Project Kangaroo

JOINT VENTURE BETWEEN BBC WORLDWIDE LIMITED, CHANNEL FOUR TELEVISION CORPORATION AND ITV PLC RELATING TO THE VIDEO ON DEMAND SECTOR

Parties' Statement of Case and Overview

25 July 2008

1 Context

1.1 This paper sets out the Parties' statement of case and is intended to provide an overview of the Parties' position on the competition assessment of the joint venture. It should be read in conjunction with the joint background paper on the joint venture and the three accompanying joint position papers on market definition, the counterfactual and barriers to entry.

2 Statement of Case and Overview

2.1 UKVOD is a proposed joint venture between BBC Worldwide ("**BBCW**"), ITV PLC ("**ITV**") and Channel Four Television Corporation ("**Channel 4**") in relation to the supply of video on demand (VOD) to consumers. The Parties will contribute content, technology and other resources to UKVOD which will supply content acquired from the Parties and others to consumers and other VOD sites and platforms. The majority of material available to consumers via UKVOD will be free and advertiser funded. Some content will be charged for. The proposed joint venture is pro-competitive, will generate consumer benefits and will not give rise to a substantial lessening of competition.

2.2 The development of VOD is a response to material changes in technology and consumer preferences which means that previous approaches to television viewing and internet usage are breaking down. The range of content available, increased broadband speeds and a proliferation of new hardware devices give consumers viewing options that were not previously available. Consumers now expect greater flexibility as to when and how to view content. This impacts both the range of devices through which content may be acquired and viewed – for example, PCs, iPods, Xboxes and PlayStation, not just TVs - and the ability to select content, for example via personal video recorders (PVRs), catch-up services and content streaming and download options.

2.3 VOD is materially different to linear television in a number of ways: nearly all of the content is secondary - that is it will have previously been produced for and transmitted on other media - and much linear television content (such as sport, news, talent shows and soaps) is unavailable or unsuitable for anything other than catch-up or short form clips. VOD rights (with the exception of catch-up) are likely to be increasingly separated from primary broadcast rights meaning that there will be different retail providers of primary and secondary content.

2.4 Historically only a very small percentage of archive TV material has been of a type that consumers are prepared to pay for and so released onto DVD. The proposed joint venture will enable UK consumers to access, search and locate a much wider range of TV and film content over the internet and via TV platforms than is currently available. The site will focus on providing users with a rich and deep range of content, which is not simply a catalogue list but offered with superior editorial expertise allowing viewers to access and enjoy content which they might not otherwise have thought to obtain It will differ from other VOD offerings where content is seen as supporting another proposition, for example the sale of hardware devices or a wider pay TV or retail business. Thus UKVOD will include 'dusty' archive content, that is archive content of appeal to a limited audience that would be unlikely to be available elsewhere because it would not be viable to digitise and exploit such content on a stand alone basis. The content will be organised in such a way as to allow consumers to select according to their preferences [✂]. It is this combination of a broad range of content, editorial expertise and strong search and selection facilities that will make UKVOD distinct - and a genuine innovation for consumers.

2.5 Users will have a choice of alternative VOD providers for much content that is available on UKVOD including the most popular content. These alternatives include the Parties' own websites and third party services including TV platforms and internet retail sites.

2.6 The technological developments that enable the development of long form VOD services are relatively recent but a number of clear market offerings have developed or are at a significant stage of development. Thus, Apple has leveraged off the success of its iPod device and its iTunes music download business and its US VOD experience to offer a broad range of VOD content to iPod owners; Sky offers a TV and internet based VOD service through a combination of a market leading PVR, a strong subscriber base and extensive rights to premium film content; and Amazon has acquired control over LOVEFiLM which has a very high share of the UK transactional VOD market. Other significant players developing attractive VOD options include Microsoft, Sony, BT, Tiscali and Demand Five.

2.7 Two of the three parties (ITV and Channel 4) currently have web sites that offer VOD. Both have a limited range of content and their functionality is restricted, for example it is not possible to download content from the ITV site for later viewing. BBCW as the BBC's commercial arm does not have a VOD site at present, although separately the BBC offers a 0-7 day catch-up service via iPlayer which is widely available as part of the BBC's public service obligation. iPlayer will not be included in UKVOD. It is important to note that, contrary to the view adopted by the OFT, the counterfactual to the proposed joint venture is not that each of the three parties will develop equivalent offerings to UKVOD nor that they will represent, respectively, each other's closest competitors. [✂].

2.8 Long form VOD can be classified in a number of different ways: by delivery mechanism (TV, iPod, PC etc); by nature of the viewing rights (streaming – which does not allow the content to be stored for later viewing; download to rent (DTR) - which allows later viewing for a specified period of time; download to own (DTO) - which allows viewing for an indefinite period of time); by whether the content is available to the viewer free or for a payment (the latter is described as transactional content) and by the nature of the content (first broadcast within the last 30 days – catch-up; older broadcast content – archive and film).

2.9 These different means of classification reflect the commercial reality that VOD can be acquired and viewed in different forms and combinations by a user. For example, a user may view streamed free archive material over a TV or paid for DTR material over an iPod. While there are particular combinations that are more common, for example catch-up is usually free and DTO is usually transactional, there are a large number of possible combinations. Combinations that are available for any particular item of content will reflect in part the technology and business model of the supplier, for example Apple, Microsoft and Sony are driven by the desire to market their hardware devices and largely regard content as a means of driving hardware sales, and in part the choice of the consumer and the relevant occasion, for example a consumer may choose on one occasion to view downloaded archive material over a laptop or portable device on the train on the way to work and on another occasion to view catch-up on a PVR over the TV.

2.10 The large number of possible technological and viewing choices and combinations and the nascent nature of the sector means that a conventional approach to market definition, under which a series of alternative products are considered consecutively with a view to deciding whether they are substitutes for each other, is very difficult to apply. If one takes as a starting point the narrowest possible definition of the product that will be offered by the joint venture – UK broadcast content and film over the internet – there are a number of different products and services to which consumers of such a service would switch in the event of a price increase. Not all consumers would switch to any one specific alternative but most would switch to at least one alternative. There are therefore sufficient alternatives and combinations of services to mean that significant competitive constraints exist.

2.11 Closed VOD Platforms, that is TV platforms for which some form of subscription or payment is required to access content, are the most popular means of accessing VOD because consumers can replicate the "lean back" experience of watching linear television. All closed TV platforms offer VOD. In this regard PVRs are considered within the industry and by consumers as a form of VOD. PVRs enable users to record broadcast material from linear channels. PVRs are a particularly close substitute for catch-up TV and indeed enable a wider range of content (sport is generally not available on catch up due to rights issues) to be recorded and viewed later and for a longer period of time than catch-up VOD services. Increasingly, as storage space on PVRs expands, PVRs are an alternative for older archive VOD. Reflecting this, Grif Parry, Director of Broadband and Mobile for Sky, said at an industry conference on 26 June 2008 that he considers that Sky+ (the Sky PVR) customers "enjoy the UK's biggest on demand service".

2.12 As for film and archive services, content is available on a number of different open and closed platforms such as Sky, iTunes, Amazon, BT Vision and Virgin Media. Some of this will be transactional and some free (depending in part on the platform, for example, iTunes and Amazon have predominantly transactional models). DVDs continue to be the main source of accessing longer content and they provide a real alternative to VOD offering greater portability and storage than is available for VOD. While VOD may be thought to be a more instantaneous experience than buying or renting a DVD this is not necessarily the case when internet download speeds are taken into account. Thus working on a reasonable assumption of a minute to download a minute of VOD, for many consumers this will be equal to, or longer than, the time it would take to buy or rent a DVD.

2.13 Short form VOD (of the type found on Google/YouTube) is also an alternative to long form VOD for some users. Much short form video consists of clips from longer professionally produced material, for example a particular performance from "The X Factor". While the complete programme of a talent show of this sort is unlikely to attract VOD consumers, other than on a short term catch-up basis, the ability to select content clips is attractive particularly for younger consumers whose viewing consumption is taken in 'bites' of content and who, in allocating their leisure time, will generally not discriminate between viewing two or three short form videos or a long form video depending on attractiveness of content.

2.14 Film is also an alternative to TV broadcast VOD for many consumers. While premium films (films showing on a first run window on a particular medium) enjoy a higher pricing point that broadcast VOD, other film is priced similarly to equivalent length TV content and, from the perspective of viewers, can be an alternative. A consumer may therefore choose between archive TV drama and an older film based on price and attractiveness of content.

2.15 The Parties are aware of the concern that their combined strength in UK linear television will give UKVOD a strong competitive advantage in the long form VOD sector. This concern centres on the argument that the Parties have strong market positions in respect of rights over UK TV content and that UK TV content is unique and does not compete with other English language content (predominantly US content). Both of these propositions are misconceived.

2.16 It is not the case that the Parties' strength in respect of UK linear content is replicated in the VOD world. Much UK linear content, such as sport, news, talent shows and soap operas is unsuitable for VOD (other than catch-up or short form clips) because its appeal is very short term. Thus most of this content, which is amongst the most popular, cannot be offered on an archive or a transactional basis. Much of the remaining UK content, such as comedy and drama series, will be more appealing in the VOD sector but, with the exception of catch-up, there is a separation between the acquisition of primary and secondary VOD rights to such content. Thus, under the PACT terms of trade which govern the acquisition of rights by the Parties, the producer of content is permitted to sell archive VOD rights separately from the primary rights. As the VOD market develops these rights will become increasingly valuable and it can be expected that VOD sites and platforms will seek to acquire them. It cannot be doubted that players such as Apple, Sky, Amazon, Microsoft and Sony have the know-how and resources to make highly competitive offers for VOD rights if they should wish to do so. Independent production companies such as Endemol are large and sophisticated organisations that are perfectly capable of taking advantage of commercial opportunities by separating linear and VOD rights. They have contractual ability to do this and the financial incentive to sell VOD rights separately.

2.17 If UK TV content was considered by viewers to be distinct from US content it would also be expected that UK and US content would be classified separately on VOD menus and in DVD stores. This is not the case – the primary classifications are by popularity or genres. Any distinction between US and UK content, if made at all, is at a secondary level. Further, the Parties' high combined share of linear broadcast rights for UK content arises in large part from their regulatory obligations to commission UK content. It does not necessarily reflect a market driven choice of the Parties - outside the public service broadcast sector, where the regulatory obligation relating to UK content does not apply, channels carrying primarily US content such as Sky One compete very strongly with channels with a large UK content element such as UK TV. Neither is it the case, as suggested by the OFT, that the Parties are the closest competitors to each other in respect of VOD. Competition for content is more likely to be by genre than nationality. Thus, UK comedy is more likely to compete with US comedy than, say, with UK science fiction and, within any particular genre, there is no evidence to suggest that UK offerings are seen by users as closer substitutes than US offerings.

2.18 Catch-up rights are closely linked to the value of primary rights in that if primary material is made available as VOD by other parties shortly after it is first broadcast the value of the primary rights are diminished. Catch-up rights are therefore exclusively available to the primary rights holder under the terms of trade (a similar logic applies in respect of holdback which prohibits any exploitation of secondary rights within a specified period of first broadcast).

2.19 [✂].

2.20 [✂].

2.21 [✂].

2.22 [✂].

2.23 [✂].

2.24 The OFT concluded that it was not able to dismiss concerns that the joint venture will be able to raise prices to other platforms seeking to offer VOD. This was based on the assumption that the Parties' constitute very close competitors. For the reasons described above this is disputed. The OFT's view was also based on views from some third parties that UK independent producers are too fragmented and do not hold sufficient rights to act as a strong competitor to the joint venture. This reflects a misunderstanding of how the markets operate. Even on the assumption that independent producers do not have market strength and sufficient know how, which is disputed given both the very strong trade association – PACT – (the collective negotiation body for independent producers) and the size of the larger producers, the major downstream competitors of UKVOD such as Sky, Apple, Amazon etc certainly do have the ability to acquire content directly from independent producers and the most recent PACT terms of trade specifically carve out VOD rights from the sale of primary rights in order to give third parties this opportunity.

2.25 To summarise, at the retail level the joint venture will not impact the supply of the bulk of VOD content which will be available free to consumers. For catch-up content there will be a wider of choice of platforms as compared to the counterfactual, as this content will be available from the Parties' own web sites as well as UKVOD (and as now over iPlayer). Consumers will have access to much archive content that otherwise would not be available (because limited demand means it is not worth commercialising such content other than in the context of a content driven site such as UKVOD). While it is difficult to be certain about market shares in a nascent market, it is estimated that, for transactional content UKVOD's market share will be about 11 per cent if film and broadcast VOD is included in the relevant market (as the Parties believe they should be) and 21 per cent if only broadcast VOD is included. UKVOD will face strong competition from other sites such as iTunes, Amazon and Sky. Such competition will be both from US content and UK content the rights to which have been sold separately to primary broadcast rights. The strength of alternative platforms and the different business models as between such platforms will mean that competition will be vigorous. In particular platforms largely driven by the desire to sell hardware – such as Apple, Microsoft and Sony – will have every incentive to price low and to maximise the range of available content as their content sales are largely aimed at driving hardware sales. UKVOD will also face competition from other sites to which the Parties' content has been supplied – particularly in respect of DTO for the most popular content. This, combined with the strong competition from US content, means that UKVOD will not result in an increase in retail prices to consumers for transactional content.

2.26 Competition at the wholesale level will reflect competition at the retail level as competing transactional platforms will wish to ensure that they have attractive retail offerings. They can be expected to take full advantage of the opportunity to acquire VOD rights for content, including UK content. Competitors have the know-how and resources to acquire such content. For UK catch-up, which is the only content in respect of which rights are not available directly from producers, PVRs are a close substitute. [✂]. Pricing will be constrained by the alternatives available to customers and the importance to UKVOD and the individual Parties of maximising access to content in order to cover the high fixed costs of rights acquisition.

2.27 The two other markets impacted by the transaction (in addition to the retail and wholesale supply of VOD) are the market for the sale of internet advertising and the market for the acquisition of rights in content.

2.28 The Parties will compete with each other for the sale of advertising in and around their content on UKVOD. The joint venture will not change anything in this regard other than to create additional advertising opportunities for agencies. UKVOD will sell advertising on common areas of the site. The share of internet display advertising sales enjoyed by the UKVOD will, in any event, be very small (about 1 per cent).

2.29 On rights acquisition, the parties will continue to be strongly incentivised to compete with each other for VOD rights. [✂].

2.30 Although the VOD markets are at an early stage of development it is already clear that there is a significant level of competition at all levels. While market entry itself is not difficult, the strength of competition in the market and the diverse business models adopted by the various players means that success is highly uncertain. UKVOD will come to these markets with a differentiated product that will focus on the range, quality and choice of content. This is an offering that could not be replicated by any of the

Parties alone. UKVOD will not enjoy the advantages of related hardware devices, existing internet distribution businesses, a strong subscriber base or the ability to enter into global deals. All of its major competitors will have one or more of these benefits. In short UKVOD will add a differentiated competitor to a dynamic marketplace. It is in this context that the merger needs to be assessed.