

Response to Competition
Commission review of
Project Kangaroo

pact.

July 2008

Executive summary

The market

- 1) In Pact's view, Video-On-Demand (VOD) is one of the key emerging markets for UK content that has been created by recent developments in technology. The overall VOD market in the UK is currently relatively small, but is showing strong potential for growth. Ofcom has predicted growth of 50% per annum through to 2011. This would equate to annual revenues of £500 million from television and film content offered through television and online VOD services.¹
- 2) VOD revenues purely from television programmes (as opposed to film) are also forecast to grow strongly, from £14 million in 2007 to more than £242 million in 2012.²
- 3) VOD is a separate and complementary market to the basic model for television, its key distinguishing feature being the convenience for viewers of accessing content at a time of their choosing. In contrast, linear television broadcasts programmes according to a fixed scheduled time so that they can only be watched at that specified time.
- 4) In terms of different forms of delivery within the VOD market, there are VOD catch-up services and VOD rental. VOD download-to-own is a separate market, but is related.
- 5) As regards different forms of content, film and television programmes in Pact's view form two separate markets within the overall VOD market. Although the two are complements, film and television content are distinct markets on a number of grounds, including significant differences in pricing to the consumer and release windowing, as well as the fact that the wholesale price of television content is not constrained by that of film.

¹ Ofcom, BBC new on-demand proposals: Market Impact Assessment, January 2007.

² Oliver & Ohlbaum analysis for Pact: all O&O analysis attached as Appendix; see pages 15 and 16 for television VOD forecasts referred to here.

- 6) Within the television content market, individual television programmes, whether they are made in the UK or the US, are likely to be only weak substitutes within a sub genres (such as drama) and complements across different genres.

Competition: building critical mass

- 7) VOD and linear television are separate (and complementary) markets. Demand for specific VOD content is driven by viewing of the same programmes (or episodes in the same series) in the primary broadcast market - i.e. the programmes that are broadcast in the “shop window” of BBC1 and BBC2, ITV1, Channel 4 and Five. Between them, these channels have an audience share of nearly 70% (this does not include their digital portfolio channels),³ meaning that the programmes they show have a high awareness amongst UK consumers, who are likely to seek out those specific titles in the VOD market.
- 8) These channels also control the market for television content made in the UK, as they account for 90% of all investment in new UK programmes.⁴ This means these broadcasters control the market for content made by independent production companies: out of the total £1.35 billion market for independent producer content, approximately £1.17 billion comes from the BBC, ITV, Channel 4, and Five (including their digital portfolio services), with the remainder invested by commercial multi-channel services and S4C.⁵
- 9) Consumers come to VOD retailers as shoppers come to high-street retailers – for the breadth and depth of programmes on offer. To succeed as a retailer, VOD service providers need a critical mass of leading programme titles familiar to the UK audience. A VOD retailer might be able to succeed without one (or even perhaps two) of the programming libraries of the BBC (licence

³ Public Service Broadcasting: Annual Report 2007, Ofcom, page 25.

⁴ PSB Review Phase 1: The Digital Opportunity, Ofcom, page 56.

⁵ Independent Production Census 2007/08, Digital-i for Pact, page 19.

fee and commercial), ITV, Channel 4 and Five, but they would probably need at least two of these sources to offer a reasonable service.

Impact of Kangaroo

10) By combining together as Kangaroo, BBC Worldwide, ITV and Channel 4 ensure they have the critical mass to succeed in television VOD. These broadcasters have a combined audience share of approximately 70% (including their main terrestrial channels and digital portfolio channels),⁶ meaning that have access to a critical mass of television content that is well known to UK audiences. These broadcasters then control VOD rights in three key areas:

- a. They retain exclusive control of all of the independent producer VOD rights for new programming for the period immediately after broadcast. They also control independent producer VOD rights on returning series (the most commercially valuable property in the television VOD market) for at least two years; and
- b. They control the programming of ITV and the BBC that is made in house in perpetuity; and
- c. They control all independent producer content archived before the Codes of Practice came in in 2003.

11) Control of this extensive portfolio gives the Kangaroo partners the ability to deny a critical mass of VOD content to other retailers or - as is more likely - to push up the price of this offering to others, either squeezing them out of the market or pushing up competing retail prices. This power in the VOD catch-up and rental market could be leveraged across into the DTO market, where cross promotional and scale benefits from a dominant catch-up and rental service would be significant.

⁶ Ofcom, Pact estimates.

12) Rival retailers would therefore face significant barriers to effective market entry. This would not be the case if independent producers retained a greater share of their VOD rights. This could open up for competing VOD services a substantial level of television content that is well known to UK audiences, having built awareness by airing previously on the primary linear television channels. Television content made by independents accounts for more than 40% of all qualifying BBC and ITV1 content, and more than 80% of all Channel 4 and Five programming.⁷

⁷ Communications Market report 2007, Ofcom, page 142. BBC figure according to separate data from BBC.

Introduction

- 1) Pact is the trade association that represents the commercial interests of the independent production sector. We have more than 600 member companies across the entire UK, involved in creating and distributing television, film and interactive content.

- 2) Independent production companies account for approximately 50% of all new UK programmes on television screens each year. Overall turnover in the independent sector is more than £2 billion,⁸ while the sector employs 20,950 people – more than the terrestrial broadcasting and cable and satellite sectors respectively.⁹

- 3) This submission outlines our concerns over the joint venture of Kangaroo, addressing in order the general areas outlined by the Competition Commission in its letter of July 16 2008:
 - the relevant markets;

 - how these markets will evolve;

 - information on competitors, customers and suppliers;

 - current and future competition;

 - barriers to entry; and

 - impact of the joint venture on customers.

⁸ Independent Production Census 2007/08, Digital-i for Pact.

⁹ Employment Census 2006, Skillset.

- 4) In addition, we have commissioned a detailed analysis of the UK VOD market and future developments from Oliver & Ohlbaum Associates. We have forwarded this as a separate Appendix.
- 5) VOD television content in the UK is essentially content that was originally commissioned for linear television (by a linear broadcaster) and then is subsequently made available on an on-demand platform after it has aired on linear television. As such, VOD content made by independent producers is typically commissioned under the Codes of Practice created by the 2003 Communications Act, and the ensuing Terms of Trade.
- 6) The Codes of Practice apply only to content made by independent producers and commissioned by the Public Service Broadcasters (BBC, ITV1, Channel 4 and Five), who are responsible for 90% of commissioning in the UK.¹⁰ The Codes require that copyright to a programme remains with the independent producer, which then licenses certain rights to the commissioning broadcaster. They call for a clear distinction between the types of IP rights acquired by the broadcaster, as well as between the prices paid for those rights.¹¹
- 7) The Codes of Practice have had two key impacts. They have stimulated growth across the independent production sector, allowing companies to share in the value chain of programmes they create and generate additional investment. Turnover in the independent production sector has grown strongly since the introduction of the Codes of Practice, with a total increase in turnover over the last three years of approx 26.6% in real terms (we estimate approximately a third of this growth is in areas directly related to the Codes of Practice).¹²
- 8) The Codes of Practice have also opened up the general market for IP rights, allowing secondary services greater access to UK independent producer

¹⁰ PSB Review Phase 1: The Digital Opportunity, Ofcom, page 56.

¹¹ Communications Act 2003, Section 285.

¹² Independent Production Census 2007/08, Digital-i for Pact.

programming commissioned by the Public Service Broadcasters, and thereby increasing choice in how content is made available to the public. However, the Codes of Practice/Terms of Trade impose certain limitations on how independents are able to sell on VOD rights to third-party services. The primary broadcaster retains exclusive control of VOD rights for up to 30 days after the initial transmission and, during this period, may typically negotiate for an extension of VOD rights so that they continue to have exclusive control beyond the period of the primary window. If there is a failure to agree terms, a hold back period kicks in during which no party may exploit the content on VOD.

- 9) After this hold back period, most content can be exploited on third-party VOD services, although the primary broadcaster retains non-exclusive rights. However, returning series, the most commercially valuable television content in the VOD market, are an exception. The primary broadcaster retains control over VOD rights for two years after the end of the series, meaning that the series is typically not available to third-party services for up to three years after the initial linear broadcast.

The relevant markets

Overview

- 1) In our view, the UK VOD market is a separate and complementary market to television and other offerings such as DVD, as we outline in this section. The VOD market encompasses VOD catch-up and VOD rental, although these should not be confused with time shift channels that merely broadcast a programme at a later point, or with PVR viewing where a viewer must pre-programme a device to record a programme in advance. We also see download-to-own (DTO) television programmes as a separate but related market. It is likely that VOD service providers will seek to offer both, and significant marketing and cross-selling synergies exist between the two offerings of catch-up/download to rent and DTO.
- 2) Within VOD, there are both separate and complementary film and television markets. Individual television titles, whether of UK or US origin, are most probably weakly substitutable within each sub genre (such as drama), and complements across different genres.

VOD is separate and complementary to television

- 3) From the viewer's perspective, the key distinguishing feature between traditional television and VOD is the "on demand" convenience factor. The essence of VOD is the ability to watch programming at the viewer's discretion, without having to adhere to specific scheduling times. VOD operates like an online library for different types of television content, providing the viewer with an opportunity to see recently broadcast programmes ("catch-up"), as well as archived content. VOD content can be watched at any time the viewer chooses (although some content may

have a specific window within which it can be watched repeatedly whenever a viewer chooses, e.g. the BBC catch-up service).

- 4) This makes VOD distinct from the basic model for the current television market, which broadcasts programmes according to a fixed scheduled time so that they can only be watched at that specified time. The difference has been characterised as linear (broadcast television) and non-linear (on-demand).
- 5) In this regard, VOD is distinct from both the primary television market – BBC1 and 2, ITV1, Channel 4 and Five – and the secondary television market of digital, cable and satellite channels.
- 6) We therefore view VOD as separate to television; however it is also complementary, with the potential for retailers to bundle on-demand services with television platform access, as is currently the case.

VOD is separate to DVD

- 7) VOD is also separate from hard formats such as DVDs. Such formats do not act as a substitute for catch-up services because they are generally not available until several months after the end of the series.
- 8) There are exceptions – DVDs for an entire television series may be released the day after transmission, but tend to be only available as a boxed set for all episodes in the series. In contrast, VOD enables specific episodes to be selected. These VOD episodes will be at a far lower price than for a boxed set containing an entire series – and will often in fact have no charge to the viewer at all. Some DVDs for feature films are released “day and date” with the release of a film in cinemas, but this typically only applies to films released by the Hollywood studios.

VOD separate to Sky+ and other PVR services

- 9) Viewing of content via Sky+ must be planned in advance to ensure that the programme is pre-recorded, so it is not truly “on demand” and does not have the convenience that defines the VOD service.
- 10) Other PVRs can provide a range of recording functionality, including one-touch video recording via electronic programme guides and a series link which allows the viewer to set the PVR to record an entire series. But, as the OFT notes, they rely on the user to know what programmes they wish to watch, and to take steps to ensure recording. This differs from VOD, which allows users to browse through content for programming they may not have considered or missed due to unforeseen circumstances.

VOD separate to multiplex/time-shift services

- 11) A multiplex/time-shift channel is created when a broadcaster simply commences the transmission of the channel later than the original, initial, broadcast, enabling a viewer to watch a programme at the later time. Such multi/time-shift services offer the viewer a form of catch-up service, but this is fundamentally different to the catch-up service offered by VOD. Under the former, the viewer is still subject to the scheduled time shift, and the programme cannot be viewed on demand.
- 12) This distinction also holds true for broadcast archive services, such as a channel of classic comedy programmes. VOD archive services represent a different product in that they allow the viewer to watch content at a time of their choosing, rather than being subject to a fixed broadcast schedule.

Film and television VOD content separate and complementary

- 13) In our view, film and television VOD content are separate, but complementary, markets. From the broadcasters' perspective, film and television VOD content is not substitutable because the pricing of television VOD rights is not sufficiently constrained by the pricing of film VOD rights. From a viewer's perspective, television and film content are not easily substitutable because the timing constraints differ considerably: spending 30 minutes watching a television show is less demanding than dedicating up to three hours to a film.
- 14) The difference between the secondary viewing windows for film and television also suggests that they are not substitutable. Television programmes can be accessed as a catch-up experience immediately after primary broadcast, whereas there is typically a delay of several months from theatrical release of a film to its release into the secondary market.
- 15) Additionally, VOD television content tends to be free or sold at a low price point per viewing within a subscription VOD model, while films sell at higher price points and on a pay-per-view basis.

How these markets will evolve

- 1) The market for the supply of television content for linear broadcast is at a relatively mature stage. In contrast, the VOD market is at an early stage and is still small, but the prospects for growth are strong as broadband penetration increases and consumer awareness grows.
- 2) Ofcom estimated the value of the overall VOD market at £66 million in 2006 and stated that it would be expected (at least until 2011) to grow by 50% per year. This would equate to £148 million in 2008 and £500 million in 2011.¹³
- 3) Separate analysis of the VOD market commissioned by Pact from Oliver & Ohlbaum Associates also suggests strong growth, albeit from a small base. O&O forecasts hours of television programme VOD viewing rising from 185 million in 2007 to 803 million in 2012. Revenues from television programme VOD are predicted to increase from £14 million in 2007 to more than £242 million in 2012.¹⁴
- 4) There are two main types of VOD: television VOD delivered across digital multi-channel television platforms; and internet VOD delivered across internet platforms. Television VOD is primarily offered by the television platforms (e.g. digital terrestrial such as Freeview, cable and satellite such as Virgin Media and closed IPTV networks like Tiscali), not the primary television broadcasters.
- 5) Online VOD is increasingly viable as bandwidth improves. The larger linear television broadcasters have launched online VOD services, while specific VOD platform service providers, including Joost, Hulu and Babelgum, are also active, as are internet players such as Yahoo!, MSN and Google.
- 6) Viewing figures for VOD services run by the main linear broadcasters are growing rapidly. The single most significant development in the UK VOD market to date was the launch of the BBC's iPlayer in December 2007 and its subsequent performance. The iPlayer now records more than 20 million

¹³ Ofcom, BBC new on-demand proposals: Market Impact Assessment, January 2007.

¹⁴ All O&O analysis attached as Appendix, see pages 15 and 16 for television VOD forecasts referred to here.

requests to view content each month, and accounts for around 5% of all UK internet video traffic.

- 7) Along with the success of the iPlayer, video views across the ITV.com catch-up TV service have increased by 76% since the start of the year to 9.9 million in April.¹⁵ Channel 4's 4OD has delivered 60 million programmes since launch.¹⁶
- 8) In our view, both online and television VOD services are likely to require a minimum proportion of all high profile television programmes in order to achieve critical mass as providers of VOD television content. Consumers come to VOD retailers as shoppers come to high-street retailers – for the breadth and depth of programmes on offer. To succeed as a retailer, VOD service providers need a critical mass of leading programme titles familiar to the UK audience.
- 9) In terms of television programmes (as opposed to film), these will be the programmes that are transmitted on the main PSB terrestrial channels, i.e. BBC1 and BBC2, ITV1, Channel 4 and Five. Between them, these channels have an audience share of nearly 70% (and as much as 80% factoring in their digital portfolio channels), meaning that the programmes they show have a high awareness amongst consumers and are likely to be sought out in the VOD market.¹⁷
- 10) A VOD retailer might be able to succeed without one (or even perhaps two) of the programming libraries of these broadcasters, but they would probably need at least two of these sources to offer a reasonable service - especially if they are competing with a service that has access to all the main broadcaster libraries.

¹⁵ See <http://www.guardian.co.uk/media/2008/may/15/itv.mediabusiness>.

¹⁶ See Channel 4 2007 annual report, page 26.

¹⁷ Public Service Broadcasting: Annual Report 2007, Ofcom, page 25, and Pact estimates.

Information on competitors, customers and suppliers

- 1) As we have noted in the previous section, the ability of any VOD service to build critical mass will be dependent on being able to offer an appropriate amount of high profile content. In terms of television programming, consumer awareness of individual VOD television titles is driven by their presence on the primary linear television broadcast platform. Programmes that build a profile on linear television will be the programmes that drive VOD services. The UK market for the supply of VOD television content is thereby closely linked with the market for the supply of programmes for UK television programmes - the VOD market is secondary to the television market.
- 2) ITV and the BBC will automatically have access to a substantial level of the most popular content for VOD services by dint of their in-house content production operations. The BBC's in-house production department has a turnover of close to £1 billion annually, while ITV is more than £600m.¹⁸ This represents nearly half of all programming made in the UK each year. ITV and the BBC retain exclusive VOD rights to this in perpetuity.
- 3) The bulk of remaining new UK television content – i.e. approximately half the total market - is made by independent production companies. Prior to the introduction of the Codes of Practice in the 2003 Communications Act, independents were unable to retain any rights to programming they made; consequently, the PSB broadcasters have exclusive VOD rights to most independent producer programmes made before 2003, in addition to their exclusive control over programmes made by their in-house departments.
- 4) The Codes of Practice were created because the commissioning of new UK television programmes is a buyers' market. Hundreds of external production companies compete with each other and broadcasters' in-house production departments to supply content to broadcasters. In contrast, the five Public Service Broadcasting (PSB) channels – i.e. BBC1 and BBC 2, ITV1, Channel 4 and Five – account for 90% of all investment in commissioning new UK

¹⁸ Review of the Television Production Sector, 2006, Ofcom, page 50.

programming (in-house and external).¹⁹ The Codes of Practice and the ensuing Terms of Trade apply only to these PSB channels, plus the BBC's portfolio channels. They generally do not apply to the digital channels belonging to ITV, Channel 4 and Five, nor the channels run by cable and satellite broadcasters and other commercial digital services.

- 5) Under the Terms of Trade, when commissioning a television programme from an independent producer, broadcasters typically obtain a multi-year licence to broadcast that programme on their television channels. Broadly speaking, this licence contains three periods – an initial exclusive window, a holdback period, and a secondary window during which a broadcaster retains non-exclusive broadcast and VOD rights but when the producer can also sell non-exclusive rights to a secondary broadcaster or service. Importantly, the primary broadcaster retains a significantly longer period of control over returning series, the most commercially valuable type of television programming for VOD, as we detail below.
- 6) It is important to bear in mind that the terms of trade are minimum terms. Within the framework of the Terms of Trade, there is scope for separate negotiation of VOD rights. Also, the current arrangements with 4OD and ITV.com are only in place for two years after the launch of those services, so that they can be re-negotiated to reflect any market developments. The launch of Kangaroo will effectively cut across those arrangements.
- 7) On request, we would be happy to provide a further more detailed analysis of the Codes and Practice and Terms of Trade for each broadcaster comparing the respective arrangements for each of the partners in Kangaroo.

The exclusive primary window

- 8) The licence under the Terms of Trade is generally exclusive for an initial period, which is referred to as the primary window. The length of the

¹⁹ Ofcom PSB Review Phase 1.

exclusive primary window differs between broadcasters, but for VOD rights is up to 30 days from first transmission.

- 9) During the exclusive window, a producer is prevented from exploiting both the programme broadcast rights and the secondary VOD rights in the UK. This means that during the primary window a producer cannot sell the programme to a secondary channel or a VOD service even if such a third-party wishes to offer that content to the public.
- 10) During this period, most broadcasters may negotiate for an extension of VOD rights so that they continue to have exclusive control beyond the period of the primary window. If there is a failure to agree terms, a holdback period kicks in, as outlined below.

The holdback period

- 11) After the exclusive primary window, if terms for an extension have not been agreed, a holdback period on the rights to exploit the content is introduced. These periods, which differ in each broadcaster's Terms of Trade but can be around five months, prevent a producer from licensing rights to content to any competing platform. Other than the BBC, no party can exploit the content via VOD during this period. The BBC says that it allows the content to be exploited in certain, very limited cases.
- 12) Returning series are an exception in that they are not released for producers to exploit for far longer, typically two years or more after a series has finished its first transmission. This means that third-party services will not be able to access returning series for up to three years after it has started on primary television. Whilst a producer is prevented from licensing VOD rights during this period, the primary broadcaster has exclusive rights to show the programme on its own platform.

Secondary window

13) After the exclusive period and the holdback period, the VOD rights to a programme are available to a producer to sell on to a third-party service such as BT. The original commissioning broadcaster retains non-exclusive rights during this period.

Impact of Codes of Practice

14) Prior to the Codes of Practice/Terms of Trade, independents lacked negotiating strength, and were forced to effectively work for hire, taking a fee while the broadcaster retained all ownership of the IP rights to a programme.

This had two impacts:

- a. independent companies were unable to attract investment into their businesses; and
- b. broadcasters were able to hold back IP rights from rival services such as cable and satellite channels interested in exploiting them, thereby restricting choice for the public in how it accessed that programming.

15) The Codes of Practice, and the ensuing Terms of Trade negotiated between broadcasters and independent companies, addressed this market power by stating that copyright remained with the independent producer, which then licensed certain rights to the commissioning broadcaster.

16) This has enabled independent companies to develop as sustainable businesses. By allowing content creators to retain copyright to their programmes, the Codes of Practice/Terms of Trade have allowed them to share in the value chain of revenues from the programmes that they create.

- 17) We estimate approximately a third of the independent sector's growth post 2004/2005 has been in areas directly related to the Codes of Practice/Terms of Trade. Many of these growth areas fall outside broadcasters' core business and may never have been developed without the Codes of Practice/Terms of Trade.
- 18) The public has also benefited from greater competition and choice in how content is delivered. Previously, PSB broadcasters were able to use their market power to take all exploitation rights to a programme, even those rights which they did not use. Now, certain IP rights to a programme are available to the wider market, allowing other services to gain access to that content and develop new ways of offering it to the public. This is often on a non-exclusive basis, so that the PSB broadcaster can still exploit the rights at the same time as a third-party service.
- 19) We have seen no evidence that the Codes of Practice/Terms of Trade have had any substantial cost for PSB broadcasters. In fact, all broadcasters have increased their commissioning of programmes from independent companies since the Codes of Practice/Terms of Trade were introduced.
- 20) Ofcom's forecasts indicate that the PSB broadcasters will continue to dominate spending on UK programming into the foreseeable future. This means that the Codes of Practice/Terms of Trade are likely to remain important to mitigate against broadcasters' negotiating power.
- 21) There has been consolidation in the independent sector, and the largest companies have annual turnovers of £300m plus. However, no independent producer group accounts for more than 15% of the total commission spending of any one of the PSB channels.²⁰ This suggests that no company has any significant negotiating power over any PSB channel, although a hit show will always command a premium.
- 22) Ofcom has therefore concluded that the Codes of Practice/Terms of Trade remain important. It stated that: "The main terrestrial broadcasters remain the main buyers of originated [ie new UK] content, and are likely to remain so in the medium term. As a result, Ofcom remains of the view that intervention is

²⁰ Data from Oliver & Ohlbaum Associates and Attentional.

still required in order to address the imbalance in negotiating strength between the main terrestrial broadcasters and independent producers, and the Codes of Practice are a useful tool in achieving this objective.”²¹

²¹ Review of the Television Production Sector – Policy Statement, October 2006, Ofcom, page 17.

Current and future competition

Overview

- 1) As we have previously outlined, the market for VOD services is at an early stage, but is rapidly increasing in popularity. The VOD market in the UK therefore presents a considerable business opportunity, as demonstrated by the successful launch of iPlayer, ITV.com and 4OD.
- 2) In addition to the incumbent PSB broadcasters, Pact would have anticipated a high level of competition for audiences, and for secondary VOD rights to UK content, from relatively new entrants to the sector, such as BT, Virgin, and Hulu.
- 3) We are concerned, however, that Kangaroo will lead to a significant dampening of this competition in the UK market for VOD services. By combining together as Kangaroo, BBC Worldwide, ITV and Channel 4 ensure they have the critical mass to succeed in television VOD.
- 4) At the same time, the Kangaroo partners retain the ability to deny this critical mass to others or - as is more likely – to push up the price of this offering to others, either squeezing them out of the market or pushing up competing retail prices. We consider that it will lead to Kangaroo either reducing other VOD suppliers such as BT and Virgin to marginal roles or forcing up the price of such services to consumers.
- 5) This power in the VOD catch-up and rental market could be leveraged across into the DTO market, where cross promotional and scale benefits would be significant.

A joint venture, not just a combined portal

- 6) It is clear from the brief description of the anticipated joint venture provided by the BBC, ITV and Channel 4 as published on your website that Kangaroo is a commercial joint venture, not just a joint portal.

Kangaroo is said to be: “A standalone business with dedicated staff and an expert management recruited to focus specifically on the VOD market.”²²

- 7) It also appears that at least some of Kangaroo’s revenues and profits will be shared between its parents, although the basis for distribution of profits is unclear. Although the brief description says that the parties will compete for some advertising, it does not elaborate on what happens to those revenues. It does state, however, that: “General advertising on the Kangaroo site (i.e. not content related) will be sold by Kangaroo (through an agent).”²³
- 8) Furthermore, Michael Grade, Executive Chairman of ITV plc, said in the press release for the launch of the venture that: “The deal is structured so that we each benefit from content being viewed, ensuring that there is significant revenue potential in the growth of the venture for all involved.”²⁴
- 9) Revenue sharing will change the economic incentives of Kangaroo’s parents. Before Kangaroo, the BBC, ITV and Channel 4 would be incentivised to compete against each other individually; post-Kangaroo, however, their incentives are aligned, in that they now have a joint interest in the commercial success of Kangaroo.

Market power

- 10) The UK broadcasters partnered in Kangaroo are well placed to enter and quickly penetrate the VOD market due to their strong brands, their

²² A Brief Description of the Anticipated Joint Venture provided by the Parties, Competition Commission website, paragraph 1.2.

²³ *Ibid*, 1.13.

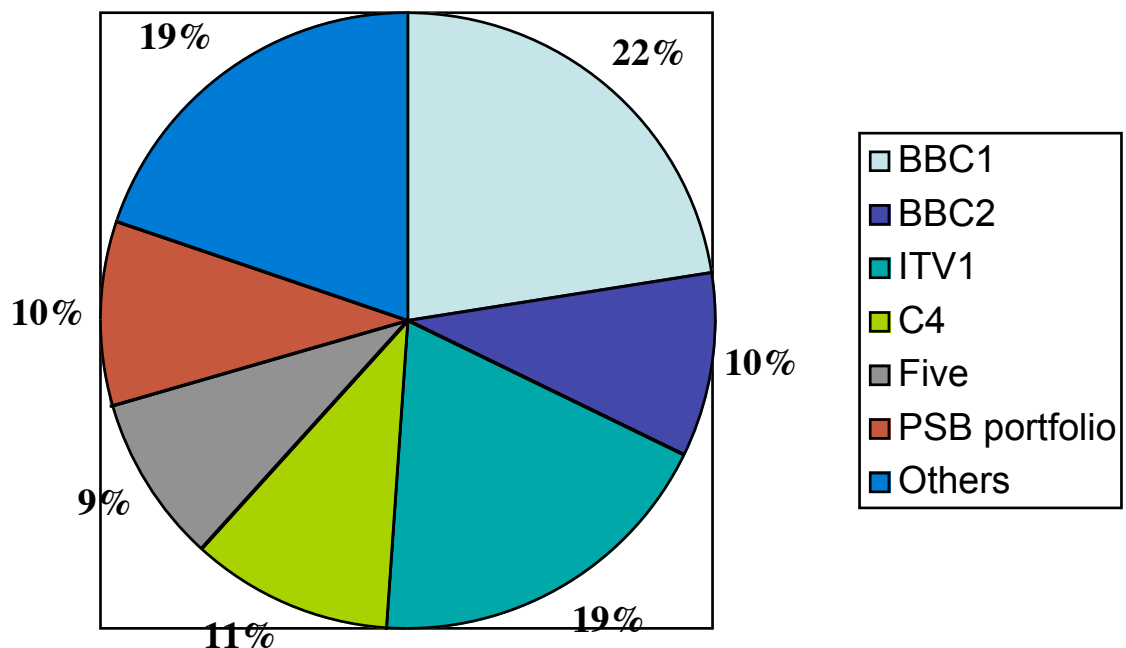
²⁴ Press release: BBC Worldwide, ITV and Channel 4 to launch joint on-demand service, 27/11/2007.

existing archive of programmes, control over investment in content, and their ability to cross-promote.

11) The broadcasters partnered in Kangaroo have a combined audience share on their main channels (i.e. BBC1 and BBC2, ITV1 and Channel 4) of around 60% in all homes. This does not include the additional audience share generated by their digital portfolio channels, which account for an estimated 10% over and above this figure.

12) This means that the broadcasters partnered in Kangaroo will have access to a substantial pool of television content that has a high awareness amongst UK consumers. The table below details the audience share of the main broadcasting groups (i.e. their combined portfolios of services).

Audience share of channels (all homes)



Source: Public Service Broadcasting: Annual Report 2007, Ofcom, page 25, Pact estimates (adjusted data)

13) In addition to their audience share for linear broadcasting, these PSB broadcasters control three key sources of high profile content:

- a. They retain control of all independent producer VOD rights for new programming for the period immediately after broadcast and for several months thereafter. They also control independent producer VOD rights on returning series (the most commercially valuable property in the television VOD market) effectively for up to two further years after the first broadcast of the series; and
- b. They control the programming of ITV and the BBC that is made in house in perpetuity; and
- c. They control all independent producer content archived before the Codes of Practice came in in 2003.

14) As we have noted previously, their existing VOD services have grown rapidly and are already market leaders. While market size and market shares are difficult to measure at this stage due to the lack of market research and the rapid growth in users, it is reasonable to expect the major PSB broadcasters to continue to take a considerable share of this market due to their strong positions in the primary UK television market. Viewers will be driven to VOD services offering content that has been showcased on linear television, which effectively acts as a shop window in much the same way as a cinema release does for films.

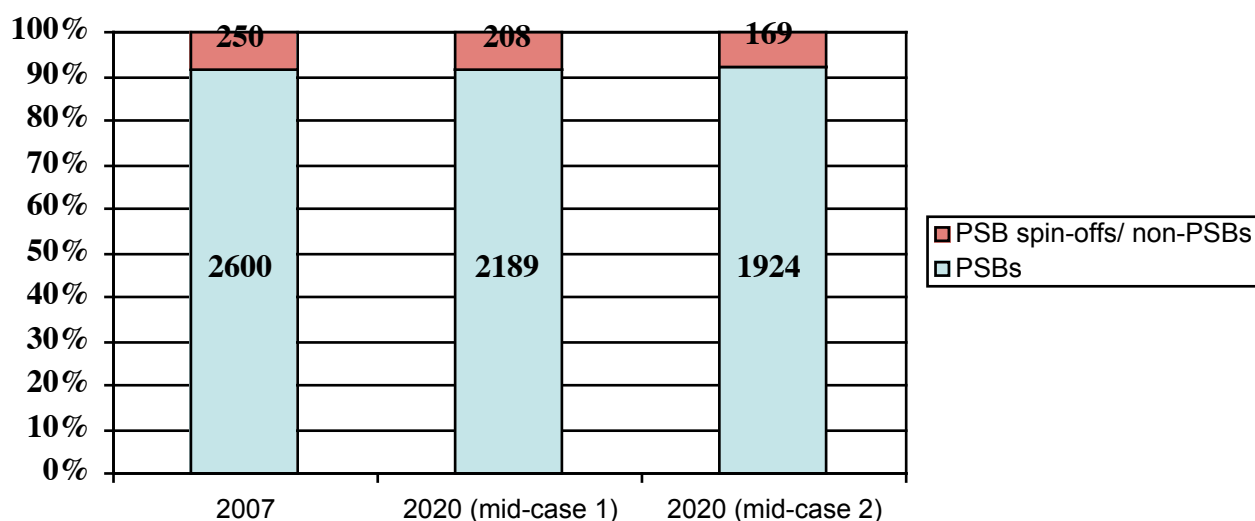
15) The market power of the broadcasting groups partnered in Kangaroo means that their already significant ability to cross-promote their services through channel and other media ownership will be substantially augmented by their joint presence in Kangaroo. We note that this is one of the explicit roles of each partner, as outlined in the description of the service provided by the parties, which states that: "Shareholders themselves will promote the service through their own TV channels and

other owned media.”²⁵ We also understand that other services, such as National Geographic, may possibly partner with Kangaroo, creating a further market concentration.

16) The Kangaroo partners will be able to use their market power to deny rival services access to VOD rights to enough compelling content to build critical mass. We consider that it will lead to Kangaroo reducing other VOD suppliers such as BT and Virgin to marginal roles. During the exclusive period, Kangaroo will be the only realistic source of supply for UK VOD content, as the independent producers cannot exploit VOD rights during that period.

17) Rival services are unlikely to generate enough new content of their own as the economics of non-PSB commercial digital channels mean they have few incentives to invest in new UK programmes. The Kangaroo partners account for 80% of all investment in new UK programming - Five and the non-PSB multi-channel services represent the remaining 20%. This is predicted to continue through to 2020, as the table below shows.

Current and future investment in UK programmes (£,000s)



Source: Ofcom PSB Review Phase 1

²⁵ A Brief Description of the Anticipated Joint Venture provided by the Parties, Competition Commission website, 1.9.

- 18) Even if non-PSB services did invest in their own content, it would be difficult to build consumer awareness of this content due to the PSB broadcasters' majority audience share.
- 19) Without appropriate access to rights to a sufficient amount of compelling content – i.e. content that has recently been broadcast on the PSB services - competing platforms will effectively be marginalised. Even if only partial foreclosure occurs, Pact is concerned that this would leave our members' potential customers in a weakened state, reducing our members' options for exploiting any available VOD rights.
- 20) This would not be the case if independent producers retained their VOD rights. This could open up for competing VOD services a substantial level of television content that is well known to UK audiences, having built awareness by airing previously on the primary linear television channels. Television content made by independents accounts for more than 40% of all qualifying BBC and ITV1 content, and more than 80% of all Channel 4 and Five programming.²⁶

Impact on purchase of VOD rights

- 21) Pact is also concerned that Kangaroo could lead to a significant lessening of competition with respect to the purchase of VOD rights.
- 22) Kangaroo could undermine Pact's ability to negotiate Terms of Trade with the PSB broadcasters. Given that Kangaroo will be a commercial venture for the exploitation of VOD rights, this creates a strong incentive for the Kangaroo partners fully to align their position with respect to VOD rights, thereby imposing worse Terms of Trade on independent producers.

²⁶ Communications Market report 2007, Ofcom, page 142. BBC figure according to separate data from BBC.

Thus, the joint venture partners in Kangaroo would likely significantly adversely affect competition in the buying market for UK VOD content.

23) Equally, Kangaroo could potentially eliminate any existing competitive tension in the buying of VOD rights between its partners which exists outside the framework set by the Terms of Trade. Once the exclusive window or licence term of VOD rights has expired, the producer is free to licence its VOD rights to any party. Kangaroo means that effectively three buying points are reduced to one.

24) Pact does not agree with the Kangaroo members' statement that: "the Parties will continue independently to buy and compete for the acquisition of VOD as well as other rights as they do now."²⁷

25) First, Kangaroo may facilitate explicit co-ordination between its parents. Kangaroo can serve as a mechanism (e.g. through its board) for exchanging commercial information which would enable its parents to align their position with respect to the negotiating and buying of VOD rights. Secondly, even if Kangaroo had no impact on information flows between the parents, their economic incentives will change considerably, given that the Kangaroo business model appears to provide for revenue sharing between its parents. Again, Kangaroo's business model means that the independent producers' choice of core buyers would potentially be reduced from three to one.

²⁷ A Brief Description of the Anticipated Joint Venture provided by the Parties, Competition Commission website, paragraph 1.17.

Barriers to entry

- 1) We believe that barriers to entry are low, but barriers to expansion to a competitively significant commercial scale are high. While a number of companies have entered the market for VOD services, few have managed to build genuine scale due to the lack of available high profile content.
- 2) As we have outlined, demand for specific VOD content is driven by viewing of the same programmes (or episodes in the same series) in the primary broadcast market – i.e. BBC1 and BBC2, ITV1, Channel 4 and Five. Between them, these channels have an audience share of nearly 70% (this does not include their digital portfolio channels),²⁸ meaning that the programmes they show have a high awareness amongst UK consumers, who are likely to seek out those specific titles in the VOD market.
- 3) To succeed as a retailer, VOD service providers need a critical mass of leading programme titles familiar to the UK audience. By combining together as Kangaroo, BBC Worldwide, ITV and Channel 4 ensure they have access to a critical mass of television content that is well known to UK audiences.
- 4) These broadcasters then control VOD rights in three key areas of content supply. In terms of independent producer-made content, they control VOD rights for new programming for the period immediately after broadcast, and on returning series for at least two years, as well as all content archived before the Codes of Practice came in in 2003. In addition, they control the programming of ITV and the BBC that is made in house in perpetuity.
- 5) Control of this extensive portfolio gives the Kangaroo partners the ability to deny a critical mass of VOD content to other retailers or to push up the price of this offering to others, either squeezing them out of the market or pushing up competing retail prices.
- 6) Rival retailers would therefore face significant barriers to effective market entry. This would not be the case if independent producers retained their

²⁸ Public Service Broadcasting: Annual Report 2007, Ofcom, page 25.

VOD rights. This could open up for competing VOD services a substantial level of television content that is well known to UK audiences, having built awareness by airing previously on the primary linear television channels. Television content made by independents accounts for more than 40% of all qualifying BBC and ITV1 content, and more than 80% of all Channel 4 and Five programming.²⁹

- 7) With respect to the primary market for UK television, ITV suggested in the Sky/ITV investigation that: “there were barriers to new entrants securing significant viewing shares.” This was because, with “the position of established incumbents with strong brands and high programming budgets, the required level of investment is likely to be high”.³⁰ We ask the Competition Commission to consider whether these considerations apply equally to the VOD market.
- 8) This suggests that, whilst it might be relatively straightforward to set up a new VOD provider, acquiring or producing quality content that would be sufficiently attractive to capture a significant share of viewing would require high levels of investment. In order for the competitors to the Kangaroo platform to establish a competitive position in the UK VOD market they would need to invest in the commissioning of programming.
- 9) Pact rejects the arguments put forward by Kangaroo’s parties that their individual ability to compete with new and current providers of VOD services is limited. On the contrary, the ability of the incumbent broadcasters to leverage their position as the commissioners of 90% of UK content gives them a substantial advantage in the nascent VOD market.³¹ None of their competitors are active in the television broadcast markets; the rights they would be interested in acquiring in respect of commissioned programmes are restricted to VOD rights. Consequently the programming budgets would be significantly reduced from those currently attained by producers for content that is commissioned for distribution across several markets, notably the

²⁹ Communications Market report 2007, Ofcom, page 142. BBC figure according to separate data from BBC.

³⁰ Competition Commission report Sky/ITV, paragraph 4.92.

³¹ We have included a brief analysis of broadcasters’ investment in new UK programming in the previous section (Source: Ofcom PSB Review Phase 1).

primary television broadcast market and the secondary VOD exploitation market. Indeed, programming budgets based purely on potential on-demand revenues would be so small as to make the production of the programme impossible.

- 10) Even a reduced programming budget would be detrimental to the quality of the programming – not only would this limit a programme's ability to compete for viewers with programmes funded by the incumbent broadcasters in Kangaroo, the budget offered would not be an attractive commercial incentive for the content producers to produce programming.
- 11) Moreover, advertisers' budgets for advertising space are competitively priced based on the viewer ratings for specific programming. Consequently, advertisers would be less likely to buy advertising airtime on the VOD platforms such as Joost, Hulu, Babelgum, BT or Virgin, which did not feature the high quality programming that currently attracts high viewer rating, such as those on the main broadcast channels.

Effect on customers

- 1) Historically, the analogue broadcasting era has been characterised by an oligopoly whereby a handful of incumbent broadcasters controlled how content was made available to the public. Developments in technology, such as the delivery of content online, offer the potential to change that, driving choice and competition for the viewer.
- 2) This opening up of distribution services is complemented by a more open framework for the IP rights to content created by the Codes of Practice in the 2003 Communications Act. Previously, the market power of the main broadcasters allowed them to bundle additional rights, such as new media, into the main television license and 'warehouse' rights – ie keep hold of rights in order to suppress competition from new markets. Additionally, the conditions attached to holdbacks frequently restricted the producer's ability to sell on programming.
- 3) The Codes of Practice in the Communications Act, and the ensuing terms of trade negotiated between Pact and the broadcasters, have disaggregated the rights to content. As a result, new platforms and services have greater access to UK-made content, alongside the traditional broadcasters. These new entrants offer the potential provide greater competition, encourage value for money, provide more investment and offer more choice to UK citizens and consumers.
- 4) In the VOD market, Kangaroo could potentially significantly dampen this competition by rapidly building critical mass in what is a nascent market. The Kangaroo partners retain the ability to deny this critical mass to others or - as is more likely – to push up the price of this offering to others, either squeezing them out of the market or pushing up competing retail prices. We consider that it will lead to Kangaroo either reducing other VOD suppliers such as BT and Virgin to marginal roles or forcing up the price of such services to consumers.