

30. The media public interest consideration specified by the Secretary of State in the intervention notice dated 26 February 2007 and incorporated in our terms of reference was 'the need, in relation to every different audience in the United Kingdom or in a particular area or locality of the United Kingdom, for there to be a sufficient plurality of persons with control of the media enterprises serving that audience'. This public interest consideration is set out in section 58(2C)(a) of the Act.
31. We took plurality to refer to the range of information and views provided to different audiences. We thought that it was appropriate to distinguish between the range of information and views that are provided across separate independent media groups (external plurality) and the range that are provided within individual media groups (internal plurality).
32. We note that the regulations in relation to plurality and impartiality are distinct. Impartiality relates to the fair and balanced treatment of differing viewpoints in relation to particular news stories. Safeguarding plurality is also a way of ensuring

that decisions about the relative importance of different news stories are made by a range of independent people and reflect diverse perspectives.

33. We looked qualitatively at sufficiency, and the change in plurality that arose as a result of the acquisition, in relation to both internal and external plurality. Our interpretation of sections 58A(4) and (5) of the Act allowed us to look at the actual degree of control acquired, rather than assuming that there had been a full merger between the media enterprises that had ceased to be distinct.
34. We believed that news and current affairs were the genres most closely connected with the formation of public opinion about issues of national significance and that national news was a reasonable indicator to use. We looked at both national television news and cross-media news (obtained via television, radio, newspapers, magazines and the Internet). We also looked at the diversity of behaviour within audiences—for example, variation in terms of location and socio-economic group. While the parties do not overlap in the provision of regional news, we considered whether the acquisition was likely to have a differential effect on news audiences in the regions or nations of the UK, including Scotland, Wales and Northern Ireland.
35. We found that the regulatory framework, while relevant to plurality and, hence, the statutory public interest assessment, did not on its own ensure a sufficiency of plurality.

Existing levels of plurality

36. We looked at the existing levels of plurality for national television and cross-media news audiences absent the acquisition. We noted the following indicators of plurality:
 - (a) While television news programming is available on a range of channels, the five main channel providers (BBC, ITV, BSkyB, Channel 4 and Five) account for at

least 97.5 per cent of total television news viewing. The BBC is by some margin the most widely viewed channel provider for news, followed by ITV.

(b) Television news programme supply is more concentrated still. There are three main providers of news programming, BBC, ITN and Sky News, providing news programming to all of the five main channel providers.

(c) Looking across media, television is most likely to be regarded by people as their main source of news, with newspapers and radio considered to be the next most important sources. While the Internet is growing rapidly, people still largely rely on traditional sources of news and traditional news providers.

(d) Content analysis of television news reveals less diversity than a simple tally of news providers might suggest.

37. We noted that ITV was a significant channel provider for television news and that BSkyB, whilst smaller, was still significant. ITV was the most widely-viewed alternative to the BBC, with BSkyB one of three smaller players in news provision (together with Channel 4 and Five). The parties' links to related companies—in particular ITV's links to ITN and BSkyB's links to News International and News Corporation—further increased the potential significance of the acquisition in both television and cross-media news. In television news, existing regulatory mechanisms reduced the scope for influence over editorial decisions by owners of television channels which broadcast news. There were fewer regulatory restrictions on newspapers.

38. We looked at how the acquisition might affect plurality in terms of direct editorial influence or commercial influence. We noted that both BSkyB and ITV said that the editorial content of ITV news would be unlikely to be a matter of strategic importance. We found that there was a strong commitment to editorial independence across television news broadcasting which would lead to editors resisting any intervention

from the board or from shareholders to set the news agenda. We also noted that there were a number of internal and regulatory constraints in the production of television news which were likely to limit any possible single minority shareholder influence on editorial decisions.

39. We came to the conclusion that there was insufficient evidence to suggest that the acquisition of a stake of this nature would give BSkyB or its parent companies the ability or incentive to exert editorial influence over ITV's news output.
40. We thought it likely that ITV was able to exert commercial influence over ITN. We noted that ITN would provide ITV with news programming until 2012. ITV's commercial influence over ITN could, in principle, extend beyond ITV's news output. In particular, if ITN were unable to function as an effective independent supplier of news content in competition to Sky News, this could reduce the ability of other channels, such as Channel 4, to provide an independent news voice.
41. However, while we consider it likely that BSkyB would have an incentive to favour Sky News over ITN, it is not clear to us that the acquisition would significantly alter BSkyB's ability to influence ITV to do so. We therefore concluded that the acquisition of a 17.9 per cent stake in ITV did not give BSkyB the ability to exert significant commercial influence over ITV's news output or more widely over ITN.

Provisional conclusions on plurality

42. In our view, the regulatory mechanisms, combined with a strong culture of editorial independence within television news production, were likely to be effective in preventing BSkyB with its 17.9 per cent shareholding from prejudicing the quality and independence of ITV news.

43. We therefore concluded that, in light of the actual degree of influence that could be exerted by BSkyB over ITV, the acquisition was unlikely to have an adverse effect on the sufficiency of plurality. The acquisition may therefore not be expected to operate against the public interest, having regard only to the relevant public interest consideration, namely the need for a plurality of media ownership.

Provisional conclusions on the reference

44. Under section 47 of the Act, we are required to consider the possible impact of the acquisition on competition (the SLC) and, taking account only of the SLC and the media public interest consideration specified by the Secretary of State, to consider whether the acquisition operates, or may be expected to operate, against the public interest. We concluded that BSkyB's acquisition of a 17.9 per cent stake in ITV may not be expected to operate against the public interest having regard to the media public interest consideration. However, we also concluded that it was likely to result in an SLC based on our assessment of the competitive effects of the acquisition. In these circumstances, we concluded that, overall, the acquisition may be expected to operate against the public interest.