

6 The views of NTL and CWC

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Introduction

6.1. This chapter summarizes the views of NTL and CWC, the main parties to this inquiry, which were presented in written submissions and at hearings.

NTL

NTL's general submission

6.2. NTL submitted that it and the businesses to be acquired had no competitive overlaps in the services they offered. The transaction offered significant pro-competitive advantages in equipping NTL better to meet competition from existing incumbents, notably BT in telephony and BSkyB in pay-TV.

6.3. The relevant markets for assessing horizontal issues were: national retail pay-TV; fixed line retail telecommunication; interactive services; and Internet access. The transaction did not have a detrimental effect on competition. There was an absence of actual or potential competition for customers between cable franchisees in pay-TV because of the lack of geographic overlap between cable TV networks. There was no material competitive overlap between NTL and the acquired businesses of CWC in telecommunication markets or in interactive service markets. The parties' combined market shares in any telecommunication market were low. There was no actual competition between the parties in digital interactive services as there was no geographic overlap between the parties' cable networks. In any event, this market was one where rapid growth was likely to take place and existing market shares were of little significance.

6.4. Competition would be intense. There were very strong competitors in the relevant markets, in particular BSkyB and ONdigital in national retail pay-TV; BT in retail telecommunication; and Open in interactive services. New entrants and (from 2001) BT would be able to compete in interactive services and retail pay-TV through BT's existing network (using ADSL or xDSL technology). Furthermore, competition was likely to be extended significantly after 2002 as a result of the launch of UMTS, the third generation of mobile telephony technology which was capable of carrying picture and data services.

6.5. The transaction would:

- (a) assist NTL to continue to develop its cable business and result in more cost-effective and improved telephony and TV services for a larger customer base, putting pressure on traditional providers. The introduction of lower-priced cable packages to a wider customer base was likely to produce a competitive response from BSkyB and ONdigital;
- (b) result in more sustained investment in new technology and more rapid roll-out of digital-based services, leading to considerable benefits for the consumer. As a result NTL would become a more credible competitor to BT, BSkyB and Open; and
- (c) result in efficiencies of scale and scope as well as efficiency improvements across the merged business. Competition with BSkyB, ONdigital and BT and, in due course, others would ensure that these benefits were passed on to consumers in the form of lower costs or improved services at the same cost. By operating on a national scale, in contrast to the previous local and fragmented scale of the cable industry, there would be further benefits from national branding, with particular appeal to national advertisers.

6.6. The merger would provide CWC's customers with the greater degree of choice and flexibility available through NTL's services. NTL was recognized to be a market leader in the packaging of pay-TV with telephony and Internet access. The success of this approach was demonstrated by NTL's penetration rate—the number of customers whose home was capable of taking cable service who chose to do so—compared with the industry average. NTL was also recognized to be an industry leader in reducing customer churn. NTL believed this was a result of its commitment to service quality. Following previous acquisitions, the NTL approach had been successfully applied in these acquired businesses. NTL saw no reason why the same approach could not be applied with equal success to CWC's customers.

6.7. The cable industry was facing considerable competitive pressure and consolidation was necessary to keep up with the development of the market and to ensure that it continued to be able to attract continued viable investment, particularly in the light of the amount of investment required to introduce digital pay-TV and interactive services and to compete with programming deals that BSkyB was able to assemble. The transaction would contribute to NTL's ability to offer new services, especially high-speed

Internet, at cost-effective retail prices. This would accelerate penetration levels and increase the number of UK consumers able to access the Internet and interactive services. For these reasons NTL submitted that the transaction would have significant public interest benefits.

The relevant markets

6.8. NTL submitted that the parties did not in practice compete in the delivery of pay-TV; telecommunications; interactive services; and Internet access.

6.9. NTL contended that the relevant product market could be defined as the provision of retail pay-TV services and extended to three delivery platforms—namely DTH satellite; cable network; and DTT. The market was not wider than pay-TV; this had been consistently recognized by the European Commission, which had distinguished retail pay-TV from free-to-air commercial TV and public service broadcasting TV.¹ The same product market definition for retail pay-TV had been acknowledged by the ITC and OFTEL.² In practice, satellite, DTT and cable were substitutable. They competed aggressively for customers, responding to each other with respect to the pricing and distribution of set-top boxes. BSkyB's and ONdigital's set-top boxes had been initially sold for an up-front fee at a similar price level, but BSkyB recently changed its strategy and decided to offer the set-top box and satellite dish free upon subscription (and a one-off installation fee of £35 to £40), a practice which ONdigital had also followed with respect to its set-top box. This strategy was partly a response to the cable companies whose subscribers did not pay a lump sum up front for a set-top box as the cost of the box was included in the monthly subscription fee (a one-off installation fee of up to £50 might be charged by NTL and CWC).

6.10. The fact that consumers were no longer required to pay £200 or more for a digital set-top box had significantly reduced switching costs between providers and reinforced the point that the consumer was indifferent to the technology by which the product was delivered. This conclusion had also been reached by the European Commission,³ the ITC and OFTEL.⁴

6.11. The market for retail pay-TV included both analogue and digital pay-TV. It was anticipated that digital pay-TV would replace analogue pay-TV in its entirety over the next few years. Digital TV had been launched by BSkyB, ONdigital, CWC and Telewest. NTL was in the process of developing its offering with the intention of launching its digital pay-TV service shortly. The European Commission, the ITC and OFTEL had all taken the view that analogue and digital pay-TV belonged to the same product market.⁵

6.12. As to the geographic market, there was a consensus that the market for pay-TV was national rather than international in scope. Linguistic differences between different countries and national laws relating to spectrum allocation and the language of programming effectively prevented broadcasters from transmitting across borders. Cultural differences also served as an unofficial barrier to trade in pay-TV services. The film industry and the content providers restricted contractually the freedom of pay-TV service providers to broadcast programming in other countries. There were also certain restrictions imposed by national law.

6.13. There had been no definitive finding by a competition authority on whether the market could be subdivided further to regional level within the UK, but the ITC and OFTEL in their consultative paper of April 1999 on the bundling of TV and telephony stated that BSkyB set prices nationally and therefore exerted uniform competitive pressure on cable franchisees across all localities. In addition, the ITC and OFTEL had said, BSkyB's wholesale price rate for Sky premium channels influenced the prices of ONdigital and all cable retailers of pay-TV, regardless of their location. NTL believed that there were a number of additional factors which indicated that the market was national. First, the licensing of pay-TV operators was carried out on a national basis; second, pay-TV operators themselves priced nationally; third, programming was purchased on a national basis.

¹European Commission in *Bertelsmann/Kirch/Premiere* decision, case no IV/M 993, OJ (1999) L 53/1, paragraph 18.

²'The bundling of television and telephony', ITC and OFTEL, Consultative paper, 20 April 1999, paragraph 13.

³European Commission in *BiB* decision, Case no IV/36.539, OJ (1999), L312.1 at paragraph 26.

⁴'The bundling of television and telephony', paragraph 17.

⁵European Commission in *BiB* decision, paragraph 25, and the ITC/OFTTEL in 'The bundling of television and telephony', paragraph 14.

6.14. At the same time NTL submitted that, notwithstanding the fact that the geographic market for pay-TV in general was national, it was necessary to take into account that cable franchisees only operated on a local or regional basis and did not compete against one another for customers. Furthermore, they were unlikely to compete even after the removal of the exclusive franchise system, as overbuild was not considered an economically viable option.

6.15. With regard to the telecommunication market, NTL submitted that the relevant market was fixed line retail telecommunication services. NTL considered that telecommunication services provided to residential and business customers via cable formed part of the same fixed telecommunication services market because the telecommunication services offered to residential and business customers were not only substitutable, but also generically identical in nature. This view was consistent with the positions taken by OFTEL and the European Commission. The European Commission had stated that the relevant product market could only be precisely defined within the framework of individual cases, although it had indicated that distinct services markets could exist for terrestrial network provision, voice communication, data communication and satellites.¹ More recently, the European Commission had stated that different telecommunication services would be considered substitutable if they showed a sufficient degree of interchangeability for the end-user, which would mean that effective competition could take place between the different providers of these services.²

6.16. NTL did not consider that fixed-mobile convergence had yet reached the stage at which it would be appropriate to extend the market definition to include mobile services. However, if this were the case, the merging parties' share of the relevant market would be reduced.

6.17. NTL considered that the relevant geographic market, in telephony, was the UK.

6.18. As to the market for interactive services, there were several possible definitions of the relevant product market. A narrow definition would encompass interactive services provided uniquely via TV, while a broad definition would encompass interactive services provided via any medium. The wholesale market would cover the provision of services to retailers, banks and others who wished to offer their products to consumers, while the retail market would cover the provision of a package of interactive services to consumers. The European Commission had stated in its decision on *BiB* that the market for interactive services via TV could be distinguished from PC-based on-line services as well as from pay-TV and high street retailing.

6.19. NTL believed that the relevant market ought to include all interactive services. However, even using a narrow market definition limited to digital interactive TV services, it was clear that the proposed transaction could not be expected to operate against the public interest. *BiB* had a significant head start in this market and competition would be fierce. Likewise, NTL left open the question of whether the market should be subdivided into a retail and a wholesale segment, since, in either case, there was no adverse effect on competition from the merger.

6.20. NTL considered that the relevant geographic market for interactive services was the UK for the same reasons that the market for pay-TV was the UK. This was consistent with the European Commission's notice in the *BiB* case, where the relevant geographic market for digital interactive TV services was defined as the UK.

6.21. NTL said that *BiB* (Open) launched its digital interactive TV service over satellite in autumn 1999. NTL had not yet launched a digital interactive TV service although it launched a non-digital interactive TV Internet service at the end of March 1999; [*Details omitted. See note on page iv.*] and was available over NTL's telephone line and set-top box (and not linked to NTL's cable infrastructure). CWC offered a digital interactive TV service in certain areas as part of its roll-out of digital TV services. BT would be likely to have the potential to become a major provider of digital interactive TV services as ADSL was installed on its network. ONdigital had announced that it would offer its own package of digital interactive TV services.

6.22. As a result of OFTEL's requiring BT to open up its local network to third parties, there was scope for market entry by other service providers into the interactive service market.

¹European Commission guidelines on the application of the EC competition rules in the telecommunications sector, OJ 1991 C223/2.

²European Commission notice on the application of the competition rules in the telecommunications sector, OJ 1998 C265/2.

6.23. NTL submitted that the transaction did not raise competition issues in relation to Internet access and services.

6.24. NTL was of the view that the transaction would not affect any other markets. It was aware that some programmers had raised with the OFT the wholesale purchasing of programming and the commissioning of content and production. Currently content provision was dominated by BSkyB. This transaction would improve the negotiating position of the merged entity in comparison with the present NTL in relation to BSkyB, but still left the merged entity reliant on BSkyB, as before, for a significant proportion of programming. Other programmers also had an ability to set terms including minimum revenue provisions (which had effectively replaced MCRs). The transaction would in no way adversely affect these programmers.

6.25. NTL explained in detail why the transaction would not confer on NTL significant buyer power in relation to programming as a result of the increased scale of the merged entity. The supply of channels to pay-TV providers could be divided between basic and premium content, but premium programming was the far more important content type. BSkyB dominated in the supply of premium content because of its having acquired exclusive rights to major sports events and films. The discount structure which BSkyB could offer on prices was regulated by a rate-card. However, this rate card contained certain volume discounts which NTL was currently unable to achieve; only BSkyB was able to benefit from the volume discounts and it did so in supplying programming to itself. BSkyB was currently attempting to increase the qualifying thresholds for volume discounts in order to ensure that the merged entity would not qualify. If BSkyB did not alter its terms, the merged entity would qualify for such discounts. Volume discounts were offered by other content providers to NTL and other pay-TV operators.

6.26. NTL believed that the price for programming in the UK was unduly high, partly due to the fact that it could not currently achieve the maximum available volume discounts. One of the main efficiencies which the transaction would bring would be to give the merged entity a larger customer base than NTL had currently and therefore give the merged entity more bargaining power vis-à-vis BSkyB and other producers of channels to obtain such discounts. NTL believed that the merged entity would be in a better position to negotiate such discounts from BSkyB despite BSkyB's attempts to amend its rate card.

6.27. In addition, NTL's current greater penetration compared with CWC should result in a net increase in the total number of UK households subscribing to pay-TV. Given that the cost base of most channels was relatively insensitive to the number of viewers, this should result in an overall increase in efficiency (ie reduced cost per subscriber). Tangible benefits for the consumer would result, for example, by way of improved content for a particular price package.

6.28. In addition to its powerful position as a content provider, and the fact that it was allowed to supply itself at more favourable rates than those made available to other pay-TV providers, BSkyB also appeared to obtain more favourable terms than the cable operators from third party content providers. Producers of content regarded BSkyB as the platform of choice for their channels and were willing to grant better terms. The transaction would give the merged entity increased bargaining power with content producers because it could guarantee a greater number of viewers.

6.29. Other channel producers had historically imposed MCRs on cable operators. These were requirements to provide the channel to a set percentage of the pay-TV customer base, as a price extracted for being able to carry the channel at all. Minimum carriage obligations had now been prohibited by the ITC. However, many content providers had negotiated minimum revenue guarantees in their programming agreements with NTL. From this it was clear that programmers remained in a strong position vis-à-vis cable operators, and a stronger position of the merged entity than the present NTL would therefore be no bad thing. Part of the programmers' strength arose from coverage by BSkyB and the need for cable operators to provide a very similar offering compared with BSkyB. In addition, with the introduction of digital TV, NTL would need to purchase increased amounts of content which would increase the bargaining position of the content providers.

6.30. The consumer's primary interest was to receive a variety of good channels at a reasonable cost. The consumer did not benefit from receiving channels that were of no interest to him or her. NTL was committed to responding to customer choice. Whereas BSkyB had traditionally adopted an approach of having a big basic package and adding on premium channels at relatively high prices, NTL had reduced entry barriers by giving customers a small basic package at a lower price and giving the consumer the ability to choose particular channel groups over and above the basic package. In order to be able to offer a

small basic package, NTL had had to reduce minimum revenue obligations. This in turn would reduce consumers' financial barriers to choosing cable TV and help penetration.

6.31. The consumer's interest would also be served through the extension to CWC's customers of NTL's excellent track record on customer service, and increased cable penetration. Ultimately, the enlarged NTL would also have more scope to commission and produce its own programming, thereby giving the consumer more variety and choice within packages.

6.32. NTL was dependent on being able to obtain good-quality and popular content in order to make its product attractive to customers. In the past content providers which offered more than one channel had required NTL to carry all of their channels, even if some of these channels were unpopular with viewers or had inadequate content. NTL had been forced to give channel space to these products in order to ensure supply of the other, more popular channels. The merger would result in increased coverage which would give NTL greater bargaining power with content providers. The result would be that fewer redundant channels would be forced upon the consumer by content providers who were using NTL's dependence on good-quality and popular content as a vehicle to ensure carriage for inadequate or unwanted content through effectively refusing to supply one channel unless others were also carried. This in turn would free up NTL's carriage capacity to those who offered consistently good programming.

6.33. NTL's primary interest was the ability to purchase a variety of good channels at a reasonable cost. Those channels made NTL's product offering attractive to consumers. The financial viability of content providers was a key element of NTL's continued success. NTL did, however, believe that increased scale would allow it to benefit from volume discounts and other cost reductions, which it could not currently achieve, as well as growing the overall size of the pay-TV market to the benefit of suppliers and customers alike.

6.34. As a result of its increased scale, NTL would also be in a position to commission and produce its own programming and as a result improve the content and choice for its customers. Currently, NTL was involved in three ventures relating to the provision of programming for pay-TV. It was a party to the Front Row joint venture with Telewest and might not have been able to set up this service on its own. In addition, NTL had an agreement with Eurosport to support the creation by Eurosport of British Eurosport, a basic tier sports channel available to all platforms. The third venture was a variety of local programming activities undertaken by NTL in various franchise areas, which were not, at least at present, regarded as a fully commercial activity. In addition to these existing ventures, NTL was in discussion with a number of potential joint venture partners about further possible programming ventures. NTL had focused its attention on those areas where it believed that there was currently either inadequate choice or inadequate quality in terms of third party offerings (for example, Front Row as a response to BSkyB's near monopoly position in premium film programming). NTL had recently announced content partnerships with Newcastle United and Aston Villa and had entered into a media joint venture with Channel 4 and the BBC relating to horse racing.

The effect of the proposed merger on the present competitive situation

6.35. NTL submitted that the transaction did not give rise to competition concerns. There was no significant increase in market concentration and, for the most part, no overlap between the parties. In each of the relevant markets there were sufficient players to ensure customer choice and to result in a passing on of the merger synergies to the customer.

6.36. In the pay-TV cable market, NTL and CWC did not compete against each other for customers. Their competitors were the other platform providers, namely BSkyB and ONdigital. Each had geographically distinct franchises which had until recently been operated as exclusive territories. Some of this exclusivity had been surrendered on a voluntary basis, and all exclusivity would come to an end on 1 January 2001. Where such exclusivity had been surrendered on a voluntary basis, competition for customers within a territory was still highly unlikely due to the high cost of overbuilding a cable network relative to the likely returns in a franchise area where a network already existed. Limited build-out might be possible but only at the fringes of franchise areas where there was no existing network. The merger would not reduce customer choice as pay-TV customers did not currently and would not, even in the absence of the merger, have a choice of cable TV provider. However, they could choose and would continue to be able to choose to receive pay-TV through other modes of delivery, ie satellite or digital terrestrial (and soon via DSL technology).

6.37. After the transaction, the merged entity would have a market share of approximately 27.1 per cent by number of subscribers in the pay-TV market nationally. Its market share by revenue was likely to be lower at around 20 per cent. This was significantly lower than that of the market leader, BSkyB, which had 50.4 per cent pay-TV market share by subscribers and an estimated 65 per cent by revenue. In addition, ONdigital was the main provider of digital terrestrial pay-TV, with 5.8 per cent market share by subscribers since its launch in November 1998.

6.38. After 1 January 2001 BT would be able to provide TV services via its local loop. BT was upgrading its network to support broadband interactive ADSL technology which would have the capacity to support pay-TV services; it was already free to provide VOD over its network using ADSL technology which would compete with existing premium and PPV content. BT had announced the launch of its wholesale ADSL product in spring 2000. NTL believed that this product could be adapted to carry pay-TV, and could certainly already offer competing PPV services. Such services were already available in London from Video Networks Limited. The next range of DSL technology would be able to offer a full range of pay-TV services. In future there would be at least four means of delivery for pay-TV, all of which would compete with each other: satellite, digital terrestrial, cable and BT local loop. Other technologies such as MVDS (wireless cable) might also be introduced. Competition in the pay-TV market both in terms of price and product offering would therefore continue to increase. For these reasons, the merger would not lead to a reduction in customer choice in pay-TV in the UK.

6.39. With regard to fixed line retail telecommunication, the business which was being transferred to NTL accounted for approximately 3.8 per cent market share by call revenues. NTL had market share of below 2.5 per cent and therefore the merged entity would have a market share of approximately 6.3 per cent. This compared with a market share for BT of 71.2 per cent.¹

6.40. On the basis of the number of exchange lines, the parties' market shares according to OFTEL² were 4.6 per cent for CWC and 3.9 per cent for NTL, giving rise to a combined market share of 8.5 per cent. This compared with a market share by exchange lines for BT of 85.4 per cent.

6.41. When segmenting the market further by reference to the destination of the call (local, national or international), the highest combined share that would exist in relation to local calls was 8.2 per cent. This compared with a market share for local calls for BT of 80.9 per cent.

6.42. If one looked only at residential customers and segmented the market by destination of the call (local, national or international), the highest combined share that would exist in relation to residential international calls was 11.6 per cent. This compared with a share for residential international calls for BT of 74 per cent.

6.43. On the basis of the figures in paragraphs 6.39 to 6.42, the transaction would not have any appreciable effect on competition in the market for fixed line telephony in the UK. Even on the narrowest segmentation of the market the highest combined share remained below 12 per cent.

6.44. In addition, the parties did not compete for telephone customers outside their own exclusive franchises, except to a very limited extent through CWC's indirect telephony service. The transaction would not therefore lead to a reduction in consumer choice.

6.45. As for interactive services, the provision of interactive services via TV was as yet in its infancy. Most interactive services were currently provided via a PC. NTL believed that it would be inappropriate to divide the market by mode of delivery and submitted that there was one market for interactive services.

6.46. Following the merger, the existing providers of interactive services via PC would also remain in the market as competitors. New technology was also expected to bring higher speed to interactive services via PC thereby making them more attractive to consumers.

6.47. Even if the market were confined to digital interactive TV, there would be no increase in market shares as a result of this transaction. CWC was in the process of launching its digital interactive services via TV. At present CWC's market share was insignificant. NTL had not yet launched any digital interactive TV products. In the future competition was likely to be intense, with Open, BT (so far as it

¹Based on latest published OFTEL figures of market share by call revenues, April 1998 to March 1999.

²Fourth quarter 1998/99.

was permitted to compete as a participant under the terms of the Open joint venture agreement), and ONdigital all competing for customers. Both Open and ONdigital had recently started giving away set-top boxes free of charge in order to increase the penetration of their service and to aid the penetration of digital interactive services.

6.48. In order to compete effectively in this new market, NTL would need to acquire critical mass and provide a real alternative to Open and the established providers via PC. Open had the advantage that its service could reach virtually the whole of the UK population and as a result would be the service of choice for retailers and advertisers requiring national coverage. Open also had a significant first mover advantage over other providers of TV-based services. In the absence of the merger, neither CWC nor NTL could offer a national service so as to compete with Open. The merged entity, on the other hand, would have networks passing approximately 33 per cent of UK households, covering most of the UK's major cities, and could potentially pass approximately 50 per cent if fully built.

6.49. NTL submitted that the transaction did not have any material detriment on competition in this new market due to the absence of actual market shares and the vigorous competition that already existed. The transaction would have pro-competitive effects in providing a credible competitor with something approaching national reach to compete with Open, ONdigital and the existing providers of PC-based services.

6.50. As for Internet services, the barriers to entry in Internet access and services were very low and recent years had seen considerable entry into the market. Due to the expanding nature of the market and the ever-increasing number of competitors, the transaction did not raise competition issues in this market.

6.51. The Internet services market could be divided into a number of segments. Customers required physical connections from which to originate calls (and this was the provision of a telephony service), and then required a portal offering access to the world wide web (and this was provided by an ISP). There were also a range of ancillary services offered by ISPs including e-commerce, e-mail and web-site hosting.

6.52. The merger would have no effect on competition in the market for physical connections to the Internet, as NTL and CWC currently did not compete with each other in this market because of the lack of geographic overlap of their networks (save to a small extent as regards CWC's indirect access customers). In addition, consumers could connect to an ISP via any telephony provider of their choice and this market was therefore effectively part of the general retail telecommunication market. The CWC ISP business, and its associated services, would remain with C&W. However, as part of the transaction, the largely residential 'dial-up' accounts of the existing customer base for the ConsumerCo business would be transferred from CWC to NTL. NTL's and CWC's ISPs did compete with each other, but the effect on competition in the market was minimal given the number of ISPs available to users of the Internet, coupled with the expanding nature of the market's customer base. The market for Internet dial-up accounts was, at its widest, national in nature.

6.53. The Internet access market was enjoying a period of dynamic growth. Switching ISPs was not difficult and latest estimates of people with Internet access suggested between 10 and 15 million in the UK. Freeserve and many others had entered the Internet access market. Internet access was currently buoyed by a wave of investor optimism, but was also seeing extensive entry from new parties eager to establish an e-commerce presence. In these circumstances, the transfer of ISP accounts from CWC to NTL would have little impact on the market. Following the merger, customers who preferred to have Internet access through C&W rather than through the enlarged NTL would either switch from the merged entity to C&W or hold both an NTL and a C&W account. There were, in any event, so many ISPs entering the market due to the extremely low barriers to entry, and so much competition, not least on price, that it was highly unlikely that NTL would gain any competitive advantage through the acquisition of these customers. On the contrary, NTL believed it would have to work extremely hard to retain those customers' Internet business given the highly competitive market in which they operated.

6.54. We asked NTL at a hearing whether NTL and CWC competed against each other indirectly, for example in innovative developments. NTL said that the scale of the merged entity would increase the possibilities for innovation, bearing in mind the technological developments required. For example, major grocery chains would only be interested in negotiations on interactive services with a pay-TV company of some substance. NTL had had a history of innovation even as it had become larger. It would now have the advantage of access to more resources. Concerning interactive services, CWC had developed a closed

model with a 'walled garden' Internet site, whereas NTL in developing its model, which was not yet on the market, preferred to provide open access to the Internet. After the merger, the offerings of the two companies could be combined in such a way that CWC's previous customers would receive open access to the Internet in addition to CWC's current services.

6.55. We asked NTL whether it was likely that it would seek to build cable networks in franchise areas which had previously been allocated to other cable companies. NTL said that it doubted if this was a commercial reality. However, it might explore ADSL outside its service territory. The unbundling of the BT local loop allowed ADSL provision under the right economic terms in any area. NTL was carrying out its own ADSL trials and might use ADSL to deliver a full TV service to the home in the future. In this connection, NTL noted that BT was choosing to roll out ADSL only in certain areas where it had appropriate copper fibre near its customers, but these roll-out plans did in fact target the cable franchise areas.

6.56. We asked NTL if channel providers would suffer as a result of the merger reducing the number of cable operators from three to two. NTL replied that the first and foremost task of any programming supplier was to secure carriage on satellite, because BSkyB had the dominant share of the viewership. Prices offered to BSkyB for programming were lower than prices offered to the cable operators, and the terms of trade were different. BSkyB had extracted ownership of certain channels in exchange for carriage. Following the merger, it would still be the case that what mattered most to programmers would be the negotiations with BSkyB. In a recent case, when NTL had negotiated with a large programming supplier, [*Details omitted. See note on page iv.*

]. However, as the programme had been necessary, NTL had paid what was demanded, although it believed that it was paying significantly more than BSkyB. The balance of power sat significantly with the programme suppliers, and that situation would not change as a result of the merger. Generally speaking, the market power of a programmer depended on how many people watched the programme and the interest level. In the analogue environment, tough choices had to be made between channels. However, in the digital environment capacity would be much improved and NTL had never yet refused a channel access in the digital context. It should also be borne in mind that channel providers, including Sky, tended to make unreasonable bundling demands in negotiations.

6.57. We put to NTL the possibility that France Telecom's involvement in the merger might distort competition because it was state-owned and subsidized. NTL said that the France Telecom investment in the merged entity would be permitted, subject to certain divestments. France Telecom would be a shareholder in the merged entity but was not in any way paying a special price and would have no opportunity to subsidize the merged company's operations.

The possibility of the merger creating or enhancing the market power of the merged entity

6.58. We put to NTL the contention that cable companies did have market power and indeed because of the closed nature of their networks were able to dictate what content those networks carried and what prices content providers should pay. NTL said that it did not believe other platforms were genuinely open to all channel providers. However, the cable industry's ability to package TV and telephone services in flexible ways had been and still was crucial to the industry's survival. In order to eventually become profitable, it was essential for a cable operator to be able to mix and match products and offer discounts and promotions. In any event, the notion of an 'open' system was complex, and 'open' had many definitions. NTL had experimented with different kinds of relationships with channel providers and with different ways of selling channels. What looked like a 'closed' system was really a product of the fact that there was a limited number of analogue channels, but this could be expected to change as analogue transmission was replaced by digital transmission. NTL had to provide what its customers wanted, and it could not give in to demands from channel providers that their entire collection of channels be broadcast.

6.59. NTL went on to say that the cable networks were not an essential facility. They were only one of three (soon to be four) competing platforms which could deliver the same items to the same customers and programmers had the opportunity to sign up with any one or more of the platforms. However, even if the cable networks were to be regarded as an essential facility, it had been recognized in both US and European competition law that companies could have legitimate business justifications for denying access to competitors. NTL had doubled its penetration rate since it started offering cable services and had significantly reduced its churn rate; if it were forced to offer open access to channel providers, its

penetration might well drop because customers would resent not being offered channels that they wanted. Customers had to be treated in a way which allowed the cable operator to pay for the facility it had created and NTL had come in to the market in the first place on that understanding. What was at risk here was NTL's right to earn a return on its \$8 billion investment.

6.60. NTL submitted that the notion that its network was open to some and closed to others was really a description of the different commercial relationships it might form with different companies. It was not open to NTL to refuse to carry the content of a popular channel provider, because that channel would also be likely to be available via BSkyB or ONdigital and so reach customers through the satellite or DTT platform. There was a very close replication of the channels which were available on different platforms and NTL had to match closely what was available on its competitors' channels in order to retain customers.

6.61. If content providers wished to transmit their channel via satellite without those channels forming part of BSkyB's offering, they needed to rent transponder space and make conditional access arrangements. This was not a realistic option for small or niche channels acting on their own. Furthermore, although channel providers could buy access to a Sky set-top box, that did not give them the right to know in which homes those boxes were currently located. In reality channel providers had to build their own customer base. This was why only a few companies had taken advantage of the so-called open nature of the satellite platform, for example the racing and Asian channels.

6.62. We put to NTL the contention that the merger would enhance the cable industry's ability to abuse the unfair advantage which resulted from its unique ability to bundle TV with telephone services. NTL said that the proposed merger did not as such affect the bundling of TV and telephone services; cable companies had always done this. Cable's bundled offer did not result in market power because the customer had the opportunity to buy BT's telephone service and effectively to self-bundle. NTL also pointed out that BSkyB also offers a bundled service. As a matter of marketing, NTL had chosen to offer pay-TV and telephony at a single price, but it was not seeking dominance in one service to subsidize the other unfairly.

6.63. We told NTL that our attention had been drawn to NTL's shareholding in SDN, and that BSkyB had been required by the OFT and the EC Competition Directorate in 1997 to divest its 33 per cent shareholding in ONdigital when digital multiplex capacity was awarded to ONdigital, on the grounds of BSkyB's strong position in satellite distribution. It had been put to us that NTL ought to be required to divest itself of its holding in SDN if the merger were to proceed. NTL said that its shareholding in SDN was not a consequence of the merger. It would not be in a dominant position in the pay-TV market, which had been the basis for BSkyB being required to divest its interest in ONdigital. The ITC had encouraged its stake in SDN. SDN was not currently involved in the provision of pay-TV services.

6.64. We asked NTL about the market power which the merged entity would deploy against the power of pay-TV channel or programme providers including providers of interactive services. NTL said that after the merger it would account for 25 per cent of the pay-TV market, but the dominant source of the content on which that market relied would still come from BSkyB as content provider. Concerns about limited access to cable for content providers were essentially short-term while analogue programming still continued. It was NTL's intention when it moved to digital broadcasting to have an open environment and to take all comers. Although it was possible that, even in a digital environment, NTL would refuse to take channels if difficult conditions were attached or customers were not interested, NTL also attached great importance to flexible contract arrangements with channel providers; it believed that both MCRs and channel bundling were fundamentally against their customers' interests. The ITC had been a helpful regulator in getting rid of MCRs and channel bundling. The OFT had just announced that it would be reviewing the Sky rate card, and that might include examination of whether Sky should be able to bundle together at the wholesale level multiple numbers of channels.

6.65. We asked about the timescale for the move to the digital environment. NTL said that this would depend on how successful it was in converting analogue customers to digital customers and how it packaged the digital product. Some customers might resist switching from the analogue package. Sky had recently implied that it might be able to abandon analogue transmission by the end of 2000.

6.66. We asked about NTL's policy of small entry packages. NTL said that its entry level package was priced at £9.25 but it had a strong incentive to encourage subscribers to take more channels and it had to work with programme providers on the policy of where their channels were to appear. It was difficult

in some cases to avoid a situation where channels were subsidized by others in the package. The ending of MCRs had meant that channels had had to 'stand on their own two feet'. NTL had been eager to negotiate reasonable commercial terms with channel providers and had been ready to offer minimum revenue guarantees, but not all channel providers had taken up NTL's offers.

6.67. We asked NTL about the terms for transmission of free-to-air, public service programmes. NTL said that it did not charge public service broadcasters for transmission of their programmes, but it could not guarantee that this policy would be reflected over time in prices to its viewers. Pricing depended on packaging decisions which were made once or twice a year.

6.68. NTL commented that, despite its name, the Open interactive service was not in truth 'open' because it did not give consumers an unfettered open access to the Internet. Asked about the possibility of Open being carried on the cable network, NTL said that it was highly unlikely that Open, whose shareholders were BT and BSkyB, would end up being carried on the cable networks. Equally it was most unlikely that the merged entity would seek carriage of its interactive offering on the satellite platform.

6.69. We asked NTL whether, where terms to channel providers currently differed between NTL and CWC, the merged company would be likely to impose the inferior of the two terms on channel providers. NTL said that that would depend largely on the terms of the negotiations but added that it was not always successful in getting channel providers to agree to its terms.

The interests of consumers

6.70. With regard to consumer interests, we asked NTL whether, where prices to customers differed between NTL and CWC, the merged entity might impose the higher of the two prices on its customers. NTL said that the competitive constraints on the pricing of the merged entity, namely BT, BSkyB and ONdigital, would be the same as the constraints on NTL and CWC before the merger. One of the merged entity's aspirations would be to increase penetration of UK households, and offering value for money would be one of the key mechanisms. The approach would be to provide more value and appropriate flexibility in the packages offered to consumers and not just the lowest possible prices. One company taken over by NTL last year had had cheaper telephone access fees, but NTL had thought it desirable to convert that company's fees to its own successful formula which increased penetration.

6.71. We put it to NTL that, in so far as the merger allowed it to compete more effectively for the acquisition of rights, there could be a risk of fragmentation of sport and movie rights between different platforms, reducing the choice available to most viewers. NTL said that its role in rights acquisition or programme supply had been broadly that of a catalyst; it had sought to make acquisitions in areas where there was no supply of programmes available, or supply was weak. NTL and Telewest had jointly started Front Row for PPV. That was a break-even rather than a profit-making enterprise.

6.72. NTL went on to say that it had invested in British Eurosport in order to provide more British programming and look for sports rights that were still available. In this context it should be noted that Sky had moved Sky Sports from a basic channel to a premium channel, thus making it more difficult for cable operators to get a return on their investment in that programme. Football was currently foreclosed to NTL and large amounts of cricket were currently foreclosed to NTL, but it had entered into Heads of Agreement with the BBC to take a sub-licence of the rights relating to the European Rugby Championships and Shield. NTL had looked closely at Premier League rights and would expect to be a bidder for those rights when they became available. Football clubs themselves were likely to want to reach the widest possible viewership and might realize that perpetuation of an exclusive contract was not desirable. More diversity of the showing of the Premier League would be an excellent outcome. Football was shown in the UK for fewer hours than in France or Italy and there was definitely a demand for more of it. Generally, NTL would in the future intend to invest to fill gaps where the current market was not delivering a product although it should also be said that by and large NTL was not a content company.

6.73. We asked NTL if there was a further risk that cable consolidation could lead to a loss of diversity of content as smaller channels were squeezed out. NTL said that the advent of digital transmission would mean that there was room for all channels. Developments on the Internet showed that there was room for programmes rather than channels to reach viewers directly in the future.

The question of whether the merger could increase competition

6.74. Turning to the question of whether the merger could increase competition between pay-TV platforms, NTL submitted that as a result of its increased coverage to 33 per cent of UK households, the merged entity would become a credible competitor to BSkyB, ONdigital and BT, who so far had been the only companies to offer national products under a national brand. As a result, inter-platform competition would increase as each platform attempted to become the market leader. In addition, the extent of its wider coverage would enable the enlarged NTL better to promote and leverage its brand; this would increase the penetration it would achieve across its network.

6.75. The transaction would also increase the rate of technological advancement and speed up the roll-out of digital services. This was primarily due to the increased return that the enlarged NTL would achieve on its research and development of new interactive services. Increased funding would become justifiable on such research and development activities given the larger potential customer base to which new ideas could be applied.

6.76. NTL after the merger would be able as a result of interconnect efficiencies to offer lower-cost telephone calls and flexible calling rates to its customers. As a result of other price reductions and efficiencies, the overall cost of operating the network on a per customer basis was likely to fall in the longer term. Competition with BT, BSkyB and ONdigital would ensure that such efficiencies were passed on to the customer.

6.77. NTL believed that programming costs in the UK were unduly high. To drive down the cost of programming, NTL needed increased coverage of the UK population in order to have greater bargaining power and to benefit from volume reductions which ought to be available in programming contracts offered by BSkyB. NTL believed that BSkyB paid significantly lower prices than cable for its programming.

6.78. The merged entity would be able to resist more effectively minimum revenue obligations which the content providers sought to impose (see paragraph 6.29). The transaction might serve to redress the imbalance in purchasing power in the wholesale market for programming between BSkyB and other operators. The enlarged NTL would have a status in the market for programme content that would enable it to obtain content which it currently could not obtain at all or on acceptable terms. The merged entity would qualify for volume discounts when purchasing Sky's programmes unless the rate-card review announced in January 2000 changed the conditions for eligibility.

6.79. When NTL had created Front Row, the alternative would have been to take Sky Box Office. That would have resulted in a higher level of retail price per movie to customers. The creation of Front Row had 'broken the mould' in that a credible alternative to Sky had been put on offer.

Benefits and synergies of the merger

6.80. NTL told us that it was currently formulating its plan to acquire the relevant businesses of CWC and integrate them into NTL's operations. A number of key benefits would come from the transaction, some of which would only be fully quantifiable once that plan was finished and put into place. At this stage, NTL was confident that it would achieve both synergies and benefits. Synergies would arise from opportunities to make cost savings and revenue enhancements from consolidating the acquired business into NTL. Benefits would arise from the new scale that the enlarged NTL group would attain. This scale would enable it to increase the quality and extent of its service offerings to consumers. Benefits would also arise from the application of 'best practice' processes and producers.

6.81. NTL was confident that these synergies would be passed on to the consumer. They were likely to be effected through price reductions, or improved service or offerings without a proportional increase in price, and service improvements for the customer. The transaction would result in greater choice for the consumer due to NTL's commitment to offer a greater choice of innovative pricing packages.

6.82. The synergies that NTL had identified to date were: lower interconnect costs; headcount efficiencies; property rationalization; purchasing; sales and marketing; and programming. The benefits that had been identified to date were: improved services from the roll-out of digital technology; increased penetration; indirect customers and reduced churn.

6.83. After the transaction, the enlarged NTL would be able to achieve certain interconnect cost savings. It would be able to carry more calls on its own network without having to resort to the BT network. Being able to use the NTL network to carry a larger number of calls would permit NTL to offer more innovative pricing packages to customers for such calls. Even where the call could not be carried on the NTL network all the way to its destination, it would remain on that network for longer thereby reducing the cost of the interconnection. More efficient routing of calls would become possible. Increased volume would also generate sufficient scale to justify more direct connections to other licensed operators.

6.84. With regard to headcount efficiencies, NTL had identified potential efficiencies in the areas of customer call centre operatives, field operatives, risk management and other minor management roles. However, job reductions were expected to be more than offset by the need for new employees in a number of areas, especially the launch of digital services and the increase in the merged entity's customer base. NTL had a consistent track record of generating employment and did not expect a net reduction in total headcount in the first year after the transaction. NTL expected in the short and medium term to redeploy some of its skilled UK personnel to other European-based investments, notably Cablelink in Ireland. NTL had nurtured some significant skilled personnel during the period of the development of its UK network which could now be used to bring its other investments up to its UK standards.

6.85. NTL expected to achieve some rationalization of property costs. Approximately six properties were expected to be shared between CWC's retained and transferred businesses. All other CWC properties were to be allocated to either the merged entity or to C&W. Some cost savings were expected from these arrangements although their extent was not yet known.

6.86. The enlarged NTL would gain three principal purchasing-related synergies: supplier rationalization; cost savings and working capital improvements; savings from procurement processing and holdings of stock items; and purchasing power, for example in relation to hardware purchases such as set-top boxes and digital-related assets required for digital roll-out and in relation to programme content purchasing deals.

6.87. In the area of sales and marketing, NTL had recently been relaunching its brand as a national brand in order to compete with the national product offerings of BSkyB and ONdigital. In order to do so, NTL had to achieve increased coverage which this transaction would bring. Marketing costs would be spread over a larger potential customer base as NTL expected to be able to achieve increased penetration within CWC's franchises. The extent of the financial impact was not yet known.

6.88. On programming, the result of the transaction would be a greater choice of channels which the consumer actually valued and demands would be provided at a lower cost.

6.89. Improved services would result from the roll-out of digital technology. Such roll-out would require significant investment. The transaction would bring the impact of NTL's financial resources to CWC customers and permit a faster and more cost-efficient roll-out of digital cable. The cost per customer would be reduced and ultimately this would result in lower prices to customers.

6.90. NTL believed that after the merger there could be a substantial impact on its profitability based on certain key assumptions regarding pricing, churn, homes passed and the speed at which the CWC franchise areas' penetration rates could be raised to those achieved by NTL. NTL's expertise and active management would be critical to determining the extent of the benefit delivered to customers.

6.91. NTL believed that the enlarged group would be better able to convert certain indirect customers to become direct customers. Based on a series of key assumptions regarding the size of the market, conversion rates and average revenue per user, NTL currently estimated the annual benefit of such a conversion of customers to be some £25 to £45 million.

6.92. NTL hoped to reduce churn in the merged entity. It believed it could do this by applying the NTL approach to customer care to CWC's present customers; by marketing its brand across a wider geo-

graphical area; and by applying its research and development of new service offerings. CWC's churn rate was currently in excess of 30 per cent.

6.93. We asked NTL about customer service levels. NTL said that the churn rates of companies it had acquired last year had all reduced. NTL would aim to standardize the basic offering of the merged entity with the aim of giving more value for money and getting the penetration rate up to 40 per cent. NTL had a very simple value proposition, which was to offer TV, Internet and telephony for the same price as a telephone service from BT. On the service offered to consumers who reported faults, NTL scored highly in OFTEL and other reports.

The effect of the associated interconnection agreements

6.94. NTL said that, as part of the transaction, NTL would enter into an agreement with DataCo relating to interconnection with DataCo's telecommunication system. NTL said that for DataCo to retain the business, the rates offered by DataCo had to be at least as good as those offered by BT or, where applicable, other telecommunication operators. However, although the interconnection agreement had been negotiated as part of the transaction, NTL could have negotiated a similar agreement with DataCo independently of the transaction.

6.95. The interconnection agreement was very important to NTL. It had to be seen in the context of CWC's being split into two parts. Some such supply arrangement was a necessary part of planning for the merged entity because NTL could not put any alternative arrangement of its own in place in the time frame. Within the period of the agreement, however, it intended to provide such facilities itself. A transition plan was necessary as a basis for moving to self-provision and this was essentially what the interconnection agreement provided. NTL also asked us to note that the agreement had been presented to it as a condition of the transaction by CWC. NTL said that amount of traffic covered by the interconnection agreement was only a small part of the overall market and related to a certain extent to traffic previously being carried within CWC and not available to the market: hence there was little effect on other operators. Essentially both NTL and DataCo would continue to compete with BT and by NTL creating a larger integrated telecommunication company, with an extensive local access network, competition would be much increased.

6.96. We asked if the interconnection agreement was in fact NTL's price for buying the appropriate part of CWC. NTL said that that was not the case. A similar agreement had been planned in the case of the proposed merger with Telewest which had not come to fruition.

6.97. We told NTL that OFTEL had concerns about its original agreement with DataCo on [*Details omitted. See note on page iv.*]. (This agreement was subsequently amended; see paragraph 6.119.) NTL said that this was intended only to provide a benchmark, [*Details omitted. See note on page iv.*].

6.98. We asked NTL about its preferred supplier agreement with DataCo, whereby DataCo would be NTL's preferred supplier where NTL [*Details omitted. See note on page iv.*]. NTL said that this agreement concerned a preferred supplier, not an exclusive supplier. It was benchmarked [*Details omitted. See note on page iv.*]. NTL added that it had a number of other preferred supplier agreements, essentially because these kept down costs.

6.99. We put to NTL the argument that, although C&W and NTL generally had a relatively limited share of the main business or wholesale telecommunication markets, they tended to have the most modern capacity, and spare capacity, and competition between them might therefore be significant in determining prices. NTL said that the proposed interconnection agreement would have no effect whatsoever on competition between NTL and C&W. NTL expected that competition with C&W would continue to be fierce. Asked if there were any particular points where NTL's position might be stronger than that of competitors such as BT, NTL said that there were some point-to-point routes where it had more capacity than other telecommunication companies, but there were others where it had no capacity and so needed to use other carriers. NTL added that by creating a larger integrated telecommunication company, NTL was in effect creating a much more competitive environment.

6.100. We asked NTL about the reasons for the interconnection agreements with France Telecom that were now being proposed and their likely effects. NTL said that when France Telecom had agreed to invest in the merged entity it had offered to purchase from DataCo the preferred supplier status which NTL had originally agreed to give to DataCo (that is, the preferred supplier for international traffic). As far as NTL was concerned, its position had not been altered by this change. The agreement with France Telecom was not exclusive.

6.101. NTL said that the OFT was considering the interconnection agreement under the Restrictive Trade Practices Act 1976 and might do so under the Competition Act 1998, and that OFTEL might also consider it.

C&W interest in the merged entity

6.102. We asked NTL about the extent of C&W interest in the merged entity. NTL said that the size of C&W's shareholding in NTL would depend on how investors made their elections under the 'mix-and-match' arrangement (see paragraph 3.58) but it estimated that the level of C&W's shareholding would be between 8.4 and 16.6 per cent on an outstanding basis (ie in terms of issued voting stock). If C&W were to end up with a shareholding of over 7.5 per cent in the merged entity on a fully diluted basis, it would be entitled to one director, but that director would be excluded from decisions concerning matters in which C&W had an interest. Generally, NTL took care to have an arm's length relationship with C&W.

Hypothetical remedies

6.103. We asked NTL for its comments on possible remedies on the hypothetical basis that the merger had been found to be against the public interest. Concerning the possible remedy that there should be open access to the digital cable operations of the merged entity, in order to limit the market power resulting from the merger, NTL said that it did not believe the merger had any bearing on this problem, if it was a problem, in any way. In the current environment and in the future environment, it was to the benefit of consumers that NTL should have control over what programmes were broadcast. Asked about the possibility of a limited form of open access, NTL said that it would be against the possibility of open access on a limited basis. Its negotiations with channel providers were very complex and it was fearful of having an over-simplistic remedy imposed on it. If such a remedy were to be considered in detail by the OFT, definitions would be needed on the extent of access and the number of consumers who might be entitled to certain channels or programmes under certain conditions. The economics of the operation might even change to the extent that programmers might need to be charged to have the right to get on to the cable system. Broadly, NTL considered that the nature of a merger inquiry did not lend itself to solving any difficulties which might be perceived by other parties in other contexts about the issue of access to cable operations. Resolving that issue would take time and probably would be fatal to the merger being implemented. Furthermore, OFTEL and the ITC were due to consider this matter in a general context and would make recommendations.

6.104. NTL reiterated its view that the problems were not so much about access as about the price paid by channel providers to get on to the cable system. Negotiating conditions for channel providers would inevitably change in the digital environment. It should always be remembered that channel providers had the option of putting their services on to the satellite or DTT platforms.

6.105. We put to NTL the argument that smaller operators should have access to the cable platform in the interests of innovation and diversity. NTL said that there was no monopoly of innovation in this area in the hands of CWC or NTL or both together. This was a fast-moving dynamic sector and it was incredible that the merger would have any impact on innovation in such a way as to slow it down. NTL had been particularly successful with attracting small companies which were starting up on to its Internet services, and was ready to assist them in getting access to the TV platform.

6.106. NTL said that there were very few sectors where suppliers had guaranteed access to the market. It was very difficult to see why interactive service providers should have preferential access to the market above and beyond that which participants in other sectors had.

6.107. We asked NTL to comment on the suggestion that there should be no bundling of telephony with pay-TV charges. NTL said that the sectoral regulators (OFTEL and the ITC) were considering this matter and that the situation in general was not affected by the merger.

6.108. We asked NTL to comment on the suggestion that there should be no charge for the carriage of free-to-air channels. NTL said that it did not currently charge the free-to-air channels for carriage, although these channels did pay a charge on other platforms. A stipulation applying to all platforms would be fair, but an imposition only on the merged entity would not be fair, since the issue was not related to the merger. If the point was that customers should not be charged for the free-to-air channels, then NTL's view again was that it would not object to any restriction which was imposed on all platforms. The current position was that pay-TV platforms were permitted to charge public broadcasters the cost of access to their viewers, but were not permitted to charge further. NTL had chosen not to make any charge at all.

6.109. We asked NTL to comment on the possibility that there might be a divestment of interests in Front Row and SDN. NTL said that Sky was permitted to own as much content as it wished and also operate as a platform provider; it would not be right in those circumstances to force the merged entity to divest itself of some of its content. As for SDN, NTL believed that its involvement, and in the future the involvement of the merged entity, would be helpful (see paragraph 6.63).

6.110. We asked NTL to comment on the suggestion that there should be no increased charges to NTL or C&W customers following the merger. NTL said that it was opposed to formal price control being a condition of the merger.

6.111. We asked what would be the effects if the merger were disallowed. NTL said that originally, when a merger was contemplated between Telewest and CWC, it had had business plans that assumed its survival as a stand-alone entity. However, the merger between NTL and the cable interests of CWC had been announced and was widely assumed to be meeting no hurdles. The reference to the Commission had been unexpected. It followed that if the merger were prohibited, the immediate effect would be dramatic and catastrophic. The Commission would in effect be preventing any further consolidation of the cable industry. C&W would be left holding an unwanted asset with a smaller universe of buyers. Outside buyers would be discouraged and share prices would be affected. Previously, consolidation of the industry had been encouraged by regulators; a finding which would be seen as hostile to consolidation might well upset the attitude of the capital markets as well. Sky would probably raise prices to its customers and also raise its wholesale prices; BT's prices for residential customers might also rise.

6.112. NTL said that many interesting issues had been raised which would be much debated in the industry for a long time to come. However, it was doubtful whether any of them really related to the merger—for example, the technology advances would be the same whether the merger went ahead or not. Contentious issues were being considered by the sectoral regulators. It was arguable that the Commission's position in the regulated sector was slightly different from its position in the general sector because the regulators had duties and powers and had to be expected to exercise them. It was undesirable that companies be placed in a position of being subject to several regulators on issues such as open access and bundling.

6.113. There was a huge rate of change in the media industry. The merger of AOL and Time Warner showed that innovation was not threatened by consolidation. It was in reality highly unlikely that the merger would have adverse effects on cable's main competitors. BT had expended much resource on developing DSL networks, and it was just not credible that these networks would not offer competition to the cable operators. BSkyB had argued in the past that it ought not to be subject to regulation and it had no basis now for its arguments that the cable companies were threatening its position. There was no justification for arguing that cable networks were essential facilities because there were other routes to market for those who provided services over these networks. It should be noted that the essential facilities doctrine was used very sparingly by other regulatory bodies.

6.114. Other regulators had been in favour of the merger and OFTEL's concerns appeared relatively minor. NTL took pride in what it had achieved from small beginnings in 1993. In seven years it had transformed what had been a moribund industry and one that had been seen as risky into an industry that was thriving by any measure. NTL had prospered by being focused on its customers and believed that it could bring even better services to customers as a result of the merger.

NTL's further submissions

6.115. Subsequent to the hearing, NTL made a further submission in which it pointed out the overwhelming market power enjoyed by BSkyB both in the wholesale and retail markets. As to the wholesale market, it said that BSkyB had a very significant first mover advantage in pay-TV and as a result had achieved 2.25 million digital subscribers at the end of 1999; had been able to purchase rights on a long-term basis at a time when most of its competitors were not in a position to bid for such rights; as a result had achieved 'must have' status for its programming; had achieved a situation where cable companies were dependent on BSkyB programming; was dominant in the provision of premium sports and film programming; enjoyed a dominant market share in the provision of film channels (Front Row's market share was insignificant); and was able to manipulate its wholesale prices to ensure that its own satellite platform always benefited from lower programming costs than other cable or DTT platforms. As to the retail market, NTL said that BSkyB had near national coverage with a very strong national brand and the highest market share of any UK platform. Its hold on content attracted customers with particular interest in sport and movies and it was the only platform with a national digital product which could also offer digital interactive services.

6.116. NTL made further submissions on the question of open access. It said that open access should be considered only where cable networks might be considered an 'essential facility'. The European Court of Justice had defined an essential facility as having two significant features: likelihood of eliminating all competition and indispensability.¹ Neither of the two links was satisfied in this case. There was no consensus as to what was meant by 'open access' and heavy regulation would be needed if cable franchisees were to become common carriers for other communication companies. The UK sector regulators and the European Commission were starting to address this issue and it was they who were the authorities best equipped to do so.

6.117. NTL said that the advent of digital technology would bring an immediate 400 per cent increase in the available channel capacity on all platforms, and content providers would then be in a very strong position. NTL reiterated that the merger would bring significant consumer benefits as well as synergies. NTL also restated its belief that its TV/telephony product could deliver important economic benefits.

6.118. Subsequently, we noted in an article in the *Independent* on 9 February that Mr Barclay Knapp, Chief Executive, was reported to have stated that NTL had missed its September launch date for digital services and that some analysts thought this was due to problems with software provided by Microsoft, which had invested £500 million in NTL. Mr Knapp also was reported to have stated in that article that NTL's strategy was skewed more to distribution than to content.

6.119. The terms of the interconnection agreements were revised during the course of the inquiry. Under the original preferred supplier agreements, DataCo was to supply all relevant services to NTL for [§<], provided only that the terms of supply were no more expensive than specified comparison rates, which in some cases were the relevant published rates, or those made available to any other DataCo customer, and service standards were met. Subject to those criteria being met there was also provision for a minimum value of services to be placed by NTL with DataCo. The original Heads of Agreement between DataCo and NTL also provided for the parties to offer each other preferential terms for terminating calls, although without specifying the extent of any such preference. Under the revised Heads of Agreement, services would be supplied by DataCo provided that the terms of supply were no more expensive than those available from any other supplier, allowing greater opportunity for other suppliers to compete for such business. Provision of services remained subject to the terms being no more expensive than those made available to any other DataCo customer, and to the service standard being met. The provision for a minimum value of services to be placed by NTL with DataCo was deleted, as were the preferential terms originally to be offered on terminating calls. There was also a reduction in the categories of services to be covered by the agreement.

6.120. NTL told us that the OFT had informed it in February 2000 that it now took the view that where an agreement satisfied all the criteria in paragraph 1 of Schedule 1 of the Competition Act 1998, the exclusion from the Chapter I prohibition in the Act might apply irrespective of whether the agreement was made before or after 1 March 2000. The effect of this was that there was no objection in principle to the interconnection agreements being considered as ancillary to the proposed merger.

¹*Oscar Brommer vs Mediaprint* (case C-9/97).

6.121. By way of further background, NTL told us that originally the understanding reached in negotiations between the parties was that the preferred supplier arrangements would extend not only to those national services currently covered, but also to international interconnection services. However, following negotiations with France Telecom in the course of finalizing the terms of the transaction, the parties agreed that France Telecom would replace DataCo as preferred supplier of NTL's international interconnection services. [

Details omitted. See note on page iv.

]

6.122. NTL submitted that the separate interconnection arrangement for international services between NTL and France Telecom was not necessary to bring about the NTL/CWC merger and should not form part of the Commission's public interest assessment with respect to it. The agreement between France Telecom and NTL was a separate commercial arrangement related to France Telecom's investment in NTL; and that proposed merger situation had been cleared by the Secretary of State, subject to conditions.

6.123. NTL submitted that the interconnection agreement with DataCo was necessary to the implementation of the merger because:

(a) In relation to the ConsumerCo traffic, NTL needed time to build and configure its national network to absorb the large volumes of traffic originating in ConsumerCo operating areas and to interconnect efficiently the proportion of that traffic which was destined for termination by BT and other operators.

(b) [

Details omitted. See note on page iv.

]

(c) In relation to the NTL traffic, given the immediate need to continue to route ConsumerCo traffic via the DataCo network for a transitional period, it was most likely to be efficient for NTL to route further amounts of similar traffic streams via the DataCo network in order to maintain a cost-effective interconnection structure throughout its operations. The price offered by DataCo had to reflect the best price in the market; if it did not, NTL would be able to use other operators.

6.124. NTL concluded that the implementation of the merger depended in part on securing, on a transitional basis, access to certain network services in relation to a substantial proportion of the ConsumerCo business transferred. The interconnection agreement and the preferred supplier arrangement were needed to secure the necessary network utilization and economies of scale for DataCo and secure for NTL a coherent interconnection cost structure, while enabling NTL to self-provide an increasing quantity of network services. The agreement did not therefore exceed the minimum necessary to achieve these objectives which were integral to the viability of the merger. The preferred supplier arrangements in relation to both the NTL and ConsumerCo traffic did not amount to exclusivity arrangements as they allowed for NTL to self-provide any services and to use other operators where services were offered at a lower price and DataCo was unwilling to match that price.

6.125. NTL submitted that the arrangements did not operate against the public interest, for the following reasons:

(a) The arrangements were limited to the interconnection of traffic from the enlarged NTL (ie the merged entity), comprising only 7.5 per cent of exchange lines in the UK. NTL's share of the retail market constituted only 6 per cent. The effect of the arrangements was a likely switch of certain of NTL's existing interconnection business from BT to DataCo for a transitional period, but the arrangements did not foreclose the market or raise any barriers to entry to the market.

(b) The agreements were vertical by nature as the parties would be operating at different levels of the distribution chain (NTL at the retail level and DataCo at the wholesale level). The OFT had stated in competition guidelines¹ that vertical agreements did not generally raise competition concerns because competition would only be affected if market power were present at one or both levels.

¹Paragraph 5 of OFT's *Exclusion of vertical agreements: Consultation on a draft order—February 1999*. See also paragraph 6.2 of the OFT's *Agreement of Individual Agreements and Conduct* guidelines.

Neither NTL nor DataCo would have market power at either level; both would have to compete with the dominant incumbent, BT, and other operators.

- (c) BT's total interconnection revenue amounted to £5.4 billion in 1998/99, compared with DataCo's interconnection revenue of about £[] million.
- (d) The agreement aimed to ensure that NTL benefited from the most competitive rates possible and security of supply, particularly for the ConsumerCo traffic. By guaranteeing service at the lowest rates, NTL would be more competitive at the retail level.
- (e) The agreement aimed to safeguard DataCo's planned trunk network utilization levels and protect its network upgrade investment by enabling a significant amount of ConsumerCo traffic to continue to be routed via the DataCo network for a transitional period. [Details omitted. See note on page iv.]
- (f) CWC DataCo's preferred supplier status would not preclude NTL from developing its network and delivering its traffic to other operators over its own trunk network. The Heads of Agreement expressly safeguarded this possibility by excluding from the preferred supplier arrangements all traffic that NTL could, at any time, carry itself. This was a beneficial effect of the removal of the minimum annual commitments. In addition, DataCo's preferred supplier status would not preclude NTL from using other operators where their rates were lower than those of DataCo.
- (g) The parties could have entered into this arrangement independently of the merger and, had they done so, this would not have infringed competition rules.

6.126. NTL submitted further that, if the view of the parties that the interconnection arrangements as set out in the Heads of Agreement did not raise competition concerns was not accepted by the Commission, then it was essential for the Commission to consider whether the interconnection arrangements would be ancillary to the merger, ie directly related to and necessary for the merger, with effect from 1 March 2000 as, in effect, from that date, an agreement which was ancillary was acceptable in competition terms even if it would otherwise raise competition issues. This was particularly the case given that (a) the Heads of Agreement would not be finalized or enter into force until after 1 March 2000; (b) merger clearance, if given, would not take place until after 1 March 2000; and (c) the merger itself could not take place before 1 March 2000.

6.127. In addition to the considerations outlined in paragraphs 6.120 to 6.126, NTL stated that if the interconnection agreements were to raise any concerns, other regulators had jurisdiction to review the Heads of Agreements, namely the OFT under the Restrictive Trade Practices Act 1976; the OFT under the Competition Act 1998 in due course; and OFTEL under the fair trading conditions contained in the parties' respective telecommunication licences.

CWC

6.128. A submission was made jointly by C&W and CWC, who both attended a hearing; for convenience, we refer to this as CWC's submission.

CWC's general submission

6.129. CWC submitted that consolidation was necessary to enable the cable industry to achieve competitive scale. All the cable companies were loss-making and yet they had to compete against entrenched incumbents with significant market power, namely BT in telecommunications and BSkyB in pay-TV. The limited geographic reach of the cable companies made it particularly difficult for them to compete as separate companies with BT and BSkyB, both of which benefited from virtually ubiquitous access to the UK population.

6.130. Both CWC and NTL saw the merger as a means of allowing each to focus on their core businesses. The merger would give NTL the larger geographic footprint and customer base it needed to

compete more effectively. By selling its cable businesses, CWC would be able to concentrate its resources (capital and staff) on its Internet, wholesale international carriers and business telecommunications businesses in line with C&W's worldwide group strategy.

6.131. The merger would not result in a reduction in competition or in fewer choices for the consumer. Until the present time, cable companies had operated in exclusive franchise territories and so had not competed with one another. They would not compete even as exclusivity of rights within their franchise areas disappeared as it was not economically viable, particularly given their loss-making history, to build network where another cable company had already built. No cable company in the UK had ever overbuilt in another cable company's franchise and CWC had never had plans to do so. Thus the merger would not eliminate actual or potential competition as CWC and NTL did not, and would not in the future, compete with one another.

6.132. In the market for retail pay-TV services, the enlarged NTL would face fierce competition from the clear market leader, BSkyB, which had a 65 per cent market share based on revenues (as compared with 21 per cent for the enlarged NTL) and a 50 per cent market share based on the number of subscribers (as compared with 27 per cent for the enlarged NTL). In addition, BSkyB was the principal supplier of content to both NTL and CWC, as it was to all pay-TV providers, and had been recently held by the Commission (in the BSkyB/Manchester United inquiry) to have actual market power in the provision of premium content. As well as facing BSkyB, NTL would continue to compete with ONdigital, which had quickly captured significant market share even in the very short time since its launch in 1998.

6.133. In the market for fixed line retail telecommunication services, the enlarged NTL would face the incumbent BT, which had a ubiquitous network and a 71.2 per cent market share. By comparison, the enlarged NTL would have only a 6.3 per cent market share.

6.134. The remaining market, interactive services, was nascent, with technology developing at a rapid pace. It was not currently clear which technologies, let alone which companies, would prevail in the provision of interactive services. However, there was a distinct possibility that, through their joint venture Open, BT and BSkyB would be in a position to leverage their strong positions in their other markets to dominate this market as well. In any event, this merger would not result in any aggregation of actual market shares as CWC had only just launched its digital interactive TV service offering and NTL had yet to do so. Indeed, this merger was driven by the need to assist NTL in achieving a wider and more effective launch of its digital business.

6.135. At a hearing CWC said that, when the original three cable companies (NYNEX CableComms, Bell Cablemedia and Videotron) had combined with Mercury, this had been envisaged as the first step in continuing cable consolidation. In the event, however, that consolidation had not materialized and recently consolidation had not seemed to fit into the general strategy of C&W. Discussions had been taking place with Telewest about the possibility of a merger when the opportunity of a merger with NTL emerged.

6.136. C&W had now decided to focus on the wholesale market and business sector of the fixed line retail telecommunication market. 70 per cent of its revenues came from these activities, which was relatively high for a telephone company. Moreover, since business customers' requirements around the world were increasingly the same (for example, for Internet-based e-commerce services) genuine synergies were achievable on a global basis. Consequently C&W had decided to sell its cable interests. To this end, it proposed to divide CWC into two divisions: ConsumerCo, which was to be transferred to NTL; and DataCo (see paragraph 3.53). As a result of the overall transaction, C&W would own 100 per cent of DataCo (see paragraph 3.53) and it planned to use DataCo as a vehicle for rapid expansion. The merger transaction was fundamental to C&W's strategy to concentrate its financial and management resources on its core global businesses. C&W had just announced the acquisition of eight business ISPs in Europe, as well as extra network investment. It also intended to expand in the USA and Japan.

6.137. C&W would have a continuing residual shareholding in NTL (see paragraph 3.58) because, [*Details omitted. See note on page iv.*], and the minority shareholders had to be given the opportunity to decide the extent of the shareholding they wanted. Under the proposed Telewest deal which in the event was not completed, C&W would also have ended up with a shareholding in the merged entity. C&W would have a director on the board of the merged entity (ie the enlarged NTL) if its

shareholding reached a certain level (see paragraph 3.68) and would seek to ensure that its investment was protected. This investment could [*Details omitted. See note on page iv.*].

6.138. C&W considered that there would be substantial synergies for NTL as a result of the merger transaction. The merged entity would have more efficient and effective operating costs and savings in capital investment. The creation of CWC had led to a 25 per cent saving in equipment purchasing. The merger would also without doubt improve the merged entity's bargaining position against BSkyB. A large element of the costs of running a cable company in the UK consisted of payments for programme content to BSkyB which historically had held a very dominant upper hand in programme negotiations. BSkyB knew that cable companies could not operate without offering its programmes; it was not possible to run a TV cable business without live football and movies. CWC acknowledged that BSkyB had invested huge amounts of money and taken huge risks, and deserved no doubt to reap some financial reward, but as a seller of programmes BSkyB had a predominance of power. A business with more scale would be able to negotiate with BSkyB on rather more equal terms.

6.139. The merger would also bring synergies on the demand side. The merged entity would have potential access to 31 per cent of TV households in the UK and, with a larger subscriber base, would have a much better chance of negotiating for TV rights and interactive services content. For example, national retailers would be more interested in using the enlarged NTL as a route to the market for their on-line shopping services which would provide greater competition to Open.

The relevant markets

6.140. CWC submitted that the pay-TV market could be split into a wholesale market (ie provision of pay-TV content to pay-TV service providers such as the cable companies) and a retail market (ie the provision to the consumer of the pay-TV service including the licensed content). CWC was not active in the wholesale market and NTL had only a minor interest in this market via its participation in Front Row and British Eurosport. The wholesale pay-TV market was unaffected by the merger, but BSkyB's market power in the wholesale market had to be taken into account in so far as it had an impact on the ability of its competitors to offer a competitive product at the retail level.

6.141. In CWC's view, the market was not wider than pay-TV. The European Commission had consistently recognized that retail pay-TV constituted a distinct product market and had distinguished it from free-to-air commercial TV and public TV. The same product market definition for retail pay-TV had been acknowledged by the ITC and OFTEL. The market for retail pay-TV included services delivered by satellite, cable and DTT.

6.142. In practice, all the pay-TV service providers—the cable companies, BSkyB and ONdigital—competed aggressively for customers. Customers were not interested in how the service was delivered to their homes but in what content was available. The substitutability of the different delivery platforms was evidenced by the fact that the main operators of all three platforms had adopted similar practices with respect to the pricing and distribution of set-top boxes. The initial prices for the digital set-top boxes of BSkyB and ONdigital had been very similar. A few months previously, BSkyB had changed its strategy and decided to offer its set-top box and satellite dish free of charge to subscribers, with a one-off charge of £35 to £40 for installation costs. ONdigital had followed the same practice with respect to its set-top boxes. Similarly, cable subscribers did not pay a lump sum up-front for a set-top box as the cost of the box would be included in the monthly subscription fee, although an installation charge of up to £50 might be levied by NTL and CWC. The fact that consumers were no longer required to pay £200 or more for a digital set-top box had significantly reduced the cost of switching between providers and reinforced the point that differences in the technology of delivery did not affect, to any significant extent, competition between providers.

6.143. Satellite and DTT competed, or would soon compete, throughout most of the UK. By contrast, all cable companies together only reached 51 per cent of the TV households in the UK. The franchise coverage of the three principal cable companies was such that the cable companies, while competing with BSkyB and ONdigital, did not compete with one another. A fundamental reason for submitting that the merger did not give rise to concerns was the fact that, wherever a consumer had had a choice of three pay-TV service providers before the merger, that consumer would continue to have this choice after the merger.

6.144. The market for retail pay-TV included both analogue and digital pay-TV. This had been recognized by the European Commission in its decision on *BiB* (Open) and by the ITC and OFTEL.

6.145. The relevant geographic market for pay-TV was national in scope, although it was possible that the geographic market could in some cases in Continental Europe extend beyond national borders to encompass a greater region where the same language was spoken. This was the approach of the European Commission. Indeed, cultural and linguistic differences might serve as an unofficial barrier to trade in pay-TV services. For example, cricket matches in the UK were unlikely to be of interest to viewers in other European countries. Some movies also tended to play better to domestic audiences. For example, there was significant divergence between European countries with respect to tolerance of subtitling of foreign language films. There were also certain restrictions imposed on channel providers by national law.

6.146. Furthermore, copyrights covering programming were usually licensed on a national basis. Film, programming and sports rights owners all usually licensed their content to channel providers on a country-by-country basis. In turn, channel providers licensed their channels for distribution on the same geographically restricted basis as that on which their content had been licensed to them.

6.147. With respect to the question of whether sub-national markets could exist given that the cable companies operated only in specified franchise areas, the ITC and OFTEL had pointed out that local markets for cable TV could be defined only to the extent that alternative TV delivery platforms to cable would fail to constitute effective substitutes for cable. In that case, a particular cable operator would be the sole incumbent in its local market. However, in practice, satellite and DTT were substitutes for cable. Further, the pricing strategies of the different operators were heavily influenced by each other and were set on the basis of a single national price; there were no regional variations.

6.148. As the cable companies did not compete with one another, there were in effect only three competitive forces, namely BSkyB, ONdigital and the cable industry. Following the merger, the merged entity would have a market share measured by the number of subscribers of approximately 27 per cent while BSkyB's market share would be almost twice this size. ONdigital, which had entered the market only in late 1998, already had a 6 per cent market share and this share was expected to expand rapidly. By revenue, the enlarged NTL would have a market share after the transaction of approximately 27 per cent, while BSkyB had a market share of 65 per cent.

6.149. BSkyB in fact held an even larger share of the revenue generated in the pay-TV market if account were taken of the payments for content made to it by its competitors. Taking that aspect into account, BSkyB's market share by revenue was more like 78 per cent.

6.150. After the merger, BSkyB would continue to enjoy unparalleled market power due to its existing market shares, its dominant position in the wholesale market for pay-TV, its ability to reach virtually everyone in the entire country and its first mover advantages in respect of digital pay-TV and interactive services. BSkyB was a vertically integrated company in the wholesale market for pay-TV, which gave it a substantial competitive advantage at the retail level. Only BSkyB's channels carried much of the premium programming content, in particular sport and films, that pay-TV customers demanded as part of any pay-TV offering. BSkyB had created this situation by acquiring the exclusive rights to major sports events and to Hollywood films. This, in turn, obliged the other pay-TV operators to acquire the channels required by their customers from BSkyB, which was also their direct competitor at the retail level.

6.151. The key to the growth of pay-TV in the UK had been films and sport and, in particular, Premier League football. The Commission had itself concluded in the BSkyB/Manchester United report that BSkyB had market power in the provision of premium pay sports channels. Until at least 2001/02, the present Premier League rights contract gave BSkyB exclusive access to all live Premier League matches. It also had exclusive rights to show recently released films from the main Hollywood studios until at least 2003. Rupert Murdoch, the Chairman of BSkyB, had referred unequivocally to the importance of sport and films for growing the pay-TV market. Similar views had been expressed by witnesses giving evidence on behalf of BSkyB to the Restrictive Practices Court in the recent case brought by the DGFT against the Football Association Premier League. This view was also supported by

the fact that over 90 per cent of DTH satellite subscribers took the premium sports channels and 25 out of the 30 highest-rating programmes on DTH satellite in 1997 were live football matches.¹

6.152. CWC had no, and NTL only minor, involvement in the wholesale market for pay-TV. The cable companies and ONdigital paid BSKyB annually for programming an amount equal to well over one-third of the pay-TV income of all the cable companies. Although BSKyB had given undertakings to the OFT concerning its rate card (see paragraph 4.89), CWC believed that the rate card had not served adequately to constrain BSKyB and that BSKyB was still able to use its market power to harm its retail pay-TV competitors. By redressing somewhat the balance between BSKyB and at least one of its wholesale customers (NTL), this merger should contribute to countering the adverse effects in the retail pay-TV market of BSKyB's dominance in the wholesale market. With a wider subscriber base and additional financial resources, NTL would be in a better position to bid in competition with BSKyB for programming rights, such as film and sport rights, offered by third parties.

6.153. BSKyB had an additional competitive advantage over the cable pay-TV operators in that it could provide pay-TV services to essentially all TV households in the UK, subject only to planning and environmental restrictions on satellite dishes. By comparison, ONdigital currently covered 85 per cent of UK TV households, while cable companies currently passed only 51 per cent of TV households. When marketing a particular delivery channel to a prospective channel provider or interactive service provider or advertiser, the ability to offer true national reach (ie to the whole population) was a powerful advantage. Even after the merger, the merged entity would still only provide access to 31 per cent of TV households.

6.154. BSKyB also had a first mover advantage. Just as it had had for analogue pay-TV services, so it enjoyed a competitive advantage as the first to offer digital pay-TV. BSKyB was currently pursuing a very aggressive pricing policy and compulsory 12-month contracts in order to attract and lock in as rapidly as possible as large a customer base as possible. BSKyB was also able to build a large customer base quickly because, unlike cable, its offering, being via DTH satellite, could be launched to the whole country at once, whereas cable's could be rolled out only over one franchise at a time. BSKyB had now launched a campaign to change its analogue customer base to digital. Prices for analogue and digital packages were the same, but, in digital form, smaller basic packages were offered at lower prices. A strong consolidated cable competitor was essential to overcome cable's slower start in the digital market. CWC had now launched its digital service in certain areas, but NTL had yet to launch its digital service.

6.155. With regard to the telecommunication sector, CWC submitted that the only market relevant to this merger was the market for fixed line retail telecommunication services. In this market, the aggregate share of the merging entities would be too small to present any competition concerns, particularly given BT's dominant position in the relevant market.

6.156. Fixed line retail telecommunication services comprised the provision to end-users of voice and data services (including indirect service, ISDN and leased circuits) over fixed-link infrastructure, regardless of whether these services were provided to residential or business customers and of the origin or destination of the call. CWC said that it left open the question of whether, in certain circumstances, it might be appropriate to subdivide the market according to the destination of the call, namely local, national or international, but most operators did not limit their offerings to customers in this way. It would not be appropriate at this stage to extend the market definition to include mobile services.

6.157. Telecommunication services provided to residential and business customers formed part of the same fixed retail telecommunication services market. Often these services were identical in nature, although business and residential customers tended to choose different tariff schemes. CWC's business customers connected to the cable network would be transferred to NTL as a result of the transaction. OFTEL had defined certain other telecommunication markets relating to international traffic and wholesale services to other operators, but these so-called market definitions were not relevant to the transfer of ConsumerCo to NTL. The transaction did not result in any aggregation of market share in the wholesale market. The same reasoning applied to the sale of leased circuits.

6.158. The relevant telecommunications geographic market was the UK. Aside from BT, telecommunication licences had been granted to over 200 operators in the UK. BT retained 85 per cent of

¹Szymanski and Kuypers, *Winners and Losers: The Business Strategy of Football*, Penguin Books, London, 1999.

exchange line connections in the UK. The combined market share of the merging parties would not be significant in the market for fixed line retail telecommunication services; this was estimated at some 6.3 per cent by call revenue and some 9.2 per cent by reference to exchange lines for residential customers.

6.159. The interactive services market was a new, emerging market. It included both broadband and narrowband access services and the broadband technologies included cable, ADSL, satellite and wireless. There was clear substitutability between the different broadband technologies used to deliver interactive services. The European Commission in the *BiB* decision had distinguished the market for digital interactive TV services from PC-based on-line services as well as from pay-TV and high street retailing. However, in view of the rapid changes taking place in this area, CWC submitted that it should be left open whether there was a broader market for interactive services that would include, for instance, PC-based on-line services. From a consumer's point of view, it would not seem to be practical to make a distinction between the purchase of a book from Amazon.com using the Internet accessed via a PC and the same purchase carried out using an interactive services platform that was accessed via a TV. Similarly, Internet web sites on the TV could be the same as web sites accessed via a PC, although they were usually reworked to make them more user-friendly on the TV screen. However, even using a narrow market definition limited to digital interactive TV services, it was clear that the proposed transaction could not be expected to operate against the public interest.

6.160. The relevant geographic market for digital interactive TV services was national for the same reasons that the market for pay-TV was national. There were a large number of actual and potential players in the market. As a result of OFTEL's recent decision to require BT to unbundle its local loop and BT's decision to roll out ADSL technology, there was scope for market entry by service providers other than BT or BT's partners into the interactive digital TV service market in the very near future.

6.161. CWC submitted that it was too early to establish any meaningful market shares in the market for digital interactive TV services. At present, BiB's Open service had a significant advantage over the competition, not only because it was the first service available on the market, but also because it had national coverage, which made it attractive for retailers and advertisers seeking national coverage. Open already had over 1.1 million customers while CWC had only 70,000. NTL had yet to launch its digital interactive TV service so there would not be any aggregation of market shares as a result of the merger. There was plenty of scope for competition in this market.

The effect of the proposed merger on the present competitive situation

6.162. CWC submitted that as the cable networks of the merging parties did not overlap, the number of competitive retail pay-TV services offered to UK consumers would not be reduced by the merger. The abolition of the exclusive franchises in 2001 would not change the situation, and any argument to the contrary ignored the economics of the cable industry. It was very unlikely that existing cable companies would build a cable network in the franchises which their competitors had previously held on an exclusive basis. For its part, CWC had never seriously considered the prospect of cable over-build. The cable companies had never made a profit and [*Details omitted. See note on page iv.*]. It would be difficult for any cable company to justify over-build to its investors and creditors.

6.163. The financial returns likely from competing in an area where a cable network had already been built were too low to justify the installation of competing network infrastructure. Building cable networks was an extremely capital-intensive activity. All three major cable companies had failed to meet the milestone build-out requirements imposed in their franchise licences. CWC had taken the decision two years ago to scale down network build, and renegotiation of minimum build obligations with the relevant regulator subsequently took place. Recently, Telewest, NTL and CWC had each handed back exclusive cable franchise licences in return for removal of build obligations and an end to licence fee payments. Their decision illustrated both the financial burden of build obligations and their belief that cable network over-build was uneconomic and would not occur.

6.164. Cable companies needed to allocate their limited resources to upgrade their current networks to introduce digital technology and innovative interactive services in order to compete effectively with their rivals BSkyB, ONdigital, BiB and BT. Digital roll-out, including set-top box and decoder acquisition, was a significant drain on these resources. It represented a major financial commitment and was a

further reason why the acquisition of additional funding for network over-build would be extremely difficult.

6.165. We asked CWC if cable companies competed indirectly, for example on price or innovative developments. CWC said that it did not think of itself as competing with the other cable companies. Its competitive focus was directed against BSkyB and ONdigital. As to the position of channel providers who negotiated fees, most of these channel providers [*Details omitted. See note on page iv.*] and therefore were not in a position to offer any cable operator a better deal. Concerning competition in telephony, CWC said that it did not compete with NTL in direct retail telephony because their networks were in different geographic areas. Its prices were always set so as to compete against BT. There was some small amount of competition with NTL in indirect services because some of CWC's indirect customers were in NTL's franchises. These indirect customers would transfer to NTL as a result of the merger. However, NTL would not be the only indirect access provider.

6.166. We asked CWC about the unbundling of the BT local loop and whether this would bring about another competitive means of delivery of pay-TV. CWC said that video content providers would be able to compete using DSL equipment via BT's exchanges to deliver a small retail package, but they probably could not deliver a large retail package such as that delivered by the five main retailers. Currently, ADSL was being developed in trials by BT and others. It was not possible at the present time to put out a large pay-TV package on ADSL technology. However, PPV and NVOD would be offered by this means. It might be the case that in a few years' time cable companies could use more advanced DSL technology to expand their services into those areas of other cable operators, but it was difficult to see how this would be worthwhile from an economic point of view, given their pre-existing heavy investment in cable technology.

6.167. With regard to the telecommunication market, cable operators competed only marginally with one another, and all had the challenge of competing against the ubiquitous network and historic dominance of the incumbent BT. The merged entity would have 6.3 per cent of the market of call revenue as against BT's 71.2 per cent and 10.6 per cent of the market for residential call revenue as against BT's 81.9 per cent.

6.168. The parties acknowledged that they competed against one another in relation to business telecommunication customers. However, with the exception of CWC's cable business customers (comprising about 6 per cent of CWC's business customer revenue), business telecommunication services were excluded from the transaction. C&W (ie CWC DataCo) and NTL would continue to compete in this area following the merger.

6.169. With regard to the market for interactive services, CWC said that the parties held no meaningful market shares, as NTL had not even launched its digital interactive TV service and CWC had only just done so. The digital interactive TV market was now in a period of explosive growth and once competition was established, it would be vigorous as there were a number of companies that were either already in this market or that would enter the market in the very near future. NTL and CWC operated in different franchise areas and so would not compete for customers in any event. The merged entity would be in a position to offer digital interactive TV to potentially 31 per cent of UK households and thus attract more substantial retailers and advertisers who were interested in broader geographic reach. It would also benefit from economies of scale.

The possibility of the merger creating or enhancing the market power of the merged entity

6.170. We put to CWC the contention that the closed nature of the cable system gave cable companies market power in that providers could not reach cable viewers without negotiating terms with the cable companies, in contrast to the situation with satellite. CWC responded that the contention that only cable companies had 'closed systems' was not correct. None of the pay-TV retailers, including BSkyB, granted competitors access to their distribution infrastructure or subscriber identities. In any event open access was an issue which it would be entirely inappropriate to address in the context of this merger. It was a matter which would affect all cable companies and also ONdigital and would be more appropriately dealt with by industry regulators.

6.171. CWC added that in any event the facts did not support the imposition of an access requirement on the merged entity. Access was only appropriate if a technology was vastly superior to anything else available or if there was no substitute available at all. Since the various broadband technologies available for delivering pay-TV and digital interactive TV services were substitutable and cable companies clearly did not have any advantage over competitors, there was no case for open access. In the USA, the FCC had found that the various broadband technologies were substitutable.

6.172. At a hearing, CWC stated that any channel with a significant degree of customer popularity would appear on the cable system (ie in the retailer's customer package). In reality BSKyB's system was not 'open' to any entrant because although channel providers could require a licence to the same conditional access technology as BSKyB, they would not get access to BSKyB's subscriber identities or to its transponder infrastructure. They would need to lease transponder capacity independently themselves (ie they could not require BSKyB to let them use BSKyB's own satellite distribution infrastructure). In any event, small channel providers were not really in a position to enter the retail pay-TV market as they would not have the resources to acquire transponder capacity, acquire the conditional access licence, market the service and manage (for example, bill) potential subscribers. With respect to whether channels should have the right to be included in the retail package, some rationing had been necessary as long as analogue capacity was being used, and this rationing had been applied according to the preferences of customers. CWC saw no point in its being forced to include channels in its retail package which its customers did not want. In any event, this issue had nothing to do with the merger.

6.173. It would not be right following the merger to impose a restriction on a non-dominant operation. Various means could be devised by which medium and small suppliers could potentially have access to the package, but rationing problems would remain due to capacity constraints. These would be alleviated with the introduction of digital services but capacity would still be finite. CWC stressed that if a small channel were popular, it would be included in the retail package as it would enhance the retailer's competitive position.

6.174. [

Details omitted. See note on page iv.

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6.175. We asked CWC about the concern that cable companies might charge for carrying free-to-air and public service programmes. CWC said that this issue had nothing to do with the merger but, in any event, at the moment it made no charge and it had no plans to charge.

6.176. Concerning PPV services, CWC said that the films provided by Sky Box Office and Front Row were in fact very similar.

6.177. It was impossible for the cable operators to negotiate rights to films with Hollywood studios (apart from PPV), because Sky had negotiated long contracts which came to an end at different times and therefore no competitor could be sure of coming to an agreement with the four or five major studios.

6.178. We asked whether Open's service could be distributed over the cable network. CWC said that the cable companies were developing their own offerings, which were very similar to Open. Open had a market of 1.1 million subscribers compared with CWC's 70,000, but the services were provided by content providers who were largely common to the two platforms (for example, Woolworths appeared on both). There was no likelihood of cable getting any of its interactive services on to the Sky platform with access to Sky's subscriber base and in the same way there was no immediate likelihood of Open getting on to CWC's network. However, this commercial option had been discussed but capacity constraints were an issue.

The interests of consumers

6.179. We asked whether, following the merger, the merged company might charge customers the higher of two prices where these differed between CWC and NTL. CWC said that to the extent that the

prices charged to consumers were going to be determined essentially by the existing value for money offered by BSkyB, the new undertaking was going to be the price taker in any event and would adjust the price by reference to the content and the value for money. The question could not be looked at solely in terms of price. New products and new offerings were appearing in the market and the merged entity would need to act and react to whatever value for money was sought by customers. The price of the access package as between NTL and CWC differed by only about 70p.

6.180. We asked if the merged company was more likely to make its own programmes as a result of the merger. CWC said that it could not speak for NTL but it had certainly never considered making its own programmes as distinct from buying in programmes. If the enlarged NTL were to make its own programmes, as a non-dominant firm it ought to have the discretion to choose the sources of its own input so as to determine the quality of the output. The end result in theory would be totally vertically integrated enterprises, but that result was impossible in present circumstances as far as CWC was concerned.

6.181. We asked about the possibility that cable consolidation might lead to a loss of diversity of content if smaller content providers were squeezed out. CWC said that content could not be forced on pay-TV consumers, but equally if consumers wanted certain content and cable companies could afford it, it would be included. There was no reason to believe that the merger would lead to a loss of diversity. Indeed, with the advent of the additional capacity afforded by digital technology, there would be many more channels carried.

The question of whether the merger could increase competition

6.182. CWC submitted that the merger would be a positive move for the industry and would promote the public interest in a variety of ways. Aside from general economies of scale, the merged entity would have a larger subscriber base, which would put it in a position to negotiate more favourable terms with BSkyB for the purchase of programme content, a key step towards improving NTL's pay-TV margins. In particular, the merged entity would be better placed to resist some of BSkyB's wholesale pricing practices that had hindered the development of competition in the pay-TV market. It was hoped that the enlarged NTL would be in a position to bid in competition with BSkyB for programming rights offered by third parties such as film and sport rights. The current NTL needed a wider subscriber base and additional financial resources in order to do this.

6.183. CWC told us at a hearing that at present the difference between what it sold to the customer and what it had to pay to Sky on premium channels was some 9 per cent gross, to which distribution costs had to be added. It followed that the cable companies did not have a great incentive to market the Sky premium channels, and for that reason the pay-to-basic ratio of the cable industry was rather different from that of Sky. With regard to the VOD service, CWC's gross premium was more like 13 per cent. CWC said that it could not speak for NTL's policy if the merger were to go ahead, but it believed that NTL was looking at creating a sports channel and at assembling programming, rather than originating it. Increased subscriber numbers were bound to assist the merged entity in negotiations for rights. Having said that, the merged entity would still only have 27 per cent of subscribers as against Sky's 50 per cent and therefore it would be too optimistic to expect early changes in the balance of power.

6.184. Looking at the telephone market, we asked if the merged entity would be in a stronger position to compete against BT. CWC said that that would be the case. The merged entity might be able to price more aggressively and it could devote resources to research into new features (such as call-back services) and their implementation. The strengthening of the financial position of the cable companies would also allow for improvements in service.

6.185. CWC added that the merger would bring about an improvement in competitiveness as far as the enlarged NTL's business customers were concerned because NTL would have a larger network and therefore less need to lease BT lines and so could offer more effective discounts. In addition, as a result of the wholesale interconnection preferred supplier agreement with CWC DataCo, NTL's entire business would benefit from the best rates available in the market for the carriage of NTL's traffic to the networks of other operators for termination.

Benefits and synergies of the merger

6.186. CWC submitted that the proposed transaction should provide the efficiencies needed to make the cable TV business of the enlarged NTL [redacted]. By creating a larger cable company, NTL should benefit from economies of scale which would improve its competitiveness. Among others, such economies would be found in relation to running and acquiring general systems, for example billing and subscriber management systems and head office functions, and aligning digital roll-out across a larger customer base (for example, coordination of set-top box acquisition).

6.187. On the telecommunications side, the merger would bring economies of scale for the enlarged NTL both in relation to purchasing of telecommunication equipment and general systems such as customer management and in operational matters, such as network management, customer service, complaints handling and fault repair.

6.188. In interactive services, the merged entity would also benefit from economies of scale in roll-out costs and access to a larger pool of technical experts. As technologies were evolving very rapidly in the interactive services market, scale was essential to provide the resources to [redacted].

6.189. At a hearing, CWC said that in its view [redacted]

Details omitted. See note on page iv.

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6.190. We took note of a paper provided to us by CWC which was a report by the US FCC entitled *Broadband Today*, dated October 1999. The thrust of that paper was that market competition in the USA was developing in the absence of government intervention. CWC noted that, while the situation in the UK differed from some respects from that in the USA, for example the cable industry was more powerful and there was no equivalent of Sky, the conclusion that regulatory intervention was not needed applied equally, if not with more force, in the UK. CWC added that, in its view, there was no need for any regulatory intervention in the UK and certainly no harm brought about by this merger that required an open access remedy. If, however, the view was taken that forced access was necessary, any such ruling should be applied industry-wide and should certainly not be applied as a result of this merger.

The effect of the associated interconnection agreements

6.191. At the beginning of the inquiry CWC submitted to us a briefing paper, prepared jointly by NTL and CWC for the OFT and updated for the purposes of our inquiry, on the ancillary nature of certain interconnection arrangements (Heads of Agreement) entered into on the date of the transaction. The purpose of the briefing paper was to demonstrate that most of the arrangements were directly related and necessary to the merger and thus excluded from the Competition Act 1998. In addition, the Heads of Agreement and the Transaction Agreement had been furnished to the OFT under the Restrictive Trade Practices Act 1976. The interconnection agreements were subsequently amended on 9 February 2000 (see paragraphs 3.86 to 3.118 and 6.119); the paragraphs below record submissions made and the discussion at the hearing about the earlier version.

6.192. The original Heads of Agreement provided that DataCo (that is, the part of CWC which would remain with C&W) would be appointed preferred supplier to the enlarged NTL in respect of a number of wholesale telecommunication services for a transitional period provided certain conditions were met. Those conditions were designed to protect NTL's ability to develop its service and ensure that NTL obtained the best benchmark rates.

6.193. The Heads of Agreement originally also provided for certain minimum annual revenue commitments. These were removed by the amended agreement which is discussed below (paragraphs 6.224 and 6.225).


6.194. Subsequently CWC confirmed that France Telecom had [] preferred supplier status for international traffic with NTL. This agreement had been reached on 22 November 1999 (see paragraphs 3.88 to 3.90).

6.195. At a hearing, CWC stated that, from the business point of view, it was essential to have some sort of ongoing interconnect agreement for business continuity reasons. For the sake of both the customers and the business, there had to be a reasonably lengthy period where there was continuity of connectivity to the national network. This principle had always formed part of merger discussions both with Telewest and with NTL.

6.196. CWC said that the agreements were already binding but only took effect when the merger was completed and that the Heads would be replaced by more detailed agreements in due course. They represented a fair deal to both sides and had been negotiated as an ‘arm’s length’ transaction. CWC had similar arrangements with other operators. The principle of the arrangement was that, on acquiring ConsumerCo, NTL had to buy certain connections, and those could only be delivered by DataCo. The prices for these connections were set at benchmark market rates.

6.197. CWC said that it was common for such agreements to have a clause about the requirement to match competitive prices; fixed unit price contracts were not generally accepted by customers. The benefit of the arrangements was mutual, as was illustrated by the competition benchmarking requirement.

6.198. We noted the value of the overall deal and the fact that ConsumerCo had negative assets and asked CWC if hidden assets lay behind the interconnection agreements. CWC said that no assets were involved in the Heads of Agreement, only the provision of services.

6.199. We put it to CWC that OFTEL had expressed concern that the effect of the interconnection agreements might be to reduce competition in respect of business telephony. CWC said that it did not understand this contention. NTL and C&W would act competitively in the future. It had similar interconnection agreements with companies such as [], which it had won in the free market from open competition.

6.200. Concerning business customers, C&W noted that CWC (ie CWC DataCo) was likely to become a more powerful competitor to BT given that it would now focus on this activity more fully. CWC could not see how OFTEL’s concerns were justified. In later correspondence, CWC added that the interconnection arrangements would have no impact on the business segment of the fixed line retail telecommunication market. The interconnection services covered by the agreement were wholesale services (ie carriage of traffic from A to B across different operators’ network). Operators purchased interconnection services as wholesale inputs to enable them to provide retail services to business or residential customers. By way of example, in order to provide a retail service to a customer an operator would need to purchase interconnection services enabling that operator to ensure that the customer could call any number in the country or abroad. The interconnection arrangements were of no concern, and were invisible, to the business customer who, like the residential customer, was concerned only that the call was delivered at a reasonable price—the customer did not care about the route taken to get there. In addition, the interconnection arrangements did not distinguish between whether the call was made by an NTL residential or business customer and did not in any way diminish the extent to which CWC and NTL would compete at the retail level for business customers. As evidence of the fact that these services were not directly related to one another, CWC offered services to business customers from its ‘Business Team’ which was a different part of the company from the team offering wholesale interconnection services.

6.201. We asked CWC about the maximum revenues that would be affected by these agreements. CWC said that they could not suggest a maximum figure; this would depend on marketing activity and how far traffic was moved through other operators. Subsequently, when CWC told us that the minimum annual revenue commitments had been removed (see paragraph 6.193), it added that the maximum revenue earned from the interconnection arrangements would depend on the success of the enlarged NTL’s retail business and the extent to which NTL would eventually self-provide, as well as the competitiveness of DataCo’s prices.

6.202. We discussed preferential termination rates, which were later removed from the interconnection arrangements by the amendment of 9 February 2000. We put it to CWC at the hearing that OFTEL was concerned about preferential termination rates (see paragraphs 5.27 to 5.29). CWC said at the hearing

that following the merger, [*Details omitted. See note on page iv.*]. This was standard industry practice and it would be very resource-intensive to do anything other than follow BT's rates which had been set under OFTEL's auspices. OFTEL had the jurisdiction under both companies' licences to express concern about these arrangements.

6.203. We put it to CWC that OFTEL was concerned that in the preferred supplier agreement, the terms were set with reference to [*Details omitted. See note on page iv.*].

6.204. We put it to CWC that it tended to have the most modern capacity, and spare capacity, and that competition between it and NTL might in fact be significant in determining prices. CWC said that it did not agree with that contention. The market was cut-throat and [*Details omitted. See note on page iv.*]. CWC was spending £400 million on upgrading its network.

6.205. In any event, CWC reiterated that in its view the merger did not in any way affect competition between it and NTL. The trunk and national networks would remain with CWC DataCo, which would become wholly owned by C&W and so there would be no effect on the wholesale market. In respect of the retail market, NTL and CWC did not compete to any significant extent in their local franchise areas for residential customers and would remain competitors for business customers after the merger. While some business cable customers would transfer to NTL, this would promote competition as NTL was a much smaller player than CWC with respect to business customers.

6.206. We asked about the effect of the interconnection agreements with France Telecom. CWC said that when France Telecom came in to help with the financing of the deal and became an equity holder, it wished NTL to use its international routes. Strictly speaking, the France Telecom agreements were not CWC's concern. The equity stake which France Telecom would take in the enlarged NTL had been cleared by the Secretary of State, subject to a divestment condition.

6.207. CWC added that it had no particular views on whether the interconnection agreements were considered by the Commission or OFTEL, but it was anxious to avoid delay. Its business was suffering at the moment as a result of the delay occasioned by the inquiry.

6.208. We put it to CWC that concern had been expressed that the arrangements could lead to closer links between NTL and C&W's US activities, including its Internet interests. CWC said that no such links were envisaged. The arrangements dealt only with national interconnection services. CWC did not believe that NTL was particularly active in the USA.

6.209. [

Details omitted. See note on page iv.

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C&W interest in the merged entity

6.210. We asked further about C&W's shareholding in the merged entity and said that OFTEL was concerned that there might be collusion between C&W and NTL when operating in the wholesale market (see paragraph 5.25). C&W said that this would in no way occur. The aim of C&W having one board seat if its shareholding were to reach a certain level was to protect its investment.

Hypothetical remedies

6.211. We asked CWC about the hypothetical remedy, should the merger be found to be against the public interest, of permitting open access to digital cable operations. CWC reiterated that open access was a misnomer; in its view, the suggestion was that there should be forced access. Such forced access would change the economics of the industry significantly and a condition of the merger to allow this access would not be acceptable. Great uncertainty would be created in the capital markets and CWC would [*Details omitted. See note on page iv.*].

6.212. We asked CWC about the possibility of open access being confined to smaller or non-premium channels. CWC said that it did not see how this would be possible. Any forced access would mean that CWC would have to open up its network and charge some sort of economic rent for the use of it. It would not be feasible to allow access to smaller customers (ie who might pay less) but not to larger customers. Rationing would continue to occur as capacity would be finite even in the digital world.

6.213. We suggested that space could be reserved for minority interest channels, who would need to bid for access. CWC said that that would be theoretically possible, but that the scarce supply of analogue channels would be a constraint. At a later stage, greater digital capacity might make such an idea feasible though CWC doubted that small channels with scarce resources could benefit from open access as they would be unlikely to have the resources to launch a pay-TV service. However, [*Details omitted. See note on page iv.*]. At the moment, supply and demand had to be balanced in the light of what viewers wanted to watch.

6.214. We asked CWC to comment on the suggestion that there should be no bundling of telephony with pay-TV charges. CWC said that this had nothing to do with the merger. Such a proposal would undermine the economics of the cable companies' operations. In any case CWC did not believe that there was any specific adverse effect arising from the bundling of pay-TV and telephony. There was no indication that this practice was causing any distortion in the market. Consumers could take TV and telephony services separately if they wished.

6.215. We asked about the suggestion that there should be no charge for the carriage of the free-to-air channels. CWC said that it did not charge at the moment, but it could not say how the situation might change in the future, for example if the BBC rolled out a large number of digital channels.

6.216. We asked CWC about the option of requiring the separation of NTL's interests in Front Row and SDN/ONDigital. CWC said that this was a matter for NTL.

6.217. We asked CWC about the suggestion that there should be no increased charges to NTL or ex-CWC customers following the merger. CWC said that a price control without limitation of time would be very severe. That remedy would be disproportionate and wholly impracticable, and unrelated to costs or to market conditions. It could not be regarded as a sensible solution, particularly in circumstances where the merger did not create dominance in any relevant market and CWC was a loss-making company.

6.218. We asked CWC about the suggestion that there should be wider consultation with users about the delisting of channels. CWC said that it constantly consulted customers and others on what channels were wanted. Any condition would delay the deal and further damage NTL's prospects to the advantage of BSkyB.

6.219. We asked CWC about the effect of the merger being disallowed. CWC said that a prohibition would [*Details omitted. See note on page iv.*]. Prohibition of the merger would reinforce the already very dominant position of BSkyB in pay-TV and of BT in telephony. CWC did not understand why the merger had been referred to the Commission in the first place, and repeated that the delay was very counter-productive.

6.220. CWC summed up by saying that consumers enjoyed ample choice at the moment. From the perspective of the cable companies, churn was a serious concern and might well increase unless value for money were offered by cable companies. This could only be done by improving the technology and rolling out digital cable; and by ensuring that resources were strong enough to distribute cable widely and make prices competitive with those of Sky. That was the driving force behind the merger. Without the merger, the likelihood was that [*Details omitted. See note on page iv.*].

6.221. Looking at the consequences of the merger, it was certainly a probability and probably a certainty that the efforts of the merged concern were going to be directed to new product development, more efficient use of resources and competition, and that could only be good for the consumer. Competition would occur with ONdigital, whose national footprint was developing a new and better product, as well as with BSkyB. Limiting the number of cable companies from three to two was not going to detrimentally change that competitive structure. The merger was, in effect, an enabling merger; it enabled companies currently distant from each other to come together to get closer to a national footprint. The economic consequences of the merger seemed to point solely to increased competition since competitors (Sky and ONdigital) were dramatically increasing the quality of their product and their penetration of the market. It was inherently improbable that the existence of three cable companies would result in innovations such that pressure would be put on these competitors to produce better products.

6.222. The benefit of the merger would be the ability of the new enterprise to be more competitive with BSkyB and a more effective buyer of product from BSkyB and third parties. What this merger did was to increase the ability of the current cable companies to get closer to their objective of offering the consumer a better deal.

6.223. Subsequent to the hearing, CWC drew our attention to the provisional conclusions of the ITC and OFTEL, dated 8 February 2000, resulting from their consultations on the bundling of TV and telephony. The ITC and OFTEL concluded that this practice did not give rise to concerns at the present time. Their conclusion was the same whether markets were defined as local or national in scope, and, if local, where a cable company held a market share of 80 per cent. CWC questioned the accuracy of the 80 per cent cable share alleged to exist in certain franchise subscriber areas and said that, in its view, shares did not reach this level in any franchise area. Such a share could exist only in certain very small districts in which BSkyB was unable to offer service due, for example, to planning restrictions.

CWC's further submission

6.224. As noted in paragraph 6.119, the terms of the interconnection agreements were revised during the course of the inquiry.

6.225. Concerning the revised interconnection agreements, CWC was of the same view as NTL (see paragraphs 6.120 to 6.127).

6.226. CWC also provided a note on so-called 'closed systems'. CWC stated that all retailers, not just the cable companies, had closed systems. All pay-TV retailers used infrastructure to distribute their services to their customers. A company with TV content wanting to enter the retail pay-TV market needed first to acquire distribution infrastructure. Companies could do this by building a cable network or leasing transponder capacity on a satellite or leasing capacity on one of the DTT multiplexes. Leasing capacity on a satellite was the preferred option.

6.227. Having set up the distribution system, the prospective entrant would then have to obtain a licence for encryption and conditional access technology. Although all pay-TV retailers were required by the EC directive on TV transmission standards to make their conditional access systems available to third parties on fair and reasonable terms, these provisions only had real meaning in the UK with respect to the conditional access system operated by SSSL, a subsidiary of BSkyB. As a result of the requirement that a holder of the conditional access technology must negotiate to license the technology, it was possible for a new entrant to lease satellite capacity to beam its signal down and to manage its own subscriber base using the same conditional access technology as BSkyB. However, that new entrant would not be using BSkyB's own distribution infrastructure (ie its satellite transponders) and it would not have access to details of BSkyB's customers. Thus the new entrant would need to build up its own customer base through advertising and manage that customer base.

6.228. There was no harm brought about by the proposed merger that would require the remedy of open access, which should more accurately be called 'forced access'. Only if cable were the only route to market for a potential entrant to the retail pay-TV market, and that situation were brought about by the merger, would such a remedy be of any relevance.

6.229. With regard to issues facing channel providers, a channel provider would typically already have content for which it would want to find a route to market. The usual route for the channel provider

would be to negotiate with a pay-TV retailer (ie distributor) for inclusion of the channels in the retailer's pay-TV package sold by that retailer to that retailer's own customers. If the content were of sufficient appeal to customers, a channel provider would be in a position successfully to negotiate with retailers and reach a wide subscriber base. An alternative for a channel provider with the necessary resources was to enter the TV market as a retailer itself on a cable, satellite or DTT platform; in that case, it would have to acquire infrastructure or build infrastructure itself.

6.230. Two scenarios must be distinguished. A party arguing for open access in the sense of forced access was arguing in favour of the merged entity being forced to allow new entrants to the retail pay-TV market to use its cable network as a distribution mechanism. A party seeking mandatory access to the retail pay-TV package was not seeking the right to use the cable network, but was rather seeking the imposition of a 'must carry' obligation on the retailer. Such an obligation was inappropriate. It would represent an unnecessary regulatory interference with freedom of contract and the power of the merged entity to develop a retail TV package that its customers wanted and was best suited to compete with BSkyB. There was no competition case for mandating access to the retail package. In CWC's view, parties appeared to be using the Commission process not to resolve competition concerns but to avoid or distort the negotiation process with the retailer and to avoid the reality that content must be of good quality and suitable to meet demand if it was to be carried.

6.231. 'Must carry' obligations were unnecessary and distorted the market. As long as the analogue service remained, there would be capacity constraints and cable retailers had to retain discretion on the decision to carry channels. Any obligation to carry minority or small channels could force retailers to remove other channels. If customers valued the relevant content, the channels would be included in the package so as to ensure that the retailer's offerings remained competitive with those of BSkyB and ONdigital. Furthermore, any obligation on the enlarged NTL to force it to carry minority channels would place NTL at an unfair competitive disadvantage vis-à-vis its competitors given that they would not be subject to a similar obligation. A 'must carry' obligation might affect prices for consumers, and would amount to the reintroduction of MCRs which had already been banned by the ITC.

6.232. The ITC oversaw those mandatory 'must carry' obligations that did exist, namely that cable operators must carry most free-to-air channels. It had also banned MCRs imposed by channel providers, although it did not outlaw minimum revenue agreements. In this context, it should be noted that the ITC had still to rule on whether the cable companies' carriage of Sky One amounted to an MCR imposed by BSkyB. The motivation for the ITC's decision on MCRs was to protect the cable companies against what they saw as unfair practices of the channel providers.

6.233. In summary, CWC submitted that there was no harm brought about by the proposed merger that required any remedy involving open access. All pay-TV retailers operated closed systems. With sufficient resources, a channel provider could enter the UK pay-TV market as a retailer using satellite capacity, DTT capacity, ADSL or any of the new technologies now coming on-line. In any event, channel providers could negotiate with any or all of the pay-TV retailers for their channels to be included in the retailer's own offering to customers.

D P B KINGSMILL (*Chairman*)

R D D BERTRAM

C DARKE

A STEELE

P A BOYS (*Secretary*)

25 February 2000