

Project Kangaroo

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

Parties' Joint Background Paper on the Joint Venture

25 July 2008

1 Context

- 1.1 This joint paper provides background information on the Parties and the rationale for the joint venture. It should be read in conjunction with the three accompanying joint position papers on market definition, the counterfactual and barriers to entry and the joint statement of case and overview.
- 1.2 This paper is divided into three substantive sections:
- Section 2: provides a description of the Parties, including the existing entities in which the Parties (or their parents) are, variously, co-shareholders.
 - Section 3: provides a description of the transaction, including a high-level outline of the joint venture, the circumstances leading up to it and a summary of the agreements entered into and governance.
 - Section 4: describes the Parties' rationale for the joint venture. This section includes a summary of the development and state of the UK retail VOD market, and the consumer benefits that the Parties expect will be delivered by the joint venture.
- 1.3 [§<].

2 The Parties

BBCW

- 2.1 BBC Worldwide Limited ("**BBCW**") is a wholly owned subsidiary of the British Broadcasting Corporation (BBC). BBCW operates on an arm's length basis from the rest of the BBC and has no, and is prohibited from having any, influence over the BBC's public interest decision making. BBCW engages in a wide range of commercial activities in the audiovisual sector, mainly involving the worldwide commercial exploitation of audiovisual material produced by the BBC. BBCW also invests in programming commissioned by the BBC from independent production companies and other producers in return for commercial rights in the content. The BBC's Royal Charter (the "Charter") and Agreement with the Department for Culture Media and Sport impose certain duties on the BBC Trust and Executive Board in respect of Fair Trading which, inter alia, require the BBC's Commercial Activities to comply with certain specified criteria, including the avoidance of market distortion.
- 2.2 BBCW's activities include the provision of a range of foreign and domestic satellite and cable television channels (including, in the UK, the UKTV suite of channels, as part of a joint venture with Virgin Media Television; and, outside the UK, UK.TV in Australia, BBC America in the US and a suite of genre-based channels (BBC Entertainment, BBC Knowledge, BBC Lifestyle and CBeebies) some or all of which operate in various

territories around the world including Singapore and India with further territory launches to follow over the next few years. BBCW operates the UK's third biggest magazine publishing business with titles including Top Gear, Gardener's World, BBC Good Food, Olive and BBC Focus. Many of the magazines also have companion websites such as Topgear.com, BBCGoodFood.com. BBCW also has a Book Publishing venture (BBC Books) as an imprint of Random House and an educational publishing venture (BBC Active) operated by Pearson Education, in each case holding a minority stake in the venture. It has a DVD format business (as part of the 2 entertain joint venture with Woolworths) and syndicates VOD content to certain third party platforms. In the digital sphere, it also operates bbc.com which is an international advertiser funded facing version of the BBC website bbc.co.uk. BBCW also has an interest in a number of independent production companies both in the UK and abroad. Examples include a minority shareholding in Australian independent producer Freehand, and a 24.9% shareholding in Left Bank Pictures in the UK.

- 2.3 BBCW's activities allow it to return profits and dividends to the BBC which helps enable the BBC to perform its public service broadcasting obligations. The BBC's Charter states that the BBC "exists to serve the public interest", that its "main object is the promotion of its Public Purposes" and that it may only involve itself in commercial activities to the extent allowed by its Framework Agreement with the Secretary of State (the "Agreement").¹ Under the Agreement, the BBC is licensed to provide a number of services (called "UK Public Services") and the licence for each must set out how the service promotes the Public Purposes outlined above.² The Agreement specifically requires the BBC to "do all that is reasonably practicable to ensure that viewers, listeners and other users (as the case may be) are able to access the UK Public Services that are intended for them, or elements of their content, in a range of convenient and cost effective ways which are available or might become available in the future", and "making content available on demand" is envisaged as one such means of access.³ The BBC is also prohibited under the Agreement from charging viewers, listeners and users for the receipt of UK Public Services.⁴
- 2.4 BBCW does not have a retail VOD presence in the UK market. [X].
- 2.5 In December 2007, the BBC, as part of its public service remit, launched a catch up via the internet service for days 0-7 from transmission (known as the BBC iPlayer).⁵ The iPlayer, which is available on the BBC's website, incorporates a media player and an electronic programme guide. It allows users to stream or download on to their PCs programmes after two hours and up to seven days following broadcast. Where downloaded, the material may be viewed up to 30 days from the date of downloading: once viewed, the content will be automatically deleted from the computer after seven days but within that time it may be viewed repeatedly. The iPlayer was launched as a beta site in July 2007, with a full consumer launch in December 2007 following an extensive development and testing programme.
- 2.6 The Agreement lists "bbc.co.uk" as one of the UK Public Services⁶ and the BBC Trust, as it is empowered to do,⁷ has amended the bbc.co.uk service licence to include BBC iPlayer. The BBC is therefore obliged to make its iPlayer, as defined in the BBC Trust's service approval, available free of charge and to ensure that viewers, listeners and other

¹ Clause 3 of the Charter. Clause 4 goes on to list the BBC's Public Purposes: (a) sustaining citizenship and civil society; (b) promoting education and learning; (c) stimulating creativity and cultural excellence; (d) representing the UK, its nations, regions and communities; (e) bringing the UK to the world and the world to the UK; and (f) in promoting its other purposes, helping to deliver to the public the benefit of emerging communications technologies and services and, in addition, taking a leading role in the switchover to digital television.

² Clause 17(2) of the Agreement

³ Clause 12(1) of the Agreement

⁴ Clause 13 of the Agreement

⁵ Approved by the BBC Trust within its 'Public Value Test' framework (incorporating a market assessment by Ofcom: For further details see:

http://www.bbc.co.uk/bbctrust/consult/closed_consultations/ondemand.html

⁶ Clause 11(5) of the Agreement

⁷ Clause 11(6) of the Agreement

users can access iPlayer content in a range of convenient and cost effective ways. Any failure to do so would potentially breach the BBC's obligations under its Charter and its Agreement with the Secretary of State. The BBC intends to offer links to the iPlayer from other open internet services, pursuant to its Syndication Guidelines. The BBC also syndicates iPlayer to closed service providers (e.g. Virgin Media).

2.7 In the financial year to 31 March 2008 BBCW had a turnover of £916.3m.

C4C

2.8 Channel Four Television Corporation ("**C4C**") is a publicly owned not-for-profit corporation active in the audio-visual sector. It owns and operates Channel 4, a public service UK television station, which is available on both analogue and the main digital broadcast platforms maintaining a core focus on the values of innovation, creativity and diversity. Through its subsidiary 4 Ventures Limited ("**4V**"), C4C also operates a suite of commercial channels including E4, More4 and Film4. C4C also operates time-shifted versions (referred to as 'Channel 4+1' etc) of Channel 4, E4, More4 and Film4, which enable viewers to view those channels one hour later than originally broadcast. A high definition service, 4HD was launched on satellite in 2007. C4C also uses interactive platforms to help extend the depth and impact of its programming output, reinforcing its public service contribution, and to develop new commercial opportunities. These include channel 4.com and e4.com.

2.9 As a member of the 4 Digital Group consortium C4C holds a licence to operate the second UK Digital Audio Broadcasting ("**DAB**") radio licence, which from 2008 will operate 10 UK radio stations including Channel 4 Radio, E4 Radio, Sky News Radio (run by BSkyB and Global Radio UK) and Emap digital radio. C4C owns a 50% stake in Box Television Limited ("**Box**") being a joint venture with Bauer Consumer Media Limited. Box owns and operates a suite of 7 digital music based channels and gains subscription revenues. One of these, The Hits (soon to be re-branded as 4Music), is available on Freeview, the remaining on cable and satellite only. All of C4C's wholly owned channels are broadcast free-to-view.

2.10 C4C is funded through the revenues it generates from its commercial activities, including the sale of on-air advertising airtime and programme sponsorship, as well as its share of income deriving from the exploitation of programme content (e.g. in overseas television sales). C4C also benefits from the profits generated from the activities of 4 Ventures Limited, which has business activities in DVD distribution, consumer products, and events. C4C's VOD business, 4oD, sits within 4V. 4V also has shareholdings (minority or JV) in a number of commercial undertakings involved in related activities.

2.11 Channel 4's public service remit as a public broadcaster is set out in the Communications Act 2003.⁸ This applies to its linear activities and requires the provision of a broad range of high-quality and diverse programming which, in particular: demonstrates innovation, experiment and creativity in the form and content of programmes; appeals to the tastes and interests of a culturally diverse society; makes a significant contribution to meeting the need for the licensed public service channels to include programmes of an educational nature and other programmes of educative value; and exhibits a distinctive character.

2.12 Channel 4 recently announced a vision for its future remit (Next On 4), and stated its ambition to become a commercially funded, not-for-profit multiplatform public service network. Next On 4 sets out C4C's vision for the public purposes it believes should represent its aims for the future, into digital switchover and beyond, and is a commitment to ensure that C4C's content is as relevant and widely available as possible, across linear television and new platforms. At the same time it recognised the need to balance that with the need to generate the commercial revenues required to continue sourcing and funding new content in the future. Channel 4 also has additional obligations to help

⁸

Section 265(3)

ensure that the digital terrestrial television network is extended to reach the widest possible audience in time for digital switchover in 2012.

- 2.13 C4C launched 4oD in October 2006 and the 4oD internet VOD service in December of the same year. This is an open subscription service that requires downloading of the 4oD application. All 4oD content is available on a streamed or DTR basis (the digital rights management software used by the 4oD website enables users to watch the same piece of content for up to 48 hours after it is first played). The basis on which a particular item of content is available on the 4oD website is largely dependent on the underlying rights that C4C has been able to acquire in that piece of content. Initially predominantly a pay service, 4oD has over time become a predominantly free service, with 7-day free catch-up becoming free in April 2007, 30-day catch-up in September 2007 and the majority of archive content from November/December 2007. Today, only certain US titles, whose rights are only made available on a pay basis, and most films, are provided on a pay-per-view (DTR) basis.
- 2.14 In April 2008, Channel 4's core website, channel4.com, introduced 7-day free streamed catch-up within the website, in parallel with the 4oD application. C4C's intention is to extend the catch-up offering via C4.com to 30 days in due course.
- 2.15 [§<].
- 2.16 In year ended 31 December 2007 C4C reported revenue of £944.9 m. Details of the governance of C4C can be found in the Annual Report and Accounts located at <http://www.channel4.com/about4/annualreport.html>.

ITV

- 2.17 ITV PLC ("**ITV**") is a UK media company active in a range of segments in the audio-visual sector.⁹
- 2.18 ITV is made up of four divisions:
- Channels: which operates 11 of the 15 regional Channel 3 licences that together make up the ITV Network and which are run under the ITV1 brand. The Channels division also has responsibility for ITV2 (aimed at the youth market), ITV3 (which primarily shows older drama content) and ITV4 (which focuses on a primarily male audience) digital channels and oversees the Children's ITV (CITV) and Men & Motors channels;
 - Global Content: which has responsibility for ITV Productions, ITV's in-house content production company, ITV's facilities businesses and for international programme sales, the DVD business and the merchandising and licensing business;
 - Commercial: the responsibilities of which include overseeing advertising sales;
 - Consumer: which runs ITV's internet interests, which include ITV.com, ITV Local (a series of regionally-focussed websites which provide news, weather and other services relevant to each region) and friendsreunited.com, a social networking website. The Consumer division also manages ITV's shareholdings in Freeview (the marketing consortium for free digital terrestrial

⁹ The Secretary of State for Business and Enterprise decided that British Sky Broadcasting plc, which presently has 17.9 per cent of the shares in ITV, must dispose of part of its shareholding so that it would hold less than 7.5 per cent of ITV's issued ordinary shares as proposed by the Competition Commission. The main hearing of BSkyB and Virgin Media's appeals before the Competition Appeals Tribunal against the Commission report and the Secretary of State's decisions was held on 3 to 5 June 2008 and judgement is currently pending.

television (“**DTT**”) in the UK) and SDN (the company that operates Multiplex A, one of the six groups of channels on digital terrestrial television in the UK).

- 2.19 As a public service broadcaster, ITV's regional Channel 3 licences requires that it fulfil its public service remit, which requires the provision of a range of high quality and diverse programming and also the provision of particular types of programming, including regional programming, news and current affairs.
- 2.20 In June 2007 ITV re-launched its website itv.com with 30-day catch-up content and some limited archive. All content, with the exception of some sports (such as Champions League) is provided free with advertising. The web site allows consumers to access ITV material through their PCs on a streamed basis. Some ITV content is also syndicated to other VOD platforms.
- 2.21 [§].
- 2.22 For the year ended 31 December 2007 ITV reported turnover of £2,082m.

Common shareholdings

- 2.23 The Parties (or their parents) are, variously, co-shareholders in the following commercial entities:
- (a) BBC (not BBCW), ITV and C4C are, alongside Sky and National Grid Wireless, shareholders in DTV Services Limited, the company that markets Freeview, the free-to-air platform that operates over the UK DTT platform.
 - (b) BBC (not BBCW), Digital 3 and 4 Limited (owned by C4C and ITV) and SDN Limited (owned by ITV), together with National Grid Wireless, are members of DTT Multiplex Operators Ltd, a private company limited by guarantee having no share capital, which is responsible for allocating logical channel numbers on the digital terrestrial television platform.
 - (c) BBC (not BBCW) and ITV are shareholders in Freesat (UK) Ltd, which operates freesat, the free-to-air digital satellite platform.
 - (d) BBC (not BBCW), ITV and Channel 4 are shareholders in Broadcasters' Audience Research Board (BARB), the organisation responsible for providing the official measurement of UK television audiences used throughout the television industry.
 - (e) ITV and C4C are, together with a number of commercial broadcasters, shareholders in Clearcast Ltd, which is responsible for the pre-transmission examination and clearance of television advertisements.
 - (f) ITV Network Limited and C4C are joint shareholders in Digital 3 & 4 Ltd, the licensee of a public service digital terrestrial television multiplex which was granted to C4/C3 pursuant to the Broadcasting Act 1996.
 - (g) C4C and ITV, together with Five, GMTV, ITV, Sky Media, Turner Media Innovations and Viacom Brand Solutions, are shareholders in Thinkbox TV Ltd, the television marketing body for the main UK commercial broadcasters.
 - (h) BBC (not BBCW) ITV and C4C, together with Sky and Five, are shareholders in Parliamentary Broadcasting Unit Limited, which makes pictures available for broadcasters from the House of Commons and the House of Lords.

3 The Transaction

The proposed joint venture

- 3.1 The proposed joint venture is to be entered into between BBCW, C4C and ITV and relates to the nascent and growing video on demand (“**VOD**”) sector. The aim of the Parties is to provide an on-demand service provided by “UKVOD”, a jointly controlled entity that is yet to be named, which will enable consumers to view and, in some cases, to own downloaded audiovisual material. The strategic rationale concerning the proposed joint venture is described in more detail in section 4 below. Copies of the announcement of the joint venture made by the Parties on 27 November 2007 were included in the responses to the first day letter.
- 3.2 The merger will involve each of BBCW, C4C and ITV contributing parts of their VOD businesses to the joint venture [§]. In order to launch UKVOD it will be necessary to provide the joint venture with a significant range of technology, content, staff, other assets, goodwill and customers, [§].
- 3.3 [§].
- 3.4 [§].
- 3.5 The bulk of UKVOD’s revenues will be generated through the supply of long form VOD to users over the internet. The internet site will be accessible to any UK user with a suitable broadband connection and no special technology or subscription will be required to access the site. The content available on the site will include “catch-up” content that is material broadcast over TV within the last 30 days, older broadcast material and films.
- 3.6 The content will be provided by the Parties and third parties. [§].
- 3.7 Revenue will be derived from a mix of business models: the sale of advertising in and around material that will be available free to users (catch up will be advertising funded, as well as much other material) and payment by users to access other material on a “rental” basis (that is for a limited period of time) or a “purchase” basis (to retain permanently). Rental or purchase revenues are described as “transactional” revenues. There may also be items available on a subscription basis. [§].
- 3.8 UKVOD will also distribute VOD content to other sites and platforms through syndication of the UKVOD service. The scope of this distribution will be detailed in the transaction agreements and there are a number of “carve outs” which mean the Parties will be free to independently supply certain material to other sites and platforms or control the terms of such supply.
- 3.9 Day to day management of UKVOD will be undertaken by a separate management team recruited for this purpose and enjoying a significant degree of autonomy.

Circumstances leading up to joint venture

- 3.10 [§].
- 3.11 [§].
- 3.12 [§].

Agreements entered into by the Parties

- 3.13 The SFA outlined the terms on which the Parties proposed to set up the joint venture for the proposed UKVOD VOD service. [§].

3.14 [X].

3.15 [X].

Governance of UKVOD

3.16 [X].

3.17 [X].

3.18 [X].

4 Joint Venture Rationale

Background

4.1 TV platforms have offered long form VOD content for several years but until recently the bulk of VOD material on lawful internet sites has focussed on shorter video clips such as user-generated content (“**UGC**”), excerpts from TV programmes, music and movie clips. Such sites have generated considerable user interest. The potential of such sites is demonstrated by their acquisition value, for example, Google purchased YouTube for \$1.65bn in 2006, even though YouTube is believed to still be unprofitable.

4.2 The scope for longer professionally produced internet video has until recently been limited in large part because the availability and speed of broadband bandwidth has not been adequate to support such material. This has been aggravated by uncertainty as to whether there would be sufficient consumer demand and how commercially viable licences for attractive material would be available. There is now a broad consensus that, with the greater broadband bandwidth available and continuing technological developments, the range of material that can be viewed over the internet (on either a streaming basis or to download and view later) is likely to increase. This consensus is also supported by developments in the US and, more recently in the UK. For example, in July 2008 BT announced its intention to invest £1.5bn to upgrade its telecommunications so that it can deliver high-speed fibre based broadband at 100mbps to 10 million homes by 2012 (compared to the maximum 8mps currently available to BT’s broadband users).

US developments

4.3 The US has been at the forefront of VOD developments. The US has a high percentage of TV cabled households and most cable companies offer VOD (about 30 million cable subscribers receive VOD). All the major US networks offer VOD content online, such as CBS, ABC, and also NewsCorp and NBC which have entered into a partnership called “Hulu” to offer content from the NBC and Fox TV networks and films from Universal and 20th Century Fox on a free advertising-funded basis. New services aggregating broadcast content from a wide variety of sources have developed, for example Babelgum. Cable operator Comcast is offering a new internet open VOD site called Fancast in addition to the extensive closed VOD service it offers its cable customers.

4.4 The two most successful US providers of transactional internet VOD have been Apple and Microsoft, in both cases using VOD to complement their hardware businesses (iPod and Xbox). Through its iTunes download store, Apple has an 80 per cent share of legal TV downloads, it launched an online VOD rental service in 2008 and is reported to have agreed deals with all the major studios concerning the online rental of movies. Microsoft is number two in the internet VOD sector and has turned the Xbox 360 videogame console into an entertainment platform with more than 1,000 hours of film and TV material available on Xbox Live marketplace including material from CBS, Warner Bros Entertainment, Paramount Pictures and MTV.

- 4.5 Amazon entered the VOD market in September 2006 with the launch of its Unbox service, partnering with 30 major networks and movie studios to provide content to its platform on a DTR or DTO basis. The ability to access the platform via TiVo PVRs¹⁰ was introduced in March 2007. In July 2008 Amazon announced plans to launch a new service called Amazon Video on Demand which will allow users to stream (rather than download) over 40,000 movie and TV titles to their PCs. The new online store will also be accessible via new Sony Bravia HD TVs with the purchase of a Sony Bravia Internet Video Link.
- 4.6 In July 2008 Sony launched the Playstation Video Store, which allows both PS3 and PSP users to download to rent or own TV programmes and movies. Initially, the service is offering 300 movies and 1,200 TV titles and is currently only accessible by users in the US. Content providers include 20th Century Fox, Paramount Pictures, Sony Pictures Entertainment and Warner Bros Entertainment.
- 4.7 Other major players include the video rental chain Blockbuster which bought Movielink in the summer of 2007 to expand into the VOD area and AOL which sells movie and TV show downloads.

UK developments

- 4.8 Developments in the UK have not been far behind those in the US. In the UK, pay TV operators have been at the forefront of VOD developments. Sky has offered a "Near VOD"¹¹ service since 1997 and, more recently, Virgin Media, BT Vision, Tiscali and Top Up TV have offered viewers the opportunity to access video content on a free or paid for basis. There is also a strong penetration of PVRs, which have been used by pay TV operators to offer VOD capability to viewers - Sky for example has a 43 per cent penetration among its subscribers.¹²
- 4.9 As noted above, the BBC launched the iPlayer in December 2007, which provides an internet-based catch-up service for BBC content days 0-7 from transmission. In June 2008 Virgin Media added iPlayer enabling it to offer full screen picture quality through its TV platform. Over 10.5 million BBC iPlayer programmes have been watched on this platform since June 2008, which represents one third of all iPlayer viewings.
- 4.10 Apple added DTO TV content to its iTunes UK store in August 2007 and added film content in January 2008. LOVEFiLM, a subsidiary of Arts Alliance, seen as the leader in the UK VOD market UK market, began offering content on a DTR and DTO basis in April 2006. Earlier this year, LOVEFiLM entered into a partnership with Amazon under which the latter agreed to promote LOVEFiLM services on its sites to UK customers.
- 4.11 Like the US, companies from the video gaming market are increasingly looking to offer their customers new services. Following a deal between the BBC and Nintendo in April 2008, users of the Nintendo Wii gaming platform have access to the BBC iPlayer via the internet browser built into the Wii. In July 2008 Go!View, a joint-venture between Sony Computer Entertainment Europe and Sky, was launched. Go!View is an online video-on-demand service for Sony PSP users in the UK and Ireland. Users will be able to download content from the Go!View website and transfer it to their PSP for viewing. Microsoft also entered the UK VOD market in December 2007 offering film and TV downloads on the Xbox 360 video marketplace store, similar to a service it already operates in the US.
- 4.12 The speed with which the range of competing UK offerings is developing is illustrated by developments in December 2007 and January 2008 which included an announcement by Sky that it was offering its Sky Anytime internet download service to non-Sky

¹⁰ "PVRs" are set top personal video recorders.

¹¹ "Near VOD" or "nVOD" are on demand systems in which multiple channels show the same material at staggered start times, for example every 15 or 30 minutes.

¹² See <http://www.skypressoffice.co.uk/SkyProductsServices/default.asp>. Sky claims to have a subscriber base of 8.888 million households, with 3.393 having Sky+ and 465,000 having SkyHD.

subscribers (re-branded as Sky Player); the establishment by Microsoft of its Xbox Live Video Store film download service in the UK and a deal with BT Vision and the launch of a new film VOD service, Filmon, with an extensive advertising campaign. In addition, Tesco announced on 15 April 2008 the launch of Tesco digital, which will offer VOD.

- 4.13 There has also been entry in the UK by a number of new internet based services, including the likes of Joost and Babelgum. Together with offerings from pay TV operators, telecoms companies and broadcasters, there are now a large number of players in the UK market. A search on the “find internet tv” website (<http://www.findinternettv.com/>) on 21 July 2008 brought up over 177 UK English language sites providing access to professional or near professional video content including sites by the major UK broadcasters (BBC, ITV, C4C, Five and Sky) and specialised content, for example, Bollywood and FA Cup.

Nascent and uncertain market

- 4.14 VOD markets are still at an early stage of development and there are a number of uncertainties in terms of consumer preferences and technology development. These uncertainties impact both the demand and the supply side.
- 4.15 Some aspects of VOD are, however, more mature and predictable. In particular, pay TV providers and other Closed VOD Platforms¹³ (e.g. telecommunications companies) have added VOD to their existing services, as new technologies have developed and consumer interest has increased. Thus, in the late 1990s developments in digital technology dramatically expanded transmission capacity and allowed linear TV platforms (such as Sky and cable operators) to develop more compelling nVOD offerings. For example, at its peak nVOD for films was available in approximately 10m homes and would have generated approximately £95m per annum.¹⁴ The subsequent launch and rapid expansion of set top boxes with PVRs (primarily by Sky but more recently by cable operators such as Virgin Media, and Freeview and Top Up TV services on the DTT platform) enabled both consumer managed VOD and push VOD services to launch, with consumers widely embracing the potential for PVRs to manage VOD. A further development was the addition of broadband to existing cable TV platforms, which has enabled pull VOD to be introduced as a bundled offering that consumers can access direct through their TV. The strength of this combination is evident from the success of Virgin Media’s launch of iPlayer access from its cable platform, from which 10 million iPlayer streams were accessed in June 2008 (to put this in context, there were 36 million total iPlayer streams in March 2008).¹⁵
- 4.16 Penetration of these Closed VOD Services is now relatively high, usage patterns strong and (while still growing rapidly) predictions can be more easily made about these services. This is because they do not require a step change in consumer behaviour or technological adoption patterns; they are based on adding VOD functionality to existing TV platform bases, enabling viewers to experience VOD through their primary device for TV viewing (the TV/set top box) from existing suppliers of TV services, bypassing barriers to adoption that arise from the need for separate equipment or new billing relationships. Pay TV platforms have a strong subscriber base that can be offered integrated packages, including broadband, mobile and fixed telephony services. VOD fits naturally into such a package of services and has become an important addition to a linear TV offering.
- 4.17 The success of these Close VOD Platforms is evident from Sky’s figures showing that 12 million people, in 3.4 million homes use their Sky+ PVR to record 280 million shows per

¹³ A “Closed VOD Platform” is where access is restricted to a limited group of consumers, for example on pay-TV platforms because a set-top box or a subscription is required (e.g. as operated by Sky’s satellite TV service and Virgin Media’s cable TV service)

¹⁴ C4 estimate, based on the assumption of a good ‘buy rate’ in nVOD being 25% per home per month, and an average purchase price of £3.19 (£3.75 less VAT).

¹⁵ “Virgin Media iPlayer: more than 10m viewings in June” Guardian, Monday 21 July 2008: <http://www.guardian.co.uk/media/2008/jul/21/virginmedia.bbc1>

month, with 3.4 billion instances of use in 2007. On this basis, Sky believes Sky+ customers have access to the UK's biggest VOD service.¹⁶ In November 2007, Virgin Media claimed that the VOD service offered through its cable platform was so successful that it has a bigger viewer following than Channel Five, with 30 million individual clips viewed in October 2007 from a subscriber base of 3.5 million.¹⁷

- 4.18 More recent has been the rapid development of VOD independent of core service provision by TV platforms. This includes the launch of IPTV based services¹⁸ to new set top boxes such as BT Vision and Tiscali (Tiscali has been in the market a long time but at such a low level of penetration that it can be described as immature), both still at low levels of penetration.¹⁹ "Pull VOD"²⁰ services using the open internet (primarily to PC) have been made viable by higher penetration of broadband at ever increasing speeds. This technology has facilitated entry by a number of Open VOD Services,²¹ and is employed by most broadcaster services, most notably iPlayer, itv.com, 4oD, Demand Five; retailers such as LOVEFiLM and Amazon; device-tied service such as iTunes and Microsoft's Zune marketplace; standalone offerings such as Joost and Babelgum; producer/rights holder offerings such as RDF's comedydemon.com and a number of sports sites.
- 4.19 The relatively low cost of using the internet as a delivery channel and the attraction of video as an enhanced form of entertainment on the web have resulted in VOD being seen an attractive additional service by companies in a number of sectors. These include internet service providers (ISPs) and mobile operators (e.g. Orange), games consoles such as Microsoft's Xbox and Sony's PSP and newspaper groups (e.g. the Telegraph).
- 4.20 Considerable uncertainty remains as to how this part of the market will develop despite recent entry by a number of players using the open internet. There are a number of factors that will impact upon the development and ultimate success of these services:
- The rate of expansion of broadband penetration and continuing increase of data speeds,²²
 - The response of ISPs to ever greater video usage by consumers and the potential strain this will put on existing infrastructure;
 - The speed of penetration of convergence devices that allow PC connection to TV and direct broadband connection to TV - because TV set remains the preferred means by which consumers prefer to watch VOD; and

¹⁶ Grif Parry, Director of Broadband and Mobile for Sky speaking at The IEA & Marketforce's 6th Annual Conference *The Future of Broadcasting -Maintaining profitability under mounting pressure* 25th & 26th June 2008, The Mayfair Hotel, London

¹⁷ "Virgin VoD claims more viewers than Five" Guardian, Wednesday 28 November 2007: <http://www.guardian.co.uk/media/2007/nov/28/virginmedia.television>

¹⁸ "IPTV" is Internet Protocol Television, the term used for TV or video signals that are delivered to subscribers or viewers using the technology that is used to deliver access to the internet. BT Vision uses a hybrid DTT and IPTV broadcast service, i.e. a combination of Freeview and VOD material, while Tiscali offers a pure IPTV service which includes VOD content.

¹⁹ These services offer a hybrid in that content is made available via the internet and viewed on TV but they have had a very low take up when compared to alternative TV services offered by Sky and Virgin Media although they are expected to grow.

²⁰ "Pull VOD" or "True VOD" refers to an on demand systems that store content on a server and deliver the content in real time to the viewer allowing the viewer to enjoy impulse viewing of content at any time.

²¹ An "Open VOD Service" is a service used for the delivery of content on an on-demand basis, available to any consumer with a broadband connection over the open internet and where content can be accessed via a PC without further payment for access to the site (e.g. Apple iTunes).

²² Low average broadband speeds (albeit improving); slow deployment of next generation broadband services such as fibre to the home and the vagaries of transferring data over the internet mean that, despite the spread of broadband in recent years, downloading of material over the internet is a currently less certain and more time consuming experience than would be required to be confident about the success of the internet VOD business model.

- The speed of development of rival devices such as further growth in penetration and storage capacity of PVRs, where significant increases in PVR storage capacity will provide consumers with the ability to bulk record TV and then decide what to "pull" from their PVR - creating individual mass content libraries.²³

4.21 However, the advantages held by the earlier TV platform entrants remain, in particular their significant established customer bases, the fact that they employ subscriber TV sets as the medium of consumption and the ability to bundle VOD with TV services and other additions such as broadband and mobile.

4.22 Despite the comparative advantages that Closed VOD Platforms will have over Open VOD Services, VOD over the open internet has the potential to deliver considerable benefits to the consumer, including lower costs of access (in particular from unconditional and unbundled access), access to niche content that will not be economically viable for Closed VOD Platforms to make available and potentially also greater flexibility on content usage. There will also be benefits for content rights holders, for whom the success of mass open internet services will mean increased revenues (largely paid out on a pro-rata to usage basis if existing revenue share models prevail in the market), the ability for more varied exploitation and the ability to reach consumers directly.

4.23 To deliver these benefits, Open VOD Service entrants will need to contend with strong competition that will take a number of forms, including:

- bundled products offerings from Closed VOD Platforms, which will in effect provide VOD and/or PVRs free or at a marginal cost to a large number of consumers who will have the option of greater VOD convenience from their TV set;
- the proliferation of free material on the internet in the shape of legal long form content, in particular from iPlayer which has created a step change in take-up from launch, and from UGC and newspaper content;
- the power of hardware linkages such as the link between Apple's iPod and iPhone as mass consumer devices and VOD on iTunes (as noted above, Apple added VOD to its iTunes UK store in August 2007 and added film content in January 2008 - Screen Digest predicts that it will take 80% of UK DTO revenue by 2011);
- the strong brands of global internet conglomerates, such as Google/YouTube, which have unrivalled online followings;
- the fact that DVD remains as a strong alternative for premium pay content, in particular feature films and 'box sets' of popular television series; and
- the availability of illegal content and unauthorised file sharing, which remains the biggest threat to the growth of the lawful market, including "pirated" material, for example, television programmes that have not yet been broadcast in the UK or where the TV rights lie with other parties.²⁴ This threat is significant.

²³ The range of choice and potential capacity of PVRs is demonstrated by the PVR currently offered with Sky+ and SkyHD, which allows customers to record programmes in advance, watch one channel while recording another satellite channel and even to record two different channels at the same time. It also has a feature called 'series link', which automatically records episodes of series ('series stacking'), keeping track of schedule changes. The current Sky+ box holds around 40 hours of programmes and Virgin Media's V+ box has approximately 80 hours of storage, 3 tuners and is HD compatible (Virgin Media Second Quarter 2007 Report, dated 8 August 2007). Other PVRs with even greater capacity are already appearing on the market, allowing in excess of 120 hours of programmes to be recorded.

²⁴ These are attracting a significant number of users, for example, several illegally uploaded clips on YouTube of Channel 4's "Balls of Steel" have attracted more than one million hits: "Producers tap UGC for comic potential" in Broadcast Now, 21 June 2007

According to a report prepared for the EC Commission, BitTorrent was estimated at one point to account for 30 per cent of all internet data traffic and 60 per cent of that traffic was video content.²⁵

- 4.24 There are different business models in the VOD space, and it is unclear which will be the most appropriate. Sky has to date focussed on a pay offering (either subscription or pay per view), Apple and the film sites focus on a download to purchase or rent model and sites such as Babelgum focus on amassing as much content as possible on an advertiser funded basis. This uncertainty means that although there has been a flurry of activity and significant investment by established and well funded operators, it is by no means clear what shape the future successful business model will take. There is likely to be a degree of movement with companies exiting the market, changing strategies or merging with other companies. This uncertainty is illustrated by the US experience. It was reported at the end of December 2007 that the world's biggest retailer, Wal-Mart, closed its US video downloading service less than a year after it started selling films online in an attempt to compete in particular with Apple iTunes and Amazon. It had offered 3,000 films and episodes of popular television shows. The service was provided using Hewlett Packard technology and a HP spokeswoman Anna Ichel Buxbaum was quoted as saying that the company had dropped the service because it "has not performed as expected" and would be looking at other digital entertainment ventures to invest in. She said "*The broader internet video space continues to remain highly dynamic and uncertain*". It has been reported that one of the problems faced by Wal-Mart was that its material could be only downloaded to PCs and could not be viewed on other devices. Google also closed its US DTO and DTR service in August 2007 after about a year of operation following its acquisition of YouTube.
- 4.25 Against this background, the Parties believe that the successful launch of open internet VOD offering with aspirations to the mass market requires that the following can be achieved:
- (a) Sufficient scale;
 - (b) The ability to offer premium quality product;
 - (c) Unique customer benefit; and
 - (d) Sufficient scope to access TV sets, whether by means of partnerships with Closed VOD Platforms, the development of own device strategies or further convergence.

Reasons for the joint venture and consumer benefits

- 4.26 The joint venture has been designed with the fundamental aim of enhancing the consumer experience of VOD. As explained above, the VOD market is still at an early stage of development, particularly early in the case of internet VOD. In this environment, many internet VOD offerings are driven by functionality, in the sense that they reflect the technologically possible rather than being editorially led. In the current state of the market the Parties see an opportunity to combine their existing expertise in the VOD space and create a venture that will provide a coherent offering to consumers in a manner that matches consumer demand, bringing together content from the Parties to help clarify what would otherwise be a cluttered experience.

²⁵

'Interactive Content and Convergence: Implications for the Information Society' - A study for the European Commission (DG Information Society and Media) authored by Screen Digest and others, October 2006. According to the same study, in one month during 2005, there were 350,000 downloads of the four most popular US TV shows via BitTorrent.

Consumer demand

- 4.27 The VOD market is mainly a secondary content market, which provides the consumer with a self-defined experience – it enables viewers to view content whenever they choose (subsequent to the initial broadcasting of the programme), and to choose the medium by which to view it e.g. iPod, PC, TV. The VOD market therefore involves focusing on a very separate set of propositions to achieve success to those that apply in the primary, linear broadcasting markets that the Parties are established in and will continue to individually focus on. A number of key consumer insights have informed the proposed joint venture's intended approach to the market:
- (a) Consumers prefer to watch programmes on TV than on PC: all other things being equal, consumers' screen of choice for viewing content is TV. [X].
 - (b) Consumers treat PVRs as a form of VOD: [X].
 - (c) Consumers expect content to be free on the internet: the availability of free content acts as a significant constraint in the prices and returns available from pay (i.e. DTR) [X].
 - (d) Consumers can be confused: [X].
 - (e) Content rather than channels lead consumer selection: consumers associate content with channels (especially catch-up content) and value channel brand endorsement but more often navigate through choice by content attribute rather than channel placement.
 - (f) Consumers differentiate between catch-up and archive content: the former is closely associated with channels (and drives a higher volume of consumption); the latter is a more content-led choice and offers more scope for pay per view revenues.

Strong competition

- 4.28 [X]. The Parties' market positions in the VOD space are very different to their positions in linear broadcasting. The VOD market is already highly competitive and the current home sites are limited in their ability to compete with the powerful entrants and competitors in the market. In VOD there are a number of significant entities (e.g. Apple (iTunes), Microsoft, Sony, Sky, Google/YouTube and Amazon), which have considerably stronger brands in the online environment than the Parties. These entities are global forces that have developed strong and proven internet propositions that can be easily adapted with low per territory investment. Each of these competitors can be expected to compete fiercely for consumers and content; they have the necessary skills, experience, expertise and distinct competitive advantages over the Parties (e.g. global scale, technology and related hardware devices, subscriber base, premium first window film content or deals with major studios). The development of a VOD proposition that has any chance of success must therefore be undertaken in a competitive landscape that is entirely different to broadcasting.
- 4.29 [X]. The coming together of the VOD activities of the Parties – rather than in combination with technology or internet entities – represents their interests as creators and distributors of content to focus on returns on investment in content, rather than the strategies of the strongest competitors in the market to use VOD to leverage their primary businesses (e.g. Apple's and Microsoft's focus on using content to sell technology, Sky's focus on its subscription base). In contrast, the joint venture does not factor in any spillover into the Parties' primary businesses. The focus and expertise of the UKVOD management and team on VOD will ensure that it is flexible and capable of reacting quickly to consumers' and advertisers' wishes and to changes in the competitive landscape.

Consumer benefits

- 4.30 The Parties believe that the joint venture will, under a new brand, provide them with the best opportunity to offer consumers the richness of content and convenience that will provide a genuine benefit to consumers in the online environment. UKVOD will bring a number of unique consumer benefits to the VOD market:
- Quality and trust: UKVOD will offer top quality content in one place, validated and endorsed by the parent company brands, collectively providing an industry benchmark of quality greater than the sum of the their parts.
 - Range and depth: UKVOD will bring together a wide range of content from ALL sources to create comprehensive coverage of the best of TV and film content in the consumer's eyes – all in one place.
 - Ease of use: UKVOD will be easy for the consumer to use by virtue of the comprehensiveness of its offering (making searches reliable), its understanding of consumers' relationship with content, its consumer-led (as opposed to technology-led) approach to functionality and the navigation of the service.
 - Editorial understanding: UKVOD will be an editorial-led proposition, drawing on the Parties' understanding of the consumer's relationship with their content to create a richer more interactive relationship between user and content, as opposed to the relatively prosaic 'catalogue-led' approach of many current players in the market.
 - Universality: UKVOD will be content neutral (it will not be seen as affiliated to a single content provider brand), platform neutral (not affiliated to a single platform), device neutral (available on multiple devices and on closed and open VOD), and widely distributed as a result.
- 4.31 In addition, while not a unique attribute in the market place, the scale UKVOD will bring could not be replicated by the Parties operating in isolation:
- Scale: UKVOD will bring scale of content ([><]), of technology (pooled investment amortised across high levels of consumption), and of marketing capability (mass cross-promotion available across different demographics).

Continuation of the C4C and ITV websites

- 4.32 It is important to note that C4C and ITV existing websites will continue subsequent to the implementation of the joint venture, although C4C's 4oD VOD business (including its technology and good will) will be transferred to UKVOD together with content, technology and goodwill from the other Parties. C4C's and ITV's home sites (and the BBC iPlayer) will continue to exist and play an important role in VOD subsequent to the implementation of the joint venture. The Parties existing offerings will continue to be an important supplement to their linear broadcasting channels. ITV and C4C each plan to continue to invest in the further development of their home sites. Both have recently undertaken major advertising campaigns to promote them. The effect of the joint venture for C4C and ITV will be to delineate the scope of their own VOD activities so that they can focus their home sites on making content available to consumers that are complementary to their primary broadcasting businesses (e.g. catch up, short-form, and made for broadband content). In the case of catch-up rights, which are closely linked to primary rights obtained by ITV and C4C upon commissioning of programmes for their initial broadcast, the home websites will continue to be promoted by ITV and C4C as the primary destination for catch-up content, as is the case now with BBC iPlayer. The Parties will continue to develop and enhance their existing sites and intend to make considerable investments in doing so.