Airtime Sales Rules Review

Statement

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Contents

Section 1

Executive Summary

1.1 On 29 March 2010, we published a consultation document proposing removal of the Airtime Sales Rules. These are two distinct rules relating to how broadcasters sell TV airtime. The 'withholding rule' means that all airtime available on ITV1, C4 and Five must be sold. The 'conditional selling rule' applies to all broadcasters, prohibiting them from forcing advertisers and media buyers, who want to buy airtime on one channel, to purchase airtime on additional channels.

1.2 The Rules were intended to ensure fair and effective competition in relation to broadcasting and connected services and we have an obligation to review them periodically, to check whether they are still appropriate and fit for purpose. Where possible Ofcom believes it is important to remove regulation which is no longer required; removing unnecessary regulation enables sectors to develop and gives industry players more flexibility to run their businesses. This is likely to have positive impacts on innovation and investment which could deliver benefits for consumers.

1.3 In the consultation document, we outlined our view that there are few incentives to withhold airtime. We also noted that it may be more appropriate to treat possible conditional selling by broadcasters on a case by case basis.

1.4 Consultation responses were mixed. Some supported the view that there are limited incentives for broadcasters to withhold airtime in current trading conditions. In addition, a number of respondents believed it would be appropriate to consider possible anti-competitive bundling behaviour individually in order to take account of efficient, positive bundling effects as well as any negative effects.

1.5 However, respondents raised two key reasons about why it would be inappropriate to remove the Rules. Firstly, some felt broadcasters would engage in the behaviour currently prohibited by the Rules, either now or in the future, if they were lifted. Secondly, some stakeholders suggested we postpone our review and undertake either a competition-based market study or a broader review examining the Rules together with other rules on the amount and distribution of minutage.

1.6 Having reviewed the consultation responses, our view is that no new evidence has been presented to change our conclusions that it is appropriate to remove the Rules. In addition, we believe we should complete our review now in order to ensure that unnecessary regulation does not prevent the sector from evolving. We conclude that we cannot justify launching a broader review of the market at this time given the lack of clarity about the nature and scale of possible competition problems and consumer harm, and the extended period of uncertainty that the sector would face.

1.7 Therefore Ofcom will remove the Airtime Sales Rules on 1 September 2010. This should provide regulatory certainty ahead of the next deal season for TV advertising airtime which will take place in the autumn.

1.8 We will continue to monitor the TV advertising sector and any effects of the removal. Should broadcasters engage in anti-competitive conduct following removal of the Rules, this may be subject to enforcement action by Ofcom under the Competition Act. Continuing engagement with industry stakeholders will form an integral part of our role to enable us to take account of the impact of any sector developments on the way airtime is traded.

Section 2

Summary

The Airtime Sales Rules influence the way TV advertising airtime is sold

2.1 The underlying rationale for the Airtime Sales Rules ('ASRs' or 'the Rules') is to ensure "fair and effective competition" in the provision of licensed broadcasting services and services connected with them. There are two Rules, restricting how broadcasters sell their TV advertising airtime:

- the withholding airtime rule: this prohibits the withholding of advertising airtime on analogue terrestrial channels namely GMTV[1], ITV1, C4[2] and Five [3]; and
- the conditional selling rule: this prohibits the conditional selling of any channels, which occurs when a broadcaster requires that an advertiser or media buyer, who wishes to purchase airtime on one channel, must buy airtime on another of the broadcaster's channels as a pre-condition of the sale.

2.2 The withholding rule means that broadcasters of commercial analogue channels must sell out all their available advertising time allowed under the code on the scheduling of advertising (COSTA)[4], while the conditional selling prohibition applies to all broadcasters.

We published a consultation which set our proposals to remove both rules

2.3 We published a consultation document on 29 March 2010[5] setting out our initial conclusion that the ASRs were no longer appropriate to ensure fair and effective competition. In assessing whether the ASRs continue to be fit for their purpose, we considered whether, absent regulation, there would be a realistic prospect of a broadcaster engaging in the prohibited practices.

2.4 In the consultation document we explained that a broadcaster is only likely to be able to engage in withholding or conditional selling to the detriment of its customers and the workings of the market if it has both the ability (i.e. is in a position of market power) and incentives to engage in this behaviour (i.e. it would be profitable in some way).

2.5 While we did not make an assessment of market power, we noted the changing landscape in the sector, illustrating key recent market developments including a large increase in digital TV take-up and in the number of TV channels, along with a shift in

[1] GMTV is now owned outright by ITV plc and for simplicity, we include it within our definition of ITV1 elsewhere in this document, as explained further in footnote 17.
[2] C4 is otherwise known as Channel 4 and we use the terms interchangeably in this document.
[3] These channels are referred to as the 'commercial analogue channels' in the rest of this document – or as 'commercial PSBs'.
[4] Ofcom '*Code on the scheduling of TV advertising – Rules on advertising minutage, breaks and teleshopping'* 26th May 2009 http://www.ofcom.org.uk/consult/condocs/rada08/statement/costa.pdf
[5] Ofcom *Airtime Sales Rules Review - consultation* 29 March 2010 http://stakeholders.ofcom.org.uk/binaries/consultations/asr/summary/asrcondoc.pdf

viewing from PSBs[6] toward digital channels. These changes have brought more choice for media buyers and advertisers about where to purchase airtime and are consistent with greater overall competition in the supply of TV advertising airtime – implying the ability of broadcasters to engage in the behaviour may have eroded since 2003.

2.6 We also examined incentives for broadcasters to engage in behaviour prohibited by the Rules. We considered the way airtime is negotiated and suggested that the structure of trading may incentivise broadcasters to sell more rather than less impacts (in order to obtain high 'shares of commercial impacts[7] - SOCI[8]). We provided evidence to support this, showing that broadcasters have not tried to circumvent the withholding prohibition despite it being relatively straightforward to do so. In addition we noted recent econometric analysis which suggests that withholding airtime would not be a profitable strategy for C4 and Five and although there is potentially an incentive for ITV1[9], it is likely to be very weak.

2.7 We also explained how conditional selling is a form of bundling and that bundling can potentially yield benefits to market participants. We noted that even where conditional selling might restrict competition – i.e. where a sales house has market power – any adverse effects could still be outweighed by the benefits. We set out that because of this it was more appropriate to treat possible conditional selling by broadcasters on a case by case basis, rather than through an industry-wide ban to prevent this behaviour.

2.8 Finally, we noted our preliminary view that the ASRs were no longer appropriate to ensure fair and effective competition. We also noted how removing unnecessary regulation is important to enable sectors to develop and to give industry players more flexibility to run their businesses – and that this may then have positive impacts on innovation or investment and ultimately for consumers.

A number of stakeholders broadly supported our analysis

2.9 Our consultation closed on 21 June 2010. We received twelve responses from broadcasters, media buyers, trade bodies and the Ofcom Advisory Committee for Scotland.

2.10 Several stakeholders agreed with our general analysis that, under current circumstances, there are limited incentives for ITV1, C4 and Five to withhold airtime. Similarly, several agreed that there are potential benefits and costs associated with bundling.

We conclude it is appropriate to remove the withholding rule on all commercial PSBs

2.11 Consultation responses were mixed on our proposal to remove the withholding rule.. Two respondents agreed that the rule should be lifted, and another believed that ITV would be constrained from withholding if CRR remained in place.

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[6] PSB means public service broadcaster and includes all BBC channels, ITV1, GMTV, C4, Five and S4C - non-PSBs therefore refers to all other channels, except these.
[7] A commercial impact is a single viewing of a TV advertisement by a member of the target audience.
[8] SOCI = the percentage share of the total viewings of TV advertisements.
[9] The results suggest that ITV might have a very weak incentive to withhold airtime on ITV1 since the inverse own price elasticity is slightly above 1.

2.12 On the other hand, some stakeholders, particularly on the buyer side, did not support lifting the rule. Aside from their concerns about the potential for changes to the sector to alter the incentives of the commercial analogue channels, they raised several other points on the proposed removal of the withholding rule. First, some expressed concern that if the rule were lifted, the behaviour of the commercial analogue channels would alter. Ofcom does not believe that this is likely to be the case. The commercial analogue channels already have some scope to circumvent the rule if they desired (e.g. by scheduling advertising in the middle of the night) but have not chosen to do so. It is therefore unclear, if they are not behaving this way currently, why there would be any change to their behaviour were the rule lifted.

2.13 Second, two respondents believed Ofcom misunderstood the incentives facing the commercial analogue channels under the trading model. They suggested that short run incentives to withhold and raise the price of impacts might outweigh the desire to increase SOCI in the longer run. Ofcom examined these arguments but, as outlined in Section 5, we conclude that short run incentives to raise price are unlikely to outweigh the longer run desire to increase SOCI.

2.14 Finally, given the importance of the incentive to increase SOCI in the longer run to our conclusion that there are limited current incentives to withhold, we asked stakeholders for their view of the role of SOCI in negotiations. On the whole respondents agreed that SOCI was important in negotiations, though some suggested that it is only one of several factors discussed between agencies and sales houses and that other factors are also important. We considered these responses but whilst we agree that a number of factors may be relevant to the negotiation process, we conclude that the amount of revenue a channel can attract is strongly related to its SOCI performance – and therefore the trading model will incentivise broadcasters to attain high levels of SOCI by selling more airtime.

2.15 We have thus concluded it is appropriate to remove the withholding rule on all PSBs.

We conclude it is appropriate to lift the conditional selling rule and to consider possible anti-competitive bundling on a case by case basis

2.16 A number of responses supported our view that it is appropriate to consider possible anti-competitive bundling behaviour on a case by case basis. Discovery[10] believed that the rule should be lifted from all broadcasters, while another broadcaster believed that it should be lifted from all broadcasters except ITV. Sky believed that ITV would be constrained from conditional selling if CRR remained in place. Those who did not believe that the rule should be lifted had two main concerns. First, that conditional selling is already occurring and, instead of lifting the rule, Ofcom should tighten or even extend its remit. Ofcom notes that, despite queries raised with the CRR Adjudicator, no formal complaints about bundling by sales houses have been made to either the Adjudicator or Ofcom.

2.17 Second, whilst several respondents agree in principle that there are positive and negative effects of bundling, some deny that any positive effects are felt by buyers and believe that the only result of lifting the rule would be higher prices and less choice.

[10] Discovery Communications Europe Ltd.

2.18 Ofcom does not accept that the benefits of bundling only accrue to sellers and not buyers or that we have overestimated the incremental positive effects. As outlined in the consultation document there are many ways in which bundling can lead to lower prices for buyers i.e. it can lead to cost savings (reduced number of legal contracts and administration costs between players for example), value enhancements and output increases. Only if a sales house has market power could conditional selling lead to negative outcomes and even then, these negative outcomes may be outweighed by the positive effects of bundling. We therefore believe that the blanket retention of the rule across all broadcasters/sales houses, no matter their size, is likely to prevent types of bundling which would lead to more innovative and efficient solutions for both the sales houses and their customers.

2.19 We have thus concluded it is appropriate to remove the conditional selling rule on all broadcasters[11] and approach potential negative behaviour on a case by case basis.

There are also potential benefits associated with simplifying and reducing regulation, where appropriate

2.20 Ofcom is committed to reducing and simplifying complex or unnecessary regulation where appropriate, which is in line with our general duties. This is important as there may be efficiency benefits from reducing the regulatory burden and increasing the flexibility of broadcasters. For example, as note above, current conditional selling regulation may prevent beneficial and innovative bundling of airtime which may be in the interest of media buyers and advertisers. Providing more flexibility for broadcasters could also have positive effects on investment which might, in turn, deliver benefits for advertisers and viewers.

But some respondents suggested we postpone our review of ASRs and conduct it in tandem with a review of COSTA or a broader review of TV advertising regulation (or the sector) instead

2.21 A number of respondents submitted that we should not be undertaking the review of ASRs at this time. One broadcaster proposed that we should be undertaking a comprehensive market review instead, which may result in a market investigation reference to the Competition Commission (CC).

2.22 Furthermore, the buyer trade body, the Institute of Practitioners in Advertising (IPA) stated that any decisions to lift the ASRs "*must only be made as part of a market wide review*" and two media buyers made similar points. Also, while the advertisers' trade body, ISBA, did not call for a market review, they argued there are strong linkages across different types of advertising regulation which mean they should be considered together.

2.23 The Satellite and Cable Broadcasters' Group (SCBG) advocated a broad review of our advertising regulation i.e. including COSTA and ASRs and "*wider questions about public service content funding and competition in the marketplace*". Furthermore Sky, Discovery, UKTV and a media buyer suggested the ASR review should be conducted at the same time as the review of COSTA.

[11] The conditional selling rule applies to all broadcasters licensed by Ofcom.

We believe it is appropriate to complete our review

2.24 One broadcaster stated that Ofcom should not be conducting its review of ASRs and that it should instead undertake a comprehensive competition-based review of the TV advertising market. The CC also called for such a review in its report concluding the recent review of Contracts Rights Renewal (CRR) undertakings, published on 12 May this year. The CC noted that a number of characteristics in the market may "*prevent, distort or restrict competition*", and concluded that there should be "*a wider review of the market for selling television airtime*"[12]. Ofcom has considered these calls and we believe that there are a number of reasons why it is not appropriate at this time to delay the review of ASRs in order to pursue a wider market review. We set out our reasons in further detail in the next Section - paragraphs 3.19-3.26.

2.25 We agree that the trading model is complex and there is limited transparency of prices. However we do not believe that the features identified by the CC are likely, on their own, to deliver anti-competitive outcomes. It is possible that if combined with market power the features identified could interact in such a way that prevents, reduces or distorts competition in the TV advertising sector, although we note that it is also plausible that the characteristics of the trading model are efficient responses to the uncertainty and transactions costs that key players face.

2.26 Given that, on the information available to date, there is a lack of clarity about the nature and scale of any broader competition problems arising from the way airtime is traded (or in relation to any resulting consumer harm), our current position is that the resources which we anticipate would be required to launch an own initiative market study into the issues raised by the CC cannot be justified as a matter of administrative priority at this time.

2.27 Regarding the need to complete the review with COSTA, we agree that the reviews of ASRs and advertising minutage are both linked to the sale of TV advertising airtime. However we note there are distinct differences in the scope and objectives of the two sets of rules. As made clear in our consultation document, the ASRs target how TV advertising airtime is sold and are intended to ensure fair and effective competition in the supply of advertising airtime. In contrast, COSTA sets limits on how much and how often TV advertising occurs on channels and is focused on consumer protection and limiting over-exposure to advertising.

2.28 We also believe it would be helpful to have first established whether the commercial PSBs will still be required to sell all their airtime (under the ASR review), as this will be germane to assessing the impact of the different options (under the COSTA review) for rules on the amount and scheduling of advertising airtime. However, we do not believe our analysis of the ongoing need for ASRs hinges on the outcome of the advertising minutage review.

2.29 As a result, we remain of the view that the two reviews can be considered separately and that it is important to progress with this review of ASRs in order to deliver the potential benefits of removing unnecessary regulation.

[12] Competition Commission *ITV Contracts Rights Renewal – Final Report* 12 May 2010 http://www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/final_report.pdf

Some respondents believe we should not remove the rules because of recent consolidation and possible future sector developments

2.30 In response to the consultation, some stakeholders highlighted the recent consolidation amongst TV advertising sales houses as evidence that competition has not increased in the sector, contrary to our preliminary assessment. This, in conjunction with possible further consolidation, has been cited as a reason not to remove the Rules.

2.31 Stakeholders also cited other possible sector developments as reasons why we should not lift the Rules. These include uncertainty about the long term future of CRR and possible changes to the trading model.

2.32 Ofcom recognises the consolidation that has taken place across sales houses over the last year. However we still believe that the longer-term trends since 2003 are consistent with increased competition across the sector. Furthermore, it is not clear that recent consolidation between sales houses will necessarily lead to less competition. While this is possible, it may also be the case that a smaller number of more evenly-sized sellers – in terms of more similar market shares, with strong brands and with a wider portfolio of channels and a broader range of audience demographics - could bring a more competitive environment than one characterised by one large sales house and a series of much smaller sales houses.

2.33 Furthermore, given the ASRs apply to a range of broadcasters, we have considered whether competition has changed across the sector, and not just in relation to ITV. We noted some stakeholders' concerns about ITV's strong market position but note that ITV1 still has additional regulation applying to it, giving protection against withholding and conditional selling in the form of CRR regulation. The CC has recently concluded that it is appropriate to retain the CRR undertakings[13] and we believe they would only re-review in the event of a material change to circumstances.

2.34 In addition, we do not believe it is appropriate to retain regulation on the basis that factors *might* change in the future. That said, we will monitor behaviour in the market and as part of this, continue to engage with stakeholders. If after removal of the rules, any fundamental changes occur in the sector, we will consider whether these lead to increased incentives to engage in behaviour currently prohibited by the ASRs. If it becomes apparent that market players are behaving anti-competitively, then we will consider introducing *targeted* ex ante rules, where appropriate.

We will continue to monitor the market

2.35 The rules will be lifted as of 1 September 2010. We hope this will provide regulatory certainty on this issue ahead of the next deal season for TV advertising airtime which will take place in autumn.

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[13] In its Final Report on its Review of ITV's Contract Rights Renewal Undertakings, the CC concluded that CRR should be retained but varied so as to change the definition of ITV1 in the Undertakings to include ITV1+1 and ITV1 HD. This process is now in its final stages and we expect revised Undertakings to incorporate these variations to be accepted by the CC in due course – see Competition Commission *ITV/CRR – Notice of Proposal to accept undertakings varying the CRR undertakings* 16 July 2010 http://www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/itv_crr_notice_of_proposal_to_accept_undertakings_from_ITV_160710.pdf

2.36 Finally, we would stress that we will continue to monitor the development of the TV advertising sector and any effects of the removal of the two rules. Continuing engagement with industry stakeholders will form an integral part of our ability to take account of such changes.

2.37 For the avoidance of doubt, the removal of these rules does not mean that anti-competitive bundling or withholding will be permissible. Any such conduct which is in breach of the Competition Act prohibitions could be the subject of enforcement action by Ofcom. In addition we will consider the need for new specific ex ante rules in the event that there are fundamental changes in the TV advertising sector, such as changes to the way airtime is traded.

Overview of the document

2.38 The rest of the document is laid out as follows:

- **Section 3 –** explains our approach to the review and the legal framework. We also consider consultation responses about how we have reviewed the rules;
- **Section 4** – summarises our view of the major developments that have taken place in the TV sector generally, since the last review of the ASRs. It presents stakeholders' comments on our analysis and our responses to feedback. Looking at wider changes in the sector's landscape is useful in considering whether the underlying rationale for the ASRs is still relevant;
- **Section 5** – summarises our analysis of the incentives for the channels to withhold airtime from the market and what may happen if we were to remove the withholding rule. We note stakeholders' key comments on our analysis and our responses to these;
- **Section 6** – recaps our analysis of the incentives for broadcasters to bundle airtime across several channels and what may happen if we were to remove the conditional selling rule. Again, we present stakeholders' feedback on our analysis and our responses to this feedback; and
- **Section 7** – sets out our conclusion, which is to proceed with our proposal to remove the ASRs.

Section 3

Our approach to reviewing the ASRs

Introduction

3.1 In this Section we explain why we are reviewing the ASRs and our approach to the review, summarising the legal framework set out in our consultation document. We also consider consultation responses about how we have reviewed the rules.

3.2 Under s.318 of the Communications Act 2003, Ofcom has a duty to review whether the regulation we have imposed remains appropriate for ensuring fair and effective competition. The focus of our review has therefore been whether the Airtime Sales Rules remain fit for purpose or whether they should be amended or removed.

3.3 We last conducted a review of a number of rules regarding advertising sales arrangements in 2003[14]. At that time we considered that it was necessary to retain the two prohibitions on withholding airtime and conditional selling for the purpose of ensuring fair and effective competition.

We published a consultation document on our Airtime Sales Rules review in March

3.4 When we published a consultation document on the ASRs review, we provided an overview of the scope of the Rules and an explanation of the context as well as the approach we would take in our review.

3.5 We considered it appropriate and timely to review the Rules again this year because:

i) Of significant developments in the TV sector since 2003, which are likely to have impacted competitive constraints in the supply of TV advertising airtime;

ii) The withholding rule would, unless amended, automatically fall away when digital switchover completes as it only applies to analogue broadcasters; and

iii) We stated in 2009 that we would conduct this review as a precursor to reviewing rules on the amount and scheduling of minutage broadcasters can carry (i.e. COSTA) and we reiterated this in our 2010-11 annual plan[15].

3.6 In our consultation document we set out our analysis and the reasons why we reached the preliminary conclusion that it is appropriate to remove the two Rules. We asked for stakeholders views on our analysis and our proposals to lift the regulation.

3.7 The consultation period ended on 21st June 2010. We received 12 responses from a range of stakeholders. A list of the respondents is set out in Annex 1. These

[14] Ofcom *Airtime Sales Rules* 2003 – these replaced the ITC's rules regarding Advertising Sales Arrangements (2001) and its Consolidated Statement Regarding Advertising Arrangements (1996). The Rules took effect from 1 December 2003 – see http://www.ofcom.org.uk/tv/ifi/guidance/ITV_airtime_sales/Airtime_sales_rules/

[15] Ofcom *Annual Plan 2010-11* 31 March 2010 http://www.ofcom.org.uk/files/2010/06/annplan1011.pdf

responses have been taken into account in reaching our final conclusion and are published on our website, subject to confidentiality[16].

The ASRs restrict the way TV advertising airtime is sold

3.8 The ASRs were imposed to ensure fair and effective competition in the supply of TV advertising airtime and prohibit:

- the withholding of advertising airtime on the commercial analogue channels; and
- conditional selling of any channel, which occurs when a broadcaster requires that an advertiser or media buyer, who wishes to purchase airtime on one channel, must buy another of the broadcaster's products as a pre-condition of the sale.

3.9 The withholding rule means the Channel 3, Channel 4 and Channel 5 licensees must sell all available advertising time allowed under COSTA on their analogue channels, i.e. ITV1[17], C4 and Five[18]. It does not strictly apply to digital versions of these channels. However, we note that in effect the rule has been applied to the simulcast digital versions of the analogue channels, since we believe the same content and advertising is carried on analogue and digital versions of the same channel.[19]

3.10 In contrast, the conditional selling rule applies to all broadcasters. This prohibition only refers to some bundling activities; bundling of products is not prohibited per se, only that bundling which can be described as conditional selling[20].

The Rules were intended to ensure effective competition in the TV advertising sector

3.11 The Rules took effect on 1 December 2003 and have the effect as if they were a code approved by Ofcom for the purposes of a licence condition imposed under s.316 of the 2003 Act. At the time of the last review, it was considered that a withholding prohibition was still appropriate on the basis that the commercial analogue channels had the ability to withhold airtime in order to drive up prices and increase their profits.

3.12 The 2003 review also noted that there was concern about the widespread nature of conditional selling and its impact on the TV advertising sector in terms of reduced choice and artificially high prices for media buyers and advertisers. The conditional selling rule was applied to all broadcasters and, as such, was not related specifically to the individual market power of broadcasters. As a result, all broadcasters were prohibited from conditionally selling airtime across their channels.

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[16] Non-confidential responses are available at http://stakeholders.ofcom.org.uk/consultations/asr/?showResponses=true

[17] We refer to Channel 3 as ITV1 in the rest of this document for simplicity – this definition includes GMTV (which is now owned outright by ITV plc) and all the regional and national television services broadcast on the analogue Channel 3. However, we recognise that Channel 3 is known as STV in central and north Scotland and UTV in Northern Ireland – and moreover, that there are 15 regional TV broadcasting licences, of which four are not owned by ITV Broadcasting Ltd (ITV plc) – 2 are held by STV plc and one by UTV plc and Channel TV Ltd respectively.

[18] The withholding rule no longer applies to S4C as it ceased to be an analogue channel after digital switchover completed in Wales earlier this year.

[19] The withholding rule combined with the COSTA rules in effect dictate how much advertising is allowed on commercial PSB channels.

[20] This was described in more detail in Section 6 of our consultation.

3.13 Accordingly our review of the Rules has focussed on whether they continue to be proportionate and appropriate for the purpose of ensuring that providers do not enter into arrangements or engage in practices which we would consider prejudicial to fair and effective competition in their licensed services.

A number of respondents suggested we postpone the ASR Review and instead undertake a broader review of TV advertising

3.14 A number of respondents said that we should not be undertaking the review of ASRs at this time. For example, one broadcaster proposed that we should be undertaking a formal competition-based market study review which could result in a full market investigation reference to the CC.

3.15 In addition, ISBA queried why we were reviewing different but linked aspects of advertising regulation separately and noted that a broad market review was proposed by the CC in its final report on the review of CRR undertakings. In addition, two media buyers and IPA stated that any decisions to lift the ASRs should only be made as part of a market wide review.

3.16 In contrast to a competition based review of the market, Sky, Discovery, UKTV and a media buyer argued that the ASR review should be linked more explicitly to the review of COSTA and that they should be conducted simultaneously.

3.17 In addition, SCBG called for a market review which focused on the ability of broadcasters to invest in content and specifically the content funding for PSBs i.e. something more akin to Ofcom's quinquennial PSB reviews which are not just about competition but also have a public policy focus.

3.18 As a result, different stakeholders appear to be calling for different types of market review, potentially with quite different aims. We present our response to these calls for "market reviews" below.

Ofcom does not believe a market study which may result in a market investigation reference to the CC is appropriate at this time

3.19 In its final CRR Review report published on 12th May this year, the CC noted that a number of characteristics in the market may "*prevent, distort or restrict competition*", and concluded that there should be "*a wider review of the market for selling television airtime*". In particular, it noted: *"CRR operates in a complex and opaque environment conditioned by the existence of SOB*[21] *deals, media agency umbrella deals and the SAP*[22] *trading mechanism. These characteristics of the market continue to have potentially anti-competitive effects"*[12]. As noted above, this was picked up by a few respondents with one broadcaster explicitly requesting that we postpone the ASR review in order to launch a broader competition-based review.

3.20 We have given careful consideration to the statements made by the CC and the responses to the ASR consultation requesting a market review.

3.21 We agree that the trading model is complex and there is limited transparency of prices. Moreover it is possible that the features identified, if combined with market

[21] SOB is the Share of Broadcast and represents the proportion (by value) of an advertiser's or media buyer's television advertising spend received by (or committed to) a particular channel.
[22] SAP is the average price per impact across a channel (or sometimes range of channels).

power could interact in such a way that prevents, reduces or distorts competition in the TV advertising sector. On the other hand, we note that it is also plausible that the characteristics of the trading model are efficient responses to the specific features of the TV advertising market and the uncertainty and transactions costs that key players face.

3.22 While respondents to the consultation have expressed a range of concerns, to date, we have not received any evidenced complaints in relation to the issues raised by the CC and there is a lack of clarity about the nature and scale of any broader competition problems arising from the way airtime is traded or in relation to consumer harm which might arise as a result. As a result, if we were to launch a market study, we would be undertaking it on our own initiative.

3.23 We have also had regard to the resource requirements that we expect a market study into the TV advertising sector to entail (both for Ofcom and industry players) and the uncertainty that a market study would be likely to impose on the sector during the course of a review. In these circumstances, our current position is that the launch of an own initiative market study into the issues raised by the CC cannot be justified as a matter of administrative priority at this time.

3.24 Should we receive any reasoned requests from stakeholders for a market study into the operation of the trading model or other aspects of the TV advertising sector then these will be given careful consideration. We would expect such requests to be supported by specific, relevant evidence, including evidence of any harm suffered as a result of a feature of the market in question and, if available, evidence of the actual or potential effect on consumers[23].

3.25 Ofcom will keep its decision not to launch a market study of the TV advertising sector at this time under review. We will closely monitor any stakeholder concerns and wider changes as a result of market developments, including possible further consolidation, which may cause us to consider again our decision not to launch a market study of the TV advertising sector at this time.

3.26 Since we are not minded to launch an own-initiative market study we believe it is important to progress with this review of ASRs. We note that changes to the ASR rules can be achieved quickly, in time for the next deal season. Moreover we believe there is merit in creating the right conditions in which to review the need for ex ante rules should we undertake a broad market review in the future. In other words, we consider that there are benefits to removing unnecessary regulation, in advance of any potential future market review.

Ofcom does not believe it is appropriate to delay the ASR review and instead do it in tandem with COSTA

3.27 Several stakeholders including Discovery, Sky and UKTV suggested that we delay our review of ASRs in order to undertake it at the same time as our review of the amount and scheduling of TV advertising (COSTA). They argue there are close linkages in the rationale for both sets of regulation and moreover, suggest the

[23] See also Ofcom *Guidelines for the handling of competition complaints, and complaints and disputes about breaches of conditions imposed under the EU Directives* July 2004 at http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/complaints-disputes/ and also OFT *Market Investigation References - Guidance about the making of references under Part 4 of the Enterprise Act* February 2006 at http://www.oft.gov.uk/shared_oft/business_leaflets/enterprise_act/oft511.pdf

analysis of the ASRs is contingent on the outcome of the COSTA review. Specifically stakeholders are concerned that there may be incentives to withhold airtime if COSTA rules on PSBs are relaxed.

3.28 We agree that the reviews of ASRs and advertising minutage are both linked to the sale of TV advertising airtime. However, as noted in the ASR consultation document there are distinct differences in the scope and objectives of the two sets of rules. The ASRs address aspects of how airtime for TV advertising is sold and are intended to ensure fair and effective competition in the supply of advertising airtime, whilst COSTA sets limits on how much and how often TV advertising occurs on channels and is focused on consumer protection and limiting over-exposure to advertising. Given there are different frameworks applying to the two sets of rules, which have different origins and rationales, we believe that it is appropriate to undertake the reviews separately.

3.29 We also believe that for the purposes of the advertising minutage review, it would be helpful to first establish whether the commercial PSBs will still be required to sell all their airtime (under the ASR review), as this will be germane to assessing the impact of different options for rules on the amount and scheduling of advertising airtime.

3.30 In contrast, we do not believe our analysis of the ongoing need for ASRs hinges on the outcome of the advertising minutage review. As noted in our consultation document we believe that, under current circumstances, ITV, Channel 4 and Five have few incentives to withhold airtime on their main channels. This is a position which is broadly supported by respondents, as described in Section 5. Moreover, we have no reason to believe that changes to COSTA will change incentives to withhold at the current level of minutage. We recognise that if there were a significant change in COSTA rules then it is possible that the incentive to withhold could change. However, if we substantively relaxed the COSTA rules on the commercial PSBs - i.e. allow them to sell more – there may be benefits to giving broadcasters the flexibility not to sell all the additional airtime, if it was not profitable to do so.

3.31 We also note that we do not believe that the changes in COSTA will have any impact on the incentive or ability to conditionally sell airtime.

3.32 In the event that, after lifting the ASRs, there are significant changes in the sector which may change broadcasters' ability and incentive to profitably withhold airtime, we may need to introduce targeted rules which address any specific problems which emerge.

3.33 Finally, we refer back to SCBG's suggestion that the ASR review is also connected to wider issues relating to public service content funding and that these should be considered holistically, for example, through a PSB-type review.

3.34 On this, Ofcom completed a comprehensive review of public service broadcasting last year, which looked explicitly at how PSB objectives might evolve in the run up to and after digital switchover. Our review of COSTA will take account of its findings in the process of reviewing options for advertising minutage[24]. However, we do not believe that this needs to be completed at the same time as the review of ASRs.

3.35 As a result, we are very conscious of the linkages between COSTA and the ASRs review but still believe that the reviews can be considered separately.

[24] See our update on the review of COSTA at http://stakeholders.ofcom.org.uk/market-data-research/tv-research/arr/

Ofcom does not believe it is appropriate to delay the review to give stakeholders more time to digest and reflect on the published econometric analysis

3.36 In addition, a few stakeholders - Sky, SCBG and UKTV - suggested they may need more time to digest the econometric report on the demand for TV advertising cited in our consultation document.

3.37 Ofcom commissioned an econometric analysis as part of the COSTA review to derive estimates of both own and cross elasticity effects of changes in the amount of advertising minutage on individual commercial PSBs[25]. It uses data on actual prices paid by a media buyer to different broadcasters for the period 2002-2009. The study also explicitly factors in the viewer side of the market i.e. it uses a two-sided market framework to take into account the impact of changes in minutage on viewers as well as advertisers.

3.38 The model enables an assessment of the responsiveness of advertiser and viewer demand to changes in advertising minutage for individual commercial PSBs. It also enables an assessment of the impact of cross-effects for individual commercial PSBs e.g. the impact on Five's prices of changes to the advertising minutage on ITV1.

3.39 This gives us some insight into whether a withholding strategy is likely to be profitable and so whether it would be profitable for ITV1, C4 and Five to withhold airtime if we removed the prohibition. The econometric model suggests that it is only ITV1 which may have an incentive to withhold airtime given the current situation but even then, its incentive is likely to be very weak[9].

3.40 As discussed in Section 5 of this statement, our decision to remove the withholding prohibition is based on a number of pieces of evidence. We understand from discussions we had with stakeholders during the CRR review that the trading model incentivises broadcasters to increase their SOCI i.e. to sell more rather than less of their airtime, in order to increase their long run profits. In addition, although it would be fairly straightforward to bypass the withholding rule and effectively restrict the supply of airtime despite the prohibition - by moving advertising to the middle of the night when there is likely to be little viewing and so few impacts - ITV, Channel 4 and Five have not done so. Moreover CRR regulation also incentivises ITV to sell all its airtime on ITV1. The econometric results support these findings.

3.41 In our consultation document we stated that the econometric study would be published mid-way through our consultation period. However, since its publication was delayed and it was not issued until 25 May, we extended our consultation deadline by two weeks, from 7 June to 21 June. We therefore feel this has given stakeholders adequate time to take account of the econometric findings. Moreover since the econometric results are used as supporting evidence and are not critical to our understanding that under current circumstances commercial PSB broadcasters do not have an incentive to withhold airtime on their main channels in order to increase price, we do not think it is necessary to delay our statement further.

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[25] Analysys Mason/Brand Science *Final report for Ofcom - An econometric analysis of the TV advertising market* 11 March 2010 http://stakeholders.ofcom.org.uk/binaries/research/tv-research/report.pdf

Sales side consolidation in the TV advertising sector has not significantly changed our analysis or conclusions

3.42 A number of stakeholders proposed that there are factors which mean the development of the sector is uncertain and that this could change incentives to withhold airtime or engage in conditional selling. For example, UKTV, ISBA, IPA and two media buyers noted the recent increase in concentration on the sales side of the market e.g. Sky's sales house adding the sale of airtime for channels previously sold by Viacom Brand Solutions (VBS) as well as Virgin Media digital TV channels to its existing portfolio; Channel 4 winning the contract to sell UKTV airtime and the possible acquisition of Five by one of the main UK broadcasters. Some of them said that this consolidation was changing competitive conditions and could change incentives to engage in behaviour currently prohibited by ASRs.

3.43 In Section 4, we consider the impact of recent consolidation among TV advertising sales on our analysis of changes to the competitive landscape. We note that there has been recent consolidation between a number of smaller sales houses but that this has been accompanied by increased consolidation on the buyer side over the period since 2003. Moreover, whilst fewer sales houses could imply a decrease in competition, sales house consolidation has reduced the gap between ITV and its nearest rivals, and so may also deliver more competition between more evenly sized players.

3.44 In Sections 5 and 6 we also note whether recent sales house consolidation changes our view about the incentives to engage in behaviour prohibited by ASRs. We state that it is not clear that incentives to withhold on ITV1, Channel 4 and Five will be affected by increased consolidation. On the other hand, as suggested in our consultation document, consolidation may result in more opportunities and incentives for sales houses and media buyers to bundle airtime sales and we would expect that bundling on both sides of the market will continue to exist. However it is not clear that this bundling would have anti-competitive effects and even if it were to, whether these effects would be outweighed by welfare enhancing effects. Hence, we continue to believe there is a strong case for reviewing such potential anti-competitive behaviour on a case by case basis.

Potential future changes to CRR do not justify retention of ASRs

3.45 Two respondents – SCBG and Discovery - reflected on the status of CRR, speculating that it could be removed in the future as a result of political or other reasons. Another respondent – IPA - stated our "*conclusions do not consider a trading market without CRR and SOCI*". The implication was that CRR could not be relied on as a 'check' on ITV's behaviour or as a driver of increases in SOCI across sales houses. It was suggested that given this uncertainty we should not remove ASRs from ITV.

3.46 In response to this we note that the CRR review has now largely been completed. The CC published its final report on the ongoing need for CRR undertakings and concluded that the undertakings should be retained subject to some relatively minor changes to the definition of services covered by the undertakings, specifically ITV1+1 and ITV1HD.

3.47 The CRR undertakings currently ensure that terms and conditions in relation to the sale of airtime on ITV1 by ITV plc or its subsidiaries are protected i.e. that advertisers are able to purchase advertising on ITV1 on the same terms as they did prior to the merger (leaving aside the operation of the Automatic Ratchet Mechanism (ARM). In addition, the undertakings require ITV plc to offer airtime on ITV1 (including where a buyer seeks to vary the terms of a protected contract) on fair and reasonable terms. We believe this should prevent the ability of ITV's sales house to use any market power in ITV1 to engage in conditional selling i.e. 'forcing' media buyers to buy airtime on its digital channels. Furthermore, the current CRR ARM allows buyers to withdraw revenue in proportion to a fall in ITV1's SOCI and this is likely to offset any incentive to withhold in the short-run.

3.48 Moreover we believe the CC would only re-review the CRR undertakings in the event that there is a material change to circumstances. Therefore given the current status of CRR, we believe it is appropriate to consider removal of ASRs at this time.

Possible future sector developments do not change our conclusion

3.49 Some stakeholders have made the general comment that our analysis of incentives to restrict the supply of airtime only applies under current circumstances, namely the current trading model. In this context, we would again note that several respondents support our analysis that there are limited incentives to withhold airtime. However, on the basis that the sector may change in the future, for example in terms of the way airtime is traded and the amount of airtime broadcasters can sell (following the COSTA review) some have proposed that we should retain the Rules.

3.50 For example, Discovery suggested that removal of the withholding rule could change the way in which airtime is traded and in particular, could lead to a move away from SAP trading to some other mechanism, which may be associated with greater incentives to withhold. IPA makes a similar point that there could be a move to a different trading currency, such as 'Share of Value' in the absence of the withholding rule. On these specific points we note that the existence of CRR prevents ITV from moving away from the current trading model. In addition, we believe that all broadcasters have had the ability to by-pass the current withholding prohibition relatively easily to date, but have not done so. Moreover, most broadcasters have had the ability to change the way they trade and have chosen not to. It is not clear to us why removal of the withholding rule would create an incentive to do so now.

3.51 We also reiterate our preliminary findings that it is appropriate to remove the ASRs given the limited incentives that commercial PSBs have to withhold airtime and that it may be more appropriate to consider potential conditional selling activities on a case by case basis rather than applying a blanket ban on all broadcasters. This also fits with our wider commitment to reduce and simplify complex or unnecessary regulation and is in line with our general duties. We would also reiterate that this could provide more flexibility for broadcasters and allow them to operate more efficiently – and in turn have positive impacts on innovation and investment e.g. in programming, with potential benefits for the overall sector.

3.52 Furthermore, we would stress that we intend to keep under review the impact of lifting the Rules on competition in the market. This would take place through analysis of broadcaster returns, key trends in the sector and regular discussions with stakeholders, including the buyer-side of the market and the Office of the Adjudicator (CRR).

3.53 Moreover if circumstances materially change in the sector – e.g. if the CRR remedy was removed or there were changes to the way airtime is traded or substantive consolidation in the sector – which then indicated it was more likely that broadcasters would engage in anti-competitive behaviour, then it may be appropriate to consider whether it would be necessary to reintroduce targeted ex ante rules to ensure fair and effective competition.

3.54 As a result, we believe that future potential changes in the sector should not limit our ability to make changes to regulation now, particularly where there is no certainty about what changes might take place nor when they might occur, let alone what their potential impact might be on broadcasters' incentives in relation to advertising sales. We will, however, continue to monitor the sector and develop relationships with key stakeholders, in order to review the effects of removal of the Rules and sector developments on an ongoing basis.

A few respondents are concerned about the effectiveness of the complaints process to limit abuses of market power in the event the Rules are lifted

3.55 Finally, two respondents - IPA and ISBA - were concerned that the removal of the ASRs would shift the burden of proof that broadcasters are engaging in anti-competitive behaviour on to advertisers and media buyers. They suggested this would be unwarranted and prove costly and time consuming. For instance, IPA stated "*significant extra resource and expense…would be entailed in this*" and they also suggested that the length of time taken for us to respond to complaints would mean that ex ante law would not give advertisers or media buyers any protection.

3.56 We understand these concerns and we acknowledge that there may be benefits associated with maintaining rules in terms of giving stakeholders some regulatory certainty. However we continue to believe that it is appropriate to remove the rules in this case. Firstly we note that we have no evidence that broadcasters will engage in anti-competitive behaviour in the absence of the Rules. Secondly, we believe that where possible we should remove unnecessary regulation in order to encourage flexibility and innovation in broadcasting and electronic communications industries.

3.57 Moreover our approach with respect to the ASRs is consistent to the approach we and other competition authorities take in other sectors.[26] We have a range of powers, such as the Competition Act, which may be utilised in order to investigate anti-competitive behaviour. As a result, it is our policy that for us to consider taking forward individual complaints about anti-competitive behaviour, whether under ex ante regulation such as ASRs or ex post regulation such as competition law, we expect complainants to provide evidence to support their allegations. Further information on this policy is contained in Ofcom's "Guidelines for the handling of competition complaints, and complaints and disputes about breaches of conditions imposed under the EU Directives" which may be downloaded from Ofcom's website: http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/other/guidelines.pdf.

[26] For example, there is a series of guidance papers published by the OFT on competition law for details on the competition framework applied by the OFT, Ofcom and the other sectoral regulators: http://www.oft.gov.uk/advice_and_resources/publications/guidance/competition-act/

Section 4

The changing landscape: TV advertising

Introduction

4.1 In our consultation document, we examined how the sector had changed in recent years to help our assessment of whether the underlying rationale for the ASRs is still relevant.

4.2 In this Section, we recap this overview and consider whether the responses we received alter our position. We conclude that, although the number of sales points has fallen in the last year, the longer-term trend since 2003 has been one which is consistent with increased competition overall across the sector.

4.3 We also recognise stakeholders' speculation about potential future consolidation but note that the nature and likelihood of such consolidation, or any impact on competition, is unclear: we believe it would be inappropriate to base the conclusions of the current review on outcomes which are speculative in nature and may not occur. In the event that any future consolidation took place which did fundamentally change the way TV advertising airtime is traded, so altering the incentives to withhold airtime, then we may need to revisit this issue and reassess the need for targeted ex ante rules.

In our consultation, we set out the sector developments which were likely to have increased competition in the TV advertising airtime market since 2003

4.4 In our consultation document we noted that the key development in the last six years has been the rapid increase in digital channels and digital TV uptake and a corresponding shift in TV viewing from PSBs toward digital channels. We considered this had a number of implications for levels of sectoral competition relative to 2003:

- **More fragmented viewing** - the PSB channels do not dominate viewing in the way they once did. Viewers have access to a greater choice of channels and the PSB channels have to compete more actively for viewing;

- **More commercial impacts** – the shift in viewing to digital channels has increased the volume of impacts available (i.e. viewing of advertising) from non-PSBs, which, in general terms, suggests a reduced reliance on ITV1, C4 and Five to purchase airtime; and

- **The difference in SOCI between sales houses and channels has narrowed**– we explained how we would expect lower SOCI to reduce the negotiating power of any individual channel and ultimately reduce its respective share of future TV advertising revenues. Although there were still gaps between the commercial analogue channels and non-PSBs, the fact that the commercial analogue channels are losing SOCI (and their share of NAR) whilst smaller channels are increasing their shares, may indicate increasing competition between broadcasters – although we also recognised that some of the gains in revenues are being captured by the digital 'family' channels of the commercial PSBs.

4.5 In addition, we noted how there had been long-term media buyer consolidation and some recent sales house consolidation[27]. We suggested that this may also have implications for competition as it could imply an increase in buyer power which, alongside other factors such as the increase in commercial impacts, may have contributed to reducing advertising prices.

Most of the respondents to our assessment of recent sector developments agreed with our analysis

4.6 We asked four questions relating to our assessment of the changing landscape in the sector. Seven stakeholders, a mixture of broadcasters, IPA and ISBA, provided feedback.

4.7 Our first question was whether stakeholders agreed with our description of the main developments in the TV advertising airtime market since 2003.

4.8 Five stakeholders - three broadcasters, ISBA and a media buyer - broadly agreed with our analysis that there have been changes in the market place since 2003, with more digital channels and so more choice for media buyers and advertisers as to where to purchase airtime.

4.9 A few caveats were provided to respondents' general support for our analysis:

- This included the view that many of the commercial PSBs' family channels have grown significantly over the period and have taken back some of the market share lost by the main commercial PSB channels;
- There was some concern about ITV's continued 'market dominance'; and
- One media buyer felt we overplayed buyer power and underplayed sales house power in our statements on consolidation.

4.10 The two stakeholders (IPA and one confidential respondent) who disagreed with our analysis questioned our assumptions. They noted that many of the new digital channels were not available on one of the main platforms (DTT) and overall, stated that they believed that competition has actually decreased, rather than increased.

Several stakeholders noted other market developments which may be relevant to competition in the sector

4.11 We also asked stakeholders whether we had missed any other recent market developments or trends relevant to competition in the advertising sector.

4.12 One respondent felt we had captured all the key developments. The other six respondents noted an additional development or made further points on our analysis including:

- **Sales house consolidation -** Several stakeholders, including IPA and ISBA, drew particular attention to the recent consolidation that had occurred between sales houses and suggested that this trend would continue. For example, while IPA agreed with our statement that the gap between the biggest and smallest

[27] At the time of issuing our consultation document, the most recent consolidation was Sky winning the contract to sell airtime for VBS' channels.

sales houses has narrowed, they noted that the number of sales houses 'of note' had decreased significantly: from eight in 2003 (Carlton, Granada, Channel 4, Five, Sky, IDS, Viacom and GMTV) to just six or even five if the current ownership of GMTV is taken into account (ITV (including GMTV), Channel 4, Five, Sky, IDS). IPA noted that "*in 2003 4 sales points controlled 81% of TV ad revenues; at the end of 2009 c83% of revenues were controlled by just three sales points*". They believed that this meant that choice had been reduced for media buyers;

- **The ability of commercial PSBs, particularly ITV, to deliver mass audiences** - One respondent believed commercial PSBs play a critical (non-substitutable) role in reaching large audiences; while IPA stated that ITV specifically accounts for over 95% of the top 100 mass delivering programmes on commercial television;

- **Our categorisation of non-PSBs** – for example, Discovery stated that the reality was more nuanced than our straightforward categorisation between commercial PSBs and 'non-PSBs'. They argued that non-PSBs were not one company and "*individual commercial PSBs still have a significantly larger market share than individual non-PSBs*"; and

- **The influence of macroeconomic conditions** - Two respondents stated that economic conditions have been the most substantial factor to affect the TV advertising market since 2003.

4.13 As evidence for some of the above points, two stakeholders noted that the premia (or power ratio) for the commercial PSB channels (particularly ITV and Channel 4) had grown over the period. One stakeholder also suggested that this also indicated that there was not a close link between trends in SOCI and trends in share of NAR.

4.14 We set out our responses to each of these points below.

It is not clear whether sales house consolidation would deliver increased or decreased competition between broadcasters

4.15 Stakeholders highlighting recent sales side consolidation in the sector believe that this may increase the power of sales points. A few respondents also believe this consolidation may offset any increased buyer power (from buyer consolidation) and may have implications largely (but not exclusively) for conditional selling.

4.16 In our consultation, we forecast that, due to the recent advertising downturn, we might expect to see more consolidation amongst media buyers and sales houses. For example, we noted Sky's sales house had recently won the contract to sell advertising time on Viacom's portfolio of channels[28].

4.17 We appreciate that since our consultation was issued, Sky has also taken over Virgin Media Television in June[29] and Channel 4 has announced that it will be selling airtime on the UKTV channels. We also note that Five was put up for sale by its

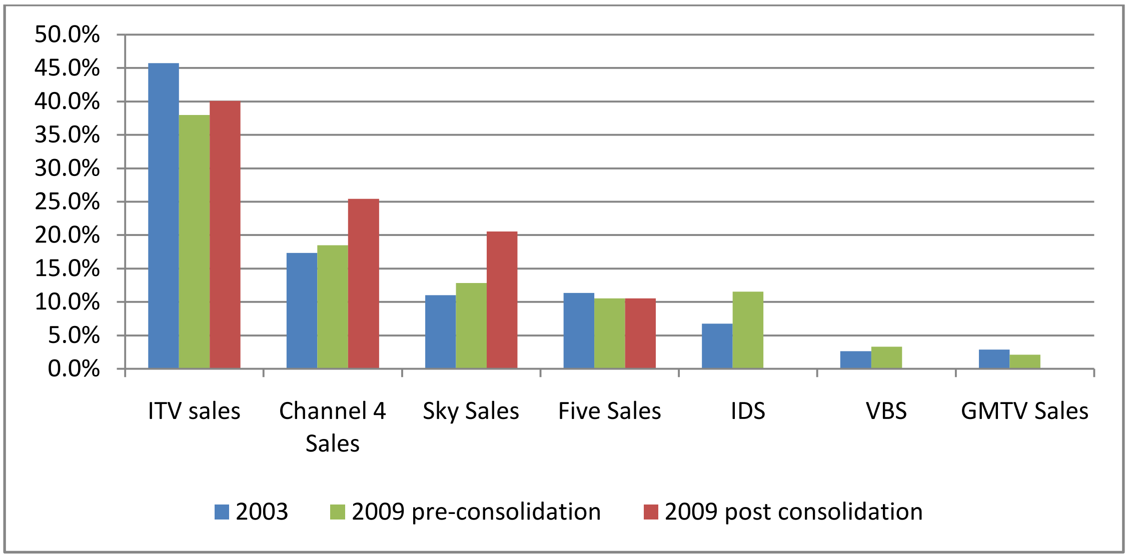
[28] Channels such as MTV, Viva, Nickelodeon, VH1 and Comedy Central have been sold by Sky's sales house since the beginning of 2010.
[29] Sky acquired VMtv which produces the LIVING, LIVINGit, Challenge, Challenge Jackpot, Bravo, Bravo 2 and Virgin1 channels. Sky will take over ad sales on the VMtv channels in January 2010.

owner, RTL - although it has just been purchased by Northern and Shell[30] so it will not lead to consolidation amongst the UK's main TV broadcasters.

4.18 We further acknowledge that the recent trend in sales house consolidation means there are only several key sales houses for TV advertising- and a smaller group of (larger) buyers may end up trading with a smaller group of (larger) sales houses.

4.19 Figure 1 below shows the major sales houses and their SOCI in 2003 and 2009. SOCI in 2009 is presented both pre and post the recent consolidation i.e. post consolidation ITV now sells the GMTV channels, Sky now sells VBS channels and Virgin channels and the Channel 4 sales house now sells the UKTV channels.

Figure 1: Adult SOCI by sales house 2003 and 2009



Source: Ofcom, BARB

4.20 The Figure shows that the difference between the sales houses has narrowed in the period partly due to the consolidation and partly due to losses in SOCI by the ITV channels. In our view this may not necessarily imply that competition between the sales houses will be lower. Whilst this remains possible, it may mean that a sales house like Sky (which in 2009 would have had around 20.6% of Adult SOCI post consolidation), is now getting closer to C4 (which for 2009 would have had around 25.4% adult SOCI post consolidation)[31]. This is not just in terms of more similar market share, but also in terms of strong brands and the range of particular audience demographics provided, and may mean that Sky has a greater ability to compete with C4.

4.21 In addition, these changes may also mean that ITV (post consolidation with GMTV, adult SOCI in 2009 would have stood at 40.1%) now has two large sales houses to compete with, whereas before it is likely that C4 was its main rival. Two large rivals may be able to compete more effectively with ITV.[32] In other words, a market characterised by a smaller number of more evenly sized sales houses could bring

[30] Northern and Shell is a publishing group – Richard Desmond is Chairman of the Northern and Shell network.
[31] The difference in Adult SOCI between Sky and C4 pre-consolidation in 2009 was 5.7% (as indicated by the green bars) - post-consolidation, the difference falls to 4.9% (the red bars).
[32] In 2003, Sky's sales house held 11% of Adult SOCI compared to 45.7% for ITV and 17.3% for C4.

about a more competitive environment than one characterised by a large sales house and a series of smaller sales houses.

4.22 Indeed, there is one marked difference between the growth in media buyers and sales houses – and that pertains to the position of the market leader. In terms of media buyers, the lead company in 2003 had a 13.6% market share whereas the new leader in 2009 – Group M – has increased its position to represent 28.9% of the market. In contrast, the lead sales house (ITV) has seen its market share (on both SOCI and NAR) fall and the gap between it and other sales houses on these metrics has narrowed.

4.23 Furthermore, in the following Sections, we consider whether recent consolidation changes our view of the incentives for suppliers of TV advertising airtime to withhold or conditionally sell under the current trading model. We note that it does not alter our analysis and thus the basis for proposing to remove the rules.

4.24 Having said that, if any future consolidation took place which did fundamentally change the way TV advertising airtime is traded, so altering the incentives to withhold airtime, then we may need to revisit this issue and reassess the need for targeted ex ante rules.

We believe that retention of CRR on ITV should offset particular concerns about its market strength

4.25 We note that a number of stakeholders are concerned about ITV's position in the market and its 'unique' ability to deliver large audiences to media buyers and advertisers. We recognise that, in its review of CRR, the CC believed buyers may have less ability to walk away from ITV1 because of their reliance on it to deliver mass audiences.

4.26 In relation to stakeholders' concerns on this point, we would stress that the regulatory remedy on ITV – CRR – was recently retained by the CC. A set of undertakings therefore exists to address the competition concerns arising from ITV's market position. CRR provides several mechanisms to protect buyers and advertisers in their contractual negotiations with ITV1. These are designed to prevent ITV1 acting to the detriment of buyers by including mechanisms which discourage withholding (the CRR ARM which links SOCI performance to SOB commitment levels) and a requirement to provide a protected offering for airtime on ITV1 (which should make anti-competitive bundling/conditional selling more difficult).

We believe it is useful to differentiate between PSBs and non-PSB channels when considering sector developments

4.27 We recognise that non-PSBs are not a homogeneous category and that there is a wide variety of non-PSB channels experiencing different fortunes in terms of their SOCI and revenue growth. However, our rationale for grouping them into one category in our analysis was to illustrate a wider set of factors and trends which apply to this group of channels vis-à-vis commercial PSBs, including the fact that:

- there are many more of these non-PSB channels;
- non-PSBs can show more ad minutage than commercial PSBs;
- there has been a large increase in viewing of non-PSBs; and

- there has been a huge increase in the volume of non-PSB commercial impacts since 2003.

4.28 We believe this type of broad analysis was useful in explaining why commercial PSBs had lost their SOCI to these other channels since 2003.

4.29 Furthermore, while we recognise Discovery's point that "*individual commercial PSBs still have a significantly larger market share than individual non-PSBs*", it is also true that the difference in market share between individual commercial PSBs and non-PSBs has fallen between 2003 and 2009. This is illustrated by Figures 9 and 10 in our consultation document which showed the percentage of Adult SOCI across the top 15 UK commercial channels.

4.30 Some stakeholders also noted that the digital channels owned by the commercial PSB channels had grown other the period, to a large extent offsetting losses in market share faced by their commercial PSB parents. We recognised this trend in our consultation document. We noted that the ITV and Five sales houses had not experienced as large a decline in their SOCI as their main channels and that in the case of C4's sales house there had actually been an increase relative to 2003. However, we still believe that the trends in the market place suggest that there may be more competition in the market place given the increased numbers of channels available and, as noted in the subsection above on consolidation, the potential for more evenly sized sales houses to be able to compete more effectively against each other.

4.31 Regarding the separate point that some non-PSB channels may be more valuable than others due to the fact that not all of the new channels are available on all the platforms (particularly DTT), we note that even if there are fewer channels available on the DTT platform, there is still a much larger number than is the case in the pure analogue world. We also note that many people have shifted to pay TV platforms such as Sky and Virgin and that these are not insubstantial parts of the market. Finally, it is possible that as digital switchover progresses, there will be more bandwidth available on the DTT platform for further channels to be launched.

We do not believe that the recent downturn should affect our analysis

4.32 IPA and one confidential respondent believe that we have missed the impact of the wider economy on the sector. IPA noted that the recent downturn meant *"…..major changes in management and company structures ensued. This has had singularly the most dramatic effect on competition*".

4.33 Ofcom accepts that the wider economic climate affects a range of outcomes in the sector – including the demand for TV advertising, prices and net advertising revenues. We also know that new models of business are explored during downturns with consolidation becoming a more likely option on both sides of the market.

4.34 However, apart from consolidation, respondents have not explained to us how macroeconomic conditions would change those developments - highlighted in our consultation document - which we believe have influenced competition in the sector. It is still our view that, despite cyclical effects, over the longer-term the evidence supports the developments shown in Figure 14 of our consultation document and suggests there is likely to have been an increase in competition since 2003. We also note reports that there have been signs of a recovery in the amounts of TV advertising spend this year.

Stakeholders generally agreed that, under the current trading model, SOCI was a key determinant for contract negotiations

4.35 We asked stakeholders whether they agreed with our view that media buyers would be more inclined to commit expenditure to broadcasters who increased their SOCI. We requested feedback on this to test the basis for some of our analysis – that is, our view that because improved SOCI can lead to higher SOB commitments from agencies, there is an inherent incentive in the trading model for broadcasters to increase (rather than reduce) a channel's SOCI.

4.36 Most respondents to this question generally agreed it was one of the key determinants, for example:

"*Discovery believes that SOCI is a key determinant in contract negotiations. It is how channels are traded on an aggregate basis for annual deals across the UK broadcast market*"

4.37 We also note that during the CRR review a number of stakeholders, as well as the CC and OFT, all made the point that audience share was an important driver of revenues.

4.38 Some respondents also described other factors that influence negotiations including share of commercial viewing, volume of commercial impacts, a channel's audience profile and coverage of particular target groups, advertisers' specific brand/audience requirements and quality of programming content.

4.39 While two of the respondents concurred that SOCI was a determinant in trading, they also pointed out that it was not the main driver of negotiations and trading. For example, IPA stated:

"*SOCI is an important benchmark for trading television airtime but is not the key determinant in negotiation and therefore committing expenditure*".

4.40 They also noted that the trends in the premia or power ratio also suggested that there was less of a link between SOCI and share of NAR that we had implied. We discuss our views on premia or power ratio in the next Section, in paragraphs 5.29-5.31.

4.41 We believe that the views of stakeholders outlined above are consistent with our understanding of negotiations. Our view is that SOCI was one key factor in contract negotiations and - as we stated in paragraph 4.21 of our consultation document - "*broadly, we would expect that broadcasters which achieve greater SOCI should be able to secure greater spend commitments from media buyers, which will then be reflected in broadcasters' net advertising revenues*."

Respondents agreed that internet display advertising was not yet a constraint on TV advertising

4.42 In our consultation document we discussed the scope for internet display advertising to eventually become a competitive constraint on TV advertising. Our view was that it did not currently constrain the pricing of TV advertising, though it may do so in the longer-term **if**, for example, internet uptake increased nearer to the level of television penetration or it was able to build mass awareness quickly across a broad range of audiences. We note that the CC, in its final report on the CRR Undertakings, had concluded that it '*saw no evidence that the sale of television advertising was* *constrained by Internet display advertising, or would be likely to become constrained in the near future*'[33].

4.43 We therefore asked for stakeholders' views on whether they believed internet display advertising could become a closer substitute to TV advertising in the next 3-5 years.

4.44 Six of the seven respondents agreed with the analysis in our consultation document that internet display advertising was not yet a close substitute for TV advertising. However, most of these respondents were unclear or sceptical as to whether it would act as a constraint in future. For example:

IPA stated "*we believe that the growth areas for digital advertising will continue to be rooted in search, direct response and social media. The actual brand display market online only represents a tiny fraction (1.3%) of total advertising spend and this is showing no signs of significant growth*"; and

Discovery stated "*It is unclear as yet what the effect of the nascent VOD*[34] *market will be on the online display advertising market but ...at this stage, it is not yet relevant to the UK broadcast advertising market*".

4.45 Only one respondent argued that internet advertising as a whole – i.e. not just internet display advertising – had increasingly become a constraint on the television advertising market and could therefore already be a closer substitute to it.

4.46 We welcome stakeholders' feedback to this question. Most of those providing views seem to agree with our analysis that internet display advertising does not currently act as a competitive constraint on the price of TV advertising, though it may do so in the future. We therefore do not intend to change our analysis of this issue.

We continue to believe that the longer-term sectoral trends in TV advertising airtime are likely to have increased competition

4.47 In this Section we reviewed stakeholder responses to our assessment of the changing landscape in TV advertising airtime. Most of those who responded to our assessment broadly supported our analysis and we have given our responses to the additional comments that stakeholders provided. Overall, we consider our analysis remains valid. We continue to believe that we identified the key market developments relevant to the sector since 2003 and that they suggest an increase in competition in the supply of TV advertising airtime. It is also possible that greater competition in TV advertising may continue in future through, for instance, further fragmentation in viewing.

4.48 Understanding the shift in the competitive landscape helped us to consider whether the underlying rationale for the ASRs was still relevant – given the rules were retained in 2003 to ensure fair and effective competition in the supply of TV advertising.

4.49 In the following Sections, we summarise our previous analysis of broadcasters' incentives to restrict the amount of airtime they sell or to sell it on a conditional basis. We present respondents' views on that analysis as well as our responses to

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[33] Paragraph 11, page 4, Competition Commission *ITV Contracts Rights Renewal – Final Report* 12 May 2010 http://www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/final_report.pdf
[34] VOD is Video on Demand.

stakeholders' views – and in doing so, we show why we have concluded that it is no longer appropriate to retain the withholding rule or the conditional selling rule.

Section 5

The withholding rule

Introduction

5.1 The previous Section outlined the changes which have taken place since 2003 in the TV advertising market. The Section and the following one consider whether it is appropriate to retain the ASRs for the purpose of ensuring fair and effective competition. This Section examines that question in relation to the withholding rule which applies to the commercial analogue channels.

5.2 We summarise the analysis which underpinned our preliminary view in the consultation and consider whether the responses we have received alter our position. We conclude that it is appropriate to remove the withholding rule because we believe that, given the current trading model there is little incentive on the commercial PSBs to engage in this behaviour.

In our consultation we set out why we believe there are limited incentives for broadcasters to withhold airtime

5.3 In our consultation we considered whether, given the developments in the TV sector since our last review and the way TV advertising airtime is traded, ITV, C4 and Five still have an incentive to withhold airtime on their commercial analogue channels.

5.4 We started from the position that a broadcaster would only withhold minutage if this would lead to an increase in its revenues and profits. Whilst under certain conditions the commercial PSBs might have an incentive to withhold airtime in order to reduce the impacts that they supply, our preliminary conclusion was that in practice there appeared to be only limited, if any, incentives for the commercial PSBs to withhold advertising airtime.

5.5 The analysis took into account the two-sided nature of the TV advertising market, where broadcasters sell impacts to advertisers on one side of the market and supply programmes to viewers on the other side of the market. The relevance of this approach is that changes in the supply of minutes (e.g. if a broadcaster withheld airtime), could have knock-on effects to the viewer side of the market (increasing or decreasing viewing and so potentially affecting supply of impacts) as well as having an effect on advertisers. The combination of these effects would determine whether a withholding policy would be theoretically profitable.

5.6 We then considered the nature of the trading model and how broadcasters behave under the current rules.

5.7 We suggested that the workings of the trading model mean that in the short run broadcasters face uncertainty about the likely success of a withholding strategy. In other words, broadcasters will be uncertain whether a fall in impacts and short run increase in price will lead to an increase in overall TV advertising spend and so increase in revenues related to the SOB commitments made during the annual deal season. As a result broadcasters are not able to predict with certainty whether withholding airtime would increase revenue. Therefore we considered that there are likely to be limited incentives for the channels to withhold in the short run.

5.8 We also considered whether there are any longer term incentives to withhold airtime. We described how 'relative impact delivery performance' (SOCI) is likely to be a key indicator of a broadcaster's ability to deliver future impacts and hence a key determinant of revenue commitments agreed in the deal season. Hence, under the current trading model, those broadcasters who increase their SOCI would find it easier to secure revenue commitments from media buyers and advertisers. As a result, if a broadcaster withheld airtime and its impacts fell significantly, this would negatively affect its SOCI and therefore damage its negotiating position in the next deal season.

5.9 Moreover, in the case of ITV1, the CRR undertakings formalise the relationship between SOCI and longer term revenues and profits in such a way that ITV is incentivised to sell all its airtime on ITV1. In addition, we noted that the undertakings may have had the effect of standardising this relationship across all sales houses not just ITV.

5.10 As a result, we suggested that, conceptually at least, many, if not all, sales houses have more of an incentive to increase their SOCI over the long run than to undertake a withholding strategy which is likely to reduce SOCI and not necessarily raise revenues.

5.11 We supported this analysis of the workings of the trading model with the observation that broadcasters do not currently appear to withhold impacts, despite their ability to maintain their levels of minutes but reduce their overall supply of impacts by manipulating the distribution of their advertising minutes across the day[35].

5.12 Furthermore, we noted that sector developments, which are likely to have increased overall competition in the supply of TV advertising airtime since 2003, mean that withholding may be less likely to be profitable now than in 2003.

5.13 Finally, we suggested that our preliminary conclusion is supported by findings from an econometric analysis we commissioned[25]. These findings suggest that the withholding of airtime is unlikely to be a profitable strategy for C4 and Five and although ITV1 might have an incentive to withhold, it is likely to be very weak. The econometric data also suggests that the broadcasters would not have a clear incentive to act in concert to withhold airtime across all three commercial analogue channels.

We consulted on whether it was appropriate to remove the withholding rule from ITV, Channel 4 and Five

5.14 In the consultation document we asked stakeholders whether they agreed with our conclusions that the commercial analogue channels did not appear to have strong incentives to withhold airtime and whether there was any other relevant evidence we should consider in order to examine the ongoing need for the withholding prohibition. In addition, we asked stakeholders whether they agreed with our proposals to lift the withholding rule.

5.15 Eleven stakeholders, including broadcasters and the trade bodies - IPA and ISBA - responded.

[35] Furthermore, the econometric evidence published during the consultation period shows a positive relationship between SOCI for a channel and the price of advertising impacts on that channel i.e. an increase in SOCI would lead to an increase in price and (all other things being equal) revenue.

5.16 Three broadcasters supported lifting the rule, although one believed that that the review should be delayed and conducted at the same time as the COSTA review. The majority of respondents (broadcasters and one agency) agreed that the commercial analogue channels did not currently withhold their airtime. However, they also expressed concern that the channels' incentives might alter if there were significant changes in the market place.

5.17 Other respondents (two media buyers, plus IPA and ISBA) rejected lifting the rule on the basis that competition in the sector had not increased sufficiently to reduce the incentives on the commercial analogue channels to withhold.

Some stakeholders raised concerns that the behaviour of the commercial analogue channels would alter if the withholding rule were lifted

5.18 Some respondents (IPA, ISBA, and a media buyer) cast doubt on our analysis that the channels would continue to behave in the same manner if the withholding rule was lifted. ISBA, a media buyer and the Ofcom Advisory Committee for Scotland (ACS) were concerned about the access to slots in the most attractive programming – for example, ACS were concerned that "*a reduction in commercial minutage may reduce the availability of premium programming for local advertisers*".

5.19 Further, Discovery noted that lifting the withholding rule would mean that it would be '*impossible to determine SAP*'. In other words, since buyers will not know the future number of minutes to be broadcast they will not be able to forecast the number of impacts likely to be delivered in a future period, and so will not be able to determine a forecast for SAP (essentially 'future revenues/future impacts').

5.20 We consider that there are several pieces of evidence to suggest that the commercial analogue channels are unlikely to withhold their airtime if the rule is lifted. First, whilst the withholding rule is drafted in terms of withholding minutage, channels do not sell minutes but instead sell impacts. The commercial PSBs could reduce the supply of impacts (and so potentially drive up their price) without reducing their minutage simply by re-distributing their minutage across the day e.g. moving advertising minutes from broadcast during the day or peak (when many viewers watch television) into the middle of the night, when very few people watch television and so very few impacts would be generated. However, whilst the commercial PSBs could currently withhold impacts without withholding minutage, they have not chosen to do so - with the channels choosing to maximise their use of (available) peak minutes and minimise their supply of airtime during the middle of the night. This implies that there are currently limited incentives to undertake withholding behaviour. This also implies that it would be unlikely that there will be any change in the supply of peak minutes or that it will be more difficult to forecast impacts.

5.21 Further, as also outlined in the consultation document, we believe that the channels face uncertainty that actions to attempt to raise short run prices will result in increased revenues and profits. Also, short run attempts to raise prices by reducing airtime and so impacts, directly run counter to a longer run incentive to increase SOCI driven by the trading mechanism. This longer run incentive is formalised in the case of ITV by the retention of the CRR remedy on ITV1.

5.22 Finally, we reiterate that our analysis of trends in competition in the market place indicate that it has increased since 2003, suggesting the channels would find it more difficult to engage in a profitable withholding strategy.

Some stakeholders disagreed with our view of the short and long run incentives on sales houses to withhold

5.23 A media buyer and IPA disagreed with our analysis of sales houses' short run and long run incentives. They disputed our assumption that broadcasters cannot guarantee that changes in impacts would lead to higher revenues within the trading year. We suggested that this was because sales houses could not be certain that any price rises as a result of withholding, would lead to an overall increase in the amount of revenues in the TV advertising market within the trading year (and so an increase in the amount of revenues they received via their fixed SOB commitments).

5.24 However, the media buyer and IPA believed that this analysis did not take account of the practical realities of the advertising market. They suggest that advertisers work to fixed communication targets - in other words, that the objective of a marketing campaign will be to obtain a set amount of impacts from each particular channel. Hence, if a channel attempted to withhold airtime and raised prices, this would result in advertisers increasing spend on the channel in order to ensure that they achieved desired campaign objectives. This would have the effect of increasing advertising budgets for TV due to the nature of the SOB commitments made by agencies at the start of the trading year. Hence, if advertisers increased spend on one channel because its prices had risen, agencies would need to ensure that expenditure rose on other channels too, in order to ensure that they met their yearly SOB commitments i.e. to ensure that certain proportions of their total TV advertising budgets were spent on each sales house.

5.25 In other words, these respondents suggest that even if one broadcaster engaged in withholding, the rise in prices and consequent spend would result in increased spend on TV advertising across all broadcasters in the market place, fuelling general price inflation. On the other hand, they accepted that in a market where SOCI performance was a measure by which airtime was traded, the incentive to maintain SOCI could outweigh these revenue gains.

5.26 These two respondents have provided no evidence to support this analysis. In fact, the available evidence shows that the commercial analogue channels have not pursued a withholding strategy to date; they schedule their available ad minutage in high rating hours, thus maximising their delivery of impacts (and SOCI) within the minutage requirements set by COSTA. This suggests that a withholding policy would not currently be profitable; and that in the current SOCI driven market place, it seems likely that the long run outcome of such a policy i.e. a reduction in the withholding channel's SOCI, would outweigh any short run benefit of a price rise.

5.27 Second, whilst we accept that, for a specific campaign, advertisers may have devised a fixed plan for impact delivery, which they may not adjust even if there were changes in relative price between broadcasters, it seems unlikely that this would be the case for subsequent campaigns over the course of the year. In other words, the planning process for future campaigns would consider the changes that had taken place in the relative prices of the channels in the market place.

Most respondents agreed SOCI plays a role in negotiations and influences revenues but a few respondents suggest a 'premium' is paid for some channels

5.28 Most respondents to this question agreed that SOCI is an important factor within negotiations, though some stakeholders (IPA, ISBA, and two media buyers) also believed that other factors (for instance, quality terms and conditions, the ability to supply popular airtime) play a role in such discussions.

5.29 A few respondents suggested that there is not a complete link between SOCI and share of NAR and that this can be seen in the trends in the premia or power ratios of the main channels. It was also suggested that the changes in the power ratios for ITV1 and C4 indicate that there has been a reduction in competition in the market place.

5.30 We consider that TV advertising is a differentiated product market. Hence, we would not expect to see uniform prices or indeed prices tending towards a particular industry average. For instance, if advertisers value mass audience attributes and these are not readily available, then channels that are able to deliver mass audiences are likely to command a greater share of revenue than their SOCI might imply – reflecting this higher valuation and the scarcity of supply. This may be the case for ITV1 and C4. It is therefore possible that certain products will command a premium in the market which reflects the value of the mix of characteristics/attributes that they offer. However, such differences in prices are not inconsistent with a competitive market and qualitatively different products may still be able to constrain the price of each other.

5.31 Overall, we believe there is value in examining the general trends in SOCI and share of NAR[36]. We note that during the CRR review a number of stakeholders said that audience shares led revenues and that the importance of SOCI was also supported by both the OFT and the CC in their reviews in relation to CRR[37]. It is therefore still our view that in general, whilst a number of other factors may also be important in negotiations, increasing SOCI is likely to lead to increasing demand for a channel's impacts and so greater SOB commitments.

Some stakeholders suggest there have not been sufficient changes in competition to justify lifting the withholding rule

5.32 Several respondents (IPA, ISBA, UKTV and a media buyer) are concerned about the nature of competition in the market place, suggesting that, contrary to our view, competition has not increased since 2003. Many respondents (for example, IPA, ISBA, Sky and a media buyer) also believed that ITV1 retains a strong position in the market place. If competition has not increased, or has even decreased, then an attempt to withhold might be more successful as customers would have fewer alternatives to turn to, should prices of the commercial analogue channels rise. In other words, that there would be a greater propensity to pay the higher prices rather than switch to other sellers.

5.33 Several pieces of evidence were presented to support the view that ITV and to a lesser extent C4, have maintained a strong position despite sector developments. For instance, as noted above respondents pointed to the increases in the 'premia' or power ratio of ITV1 and C4 as evidence of their strong market position. The

[36] We again note that the results of the econometric study also found a positive relationship between SOCI for a channel and the price of advertising impacts on that channel i.e. an increase in SOCI would lead to an increase in price and (all other things being equal) revenue.

[37] Paragraph 6.27 from OFT *Review of the CRR undertakings – OFT's advice to the Competition Commission* 11 June 2009 http://www.oft.gov.uk/shared_oft/register_of_orders_and_undertaki/CRR-review/CRR_Review.pdf and paragraph 7.13 from Competition Commission *ITV Contract Rights Renewal – Provisional Decision on Remedy Variations* http://www.competition-commission.org.uk/inquiries/ref2009/itv/provisional_decision_remedy.htm

implication of this is that both ITV1 and C4 had retained a greater share of broadcast revenue than would be suggested by their SOCI performance.

5.34 Further, some players (Discovery, ISBA, Sky and a media buyer) pointed to the CC's recent decision to retain ITV's CRR regulation as evidence of ITV's market power. Several noted that the CC believed that ITV1 retained its strong position in the market place. Some respondents (ISBA, IPA, UKTV and two media buyers) also noted that there had been consolidation on the sales house side of the market, with the number of sales houses falling significantly over the period. Some respondents believed that consolidation is likely to continue in the future, noting that Five was for sale.

5.35 As shown in Section 4, we consider that there are several indications that competition, overall, has increased since 2003. These include the increased number of non-PSB channels and higher volumes of commercial impacts in the market place as well as the decreased market shares of some of the major channels. We recognise that the recent increases in concentration on the sales side of the market (e.g. between Sky, the Virgin channels and parts of VBS; and C4 and UKTV) could reduce competition in the market place because there are fewer suppliers of airtime competing with each other. However, it may also mean that sales houses like Sky (which in 2009 would have had around 20.6% of Adult SOCI post consolidation), is now more similar to C4 (which for 2009 would have had around 25.4% adult SOCI post consolidation).This is not just in terms of more similar market shares, but also in terms of strong brands and the range of particular audience demographics provided and may mean that Sky has a greater ability to compete with C4.

5.36 In addition, these changes may also mean that ITV (post consolidation with GMTV, adult SOCI in 2009 would have stood at 40.1%) now has two large sales houses to compete with whereas before it is likely that C4 was its main rival. Two large rivals may be able to compete more effectively with ITV. In other words, a market characterised by a smaller number of more evenly sized sales houses could bring about a more competitive environment than one characterised by a large sales house and a series of smaller sales houses.

5.37 We discussed our view of the premia or power ratio in paragraphs 5.29-5.31. We believe that differences in premia are not inconsistent with a competitive market and that qualitatively different products may still act to constrain the price of each other.

5.38 We also consider that our analysis of the proportionality of retaining the withholding rule does not only rely on changes in the level of competition in the market place. We also considered the effect of the trading mechanism as well as the current minutage distributions of ITV1, C4 and Five. As suggested above, they technically have the flexibility to manipulate the distribution of advertising minutage across the day to reduce impacts whilst remaining within the letter of the withholding rule, but have not done so. We also took account of the econometric evidence commissioned for the COSTA review. All these factors suggest that there are currently limited incentives for the three commercial analogue channels to withhold their airtime.

Ofcom would be able to reassess the need for targeted ex ante rules in the event that sector developments change broadcaster incentives

5.39 As noted above, several respondents believed that under current circumstances, the three commercial analogue channels do not have an incentive to withhold airtime. However, they also considered that now is not the time to remove the withholding rule. They pointed to a number of potential changes which could take place in the near term in the market place which may change the incentives faced by the commercial analogue channels. These include: the potential for CRR to be removed; potential changes to the trading mechanism (which might remove SOCI from the negotiation process); and changes which might occur post the COSTA review.

5.40 We discussed and responded to the issues of potential changes to COSTA, removal of CRR and changes to the trading mechanism in Section 3. Fundamentally, if any of these events occurred, and there were then indications that it was more likely broadcasters would engage in anti-competitive behaviour, we would re-assess the need for a more targeted withholding rule to reflect the specific nature of any problem identified.

We consider it unlikely that ITV1 could restrict minutage regionally in order to drive up the channel's price

5.41 One media buyer suggested that if ITV1 were sold as a 'network buy', it might be able to restrict minutage in a 'cheap macro region' in order to drive up the overall network price. We interpret 'network buy' to refer to sale of ITV1 as a national channel rather than a set of regional channels.

5.42 We note the media buyer's comment that it might be possible for ITV to withhold airtime on one region in order to drive up the overall price of the channel. However, we believe that this is an unlikely scenario, given that the extent of withholding in one particular region would probably need to be significant in order to affect the 'national' price of ITV1. Such a policy might also be expected to reduce ITV1's ability to meet its contractual commitments to advertisers to supply impacts in particular patterns across the country and to deliver national campaigns. Furthermore, as shown in the minutage distribution in Figure 18 in our consultation document, while ITV could manipulate its distribution of minutage across the day to reduce overall impacts on ITV1, it does not appear have done so suggesting it has a very weak incentive to withhold airtime.

We believe the withholding rule should be removed from all commercial PSBs

5.43 Following our analysis of consultation responses, we continue to believe that it would be disproportionate to retain the withholding rule. The evidence suggests that there is not a strong incentive for the commercial analogue channels to withhold airtime in order to reduce their impacts and raise impact prices. This includes: the fact that channels are incentivised to increase their SOCI through the trading mechanism, the fact that despite being able to remain within the letter of the rule but manipulate their distribution of airtime in order to reduce their impacts, the channels have chosen not to do this; and also supporting data from our econometric study. In addition ITV faces an additional constraint in that the CRR regulation incentivises it to sell all its airtime on ITV1. Finally, we note many respondents to our consultation agreed that under current conditions in the market place, the channels did not have an incentive to withhold.

Section 6

The conditional selling rule

Introduction

6.1 This Section outlines our findings on the appropriateness of retaining the conditional selling rule for the purpose of ensuring fair and effective competition.

6.2 We first summarise the analysis which underpinned our preliminary view in the consultation document that it was appropriate to lift this rule and then consider whether the responses we have received alter our position. We conclude that it is appropriate to remove the conditional selling rule because we believe that the potential anti-competitive bundling practices are best analysed on a case-by-case basis under ex post competition law.

In our consultation we outlined why anti-competitive bundling should be considered on a case by case basis

6.3 In our consultation document we defined conditional selling as a particular type of bundling. We noted that bundling occurs in many industries and – depending on the circumstances - it can have a positive or negative impact on competition and overall economic welfare. It is not possible to be categorical as to whether bundling in general yields overall benefits or costs to industry participants and ultimately consumers/viewers. However, negative effects are only likely to arise if a firm has market power and acts in a way that is likely to have an exclusionary effect.

6.4 Given this, we proposed that bundling should not be treated as necessarily problematic and that a blanket prohibition on particular types of bundling may prevent welfare optimising behaviour by individual firms.

6.5 We also proposed that it may be appropriate to treat conditional selling by broadcasters in the same way as other types of bundling behaviour, namely on a case by case basis rather than by imposing ex ante prohibitions. In the absence of a prohibition, investigation of a complaint would start with an assessment as to whether the firm in question has market power followed by consideration of the positive and negative implications of bundling behaviour.

6.6 The Competition Act 1998 allows Ofcom to investigate the positive and negative effects of bundling behaviour on a case by case basis and, in principle, is more likely to be used to address possible anti-competitive conditional selling behaviour than the ASRs. This is because s.317 of the 2003 Act prevents Ofcom from exercising its powers to enforce licence conditions under s.316 of the 2003 Act (such as broadcasters' licence condition to comply with the ASRs) if it considers that action under the Competition Act 1998 would be more appropriate.

6.7 We also noted that the CRR undertakings should restrict ITV using any market power to 'force' media buyers to purchase airtime on its digital channels in order to buy airtime on ITV1. The outcome of the CRR Review is that this additional constraint on ITV is to continue.

We consulted on whether it was appropriate to remove the conditional selling rule from all broadcasters and sales houses

6.8 The ten stakeholders who responded to this aspect of the consultation had mixed views as to whether the conditional selling rule should be lifted. Discovery supported full removal of the conditional selling rule and Sky agreed with lifting it as long as CRR remained in place. Other respondents (one broadcaster, UKTV, IPA, ISBA and two media agencies) believed that the rule should be retained on all broadcasters. Another broadcaster believed that there should be partial removal of the rule, with retention on a particular channel.

Some stakeholders expressed concerns that conditional selling is already occurring

6.9 Several respondents (IPA, one broadcaster and two media agencies) believed that conditional selling is currently taking place anyway and is having a detrimental effect on the market place. Some respondents also believed that the rule should be more tightly enforced and a couple suggested it should in fact be extended to cover other services (such as VOD and product placement).

6.10 Some respondents made specific points about the behaviour of ITV, saying that it had already exhibited a propensity to engage in conditional selling. Some noted the number of complaints about conditional selling by ITV made to the CRR Adjudicator.

6.11 In contrast, UKTV and ISBA suggested the rule should be retained as it was successfully preventing conditional selling. UKTV suggested that if the market is working effectively retention of the regulations would have no impact on market practices. We assume by this that UKTV means that the regulation is not preventing market players competing or delivering efficiency and innovation.

6.12 In response to the suggestion that the rule should be more strongly enforced rather than lifted, we note that the rule is an absolute prohibition and as such it would be difficult to enhance the rule. In response to comments that the rule is not effective and that the behaviour is occurring despite the rule, we note that policing of the rule can only be achieved if complaints are brought to the regulator with sufficient evidence to allow an investigation to be opened.

6.13 We note that although the CRR Adjudicator has received enquiries and comments about conditional selling by ITV, neither we nor the Adjudicator have in fact received any formal complaints which have provided evidence that ITV was engaging in conditional selling behaviour. Similarly, we have not had a formal complaint that this type of behaviour has been undertaken by any other player within the market place.

6.14 In respect of general points made about retention of the rule and/or its extension to other areas such as product placement, we believe bundling is unlikely to be a problem unless it is undertaken by a player with market power – and even in this scenario, only if the negative effect of the bundling outweighs the positive effects. As such, the retention of the rule on all players or the extension of the current rule to different product areas seems disproportionate. We note that our concurrent powers under the CA98 would enable us to investigate any player with market power who engaged in anti-competitive bundling of any form – whether of channels, VOD or product placement. Further, this approach would be consistent with that used in relation to other markets.

6.15 Finally, with regard to UKTV's view that the regulation is not affecting market practices, we would repeat that we are committed to removing unnecessary regulation as we believe that this may well inhibit the ability of companies to operate effectively. One way companies can operate effectively and deliver greater efficiency is through positive bundling behaviour. In other words, we believe unnecessary retention of regulations can have an undesirable effect on market practices and may limit innovative bundling potentially to the detriment of both sales houses and purchasers of airtime.

Stakeholders have mixed views on the positive and negative effects of bundling

6.16 Most stakeholders agreed that there are positive and negative effects of bundling behaviour. However, some respondents believed that the positive effects only occur in principle and not, or seldom, in practice. IPA believed that Ofcom has overestimated the positive incremental effects of bundling and underestimated the negative effects. It also believed that any incremental benefits of such behaviour in the TV advertising market would be small, given that many such benefits would have already been achieved by the current bundling of airtime under the current regulations. It suggested that all sales houses currently optimise their airtime and no sales points are forced to negotiate sales contracts for parts of their inventory separately, aside from ITV. Furthermore, one media buyer believed that the positive effects of bundling/conditional selling were achieved by sellers whereas the negative effects are felt by advertisers and buyers.

6.17 We do not agree that the benefits of bundling are only felt by sellers and not by buyers or that we have over-estimated the incremental positive effects. As one media buyer acknowledged, even a single channel's airtime is a bundle of slots and it would be prohibitively expensive for every slot to have its own separate agreement or contract. We believe that the same principle extends to the bundling of the sale of channels into one group. As outlined in our consultation document there are many ways in which bundling can result in lower prices for buyers. For instance, we note that at the extreme, a prohibition on bundling channels together would require buyers to engage in separate negotiations and contracts for the airtime of each separate channel. We believe that this would be prohibitively expensive for both sides of the market and raise transaction costs significantly in the market place. Further removal of the prohibition could encourage beneficial and innovative bundling which may be in the interests of media buyers and advertisers.

6.18 We do not believe that we have under estimated the negative effects of bundling. As discussed in the consultation document, the main negative effects of bundling would occur via anti-competitive behaviour and would only result if a seller has market power. The majority of sales houses are unlikely to be in this position and as such, there would be little concern about the potential for their bundling behaviour to result in negative effects. Furthermore, we can investigate any possible anti-competitive bundling behaviour by players with market power, on a case by case basis under the CA98.

6.19 We do not agree with one broadcaster's point that the rule should be retained in order to provide a level regulatory playing field across the commercial PSBs. We have examined whether there is an ongoing need for the rule in line with its original purpose – to ensure fair and effective competition in the supply of TV advertising airtime – not on the basis of ensuring a regulatory 'level playing field' for broadcasters.

A few stakeholders raised additional points on conditional selling

One stakeholder criticised the model used by Ofcom to demonstrate the benefits of bundling

6.20 IPA made a number of criticisms of the pricing model used by Ofcom to demonstrate how a firm could change its pricing and bundling strategy in order to increase sales – with benefits for both buyers and sellers. It believes that the model uses valuations for buyers willingness to pay for different channels which are too divergent (i.e. that in the real world buyers' tastes are much more similar), that the model is incorrect to assume that buyers can walk away from negotiations if price is unsatisfactory and that Ofcom is incorrect when assuming that sellers will only look to realise a price equal to the sum of buyers' values.

6.21 Whilst we accept that there may be some common views as to the general value of particular channels, we do not agree that the valuations of all buyers are likely to be very similar. As part of the CRR investigation, agencies told us that one of the reasons they need to renegotiate contracts is because new advertisers have joined their purchasing portfolio and as a result they have had to change their purchasing requirements. This suggests that advertisers have relatively different demands for airtime from different channels, different demographics, times of day, terms and conditions etc, and that the market is a differentiated one.

6.22 Further, our assumption that sellers will only seek to realise a price equal to the sum of buyer's values is simply stating that the buyers have a maximum value or price that they will pay for a channel – and that as such sellers will not be able to achieve beyond that maximum price. Ofcom accepts that all models are simplified constructs which cannot fully represent the real world i.e. that ultimately they are not a precise representation of how different agents will behave. However, we believe that the theory behind the model is sound and that as such it should explain how bundling and price discrimination can yield benefits to both buyers and sellers.

IPA is concerned about relying on the trading mechanism to prevent conditional selling

6.23 IPA suggests that the trading model could alter from SOCI to some other trading currency, such as share of viewing (SOV) and as such, should not be relied on to prevent conditional selling.

6.24 In our consultation document, we noted that one of the reasons that the ITC/Ofcom had retained the conditional selling rule in 2003 was due to concerns that bundling was widespread and that this was reducing choice and increasing prices. We said that we considered that this type of behaviour could be termed 'parallel' bundling, namely whereby all the sales houses in the market place would attempt to conditionally sell, no matter their size.

6.25 We noted this behaviour is unlikely to occur across all sales houses. Smaller sales houses in particular, with potentially weaker brands and highly substitutable airtime, would find it difficult to engage in such parallel bundling behaviour as media buyers would find it easier to threaten to reduce future spend commitments in response. We believe that this is what IPA is referring to when it suggests that we rely on the trading mechanism in our analysis. However, we believe that this part of our analysis does not rely on the trading of SOCI but instead is predicated on the fact that sales houses are focussed on revenues.

6.26 In other words, we do not consider that in the case of 'parallel' bundling, the trading currency (SOB commitment or volume of spend) would be a particularly important factor in relation to the incentive to conditionally sell for smaller sales houses. Even if smaller sales houses traded on volume of cash rather than SOB commitments, they would still find it difficult to engage in parallel bundling behaviour if an agency threatened as a result to reduce spend. However, we also refer to our earlier comments regarding potential changes to the trading mechanism i.e. that should such changes occur, and behaviour which is currently prohibited become more likely, we could consider the introduction of targeted ex ante rules.

Some stakeholders expressed concerns that there had not been sufficient changes in competition to justify lifting the conditional selling rule

6.27 In a set of comments similar to those made in relation to the removal of the withholding rule, IPA, a media buyer and ISBA suggested that market conditions have not changed sufficiently to support lifting the conditional selling rule. Some respondents suggest that recent levels of consolidation have reduced the number of sales houses 'of note' significantly: from eight in 2003 (Carlton, Granada, Channel 4, Five, Sky, IDS, Viacom and GMTV) to just six or even five if the current ownership of GMTV is taken into account (ITV (including GMTV), Channel 4, Five, Sky, IDS).

6.28 IPA raised the fact that the 'premia' or 'power ratio' for Channel 4, ITV1 and their respective sales houses has risen over the period (i.e. that they were attracting relatively more share of NAR than would be suggested by their SOCI). Some respondents suggested that there continues to be market power in the sector.

6.29 We note the concerns of stakeholders about the fall in the number of sales houses since 2003, the likelihood of future consolidation as well as the strong position of the commercial PSB channels. However, as we noted in Section 4 and 5, we consider that it is unclear whether recent increased sales house consolidation would lead to increased or decreased levels of competition. The Section on withholding also discussed the premia or power ratio of channels and noted our view that differences in prices are not inconsistent with a competitive market.

6.30 We recognise that the increased size of the sales houses in the market place could lead to more incentives for sales houses to bundle. However, as discussed in the consultation document, bundling (of which conditional selling is one form), is only problematic if there is market power and if the negative effects of bundling outweigh the positive effects. We also note that currently the conditional selling rules do not just affect the larger players in the market place but apply to all sales houses no matter their size - and there are still some very small players on the sales side (such as Turner and Dolphin).

Some stakeholders expressed the view that ITV in particular has the ability to engage in conditional selling

6.31 Many respondents stressed the ongoing strength and market position of ITV. Some of them believe that this view of ITV's strength is supported by the recent decision by the CC to retain the CRR remedy on ITV1.

6.32 Sky remained concerned about ITV's position but believed that as long as CRR requires ITV to offer separate contracts for ITV1 and the ITV digital channels, sufficient protection is already in place against such behaviour.

6.33 Other respondents were less certain of the ability of the CRR regulations to control ITV's behaviour. One media buyer and IPA were concerned that without a conditional selling rule, ITV would be able to work around the conditional selling aspects of the CRR remedy. Alternatively, one broadcaster suggested that the very nature of the requirements of the remedy encourages ITV to conditionally sell. This is because they believe ITV has to sell its airtime via two contracts: one for ITV1 and one for the ITV digital channels. The broadcaster stated that this two-contract structure, along with the ARM which enables buyers to reduce SOB commitments alongside falls in ITV1's SOCI, means that ITV is uniquely incentivised to maintain SOB commitments within its portfolio and so to put undue pressure on buyers to re-direct spend from ITV1 to its digital channels.

6.34 Alternatively one media buyer believed that problems may be caused because the ITV digital channels have no 'continuity clause'. We consider that this refers to the fact that there is no ARM mechanism to regulate the performance of the ITV digital channels. The media buyer suggested that as a result ITV was able to trade its digital channels without restriction, offering punitive terms to buyers on digital contracts if ITV are not satisfied with the ITV1 deal.

CRR is intended to protect advertisers and media buyers purchasing airtime on ITV1

6.35 We note the concerns from stakeholders about the ability of ITV to engage in conditional selling. However, respondents have not explained in any detail how this occurs in the context of the protection afforded by CRR regulation. In our view, the CRR undertakings currently ensure that terms and conditions in relation to the sale of airtime on ITV1 by ITV plc or its subsidiaries are protected i.e. that advertisers are able to purchase advertising on ITV1 on the same terms as they did prior to the merger (leaving aside the operation of the ARM). In addition, the undertakings require ITV plc to offer airtime on ITV1 (including where a buyer seeks to vary the terms of a protected contract) on fair and reasonable terms. We believe this should prevent ITV's sales house using any market power in ITV1 to engage in conditional selling i.e. 'forcing' media buyers to buy airtime on its digital channels.

6.36 We note the comment that ITV's two contract structure means that ITV is incentivised to maintain SOB commitments within its portfolio. However, in our view, all sales houses are incentivised to gain as large a SOB commitment as possible from agencies and we are unclear why a two contract structure would enhance this incentive.

6.37 Regarding a 'continuity clause' for the ITV digital channels, we note that these channels, whilst popular within the market place, do not offer a unique service and do not attract very large viewing figures. As such, we do not believe ITV can trade them 'without restriction' – in other words, that there are substitutes for these channels available within the market place.

6.38 We also reiterate that despite claims that conditional selling takes place, we have never received a formal complaint about it.

We believe the conditional selling rule should be removed from all broadcasters

6.39 Following our analysis and consideration of consultation responses, we continue to believe it is disproportionate to retain a blanket conditional selling rule across all the broadcasters/sales houses. Conditional selling is a form of bundling and bundling behaviour can have positive as well as negative effects. For instance, removing the current prohibition could encourage beneficial and innovative bundling of airtime which may be in the interest of media buyers and advertisers. Negative effects from bundling are only likely to occur if the seller has market power. On this basis, we believe that a more proportionate response is to investigate such behaviour on a case by case basis should such a need arise.

Section 7

Conclusion: To lift the Rules

7.1 The underlying rationale for the ASRs was to ensure “fair and effective competition” in the provision of licensed broadcasting services and services connected with them.

7.1 In assessing whether the ASRs continue to be appropriate for that purpose, we considered whether, absent regulation, there would be a realistic prospect of a broadcaster having an adverse effect on competition by engaging in withholding or conditional selling. Our view is that a broadcaster is only likely to be able to do so to the detriment of its customers and the workings of the market if it has both the ability (i.e. ‘market power’) *and* incentive to engage in the behaviour (i.e. it would be profitable).

7.2 Having considered stakeholders’ feedback to our consultation document, we conclude that it is appropriate to remove both Airtime Sales Rules.

7.3 On withholding, we received no new evidence which would lead us to change our conclusion that there are limited, if any, incentives to withhold airtime under current circumstances. Our conclusion reflects our understanding of the trading model, in that it encourages broadcasters to increase their share of impacts combined with the observation that broadcasters have not tried to by-pass the existing prohibition although that would be relatively straightforward to achieve. Results of our econometric study also support our conclusion. Finally we note that the CRR undertakings also incentivise ITV to sell all its airtime which means the withholding rule is not necessary to address any incentive ITV might face to withhold airtime.

7.4 On conditional selling, we believe that a blanket prohibition on all broadcasters is disproportionate. Since bundling, of which conditional selling is one form, may deliver both positive and negative effects, any complaints about concerns of possible anti-competitive bundling behaviour are best assessed on a case by case basis. We also note that the CRR undertakings should limit ITV’s ability to conditionally sell across its channels.

7.5 We are making this decision in the context of a number of key market developments since the last review of the Rules in 2003 which, we believe, are likely to have increased overall competition in the sector.

7.6 We recognise some stakeholders’ concern about possible future developments – such as uncertainty about the long term future of CRR and the trading model – and their effect on broadcasters’ incentives and behaviour for selling airtime. However, it is not clear that such developments will take place and we do not believe it is appropriate to retain regulation on the basis that factors may change in the future.

7.7 We also note some stakeholders’ views that we should postpone the completion of our review in order to undertake a competition-based market study or to combine it with a review of rules on the volume and distribution of minutage. We have considered these calls but we believe that there are a number of reasons why it is not appropriate at this time to postpone the removal of ASRs pending a wider review. Also, in relation to combining a review of ASRs with a review of the rules on the volume and distribution of minutage (COSTA), we recognise that there are linkages between the two projects but we consider that it makes more sense to reach a firm decision on ASRs ahead of any advertising minutage review.

7.8 Finally, we believe there are benefits from the removal of the ASRs. It will reduce regulatory complexity and burden in the TV advertising sector, which should provide broadcasters with more flexibility to achieve efficiencies, with potentially positive knock-on effects for innovation, investment and sector development. This could ultimately deliver benefits to consumers.

7.9 We have therefore concluded that the Rules are no longer appropriate for ensuring fair and effective competition. We will therefore:

- Lift the withholding rule for all the commercial analogue channels. This means removing the prohibition on ITV1, C4 and Five. This rule will therefore not apply to them or any other broadcasters or channels; and

- Lift the conditional selling rule in relation to all channels.

7.10 These changes will take effect from 1 September 2010.

7.11 We will continue to monitor the TV advertising sector and any effects of the removal. Should broadcasters engage in anti-competitive conduct following removal of the Rules, this may be subject to enforcement action by Ofcom under the Competition Act. Continuing engagement with industry stakeholders will form an integral part of our role to enable us to take account of any sector developments on the way airtime is traded.

Annex 1

List of respondents

A1.1 Twelve stakeholders responded to our consultation.

A1.2 There were eight non-confidential responses from the following stakeholders and these are available at http://stakeholders.ofcom.org.uk/consultations/asr/?showResponses=true

- **Ofcom Advisory Committee for Scotland**;
- **Discovery**;
- **IPA**;
- **ISBA**;
- **SCBG**;
- **Sky**;
- **UKTV**; and
- **One respondent who wished to remained anonymous**.

A1.3 In addition, we received confidential responses from:

- **Three broadcasters; and**
- **One media buyer.**