

## ERICSSON/CREATIVE MERGER INQUIRY

### Provisional findings report

Notified: 27 February 2014

The Competition Commission has excluded from this published version of the provisional findings report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Glossary

## **Summary**

### **Background**

1. On 30 September 2013, the Office of Fair Trading (OFT) referred the anticipated acquisition by Telefonaktiebolaget LM Ericsson (Ericsson) of Creative Broadcast Services Holdings (2) Limited (Creative) to the Competition Commission (CC) for investigation and report.
2. Both Ericsson and Creative are leading players in the broadcast services sector. They overlap primarily in the supply of outsourced linear playout services in the UK.
3. Linear playout is a process whereby television content is prepared and compiled into a continuous stream for transmission to the audience, in compliance with the broadcaster's programme schedule.
4. Broadcasters are customers of outsourced linear playout services. They enter into contracts with playout providers that are usually procured through competitive tender. While some broadcasters, such as BSkyB and the Discovery Network, perform their own playout functions in-house, most UK broadcasters outsource this service to an external playout provider.
5. In 2012, Ericsson bought 100 per cent of Technicolor which currently supplies playout services to ITV and NBC Universal. Creative owns 100 per cent of Red Bee Media (RBM) which supplies playout services to the BBC, Channel 4, UKTV, BT Sport, Public Broadcasting Service, Japanese Satellite TV and Box TV.
6. We have provisionally concluded that if the anticipated acquisition of Creative by Ericsson completes it would result in the enterprises conducted by Technicolor and those of RBM ceasing to be distinct and, because the UK turnover of RBM exceeds

£70 million, a relevant merger situation would therefore be created. The CC therefore has jurisdiction to consider if the creation of that situation may be expected to result in a substantial lessening of competition (SLC) in any market or markets in the UK.

7. We considered the situation that would have prevailed absent the anticipated acquisition (the counterfactual). We provisionally concluded that RBM would have continued to compete in the market, although most likely under an alternative owner. We provisionally concluded that Technicolor would also continue to compete in the market.
8. We provisionally concluded that the relevant market within which to assess the competitive effects of the merger was the market for the supply of outsourced linear playout services in the UK. We did not consider it necessary to widen the relevant market to include in-house supply. The majority of customers told us that they would not switch to in-house supply in response to a small but significant price rise due to the significant investment that would be required in technical expertise, the potential distraction for management and, in the case of smaller broadcasters, a lack of scale.
9. We provisionally found that the relevant geographic market was the UK. The majority of UK broadcasters told us that they would only consider buying playout services from a provider with a UK premises.
10. We considered the playout requirements of different customers. We found that customers have differing playout requirements and this may have an impact on which providers are able to fulfil those requirements. Nevertheless, we provisionally found that these differences in requirements were not sufficiently distinct to constitute different markets.

## **Competitive effects**

### ***Nature of competition pre-merger***

11. We provisionally found that playout contracts are generally awarded on the basis of tender processes where a broadcaster seeks a provider to fulfil its particular requirements. Contracts tend to be long term, between three and twelve years. We found that, in a minority of cases, customers have opted to extend contracts with their incumbent providers rather than retender.
12. We also considered the extent to which competition may affect behaviour at times other than during a tender process that takes place prior to the expiry of a playout contract. We identified two other sets of circumstances: first, where contracts contain benchmarking clauses so that the customer can test the price it is paying; and second, the possibility of renegotiation when there is no benchmarking clause. We found that the main impact of competition occurs either at the end of contracts or (to a lesser degree) at designated points where the contract could be broken without penalty (in practice, the dates of benchmarking clauses).
13. We considered whether some customers had more complex linear playout requirements than others, whether this might make them more difficult to serve and the implications that this may have for rivalry for a particular customer's playout contract. We provisionally found that the level of complexity of a customer's requirements was the main factor that affected the ability of providers to supply certain customers.
14. We provisionally found that there are two challenges for providers that wish to meet a customer's requirements. These are: operational challenges faced by a playout provider's staff when playing out channels day to day; and challenges associated with the design and implementation of a solution that meets the requirements of a broadcaster, and subsequent engineering support once it is up and running.

15. We provisionally found that the BBC and ITV's operational outsourced playout requirements were more complex than those of other broadcasters, but not by an order of magnitude. Further, the challenge of meeting those requirements could more easily be addressed because where a broadcaster switches to an alternative provider, dedicated operational playout staff can also transfer to that alternative provider.
16. We provisionally found that the greater challenge for rival suppliers would be in gaining and demonstrating an understanding of the complex requirements of certain broadcasters and developing a proposed system that would meet those requirements. We thought that the requirements of the BBC and ITV would be the most challenging to meet. We provisionally found that the incumbent provider of playout services to a complex customer would have a clear advantage over other providers, and that otherwise experience with a playout customer with similar requirements would be an advantage in tendering for the work.
17. Overall, we provisionally found that complexity varies considerably between broadcasters and that the BBC and ITV have the most complex requirements. However, we also found that their requirements were sufficiently similar to other complex channels that it would be feasible for suppliers with experience of providing playout for other complex channels including public service broadcasters (PSBs) and sports channels to provide playout for the BBC and ITV. We noted that ITV, the BBC and other market participants thought that it would be a step up for providers other than the parties to provide playout services for ITV and the BBC. We thought that perception was important since it may affect the tender process. On the other hand, we thought that a detailed tender process with motivated participants on both sides may reduce the perceived step up and facilitate the understanding necessary for providers other than the parties to make a credible bid.

18. We provisionally found that there was a significant incumbency advantage for providers of playout to broadcasters with complex requirements. We found four causes of this advantage: incumbents' knowledge and expertise relating to customer requirements is better than rival bidders'; there may be some infrastructure costs already incurred by incumbents that rivals would have to incur if they won the business; there are a number of potential risks to the broadcaster's service quality if it opts to switch; and there are also a number of switching costs for the broadcasters. We found that the incumbency advantage does not tend to be as great for less complex customers.
19. We provisionally found that incumbency advantages affect the competitive process to some extent. However, we found that there is some evidence to suggest that even for the most complex customers this incumbency advantage is not an insurmountable impediment to switching and does not exclude a role for competition.
20. We looked at the most important factor(s) for customers when deciding which supplier to select. We provisionally found that customers' decisions appeared to be driven by a range of factors. We found that, overall, price appears to be the most important factor at the lower end of the complexity scale, where customers had relatively simple and similar needs. We found that broadcasters at the complex end of the spectrum were generally more risk-averse, and a demonstrated reputation for handling broadcasters with similarly complex requirements tended to be the most important factor for them in choosing a supplier.
21. We also looked at the weight customers place on different factor(s) for selecting a playout provider and how these change during the tender process. At the outset of the process a broadcaster's focus tends to be more on the supplier's ability to provide service quality. However, once those suppliers with the requisite capability have

been identified, the focus shifts to getting the most economically advantageous outcome (in terms of the overall balance of price, quality and risk).

22. We considered the extent to which the loss of a competitor in this market was likely, in practice, to affect significantly the outcome of the bidding process. We found that losing a potential supplier has the potential to reduce competition. This is likely to be most serious if it removes the closest competitive constraint. However, even if it does not remove the closest competitive constraint, it could still remove a significant competitive constraint affecting competitive rivalry overall.
23. We also provisionally found that the nature of the bidding process provides an opportunity for customers to mitigate any impact that the loss of a competitor might have on this rivalry. The extent to which this might occur will depend on whether other competitors are motivated to compete for a contract, whether they can reach the same level as the lost bidder, and how much effect the customer can have on the quality of these other bids (as perceived by the incumbent).

### ***Assessment of competitive effects of the merger***

24. We first considered the effect of the merger on individual contracts and types of provider, including both the likelihood of a loss of competitive rivalry, and its impact on the broadcaster concerned were it to occur. We then considered the cumulative effect on the market as a whole, so as to reach our provisional conclusion on the likelihood of an SLC arising in the market for the supply of outsourced linear playout services for channels broadcast in the UK.

### **BBC**

25. The BBC is likely to experience any competitive effects of the merger in the near future because its current playout contract with RBM expires in March 2017. It is

likely to select a provider in spring 2015. We expect the BBC's incumbent provider, RBM, to be the strongest competitor for the renewed contract due to its incumbency advantage and its strong reputation in the market.

26. We expect that the removal of a credible bidder will lead to some reduction in competitive rivalry for the next BBC contract. The significance of the reduction in rivalry will depend on the ability of the BBC to carry out an effective tender process and the ability and willingness of other providers to take this opportunity to put in strong bids, so as to offset (in whole or in part) the loss of the competitive constraint that would have been provided by Technicolor. The provisional view of the majority of the members of the panel was that the nature of the competitive process and the potential for other competitors to exert the same level of competitive constraint as Technicolor made it likely that there would be little adverse effect on the BBC.

#### *ITV*

27. ITV and Ericsson have agreed a long-term extension to their current playout agreement (conditional on completion of the merger).
28. Overall, we thought it was likely that the merger would significantly weaken competitive rivalry for the next ITV contract if that contract were to be contested in the near future, because RBM was likely to be the strongest competitor to Technicolor absent the merger, and at least an important competitive constraint.
29. However, while we could not rule out the possibility that the merger may disadvantage ITV, we provisionally concluded that, taking into account the significant uncertainty about the state of the market when the extended contract is due to expire in [a further five to ten years]—including the potential for significant changes in

technology and for significant developments in the market during the lengthy intervening period—the likelihood of such a disadvantage was remote.

#### *Channel 4*

30. Channel 4's contract with RBM expires after a number of other PSBs' current contracts. As with the BBC, we thought that RBM, as incumbent, would be in the strongest position to compete for Channel 4's next contract.
31. Overall, we could not rule out the possibility that by removing a credible bidder, the merger could reduce competitive rivalry to some degree, and that Channel 4 would therefore face a worse outcome as a result. However, there were a number of factors that led us to find that the likelihood of the merger significantly reducing competitive rivalry was low. The most important of these factors were: Technicolor may not currently represent a stronger competitive constraint on the incumbent than other potential suppliers because Channel 4's requirements were not as complex as those of the BBC or ITV, and therefore other suppliers may have good relevant experience; and there is considerable uncertainty around the competitive conditions Channel 4 would face when it next tenders (after the end of the current contracts of other PSBs). We also note that Channel 4 was not strongly concerned by the merger.

#### *Channel 5*

32. Channel 5's playout is currently supplied by Encompass. We found that Encompass would be a strong contender for Channel 5's next contract given that it had already retained that contract in competition with RBM, and that it would benefit from its position as incumbent. Further, Channel 5 told us that it would consider a wide range of suppliers and it would seriously consider self-supply if it were cheaper than outsourcing. It told us that it did not have competition concerns about the merger, because it believed that there were other players that could easily meet its

requirements, and that new technology was appearing as a strong contender. We did not therefore have reason to believe that Technicolor would provide a significant additional competitive constraint absent the merger. We therefore provisionally concluded that the merger is not likely to disadvantage Channel 5 significantly.

#### *Dedicated sports broadcasters*

33. The two providers with recent experience of supplying outsourced playout to dedicated sports channels in the UK are RBM (BT Sport 1 and 2) and Arqiva (ESPN and British Eurosport). On this basis we thought both Arqiva and RBM would be strong competitors for any such contract. In addition, Encompass has provided sports playout to Channel 5 as part of its contract and was the runner-up to Arqiva in ESPN's last tender.
34. This evidence suggests that for any sports playout contract there would remain at least three credible competitors post-merger, with Encompass and particularly Arqiva being as strong competitors to RBM pre-merger as Technicolor was. We also thought that there might be potential for other providers to expand into providing playout for these types of contracts. Further, we note that these providers did not express concern about the merger. We therefore provisionally concluded that the merger is not likely to disadvantage sports broadcasters significantly.

#### *Broadcasters with relatively simple requirements*

35. There appeared to be widespread competition for this type of broadcaster, including Encompass, Arqiva, Globecast, WRN Broadcast and several others. Technicolor did not appear to be a particularly strong competitor for these types of broadcaster, as evidenced by its poor recent record in tenders. RBM has had some limited success with this type of broadcaster, suggesting that its appeal was not generally stronger

than those of its rivals. Therefore we provisionally concluded that the merger is not likely to disadvantage broadcasters with relatively simple needs.

### **Provisional conclusion on competitive effects of the merger**

36. We next considered the impact of our findings in relation to the BBC, ITV and Channel 4 in the context of the overall market for linear playout in the UK. We noted that these were the three highest-profile PSBs in the UK, with very substantial audience shares, that the linear playout requirements lay at the complex end of the spectrum, that the contracts were of high value relative to those elsewhere in the market and that in aggregate they accounted for a significant part of the overall market.
37. Taking into account the low likelihood that we attached to a significant reduction in competitive rivalry for the ITV and Channel 4 contracts, our primary concern was with the BBC. We thought that a significant reduction in rivalry for the BBC contract was possible. However, we also thought that the nature of the competitive process and the potential for other competitors to exert the same level of competitive constraint as Technicolor made it likely that there would be little adverse effect on the BBC. The provisional view of the majority of the members of the panel is that this residual possibility with respect to the BBC, together with the cumulative effect on other broadcasters, does not constitute an SLC.

### **Provisional conclusion on the SLC test**

38. Based on the above, we have provisionally concluded that the proposed merger is not expected to give rise to an SLC in the market for the supply of outsourced linear playout services for channels broadcast in the UK.

## **Martin Cave note of dissent**

39. One member of the group (Martin Cave) dissents from this provisional conclusion, notably with respect to the consequences of the merger for the forthcoming contest for the BBC playout contract, which accounts for a substantial share of the defined market. The contract will be competed for at a time when the technology is undergoing an evolution.
40. Those seeking this contract are unlikely to be equally efficient or to adopt identical strategies with respect to technology, risk assurance and price. The number of qualified providers is generally reckoned to lie between two and four. Two of these are the merger parties. In the member's opinion, it is quite possible that these two will be the strongest tenderers, or even the only qualified ones. Thus there is a risk that the merger might remove the single effective competitive constraint on the incumbent. Even if this special case does not eventuate, the harm to the BBC might still be material.
41. The member believes that in these circumstances, where the merger removes one of a small number of rivals, with possible adverse consequences for the BBC it is desirable to let competition run its full course, by preventing or remedying the resulting loss of competition. In particular, he does not think it is safe given the uncertainties of the situation to place much reliance on precise conjecture about how, following the merger, competition will unfold. In his view, it can be concluded that removing a major competitor can easily generate outcomes which are seriously adverse to the customer, especially when they lead to the loss of a technological option.

42. For these reasons he provisionally concludes that the proposed merger may be expected to lead to a substantial lessening of competition in the market for the supply of outsourced linear playout services for channels broadcast in the UK.

# Provisional findings

## 1. The reference

- 1.1 On 30 September 2013, the OFT referred the anticipated acquisition<sup>1</sup> by Ericsson of Creative to the CC for investigation and report. The CC must decide:<sup>2</sup>
  - (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
  - (b) if so, whether the creation of that situation may be expected to result in an SLC within any market or markets in the UK for goods or services.
- 1.2 Our terms of reference are set out in Appendix A. On 19 February, the inquiry was extended by eight weeks. We are now required to take our final decision and report by 11 May 2014.
- 1.3 This document, together with its appendices, constitutes our provisional findings, published and notified to Ericsson and Creative in line with the CC's Rules of Procedure.<sup>3</sup> Further information relevant to this inquiry, including a non-confidential version of the main parties' initial submission, and summaries of hearing evidence, can be found on our website.<sup>4</sup>

## 2. The playout industry

- 2.1 The parties are both active in the broadcast services industry, which encompasses a number of discrete and overlapping services (see Appendix B) that facilitate television content being broadcast in an appropriate format and quality. One of these services is linear playout.

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<sup>1</sup> In line with our standard practice, we refer to this as 'the merger' through the report.

<sup>2</sup> Enterprise Act 2002, section 36.

<sup>3</sup> [www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep\\_pub/rules\\_and\\_guide/pdf/cc1.pdf](http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/rules_and_guide/pdf/cc1.pdf).

<sup>4</sup> [www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ericsson-creative](http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ericsson-creative).

- 2.2 Linear playout is an integral part of the overall process for delivering content to television viewers. It involves preparing and compiling this content into a continuous stream for transmission to the audience, in compliance with the broadcaster's programme schedule.<sup>5</sup>
- 2.3 Linear playout services can be provided by a third party provider or performed in-house by the broadcaster. Whilst most UK broadcasters either have outsourced linear playout or, in the case of newer broadcasters, bought the service from a third party provider since launching, there are some notable exceptions to this. BSkyB (Sky) has retained its playout provision in-house and also provides playout facilities for a number of channels in which it holds or formerly held a stake.<sup>6</sup> The Discovery network used an external playout provider from its launch but decided to bring playout in-house in 2010.
- 2.4 Of the PSBs, Channel 5 is the only one never to have performed the function in-house. The first PSB to outsource its linear playout function was the BBC in a process that began in 2002 when it incorporated its playout operation as a subsidiary, BBC Broadcast Ltd. When the new entity was created by the BBC, the relevant premises, technology and staff all transferred into it. BBC Broadcast was then sold in 2005. The sale followed an internal review of its commercial businesses. It concluded that, whilst the services provided by BBC Broadcast were vital to the BBC, they did not need to remain owned by the BBC.<sup>7</sup> After the sale to a Macquarie managed fund, BBC Broadcast was renamed Red Bee Media (RBM). The original BBC playout contract began in 2005 and was due to expire on 31 December 2015, but was extended to 31 March 2017.

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<sup>5</sup> The provision of playout for the purposes of 'on-demand' viewing online as 'non-linear playout'. Non-linear playout involves preparing programme content for use on different devices including desktop/laptop computers, mobile phones and tablets. Current examples of non-linear playout are Filmflex, Netflix and BBC iPlayer.

<sup>6</sup> BSkyB hearing summary, paragraph 3.

<sup>7</sup> [www.bbc.co.uk/pressoffice/pressreleases/stories/2005/07\\_july/22/broadcast.shtml](http://www.bbc.co.uk/pressoffice/pressreleases/stories/2005/07_july/22/broadcast.shtml).

- 2.5 ITV outsourced its linear playout requirements in 2007. The contract, which runs until [§], was won by Technicolor after a competitive tender exercise. The agreement involved Technicolor agreeing to take on ITV's existing playout premises, equipment and staff. ITV stated that the reason for outsourcing was primarily because a significant investment in infrastructure, equipment and technology was required. Additionally ITV felt that third party suppliers could potentially deliver playout to the same standards while making economies of scale savings, and avoiding the need for one-off capital investment.
- 2.6 Channel 4 tendered its playout functions in 2008. The contract was won by RBM after a competitive tender exercise and outsourcing began in 2008. The decision to outsource was driven by its aim to streamline internal resources. Channel 4's contract with RBM expires in [§]. Channel 4 told us that its contract was longer than originally envisaged to allow a greater return on the investment in equipment and migration costs. We understand that Channel 4 planned that RBM would take on Channel 4's operations and staff once contracts were signed, so that they could both run 'business as usual' and create the new service in tandem.
- 2.7 Channel 5's linear playout has been performed by an external provider since the channel launched in 1997. Playout was originally provided by London Playout Centre, which was acquired by Ascent and then by Encompass. When Channel 5 launched its digital channels in 2006 it chose RBM to provide playout. In 2010 this contract was transferred to Encompass after Channel 5 opted to consolidate provision of playout services into one provider.<sup>8</sup>
- 2.8 Most satellite, cable and digital broadcasters buy their playout service from a third party provider, though some, such as Discovery and Sky, perform their own playout.

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<sup>8</sup> [Channel 5 hearing summary](#), paragraph 6.

Sky also provides playout for some channels in which it has, or had, a commercial interest.<sup>9</sup>

- 2.9 Figure 1 shows the providers of linear playout services for a selection of larger broadcasters over the period 2005 to 2013.

FIGURE 1

**Playout arrangements of broadcasters, 2005 to 2013**

	2005	2006	2007	2008	2009	2010	2011	2012	2013
BBC					RBM				
ITV	In-house				Technicolor				
Channel 4		In-house				RBM			
Channel 5			RBM (Channel 5) & Encompass (Digital channels)				Encompass		
Sky				In-house					
Turner				In-house					Arqiva
BT Sport									
British Eurosport	NTL			Arqiva				Arqiva	
ESPN		RBM			Arqiva				
MTV Europe		In-house			In-house				
Disney			Technicolor				Encompass		
Discovery	Ascent (Encompass)		Encompass				In-house		

Source: Figure 1.1 of parties' initial submission to the CC, amended.

### **Customer contracts**

- 2.10 Outsourced linear playout contracts will vary in both their terms and their length depending on the requirements of a customer. In most cases customers hold formal tender processes, selecting suppliers on the basis of a number of criteria. Some customers do not engage in a tender process and others may choose to extend contracts with existing providers rather than retender, for example [§§].

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<sup>9</sup> BSkyB hearing summary, paragraph 3.

- 2.11 Broadcasters tend to agree linear playout contracts for periods of between three and twelve years, although there may be break clauses for certain events (such as the loss of a broadcasting licence) over the length of the contract.
- 2.12 The key requirements of a playout provider included in these contracts are:
- (a) agreed service levels (including the penalties incurred if these are not achieved);
  - (b) the pricing structure (typically a monthly service fee) either for combined services or on a service line by service line basis; and
  - (c) provisions for transitional arrangements should the contract not be renewed, such as specific requirements for the transfer of employees<sup>10</sup> or even the transfer of facilities from the incumbent to the new provider.<sup>11</sup>

### ***Customer requirements and complexity***

- 2.13 The complexity of linear playout requirements of broadcasters varies.<sup>12</sup> The complexity of playout appears to be driven by operational challenges faced by a playout provider's staff when playing out channels day to day; and planning and engineering challenges, associated with the design and implementation of a solution that meets the requirements of a broadcaster, and subsequent engineering support once it is up and running.
- 2.14 We discuss how customer requirements differ and the impact of complexity in paragraphs 8.21 to 8.51 in our assessment of the competitive effects of the acquisition.

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<sup>10</sup> Transfer of employees is generally pursuant to the Transfer of Undertakings (Protection of Employment) Regulations (TUPE). Also see Appendix B.

<sup>11</sup> Examples include Disney and Discovery.

<sup>12</sup> The OFT identified three main features of a broadcaster's output that would restrict the range of potential suppliers that it could choose to provide linear playout services. These were: reactivity and intervention levels; quality and service standards required; and scale and risk of certain channels.

### **3. The companies**

#### ***Ericsson***

- 3.1 Ericsson is a Swedish technology company with a strong focus on telecommunications. It is a leading provider of telecommunications equipment and services to mobile and fixed network operators. It has annual global revenue of over £20 billion<sup>13</sup> and UK turnover in excess of £[§] million.
- 3.2 In July 2012 Ericsson announced the acquisition of Technicolor SA's broadcasting services division for a payment of €19 million with an additional payment to be made based on a revenue share agreement calculated on 2015 revenues. Ericsson is now the 100 per cent owner of a number of subsidiaries providing a range of broadcast services in the UK, including linear playout services for television. These companies are together known as Technicolor. In 2011, the three UK legal entities that make up Technicolor had combined revenues of £34 million and generated operating losses of £12 million (of which £7 million related to asset impairment as the result of a contract termination). In 2012 revenues [§] with operating losses [§].<sup>14</sup> Technicolor's playout revenue in 2012 was some £[§] million.
- 3.3 Technicolor currently provides linear playout services to two customers: ITV and NBCUniversal, Inc (NBCU). Technicolor's current contract with ITV is due to expire in [§].
- 3.4 Over recent years Technicolor has had little success in winning new business, with the exception of Fatstone, a UK-based service for a Norwegian customer, and a contract for a new broadcaster London Live, which will commence broadcasting in

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<sup>13</sup> In 2012 reported revenue was SEK 228 billion.

<sup>14</sup> 2011 financial statements and draft 2012 financial statements of Technicolor Network Services UK Ltd, Technicolor Broadcast Services UK Ltd and Technicolor Distribution Services Ltd.

spring 2014.<sup>15</sup> It has also lost a number of previous UK broadcast customers in recent renewal exercises, including:

- (a) CSC (formerly Chart Show Channels)—Technicolor provided playout services for CSC between 2006 and 2013, but lost the contract to WRN Broadcast in a retendering exercise.
- (b) Disney—Technicolor provided playout services for Disney's UK-based channels from their launch in the 1990s until 2012, when Encompass won the contract.

### **Creative**

- 3.5 Creative through Creative Broadcast Services Limited (CBS) owns 100 per cent of RBM. As noted above, RBM was formerly called BBC Broadcast Limited and was created by the BBC in 2002. In 2005, BBC Broadcast Limited was sold to CBS, a company set up specifically for the purchase. Creative is owned by Macquarie managed funds, with some minority equity investment by Macquarie.<sup>16</sup>
- 3.6 RBM provides broadcast services in the UK, including linear playout services for television. For the financial year ended 30 June 2012, RBM reported turnover of £144.4 million, of which £128.6 million was generated in the UK. RBM has operations in the UK, France, Germany, Spain and Australia, and employs around 1,500 staff.

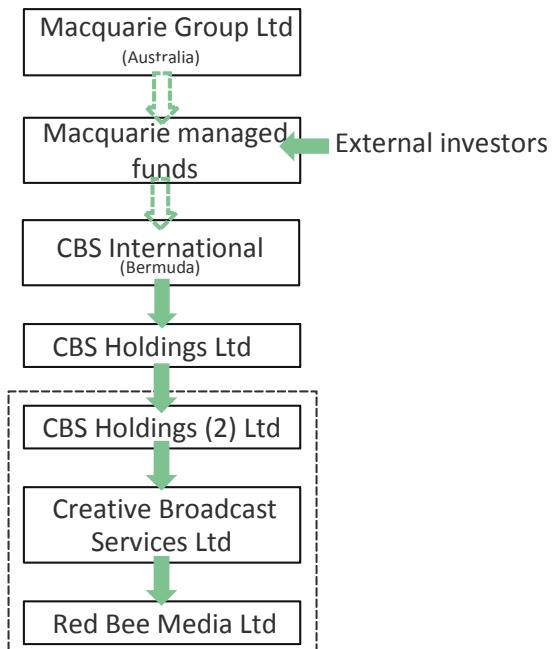
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<sup>15</sup> [www.standard.co.uk/londonlive/](http://www.standard.co.uk/londonlive/).

<sup>16</sup> This acquisition was considered by the OFT and was not referred to the CC. Case Me/1962/05 Completed Acquisition by Creative Broadcast Services Limited of BBC Broadcast Limited (2005).

FIGURE 2

**Simplified legal structure of ownership of Creative and RBM**



*Source:* CC analysis of the financial statements of group companies.

*Note:* CBS is used in the diagram as shorthand for Creative Broadcast Services. Intermediate holding companies are not shown. The subsidiaries of RBM are not shown. The companies surrounded by the dashed line are those which are proposed to be acquired.

- 3.7 RBM holds the main linear playout services contracts for the BBC, Channel 4, BT Sport, UKTV, Public Broadcasting Service,<sup>17</sup> JSTV<sup>18</sup> and Box TV.<sup>19</sup>

### ***Areas of overlap***

- 3.8 The parties overlap in two areas, media logistics and linear playout. The extent and nature of overlaps over the broadcasting chain is shown in Figure 3.

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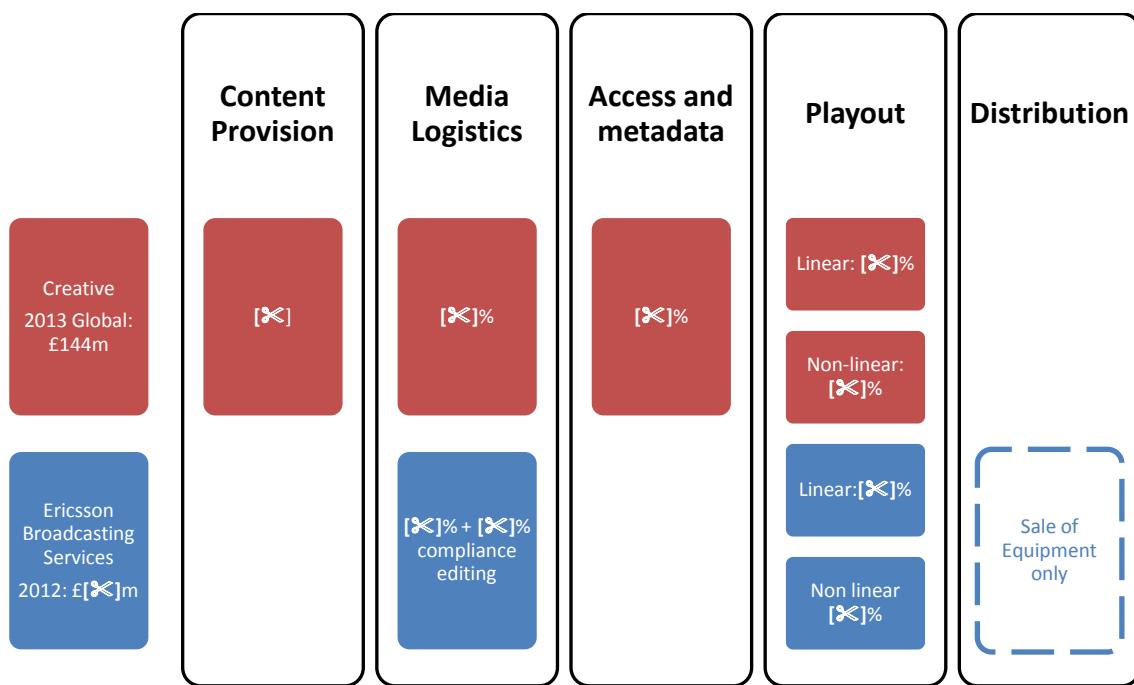
<sup>17</sup> A US network.

<sup>18</sup> Japan Satellite TV.

<sup>19</sup> A network of music channels including 4Music and The Box.

FIGURE 3

### Proportion of parties' revenues generated across broadcasting services chain



Source: CC analysis; the UK broadcasting services revenue and the percentage of the parties' revenue generated by each service is taken from the parties' informal submission, paragraphs 2.1 to 2.6, and the total figure is from the June 2013 financial statements.

## 4. Other providers of linear playout services

- 4.1 There are a number of other providers of linear playout services. These providers include the following:
- (a) Encompass provides linear playout for Channel 5 and Disney in the UK, and the A&E,<sup>20</sup> Hallmark and CBS in the USA. It entered the UK playout market through its acquisition of Ascent Media's content distribution businesses (which included Ascent's UK playout operations) in 2011. At the time of the acquisition, Encompass stated that it aimed to become the leading global service provider for outsourced services and that the acquisition was the catalyst to accomplishing that goal.<sup>21</sup> [REDACTED]<sup>22,23</sup>

<sup>20</sup> Previously known as Arts & Entertainment.

<sup>21</sup> [www.encompass-m.com/2011/02/28/encompass-digital-media-completes-acquisition-of-ascent-media-corporation/](http://www.encompass-m.com/2011/02/28/encompass-digital-media-completes-acquisition-of-ascent-media-corporation/)

<sup>22</sup> Reported UK turnover. 2013 Financial Statements of Encompass Digital Media Ltd, note 2.

<sup>23</sup> That is, the value of contracts which include the provision of linear playout but may include revenue from bundled services.

- (b) Arqiva is a provider of broadcasting services in the UK. It is particularly active in transmission and distribution services, currently providing transmission services for all terrestrial channels. Its linear playout business is small in comparison with its transmission and distribution services businesses, with revenues of around £[§] million per year in comparison with a group turnover of around £800 million. Arqiva was created as a result of NTL divesting its broadcast unit (which provided playout for, among others, ITN and British Eurosport<sup>24</sup>). This was acquired by Macquarie in 2000 and is now owned by a consortium of investors. It currently provides playout for ESPN, British Eurosport, British Forces Broadcast, Fox and Xtreme Sports, and [§].
- (c) Globecast is an international playout provider present in the UK that is particularly active in distribution services. In 2006 it entered the playout market by building a new playout suite as a response to the needs of one of its (non-playout) customers. Its UK playout clients have included B4U, BBC Worldwide (Poland), Arsenal TV, The Poker Channel and Dolphin. Its UK entity revenues are some £65 million and its parent France Telecom's revenues are in the order of €40 billion (approximately £32 billion).
- (d) WRN Broadcast is a privately-owned British company which provides media services globally. The company was founded in 1992 focusing on providing services to radio networks and entered the linear playout market in 2007. It acquired TSI Broadcast in 2009, winning the contract to provide playout services to Top Up TV the same year.<sup>25</sup> It won the CSC contract to provide playout for 18 channels in 2013<sup>26</sup> As well as its UK portfolio, WRN Broadcast manages

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<sup>24</sup> [www.broadcastnow.co.uk/ntl-builds-new25m-play-out-centre/1174375.article](http://www.broadcastnow.co.uk/ntl-builds-new25m-play-out-centre/1174375.article).

<sup>25</sup> Top Up TV ceased broadcasting in 2013.

<sup>26</sup> [www.wrnbroadcast.com/articles/press-releases/csc-media-appoints-wrn-broadcast-as-playout-partner](http://www.wrnbroadcast.com/articles/press-releases/csc-media-appoints-wrn-broadcast-as-playout-partner).

numerous HD and SD channels for international playout. Its global revenue in 2012 was £10 million, of which £2.8 million originated in the UK.<sup>27</sup>

## 5. The transaction

- 5.1 On 13 June 2013 Ericsson and Creative Broadcast Services Holdings Limited (CBSH) entered into a share purchase agreement (the Agreement) pursuant to which Ericsson will purchase the entire issued share capital of Creative, the wholly-owned subsidiary of CBSH. Creative holds the entire share capital of RBM, the operational company in the Creative group.<sup>28</sup> Completion of the transaction is conditional upon a favourable decision by the UK competition authorities (Clause 5 of the Agreement).
- 5.2 In RBM's 2010 Business plan covering FY2011 to 2015, a key business objective was to [§].<sup>29</sup>
- 5.3 [§]
- 5.4 Ericsson explained its rationale for the transaction as follows:
  - (a) Technicolor is a weak competitor in the UK. Ericsson told us that Technicolor's reputation was severely damaged by an incident during the football World Cup in 2010 when Technicolor's linear playout team accidentally cut to an advertising break at a critical moment in England's opening match against the USA (missing England's first goal of the tournament). Technicolor has since lost a number of its customers and Ericsson told us that [§].
  - (b) Increasing Ericsson's market credibility and position. Ericsson told us that RBM was one of the leading media management service providers in the UK and had a

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<sup>27</sup> WRN Broadcast Limited financial statements, 2012.

<sup>28</sup> There are other companies in the company chain, with Macquarie Group Limited the ultimate parent company. Neither Macquarie Group Limited nor the other companies in the chain are directly involved in this transaction and for the purposes of the investigation will not be referred to unless directly relevant.

<sup>29</sup> RBM Ltd 2010 Business plan, slide 6.

strong position in Europe, which was one of the most advanced markets in terms of broadcast managed services. Ericsson believed it would benefit from RBM's expertise and ability to innovate in the core areas of linear playout and media management.

- (c) Broadening Ericsson's market offering. Ericsson told us that RBM was one of the leading European providers of access (subtitling), non-linear playout and meta-data/content discovery related services.<sup>30</sup> Ericsson believed that these capabilities were complementary to its own—and would help to meet the growing demand of broadcasters for innovative ways to monetize existing content rights as the media market shifted towards digital media and multi-platform services.
- (d) Creating economies of scale. Ericsson believed that the transaction would allow Ericsson to achieve synergies in the form of cost savings in relation to both capital investment and operational expenditure.

5.5 We also note that Ericsson presented a number of potential revenue-enhancing synergies to its board when the decision to approve the acquisition was taken, including:[⊗].

5.6 Ericsson also identified a number of cost synergies to its board, including: [⊗].

5.7 The financial costs and benefits of the proposed acquisition as presented to Ericsson's board are shown in Table 1.

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<sup>30</sup> Metadata is the descriptive information attached to a media file, describing its content in various different ways. Such metadata is used in a variety of ways, including providing programme details for the electronic programme guide and television listings publications, identifying where commercial breaks can or should be inserted during playout as well as information on episode numbers. Metadata can further be exploited for video-on-demand services where users wish to search for certain criteria (such as finding any content with a particular actor in).

TABLE 1 Synergies identified by Ericsson

Synergy type	Detail	Present value of synergy £m
Revenue		[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
Cost		[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
Negative		[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
	[£]	[£]
Total		[£]

Source: Figure 6.1, Annex 18 (a) to Ericsson Informal submission.

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### ***The proposed merger and the relevant merger situation***

5.8 The OFT referred the anticipated acquisition to the CC on 30 September 2013. We are first required to decide whether the proposed acquisition of RBM (through the acquisition of Creative) by Ericsson will, if completed, give rise to a ‘relevant merger situation’. If so, we are required to determine whether the proposed merger is likely to lead to an SLC in any market or markets in the UK.<sup>31</sup>

5.9 The test<sup>32</sup> that we use to determine whether the arrangements which are in progress, if carried into effect, will result in the creation of a relevant merger situation has two limbs:

(a) first, we are required to decide whether two or more enterprises would have ceased to be distinct; and

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<sup>31</sup> Section 36 of the Act.

<sup>32</sup> Section 23 of the Act.

(b) second, we are required to test whether the transaction has sufficient nexus in the UK by assessing the turnover of the ‘enterprise being taken over’ and/or the share of supply of the merged enterprises.

### ***Enterprises ceasing to be distinct***

- 5.10 The Act defines an ‘enterprise’ as ‘the activities or part of the activities of a business’ and a ‘business’ as ‘including a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied other than free of charge’.<sup>33</sup>
- 5.11 The proposed merger concerns the acquisition by Ericsson of the entire share capital of Creative. Ericsson, the parent company of Technicolor, is an incorporated entity and carries out activities of a commercial nature. Creative is an incorporated entity and is the holding company for RBM. Both RBM and Technicolor are incorporated entities carrying out commercial activities. We are therefore satisfied that Technicolor and RBM are businesses for the purposes of the Act and the activities conducted by them are ‘enterprises’ for the purposes of the Act.
- 5.12 The share purchase agreement provides that Ericsson will acquire the contractual obligations and benefits under [§] existing commercial contracts held by RBM, a large international trade mark portfolio, [§] domain names, [§] licences, [§] leasehold properties and [§] licensed properties, and RBM staff will transfer to Ericsson as the transaction is structured as a share sale. We are therefore satisfied that should the transaction complete, Ericsson will acquire an enterprise and the enterprises of Technicolor and RBM will cease to be distinct.

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<sup>33</sup> Section 129(1) & (3) of the Act.

### **Turnover and share of supply tests**

- 5.13 The Act requires the CC to establish that the transaction has a sufficient nexus with the UK to give us jurisdiction to consider the reference. This will be the case if either the turnover test or the share of supply test is satisfied.<sup>34</sup> The turnover test is met where the value of the turnover in the UK of the ‘enterprise being taken over’ exceeds £70 million. Section 28 of the Act provides a mechanism for determining what must be taken into account in determining the turnover of the ‘enterprise being taken over’. In this case, Creative is the entity being taken over.
- 5.14 Creative is not a trading company but it consolidates the revenue of RBM, the trading company. In the financial year to June 2013, RBM generated a turnover of £145 million in the UK. This turnover was generated in the year preceding the date of the reference.<sup>35</sup> The revenue in the UK of the enterprises to be acquired therefore exceeds £70 million, as required by the turnover test, and because the turnover test is satisfied we do not need to consider the share of supply test set out in section 23 of the Act.
- 5.15 For the reasons given above, we are satisfied that a relevant merger situation would be created by merger between Ericsson and Creative and we have jurisdiction to consider whether the creation of that situation has resulted or may be expected to result in an SLC within any market or markets in the UK for goods or services.

## **6. Counterfactual**

- 6.1 In carrying out our competitive assessment, we compare the prospects for competition with the merger, against the competitive situation without the merger (the counterfactual). In assessing this counterfactual, a number of scenarios may be

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<sup>34</sup> Section 23 of the Act.

<sup>35</sup> SI 2005/1370 as amended by SI 2005/3558. See also *Merger Assessment Guidelines*, CC2, paragraph 3.3.2.

possible, but ultimately only the most likely scenario will be selected. In our assessment, we take into account the extent to which events or circumstances and their consequences are foreseeable and typically incorporate only those aspects that appear likely on the facts available to us.

- 6.2 In considering whether the pre-merger situation will continue, we have considered whether both Technicolor and RBM would continue to compete absent the merger.<sup>36</sup>

### ***Technicolor***

- 6.3 Technicolor has ongoing contracts with customers in the UK. Its current contract with ITV does not expire until [§]. Ericsson told us that if the merger did not proceed, [§].<sup>37</sup> We are satisfied that Technicolor would have remained in the market absent the merger.

### ***RBM***

- 6.4 We considered a number of scenarios with respect to the ownership of RBM: first, whether RBM would continue to be owned by its present owners; secondly, whether RBM would have been sold as part of a sale process; and thirdly, whether ownership would have transferred as a result of Creative's lenders taking an equity position in exchange for cancelling any debt obligation.
- 6.5 Macquarie told us that the refinancing of Creative<sup>38</sup> required a large injection of equity.<sup>39</sup> The investment fund that owned Creative had been put together with the express purpose of acquiring the assets of another Macquarie-managed fund, and did not have any surplus capital for new investments as the fund was due to be

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<sup>36</sup> We would not ordinarily consider whether the purchaser would continue to compete absent the merger. However, the parties referred to Technicolor being unsuccessful over a number of tenders and that its reputation has been affected as a result of at least two high-profile errors in playout during football matches.

<sup>37</sup> ibid, section 5.

<sup>38</sup> The external debt was owed primarily by Creative and intermediate holding companies and not RBM directly.

<sup>39</sup> [Summary of hearing with Macquarie](#), paragraph 13.

wound up in June 2013. Putting new money into Creative was not therefore feasible and the only viable option was to sell RBM.<sup>40</sup> In light of this evidence, we believe that it is unlikely that the present owners would have contemplated a further injection of capital into Creative. Therefore, we found it likely that the ownership of RBM would have changed.

- 6.6 Macquarie undertook a process of trying to sell RBM which commenced in [§] and a number of indicative offers were received, but these were either rejected or withdrawn.<sup>41</sup> The final sale price agreed with Ericsson was [§]. However, given the nature and length of the sale process and Creative's owner's engagement with Ericsson (contact between the two parties commenced in [§] and concluded in [§]), we cannot predict with confidence that the owners of Creative would have completed a sale with a purchaser other than Ericsson.
- 6.7 As a result of agreeing a sale with Ericsson, [§]. We thought that had a new purchaser not been found, ownership would have changed as the result of the lenders taking ownership either as a result of not being able to refinance the business or as a result of the current lending agreement.
- 6.8 We found that Creative would have continued to trade after a change of its ownership (or the ownership of its assets, including RBM). We have taken this view because, based on our assessment of the financial performance of Creative, we consider that it was a going concern and would have continued to trade. Its contract with the BBC expires on 31 March 2017 and it has a number of other substantial contracts. While Creative was a highly leveraged business, a significant amount of the debt within the group was owed to a parent undertaking as a result of the financial structure of the original acquisition of the business from the BBC.

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<sup>40</sup> ibid, paragraph 14.

<sup>41</sup> [§]

- 6.9 We considered the value of the assets of the business in the event of liquidation. The net book value of Creative's tangible assets at 31 December 2012 was £17 million. By contrast, in the year 2012, earnings before interest, tax, depreciation and amortization was £33 million and earnings before interest and tax was £12 million. Based on this, we do not think it likely that the lenders would seek to liquidate Creative because the liquidation value of Creative's tangible assets would be significantly lower than the sale price of the business as a going concern. Therefore, in our view, it is in the interests of the present owners and any prospective new owner of Creative to take any steps to avoid damaging its value.
- 6.10 We cannot assess in detail what the competitive strategy of Creative would have been in the counterfactual. However, we think that it would be in the interests of Creative and any new owners to participate actively in tenders for major contracts (as long as the perceived chance of winning and other benefits justified the bidding costs, and unless its new ownership placed it under significant financial constraints) in order to maintain its reputation and credibility in the market and potentially to generate additional revenues, which would maintain or increase the value of the business.
- 6.11 We accordingly considered the time period over which we should assess the counterfactual, and in this instance we considered that a period of three to four years was sufficiently foreseeable. We took into account the fact that Creative is a going concern, its ongoing contractual obligations and the time period for the BBC contract retendering in coming to this view. We do not consider the future strategy of RBM or the extent of investment by any new owner to be foreseeable.

- 6.12 In the absence of the merger, it appears most likely that a change of ownership of RBM<sup>42</sup> would have occurred, but we cannot conclude the nature of that change in ownership.

### ***Conclusions on counterfactual***

- 6.13 We consider the counterfactual to be the situation prevailing immediately prior to the decision of the owners of Creative to enter exclusive negotiations to sell Creative to Ericsson. We consider this to be the appropriate pre-merger situation. We considered an alternative pre-merger situation to be at the point of agreement of the share purchase agreement in June 2013, but do not believe this materially changes the counterfactual.
- 6.14 We therefore provisionally found, based on the analysis and evidence set out above, that the most likely scenario was Technicolor and RBM continuing to compete in the outsourced linear playout services market, albeit with RBM under different ownership.

## **7. Market definition**

- 7.1 The purpose of market definition is to provide a framework for our analysis of the competitive effects of the merger. The relevant market (or markets) is the market within which the merger may give rise to an SLC and contains the most significant competitive alternatives available to the customers of the merged companies. However, market definition is not an end in itself, and the boundaries of the market do not determine the outcome of the CC's analysis of the competitive effects of the

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<sup>42</sup> Creative is the holding company for RBM which is the trading entity. A different transaction structure may not have included Creative.

merger in a mechanistic way. The CC may also take into account constraints outside the relevant market (or markets).<sup>43</sup>

### **Product market**

- 7.2 The parties told us that the relevant product market was the outsourced supply of linear playout services as a whole, although some contracts might be more complex than others. We defined linear playout in paragraph 2.2.
- 7.3 In our competitive effects analysis (see below), we discuss the variation between customers' requirements and providers' abilities to service those requirements. We did not find that there were clear demarcations that would amount to different markets, but that there was a spectrum of complexity. At the simplest end, we observed simple single-channel and multichannel broadcasters without 'reactive' requirements.<sup>44</sup> At the more complex end, we observed that there are broadcasters with playout requirements that are more challenging to meet, including the PSBs—the BBC, ITV, Channel 4, Channel 5—and sports channels, such as BT Sport and British Eurosport. We therefore considered whether and how the competitive effects of the merger could vary according to where a customer is positioned on this spectrum.
- 7.4 We considered whether we should widen the relevant product market to include in-house supply of linear playout services. However, the majority of customers told us that they would not switch to in-house supply in response to a small but significant price rise.<sup>45</sup> The reasons given included:
- (a) switching costs and risks;
  - (b) a lack of technical playout expertise in-house;

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<sup>43</sup> CC2, paragraphs 5.2.1 & 5.2.2.

<sup>44</sup> We refer to reactive content, which we define as content requiring intervention by a playout operator (as opposed to content that can be played out via automation).

<sup>45</sup> See paragraph 9.3 onwards.

- (c) the need for significant investment, including putting in place skilled staff in advance of taking playout work back in-house;
- (d) the potential distraction for management involved in bringing work back in-house; and
- (e) the lack of economies of scale for smaller broadcasters, with more simple requirements, in taking the service in-house.

7.5 We therefore do not consider it necessary to widen the relevant market to include in-house supply. However, to the extent that the possibility of in-house supply may exert a level of competitive constraint on the merged companies' conduct, the strength of this constraint is considered as part of our analysis of competitive effects.

### ***Geographic market***

7.6 The focus of our inquiry is on linear playout of channels broadcast in the UK (whether or not the same broadcasters also provide the same or different broadcast services internationally).

7.7 The parties told us that currently, some UK customers preferred UK-based playout solutions, and they therefore considered the market for the purposes of this case to be no wider than the UK. They also told us that there was no plausible basis for considering a market narrower than the UK. We have not considered a market less wide than the UK since (a) most broadcasters provide services on a national basis to customers throughout the UK and (b) playout of regional or national broadcasting is typically coordinated from a single site covering the whole of the UK. Some, but not all, broadcasters told us that they found it desirable to have their playout provider located in close geographic proximity to their broadcast operations, but since playout providers in the UK are, in practice, located in the London area and supply services on a nationwide basis, we saw no reason to define a market narrower than the UK.

- 7.8 The majority of UK-based broadcasters (including those with the most complex requirements) told us that they would not consider procuring playout services from a provider unless they had a site in the UK. Playout of international channels (ie those broadcast outside the UK<sup>46</sup>) is also conducted within the UK, and those broadcasters were on the whole more flexible as to the location of that playout. However, since we have focused on playout of channels broadcast in the UK, this does not affect our view that the relevant geographic market is the UK.
- 7.9 Therefore we provisionally find that the relevant market is the market for the supply of outsourced linear playout services for channels broadcast in the UK, and as part of our analysis we consider whether competitive effects could vary depending on the complexity of the provider's requirements.

## **8. The nature of competition pre-merger**

- 8.1 In this section, we explain how competition takes place in the sector. First, we describe the nature of the tender process that is the prevalent means of awarding contracts (paragraphs 8.5 to 8.12), and the role competition may play mid-contract (paragraphs 8.13 to 8.20). Secondly, we discuss the requirements and complexity of customers and the role this plays in competition for contracts (paragraphs 8.21 to 8.51). Third, we assess the importance of incumbency (paragraphs 8.52 to 8.65). Fourth, we present the key factors that affect the award of competition, taking into account our conclusions on complexity and incumbency (paragraphs 8.66 to 8.69). Finally, we present evidence on the closeness of competition between suppliers pre-merger, including contracts currently held, historical performance in tenders, and the views of suppliers (paragraphs 8.70 to 8.90).

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<sup>46</sup> Broadcasters with international channels played out in the UK include BBC Worldwide, Disney, NBCU, ITV and others.

- 8.2 We note that competition is not based solely on price: broadcasters, especially those with more complex needs, will seek a bespoke solution that fits their technical and operational requirements, can meet the service levels they require, and fits their appetite for risk. This is reflected in the typical tender process described below, where customers identify solutions that are ‘fit for purpose’ and then try to negotiate the details of the solution and the price. Therefore broadcasters may have to trade off price against other factors when choosing a supplier. Thus in examining the nature of competition, price is one element, but other competitive parameters such as service quality and perceived risk are also important. Therefore, our concern about competitive effects of the merger is not simply whether prices will rise, but whether playout services become less economically advantageous (in terms of the overall balance of price, quality and risk).
- 8.3 By way of introduction, we observe that outsourced linear playout is a relatively immature market and that parts of the market may not have yet been fully exposed to the effects of competition. At the more complex end of the market, particularly the PSBs, linear playout has only been relatively recently outsourced. Further, the original outsourcing tended to take place using long-term contracts—in the case of the BBC, ITV and Channel 4, ‘first generation’ outsourcing contracts are still in place.
- 8.4 The process used to outsource playout services may mean that the way that competition worked for those original contracts differs from the way that competition works for those contracts when they are retendered. Both the BBC and ITV contracts involved separation of what was previously an internal function and the transfer of operational, managerial and engineering staff, equipment and facilities to the first outsourced provider. We would expect that if the service were to move to a different provider in future, it is primarily dedicated operational staff who would transfer under

TUPE regulations whereas other staff, facilities and equipment would not.<sup>47</sup> We therefore consider that the way that the competition for the original outsourcing of these contracts took place is of limited relevance to how competition for future contracts may work. We also note that for any broadcaster's first outsourced tender (including that for new broadcasters such as BT Sport) there were no incumbency issues.<sup>48</sup>

### ***The tender process***

- 8.5 Broadcasters have to make a 'build or buy' decision as to whether to supply their own playout in-house or outsource it to a specialist playout provider. If they decide to outsource, contracts are generally awarded on the basis of tender processes as broadcasters seek a supplier to fit their particular requirements. In many cases, the decision to outsource is made first, but in some cases broadcasters have proceeded with a tender or other market testing before making that decision. We understand that the majority of negotiations over price and conditions take place in the context of contracts expiring,<sup>49</sup> but we consider separately the role competition may play mid-contract (paragraphs 8.13 to 8.21).
  
- 8.6 The first step in a tender for playout services tends to be that customers describe their requirements. The degree of detail varies, with some customers being very prescriptive as to the equipment used and processes to be followed, and others specifying only the outcome that they want, leaving suppliers to propose how to achieve this.<sup>50</sup> Some customers may also include other services along with linear

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<sup>47</sup> TUPE regulations are explained in Appendix B.

<sup>48</sup> See paragraphs 8.52 onwards.

<sup>49</sup> Outsourced contracts usually include provisions for foreseeable changes of service, such as adding an additional channel, and the way in which this would be priced; so a broadcaster does not generally need to conduct a new negotiation or competition if its broadcasting requirements change.

<sup>50</sup> For example, Channel 5 told us that it aimed to produce a Request for Proposal that was fairly 'technology agnostic' so that the bidding companies had a free hand to suggest new technology and processes as they saw fit. The BBC also requested suggestions for technology in its recent market sounding.

playout in a tender, although generally we understand that customers will separate these components if necessary to get a better outcome.

- 8.7 A customer will then approach potential bidders, based on its knowledge of the market and, in particular, the record of providers in handling similar customers. This is often referred to as a Request for Information (RFI). We understand that the key purpose of this stage is to identify which suppliers are likely to be capable of meeting the customer's requirements; for example, ITV described this stage as getting 'a better understanding of who could realistically provide the service we require and an indication of possible costs'. Customers typically send this to all or a selection of suppliers they think are capable of meeting their needs (and sometimes more widely to find out if there are other capable suppliers). Most customers told us that they would like to have four or five suppliers at this stage, and then shortlist two or three.
- 8.8 The customer will then evaluate the responses it receives, often using a scorecard to rate each bidder on particular aspects of the proposal (weighting them if necessary). The key objective of this stage is to identify suppliers who are likely to be able to meet the customer's needs and take them forward to the next stage. Customers told us that price would be a consideration at this stage, but that they generally expected price to be negotiated further as requirements became better defined. The initial bid would only be considered indicative—but would help the customer to determine the approximate price that it might have to pay, and to understand how far particular suppliers were away from that.
- 8.9 The customer will then draw up a shortlist and issue a Request for Proposal (RFP) to these selected bidders. Thereafter, this stage involves working with shortlisted bidders to develop their solutions to the point where the customer is comfortable that one or more could deliver its detailed requirements. At this point, it encourages

bidders to offer the most competitive overall price, including contractual points, commercial points and service levels. In some cases, the customer may further reduce the shortlist to two bidders and have further discussions and offers. It may then move to a ‘preferred bidder’ stage where the final details of the service and price are negotiated with a single provider—this partly reflects the difficulty in negotiating these details and so the preference is to do so only once, with the threat of the other shortlisted bidder(s) as leverage. There are typically no fixed rules—for example, during this stage, some customers may be open to allowing bids from bidders who had been excluded at the longlist stage if they significantly improve their offer.<sup>51</sup>

- 8.10 For the BBC, the tender process is more formalized because it is bound by EU procurement regulations.<sup>52</sup> We understood that it was likely to use a competitive dialogue procedure. It described the stages of this procedure as: Official Journal of the European Union (OJEU) notice, Pre-Qualification Questionnaire, Invitation to Participate in Dialogue, final Invitation to Tender (ITT), then evaluation and contract award. However, these stages seem to us analogous to an announcement, RFI, RFP, shortlist and evaluation as described above. There may be several formal dialogue stages before moving to the final ITT, analogous to several rounds of discussion and negotiation in a less formal tender. However, under this procedure there is only limited scope for the BBC to negotiate once the dialogue stage has been concluded and final tenders have been submitted—because after this stage only clarification of bids and finalization of terms is permitted.
- 8.11 The metrics on which bids are commonly evaluated, at both longlist and shortlist stages, include both price and non-price elements<sup>53</sup> such as:

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<sup>51</sup> For example, Channel 5 said that companies that had not been shortlisted in some cases asked to revise their bids, and the shortlisted companies were advised of this which allowed them to revise their own bids.

<sup>52</sup> Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts as transposed into UK law by The Public Contracts Regulations 2006.

<sup>53</sup> We discuss the relative importance of different elements in paragraph 8.66 below.

- (a) price and related clauses (eg required service levels and associated service credits for under-performance);
- (b) financial stability of the provider;
- (c) knowledge of the market, ie experience and reputation;
- (d) personnel within the organization (this may relate to the pedigree of the management team or technical specialists who can design the solution);
- (e) understanding of the customer's requirements;
- (f) demonstrated ability to provide a solution (a supplier may be expected to give a demonstration of the proposed technology, in the form of a site visit, proof of concept or both);
- (g) approach to migration of services (if applicable); and
- (h) ability to provide the service without subcontracting, or proposed partners.

8.12 Our assessment of the tender process suggests, consistent with standard economic principles, that the outcome for a broadcaster will depend on the number and identity of credible bidders for the contract and on their ability to address the complexity of the broadcaster's linear playout requirements.

#### *The role of competition during long-term contracts*

8.13 We also considered the extent to which competition may affect behaviour at times other than during the tender process that takes place prior to the expiry of a playout contract. We identified two other sets of circumstances: first, where contracts contain benchmarking clauses so that the customer can test the price it is paying; and second, the possibility of renegotiation when there is no benchmarking clause.<sup>54</sup>

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<sup>54</sup> As noted in the footnote to paragraph 8.5, outsourced contracts usually include provisions for foreseeable changes of service, and so we understand that renegotiations within a contract period are relatively rare.

- 8.14 Not all playout contracts have benchmarking clauses. We identified [☒] broadcasters that had put such clauses at specific dates in their contracts, [☒] (although [☒] and so we have not been able to observe any consequences of it).<sup>55</sup> [☒]
- 8.15 In our view, customers can, under some circumstances (eg where the contract contains a benchmarking clause), use the threat of competition without actually inviting competitors to make a bid. A similar principle may apply to contract extensions at the end of a contract: a customer may be able to use the threat of a tender, and the competition implicit in that, to get good renewal terms from its existing supplier, without actually going through the expense of a tender process. (We note that the BBC has extended its contract with RBM without tender,<sup>56</sup> although it said that this was to ensure that the next tender process, and possible handover if a new bidder won it, would be conducted at a suitable time for the organization<sup>57</sup>).
- 8.16 However, our view was that benchmarking exercises were unlikely to involve the same degree of rivalry as an open tender. A broadcaster would typically seek a single benchmark price. We thought that competitors would be likely to be less inclined to provide a benchmarking price than to engage in a tender since they would know that they were being used primarily as a lever against the existing supplier rather than a genuine contender (unless the broadcaster was dissatisfied with its supplier and seeking a change), and that the incumbent would usually have the chance to match the price.

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<sup>55</sup> [☒] also have termination clauses in their contracts in the event that [☒].

<sup>56</sup> The BBC clarified that it put out a Voluntary Transparency Notice through the OJEU, telling the market that this was its intention and allowing it time to challenge the intent if it wished to.

<sup>57</sup> We understand that under the EU procurement rules a contracting authority can extend a contract where the contract includes an option to extend, or if the contract does not include such an option, the contracting authority can extend a contract as long as this amendment to the original contract does not change essential contract terms and distort competition. In other words, the extension of a contract appears to be allowed as long as the amendment to the original contract is not 'materially different in character from the original contract' (*Case C454/06 Pressetext Nachrichtenagentur GmbH v Republik Österreich (Bund) and others*).

- 8.17 Secondly, we considered whether competition may affect behaviour during the course of contracts where there is no explicit provision for benchmarking or renegotiation. Due to the length of contracts, there may be situations where a customer (or supplier) wishes to renegotiate an existing contract. For example, we understand that there may be cases where prices are renegotiated based around a technology refresh, to select the best system and share the benefits of efficiency gains.<sup>58</sup> However, we understand that there are typically substantial termination penalties and so a threat to terminate early will not generally form part of these discussions.
- 8.18 One bargaining tool at the customer's disposal is to offer a contract extension in return for better terms. The supplier would have to balance (a) a lower price for the duration of the current contract against the benefit from (b) avoiding the expense of a tender process, and (c) certainty of supply for the additional term of the contract.
- 8.19 Competition may affect negotiations through the threat of what will happen when the current contract expires, ie point (c) above.<sup>59</sup> The proposed merger could affect these negotiations by making the incumbent's position stronger and so reducing the threat of a future tender.<sup>60</sup> Therefore the customer's bargaining position would be weakened (to some extent depending on the incumbent's perception of the effect on its chances<sup>61</sup>) and it may not get such good terms, or may not be able to agree a new deal at all. However, we also took into account that the longer the current contract has to run, (a) the greater the uncertainty about the competitive situation (because

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<sup>58</sup> Another possible example might be that a broadcaster may wish to launch new channels, although our understanding is that this type of event is usually covered under existing playout contracts—see footnote to paragraph 8.5.

<sup>59</sup> Points (a) and (b) would remain part of the equation but would not be affected by the merger.

<sup>60</sup> The benefit to the incumbent of a longer contract depends on its perception of the strength of competition—and thus its likelihood of retaining the customer—at the point when the contract is scheduled to be retendered. For example, if the supplier thinks there is a 70 per cent chance that it would retain the contract at the scheduled tender point and a 30 per cent chance that it would lose it to a rival, then the benefit to the supplier of a contract extension is 30 per cent multiplied by the margin it would earn for the term of the extension. Suppose that the merger removed the most important rival to the incumbent, and as a result its estimated chances of retaining the contract at the scheduled tender increased from 70 to 90 per cent. The 'certainty of supply' benefit to the incumbent of a contract extension is now smaller—10 per cent of the margin on the extension to the term, rather than 30 per cent—and it would be less willing to agree to an extension on the same terms that it may have agreed pre-merger.

<sup>61</sup> The effect of competition differs from its effect in tenders, in that it will depend on the incumbent's perception of the strength of its competitors, and not their actual strength.

technology may change, rivals may gain reference customers, etc), and (b) the less concerned companies will be about effects of the merger at the end of that contract. ITV told us that [§]. The BBC said that [§].

- 8.20 In our competitive assessment, we took into account these possible effects of the merger on customers, but we thought that the main effects would manifest at either the end of contracts or designated points where the contract could be broken without penalty (in practice, the dates of benchmarking clauses). We did not think it would affect negotiations other than through the anticipated effects at contract break-points. Therefore our competitive assessment in Section 9 has focused on these break-points. If the merger also affects (to some degree) any mid-contract negotiations, we expect that we will also have captured that effect and we do not attempt to assess it separately.

### ***Requirements and complexity of customers***

- 8.21 As we have discussed above, some customers had more complex linear playout requirements than others. We considered the extent and nature of this, whether this might make them more difficult to serve, and the implications that this may have for rivalry for particular customers' playout contracts, depending on the capabilities of providers in the UK playout market. This section summarizes evidence and analysis that is set out in more detail in Appendix D.
- 8.22 The parties said that the requirement at the heart of all linear playout contracts was the same, ie the compilation and preparation of broadcaster's content precisely in accordance with the set programme schedule for subsequent transmission.<sup>62</sup> They said that there was no substantial variation in customer requirements from a

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<sup>62</sup> Initial submission, paragraph 3.6.

demand-side perspective.<sup>63</sup> They also said that in dealing with reactivity and intervention, the resources involved were common to all contracts.<sup>64</sup> The parties did, however, acknowledge that some contracts might be more complex than others, particularly if they required the building of a bespoke playout suite.<sup>65</sup> Nevertheless, they told us that the BBC and ITV channels were not in a category of their own.

- 8.23 The view from the majority of parties other than RBM and Technicolor was that the BBC and ITV's core channels had more complex requirements than those of any other broadcaster. This view appears to arise not from any single factor, but rather from the relatively frequent need to make changes to schedules when dealing with a combination of reactive live content, regional variations, the occasional requirements to handover content between channels, and the multigenre nature of those channels.
- 8.24 We considered whether there are key differences between different broadcasters that might affect their relative complexity. We noted that:
- (a) The BBC, ITV, Channel 4, Channel 5, Sky, BT, ESPN and British Eurosport have channels with significant amounts of live content and also need to be able to make late scheduling or advertising changes and/or to be able to broadcast live news flashes.
  - (b) Only the BBC and ITV have channels that currently broadcast regional programming.
  - (c) ITV, Channel 4, Channel 5, UKTV and Sky have different versions of their channels based on regional advertising requirements.<sup>66</sup>
- 8.25 In addition, we noted a number of other differences between broadcasters that did not appear to have a significant impact on playout requirements including specialist

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<sup>63</sup> [Response to issues statement](#), paragraph 5.24.

<sup>64</sup> Initial submission, paragraph 3.23.

<sup>65</sup> Initial submission, paragraph 3.38.

<sup>66</sup> For example, Sky produces different versions of some channels for 'pubs and clubs' than for non-commercial subscribers.

graphics, live subtitling, multilingual requirements, high definition or time-shift variants. An explanation of why these factors do not significantly increase the complexity of a broadcaster's playout requirements is set out in Appendix D.

- 8.26 The factors that we have set out in paragraph 8.24 appear to create two types of challenges for providers that wish to meet their requirements:
- (a) operational challenges—specifically those challenges faced by a playout provider's staff when playing out channels day to day (see paragraphs 8.27 to 8.41); and
- (b) design, implementation and ongoing support challenges—associated with the design and implementation of a solution that meets the requirements of a broadcaster, and subsequent engineering support once it is up and running (see paragraphs 8.42 to 8.47).

#### *Operational challenges*

- 8.27 The two main causes of operational complexity put to us were those caused by the reactive live content of the broadcaster's channels and those caused by regional aspects of their output. First, we summarize the merging parties' submissions on complexity (discussed in more detail in Appendix D), and then we address these two causes in turn.

#### *Measures of complexity*

- 8.28 The parties told us that the key indicator of operational complexity overall was the number of manual interventions required by the playout provider. The parties provided data on interventions which they told us showed that playout for ITV and the BBC was not more complex than for some of the other channels they served (such as [§]).

- 8.29 The parties also provided us with data showing that the BBC and ITV did not show more live content than certain other broadcasters. They also provided data showing that in terms of dedicated staff per channel, [☒] had the highest number of staff per channel, but that certain other broadcasters were ahead of [☒]—although when we reviewed the numbers of dedicated playout staff only, we found that the two were at the top end of the spectrum, though not by an order of magnitude.
- 8.30 We were wary of placing great weight on the details of any of these sources of data, since we did not think that any one translated directly into a measure of complexity. We thought that all of them were consistent with there being a spectrum of complexity, and the BBC and ITV being at the top end of the spectrum but not necessarily uniquely complex.

*Live content*

- 8.31 We considered the operational challenge that broadcasting live content presents for a playout provider. We found that not all live content is equally complex. For instance, a scheduled live programme with known duration and, where relevant, advertising breaks would be unlikely to present as significant a challenge to a playout provider as playing out reactive live content, such as live sport. Playing out reactive live content may require the insertion of advertising breaks on an ad hoc basis, requiring constant monitoring. In addition, if a televised event overruns or underruns, the playout provider is likely to have to make consequential changes to the rest of the schedule.
- 8.32 Some parties suggested that dealing with consequential changes was more difficult for a multigenre channel than for a dedicated sports channel, since the resulting schedule was easier to decide on a sports channel; and that live handover between channels (eg during Wimbledon) was unique to the PSBs. However, we understood

that the responsibility for editorial decision-making in these situations lies with the broadcaster (other than in exceptional circumstances when the broadcaster cannot be contacted). This means that even though the external playout provider might need to make changes to the playout schedule as a result of unplanned events or over- or underruns of live content, it will typically do so based on instructions by the broadcaster itself—and in the unlikely event that it could not get those instructions, we would expect the decision to be made by an employee that would transfer to any new provider under TUPE.

- 8.33 We found that the need to play out reactive live content is an important distinction between channels, and we saw this as the primary differentiator between broadcasters' needs. We viewed scalability as a second order factor: once a playout provider is able to handle reactive live content for a broadcaster, we thought that handling greater volumes of live content was relatively straightforward (since we understood that suitable operational staff are broadly available on the open market), and therefore that the amount of live content is not determinative of complexity.

#### *Regional content and advertising*

- 8.34 In the UK, only the BBC and ITV broadcast regional programming (although Channel 4 has the ability to do so). The BBC broadcasts national versions of BBC One, BBC One HD and BBC Two in Scotland, Northern Ireland and Wales. The BBC also has 15 English regions that have their own newsrooms and can opt out of network programming. ITV told us that it had a total of 20 regions (consisting of 18 advertising regions and 18 news regions, not all of which correspond).
- 8.35 We have not identified any evidence that indicates that regional variants of the BBC and ITV present a significant operational challenge when all is proceeding according to schedule. Automated software handles the majority of switches between feeds for

ITV and local BBC staff manually switch for regional variants of its channels. Further, the parties have provided us with data that shows that in two samples of interventions data accounting for four weeks of operations, regional programming did not cause a single intervention (see Appendix D).

- 8.36 Regional variants can pose a more significant challenge when events (often live programming) cause deviations from the schedule. However, we found that the editorial responsibility for this lies with the broadcasters. We also found that the operational complexity for the BBC lies with its own in-house Nations and Regions playout, with only a limited coordinating role for RBM. We found that the operation of ITV's regions is largely automated so a single intervention 'cascades' across regions rather than requiring manual interventions for each region (although there is again a coordinating role with the two regions that provide their own playout).

*Provisional view on operational complexity*

- 8.37 We thought that there was a spectrum of operational complexity, with the need to playout reactive live content being the most important distinction between channels at the more complex end of the spectrum and those at the simpler end.<sup>67</sup> We did not think that the total amount of live content a channel broadcasts was determinative of its operational complexity.<sup>68</sup>
- 8.38 We found that the BBC and ITV had the most complex broadcast operations. However, based on the arguments and evidence before us, we did not see convincing reasons to indicate that the outsourced playout requirements of the BBC and ITV were overall substantially more complex at an *operational level* than those of some

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<sup>67</sup> A view supported by the parties' submissions on the main causes for manual interventions in playout.

<sup>68</sup> Similarly, in the parties' intervention data (discussed below), [X] delivered content late more often than other broadcasters, and this might be viewed as a source of greater complexity for that broadcaster. As with reactive live content, we considered that the ability to deal with regular late delivery was a source of complexity, but we did not think that the frequency of late delivery from a broadcaster was determinative of its operational complexity.

other broadcasters (since even though their broadcasting was more complex, much of the resulting burden fell on the broadcaster). Therefore the operational aspects of their outsourced playout requirements were not in a class of their own.

- 8.39 We found that there were certain operational issues unique to each of the BBC and ITV, with a degree of commonality between the two (such as the role coordinating regional playout), and therefore it was unlikely that playout providers other than the parties would have experience with these issues. However, we thought that the most complex aspects would generally be handled by employees that would transfer to a new provider via TUPE if the contract changed hands. We also thought that to the extent that playout providers provide operational roles that have to deal with unique requirements (eg planners in the case of the BBC), the customer could choose to take that role back in-house if it would level the playing field for a tender. Therefore these issues need not be a significant obstacle to another provider taking over the BBC or ITV contract at an operational level, provided that appropriate systems and procedures had been put in place.
- 8.40 Some broadcasters other than the BBC and ITV also exhibit significant elements of operational complexity (primarily due to their material amounts of reactive live content). These include other PSB channels (Channel 4 and Channel 5, and some digital channels of the four PSBs), which display (to varying degrees) some of the characteristics of the BBC and ITV, but with many fewer advertising regions and without regional programming variations to be coordinated; and dedicated sports channels, which have to make a high number of manual interventions to schedule advertisement breaks and depart from the initial schedule when events over- or underrun (although again the editorial aspect of this falls to the broadcaster). We understand that live sports channels have complicated operations on a day-to-day (or

hour-to-hour) basis, with many programmes being subject to manual intervention, but they do not have regional content or large numbers of advertising regions.

- 8.41 Apart from the PSBs and dedicated sports channels, other broadcasters' operational requirements appeared to be less complex. Although these broadcasters vary in scale, we thought that their requirements were relatively straightforward, and a playout provider that could fulfil the operational requirements of one broadcaster could probably supply most others in this sector of the market.

*Design, implementation and ongoing support for the playout solution*

- 8.42 The other challenge that a playout provider has to meet is associated with the design, implementation and ongoing support for a solution that meets the requirements of a broadcaster. We thought that the two key elements for a prospective playout provider were understanding the broadcaster's needs and demonstrating that understanding; and their technical capability.
- 8.43 Many broadcasters emphasized the importance of playout providers needing to present their understanding of the customer's requirements and their proposed design for the playout process and related technological aspects during the tender process. We were told that broadcaster interfaces were best understood through direct experience of them (an incumbency advantage that cannot easily be overcome other than through hiring people with direct experience) but might be approximated by experience with a similar organization. This means that a new provider would need to have people with the relevant expertise and experience either in-house or, alternatively, they would need to engage consultants both when starting to supply a new customer and when bidding for the contract. If there is a need for particular experience at the bidding stage, and that experience is in short supply in the free-

lance/consulting market (as the evidence of [8] suggested), then suppliers with that experience in-house will be at an advantage.

- 8.44 The second major issue is technical expertise for more general design and integration skills using commoditized equipment, where such expertise may be either in-house at the bidder or contracted in for the bid. The parties said that the underlying hardware, software and processes were broadly common to all channels which then had their own specific guidelines and procedures. This appeared to be a view shared by other playout providers. They also said that none of these elements were unique to the BBC or ITV, and that RBM and Technicolor (and other competitors) outsourced system design and implementation to third party specialists, such as systems integrators, equipment suppliers, and other relevant technical consultants.
- 8.45 Design and engineering staff would be unlikely to be subject to TUPE arrangements when a broadcaster switches playout provider, since they are typically not dedicated to a single customer. These staff are needed to win a contract as well as to implement it. Therefore, unlike with operational staff, a new provider would have to either have these people in-house or subcontract them at the bidding stage.

*Provisional view on design, implementation and ongoing support*

- 8.46 Overall, we thought that the design and implementation of a solution for the BBC and ITV was more complex than that for other broadcasters, due to a combination of their regional content and interactions with nations/regions playout, their need to move content between channels, their risk aversion arising from their high profiles, and their greater propensity to change schedules due to breaking news and overrunning events. Not all of these qualities were unique to the BBC and ITV, but all were factors that contributed to their high degree of complexity overall. In each of these aspects, the BBC and ITV had more in common with each other than with other broadcasters.

8.47 We therefore provisionally concluded that playout providers with experience of the BBC and ITV's systems were likely to have an advantage in a tender for the playout of either broadcaster. Providers without such direct experience could attempt to overcome this advantage by recruiting or contracting individuals or organizations with such experience; and the customer could attempt to level the playing field by sharing as much information as possible with each potential provider.

*Provisional conclusion on complexity*

- 8.48 Our overall view on operational complexity was that the BBC and ITV's operational playout requirements were more complex than those of other broadcasters, but the burden of that complexity was shared between the broadcaster and the outsourced playout provider. We thought that, if necessary, more of that burden of planning and decision-making could be shifted to the broadcaster. The remaining operational complexity of BBC One and ITV1 would still be at the highest end of the spectrum, but not by an order of magnitude, and the challenge of meeting it could more easily be addressed by the TUPE transfer of dedicated operational staff.
- 8.49 We thought that the greater challenge for rival suppliers at the tender stage would be in gaining and demonstrating an understanding of the BBC and ITV's requirements, and proposing systems that would meet those requirements. Providers could attempt to address this by recruiting appropriate consultants or contractors, if available. However, we thought that the incumbent to a complex customer would have a clear advantage on this front, and experience with a customer with similar requirements would also be a clear benefit.
- 8.50 Taking all this into account, we thought that it would be feasible for suppliers with experience of other PSBs and sports channels to provide playout for the BBC and ITV, but we understood why it was a widely-held view (including by ITV and the BBC)

that it would be a step up for them. We thought that perception was important since it may affect the tender process. However, we also thought that a detailed tender process with motivated participants on both sides may reduce the perceived step up and facilitate the understanding necessary for a credible bid.

- 8.51 We thought it was therefore unlikely that any other UK customer could count as a reference customer to demonstrate to the BBC or ITV that a supplier has experience of meeting all of its requirements. Hence any bidder for the BBC or ITV other than RBM or Technicolor would have to find other ways to demonstrate its ability, either by using its overseas experience, if available, or by demonstrating during the tender process a good understanding of and ability to meet the customer's needs.

### ***Inc incumbency advantages***

- 8.52 The parties told us that there was little, if any, incumbency advantage at the time of contract award; [§§]. They said that this was because when contracts changed hands, this almost always required a complete rebuild/refit of the relevant facilities,<sup>69</sup> and so both incumbent and rival would incur costs and risk of transition. They also told us that these build/fit costs were not incurred until after the contract had been awarded and applied equally to both incumbent suppliers and other bidders.<sup>70</sup> They said that there were a number of recent examples of the incumbent providers losing their next generation tender to a competitor which were evidence that there was not a significant incumbency advantage.<sup>71</sup>
- 8.53 By contrast, most broadcasters with more complex requirements, including [§§], [§§], Channel 4 and BT—as well some with less complex requirements such as UKTV and CSC—thought that there was an incumbency advantage in relation to

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<sup>69</sup> Initial submission, paragraph 3.40.iii.

<sup>70</sup> Initial submission, paragraph 5.30.

<sup>71</sup> Initial submission, footnote 81.

their own playout. A number of the providers in the market, including Encompass, Arqiva and [§], also told us that they believed that such an advantage existed. We heard a number of explanations for this, particularly from providers with more complex broadcasting requirements and providers of playout services at the more complex end of the market:

(a) *Key knowledge and expertise resides within the incumbent.*<sup>72</sup> [§] Similarly, Channel 4 said that its incumbent, RBM, would have some incumbency advantage because it understood exactly what was needed to drive the service, and knew what technology it could base this on. BT told us that its incumbent had knowledge of the channels and infrastructure, connectivity, and scheduling and materials transfer processes in place with the broadcaster. UKTV told us that its incumbent provider had staff that understood its business much better than rivals. Of the suppliers, Encompass also told us that, as incumbent, there was an advantage in the knowledge and the working processes, as these differed for most customers all over the world.<sup>73</sup> Further, Encompass and Arqiva also both told us that, as a non-incumbent, they might need to incur additional costs in demonstrating the ability to meet customers' requirements compared with an incumbent.<sup>74</sup>

(b) *There are a number of risks to the broadcaster associated with switching provider.* This is in part a consequence of the previous point. Channel 4 told us that even when refreshing technology, keeping the same supplier was a lot less disruptive than trying to move to a new supplier. Channel 5 pointed to a number of risks caused by switching supplier, such as breaking systems that work, managing two suppliers during the changeover, and an increased risk of outages leading to lost revenue and quality perception. [§] Of the suppliers, Arqiva said that the potential effects on the customer—of moving its content, sorting out the

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<sup>72</sup> In the case of the BBC and ITV, this partially derives from the transfer of employees from the broadcaster to the playout provider when playout was outsourced.

<sup>73</sup> See [summary of the hearing with Encompass](#), paragraph 5.

<sup>74</sup> *ibid*, paragraphs 5 & 63.

connectivity between the incumbent and the new playout provider, and changing internal workflows and interfaces to the provider's workflows—could prove a disincentive to switching.

(c) *There may be infrastructure costs already incurred by the incumbent that other potential suppliers would have to meet.* This may include both equipment dedicated to a specific customer's playout that has not reached the end of its useful life, and broader infrastructure (eg connectivity to relevant distribution networks).

[☒] UKTV also pointed out that the incumbent had the appropriate facilities already in place. However, Encompass told us that in most cases there was no incumbency advantage from existing equipment at the end of a contract as providers needed to undertake a technology refresh incurring capital spend.<sup>75</sup>

(d) *There are a number of costs to the broadcaster associated with switching provider.* [☒] Channel 5 pointed out that switching would mean that it would need to incur costs such as changing its distribution arrangements and moving programme material.

8.54 [A playout provider] told us that the incumbency advantage was higher for customers with more complex requirements than at the simplest end of the market because less complex broadcasters could change more easily between providers because their needs were relatively straightforward. The more complex the broadcaster's needs, in its view, the greater the risk of there being a problem when moving.

8.55 Some broadcasters with less complex needs did not think there was a significant incumbency advantage. [☒] Similarly, [☒] did not think there was an advantage: it told us that [☒].

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<sup>75</sup> See [summary of the hearing with Encompass](#), paragraph 5.

- 8.56 Other broadcasters with less complex requirements did, however, identify incumbency advantages. CSC said that a current supplier would have an incumbency advantage the next time it tendered its playout requirements. It said that migrating the playout and moving a facility was a high-risk project, and that it would rather not have done so. Despite this, it had recently moved away from Technicolor because [§]. As noted above, UKTV also told us that its incumbent provider understood its business much better than rivals.
- 8.57 [§] told us that it thought there was an incumbency advantage but it did not consider it to be very significant. It said that switching involved a migration process which had to be planned and implemented at a high level of detail, with extensive testing. It told us that [§].
- 8.58 Therefore we found a general consensus among broadcasters with complex playout requirements that there was a significant incumbency advantage, and the reasons for this were broadly consistent and plausible. However, this view seemed less clear and less strong among broadcasters with relatively simple playout requirements.
- 8.59 We considered the extent to which these incumbency advantages were reflected in broadcasters' behaviour. The parties told us that switching was common relative to renewals of existing contracts. However, when we looked at the history of switching in the UK, we found that at the most complex end of the spectrum, many broadcasters are still in their first generation contracts and so there is little direct evidence about switching. The majority of (complex) switching was between in-house provision and outsourcing (and the key factors in the outsourcing of both the BBC and ITV were that the relevant parts of their organizations transferred to the outsourced supplier [§]). Channel 5 switched some of its playout, but that was driven by a strategic decision to cut costs by consolidating its two suppliers, and the provider it chose was

the one that already played out its most complex channel. As far as we are aware, the only other broadcaster with requirements at the complex end of the spectrum to have switched supplier in open competition was ESPN, and this appeared to be driven by a significant expansion of its operations and raising of its profile (when it won Premier League football rights).<sup>76</sup>

- 8.60 Several broadcasters with simpler needs have switched, eg Disney from Technicolor to Encompass and CSC from Technicolor to WRN Broadcast. This suggests that incumbency advantages are not insurmountable for broadcasters with less complex playout requirements.
- 8.61 In some circumstances, we found that incumbency factors may lead to an incumbent being given an additional chance to revise its bid after rival bids have been received. [A playout provider] told us that in its experience, a customer generally got other offers to try to persuade the incumbent to improve its own offer, and the incumbent would have a second chance to try and do that. [A multi-channel broadcaster] decided to add an additional stage into the tender process in order to ensure that the best-quality bids were submitted [☒].
- 8.62 Overall, the clear consensus among broadcasters and playout providers (other than the merging parties) was that there was a substantial incumbency advantage for broadcasters with complex requirements but that it was relatively small and less clear-cut for those with simpler needs (where we have observed some switching). Although it was not possible to observe whether the existence of an incumbency advantage deterred switching or otherwise affected tenders for broadcasters with complex requirements in practice (due to the paucity of examples of such broadcasters reaching the end of a first generation outsourced contract), we found the

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<sup>76</sup> See Appendix C, paragraph 53.

reasons we had been given for its existence to be both plausible and consistent with the way that broadcasters evaluate tenders. The nature of this incumbency advantage lay partly in the incumbent having a better understanding of a broadcaster's requirements, processes and technological infrastructure; and secondly, in the fact that broadcasters perceived the transition process away from an incumbent as risky and time- and resource-consuming, which may make them more reluctant to switch. TUPE rules governing the transfer of dedicated staff would reduce the operational concerns, but a new provider would have to get a service running and tested before that transfer took place, so they would not entirely remove this issue.

- 8.63 However, there is some evidence to suggest that even for the most complex customers this incumbency advantage is not an insurmountable impediment to switching and does not exclude a role for competition. There may be steps that broadcasters could take to reduce an incumbency advantage especially in terms of the knowledge of the customer (paragraph 8.53(a)). The BBC told us how it might try to do so by running a long and detailed tender process, giving potential bidders as much information as possible, and potentially simplifying requirements by taking certain functions back in-house.
- 8.64 Further, from the customer's perspective, competitive tenders seem to be the main way in which contracts are awarded, which suggests that broadcasters see them as producing reasonably good outcomes, and no broadcasters told us that they would not consider switching. From the suppliers' perspective, some playout providers appeared to be keen to engage in competition for major broadcasters' contracts (for example, each of the nine invited suppliers responded to the BBC's recent RFI,<sup>77</sup> and we were not aware of any tenders where the broadcaster could not attract at least

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<sup>77</sup> See the Appendix C, paragraphs 6 & 7.

one non-incumbent provider), even though bidding costs might be material, which suggests that they thought they had a non-negligible chance of winning.

- 8.65 We therefore concluded that there was an incumbency advantage which was strong for those with complex requirements and relatively weak for those with less complex requirements. We would expect that incumbency advantages affect the competitive process to some extent. They may mean that an incumbent might not bid quite as keenly, and that a non-incumbent will know that it has to produce a very good offer to win. They may deter some non-incumbent providers from entering a tender if the costs of entering are significant. Further, in some cases a customer may see the primary role of the tender as being to extract the best terms from its incumbent. However, we also found that customers are likely to be able to mitigate the incumbency advantage to some extent via tender design. We take account of these conclusions in our assessment of the credibility of alternative suppliers for each contract and the effects of the merger, from paragraph 9.58 onwards.

### ***Key factors driving decisions***

- 8.66 We asked customers for the most important factor(s) when deciding which supplier to select. The broadcasters told us the following about their requirements:
- (a) The BBC told us that it assessed the proposed final solutions and best commercial offers against clearly articulated criteria and on their quality/value for money.
  - (b) ITV said that to some extent its priorities regarding playout had changed over time. At the time of outsourcing, financial/investor issues led it to place less weight on risk. Being in a better financial position now, it placed more weight on high quality and reliability.
  - (c) Channel 4 told us that technical competency, price and reputation were given approximately equal weight in evaluation, with existing clients and reliability of services also affecting its final decision. It also said that it would not compromise

reliability, since advertising revenue was so important, and it would rather have good quality than earn service credits.

- (d) Key factors in Channel 5's final decision were price, the supplier's ability to provide the service and ease of migration. It also told us that the pedigree of personnel within the organization was a crucial factor, and noted that it would not consider a supplier with no obvious experience in the playout market.
- (e) For BT, [§].
- (f) Disney, in its 2012 tender, [§]. It said that price was a key factor in choosing a supplier.
- (g) NBCU said that it was very price sensitive.

- 8.67 Overall, we found that price tended to be the most important factor at the lower end of the complexity scale, where customers had relatively simple and similar needs. We found that broadcasters at the complex end of the spectrum were generally more risk-averse with respect to the possibility of errors—since their profile, reputation and (in many cases) advertising revenues meant that errors were more costly—and for them, a demonstrated reputation for handling similarly complex broadcasters tended to be the most important factor in choosing a supplier.
- 8.68 We also found that the focus shifts during the tender process. At the outset of the process a broadcaster's focus tends to be more on the supplier's ability to provide service quality (including its understanding of the customer's requirements, and the proposed technical solution) and the risk of switching. However, once those suppliers with the requisite capability have been identified the focus shifts to price/value for money. Technicolor told us that at the shortlist stage a provider would not expect to talk about its credibility, it only discussed its price. We would expect that most customers would try to continue to negotiate a lower price even if they have identified a preferred supplier and that other suppliers would be a primary lever for doing so.

However, we understand that each customer makes its ultimate decision on the basis of the overall economic advantages of the bids (taking into account price, quality and perceived risk, although the weight attached to each varies between customers).

- 8.69 Therefore when we assess the effects of the merger (from paragraph 9.58), we take into account the fact that customers in general appeared to be driven by a range of factors, and also the factors that each individual customer identified as important to them.

### ***Evidence on closeness of competition***

- 8.70 In this section, we summarize the available evidence on the strength of suppliers in the market based on their historical performance in competing to supply broadcasters, and the views of suppliers.<sup>78</sup> We take into account the contracts they have won, including the value of those contracts and the types of customer, tenders where they are likely to have exerted a competitive constraint (eg by reaching the shortlist), and the reasons why they were successful or otherwise. We also set out caveats in applying this evidence when assessing the effects of the merger on specific customers (which we do from paragraph 9.58 below). In particular, we note as a general theme that many broadcasters with complex requirements are still in their first generation outsourced contracts.

- 8.71 Table 2 sets out the playout provider, length and current annual value of the major outsourced contracts for linear playout. It shows that four providers accounted for almost all major contracts, of which the largest was that of [REDACTED].<sup>79</sup>

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<sup>78</sup> The views of customers are also important in assessing the closeness of competition, but we took the view that closeness of competition is best assessed from the point of view of each customer. Therefore we summarize each major customer's view when examining the effects of the merger on that customer, from paragraph 9.58 onwards. We also summarize customers' views of suppliers' ability to meet customers need in Appendix D, and their views on the outcomes of tenders from paragraph 8.80 below.

<sup>79</sup> The parties told us that [REDACTED]. We took that into account when considering the value of the [REDACTED].

TABLE 2 Major outsourced contracts for linear playout in 2013

Customer	Supplier	Contract from	Contract to	Current annual value £m
BBC*	RBM	2005	2017	[£X]
ITV*	Technicolor	2007	[£X]	[£X]†
Channel 4	RBM	2008	[£X]	[£X]‡
Channel 5	Encompass	2011	[£X]	[£X]
BT (BT Sport 1 & 2)	RBM	[£X]	[£X]	[£X]§
BT (ESPN)	Arqiva	[£X]	[£X]	[£X]¶
Eurosport	Arqiva	2012	[£X]	[£X]
Disney	Encompass	2012	[£X]	[£X]#
NBCU	Technicolor~	2008	[£X]	[£X]#†
UKTV	RBM	[£X]	[£X]	[£X]
Sony Pictures	Encompass	[£X]	[£X]	[£X]#
CSC	WRN Broadcast	2013	[£X]	[£X]
Turner	Arqiva	2013	[£X]	[£X]

Source: Parties' initial submission, third parties.

\*Including only channels with main playout provider.

†Technicolor estimate of the value of the contract attributable to linear playout services.

‡Including non-linear playout.

§[£X]

¶[£X]

#Including international channels.

~[£X]

8.72 The parties have estimated shares of supply to be as set out in Table 3. Their estimates of the equivalent value of in-house supply is also shown for comparison. It includes international channels and therefore overstates the total revenue of playout of channels broadcast in the UK. It shows that RBM has the largest share of supply, followed by Encompass, Technicolor and Arqiva.

TABLE 3 Parties' estimates of shares of supply for UK linear playout in 2013\*

Supplier	Annual revenue from contract £m	In-house and outsourced (share) %	Outsourced only (share) %
RBM	[50–60]	[20–30]	[40–50]
Technicolor	[10–20]	[5–10]	[10–20]
Encompass	[10–20]	[5–10]	[10–20]
Arqiva	[5–10]	[5–10]	[5–10]
GlobeCast	[5–10]	[5–10]	[5–10]
WRN Broadcast	[0–5]	[5–10]	[5–10]
Others	[10–20]	[5–10]	[10–20]
In-house	[40–50]	[20–30]	N/A
Total (outsourced)	[100–110]	[70–80]	100
Total (all)	[150–160]	100	N/A

Source: Parties' response to issues statement, Annex 5 (and subsequent update). Includes smaller contracts that were not listed in Table 2.

\*[£X]

8.73 The market for outsourced linear playout services in the UK is characterized by long-term and infrequently awarded contracts that tend to be awarded through competitive

tender processes. In our view, market shares are not a wholly reliable indicator of market power in such a market, because (a) they can change significantly if a large contract changes hands ([§]), and (b) they could potentially overstate the importance of contracts awarded during a time period when competitive conditions may have been different.<sup>80</sup>

- 8.74 The parties argued that competitive dynamics in the market were best reflected by examining each competitor's success in recent tenders, and submitted market shares based on contracts tendered since 2009, which suggested that [§] and [§] are the two most successful suppliers and showed Technicolor's market share as [§].<sup>81</sup>
- 8.75 We thought that using each competitor's success in recent tenders to understand competitive dynamics could be potentially misleading because the analysis excludes a number of significant contracts (including BBC, ITV and Channel 4) that were awarded prior to 2009. We thought that older contracts still have significance because:
- (a) Many parties told us that supplying some of the broadcasters excluded from that analysis, including the BBC and ITV, were important indicators of the strength of RBM and Technicolor.
  - (b) Being the incumbent supplier is likely to be an advantage when those contracts are next tendered (see paragraphs 8.52 to 8.65).
  - (c) Reputation and experience appear to be important factors in a supplier's prospects of winning a tender process (see paragraph 8.67). Looking only at recent tenders would also ignore contracts that were renewed without tender (eg [§]).
- We believe that competition is relevant to such renewals because a broadcaster's threat to initiate a tender process is a potential negotiation tool.

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<sup>80</sup> Or when other factors applied; for example, see footnote to paragraph 9.21.

<sup>81</sup> The parties said that Technicolor had secured only two contracts since 2009: (a) LondonLive and (b) one channel playout services for Fatstone, a UK-based service for a Norwegian customer. They said that [§].

- 8.76 We also noted that customers' requirements vary substantially and different suppliers have had success in different segments of the market; hence shares across the whole market do not necessarily reflect competitive strength in a particular segment.
- 8.77 For these reasons, we view suppliers' market shares as illustrative and informative, in terms of summarizing past successes and illustrating the extent to which a supplier can draw on experience of supplying similar reference customers to win a tender. We have, however, for the reasons set out above, been careful not to place undue weight on them.
- 8.78 We also analysed UK tenders, market tests and situations where a broadcaster renewed its contract without testing the market. Among other things, this helped us to understand the competitive interactions between the various providers of linear playout services. We included details of 30 tenders and related events since 2005 (of which 23 were formal tenders for playout of channels broadcast in the UK). A full description of these tenders is included in Appendix C.
- 8.79 Technicolor's recent record in tender processes has been poor. It has not won a tender for linear playout provision since it secured the NBCU contract in 2008 [§]. [§] RBM won several tenders that Technicolor participated in, including [§]. We do, however, note that Technicolor [§]. Further, Technicolor lost [§] linear playout contracts that it had previously held, all to providers other than RBM ([§]). These [§] contracts ranged in value from £[§] million to £[§] million. None of them were for particularly complex playout requirements [§].

- 8.80 There are a number of reasons put forward by broadcasters for why they did not select or shortlist Technicolor. [§]⁸² Further Technicolor was not selected for the ITV Choice tender, even though it provides playout for ITV's main UK channels, as it does not provide distribution services post-playout and would have had to partner with a supplier to deliver that part of the contract.<sup>⁸³</sup>
- 8.81 On the one hand, this may suggest that Technicolor has not been a strong competitor in recent times. On the other hand, the evidence on its ability to compete for complex customers is limited. In the last five years, the only complex customers seeking proposals from the open market have been three sports broadcasters (British Eurosport, ESPN and BT). There has not been an open tender of linear playout services for a reactive mixed-genre channel since the Channel 4 tender in 2008.<sup>⁸⁴</sup> Even the Channel 4 tender is of limited relevance, given the amount of time that has elapsed since the contract was awarded [§]. We also took into account the change of ownership and management to Ericsson in 2012—several broadcasters told us that this had improved their perception of Technicolor—which suggests that we should place less weight on Technicolor's performance prior to that date.
- 8.82 The only recent market test of a complex mixed-genre channel was an RFI conducted by the BBC in November 2012, which it used to share its strategic direction and high-level requirements with suppliers to understand suppliers' capability and maturity, and to gain insight and expertise from the market to inform its sourcing and procurement strategy. [§] This informed the BBC's current view of suppliers' abilities. However, the BBC said that the RFI phase would play no part in the BBC's eventual selection of a playout provider, which would only occur at the end of a formal procurement process. It also said that it expected to score its actual

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<sup>⁸²</sup> See Appendix C.

<sup>⁸³</sup> We note that this tender was not for playout in the UK.

<sup>⁸⁴</sup> The Channel 5 tender in 2010 was [§].

procurement against different criteria.<sup>85</sup> Since this was only a preliminary stage of a long and complex procurement process, we expect that other providers might be able to score more highly once they gain a better understanding of the BBC's requirements.

- 8.83 RBM, on the other hand, has won a number of contracts in recent years, most notably Channel 4 and, more recently, BT. It beat Encompass to the Channel 4 contract due to the scale and depth of RBM's operations, RBM's potential for staff development and RBM's reputation in the market. It has also managed to extend its playout contract for [§] without tender.<sup>86</sup> [§] It had lost its playout contracts for some of Channel 5's channels and ESPN, but both to providers other than Technicolor. [§] Further, the ESPN contract RBM held was relatively small (although the new contract won by Arqiva was substantially larger, reflecting ESPN's acquisition of valuable UK sports rights and consequent new channels). RBM has not won any contracts from Technicolor.
- 8.84 Encompass, a rival provider, has won two new contracts over the past ten years. First, it won the contract for Disney's UK playout operations that used to be provided by Technicolor (although we do not believe Disney's needs to be particularly complex). Secondly, it retained the playout contract for Channel 5 and gained the contract for Channel 5's less complex channels, which had previously been serviced by RBM.<sup>87</sup> Encompass was also shortlisted for the Channel 4 contract but lost to RBM (see above). The only significant contract lost (by Ascent, before it was purchased by Encompass) was that for the playout of Discovery's channels, which were taken back in-house (although we understand that this was largely a strategic

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<sup>85</sup> The BBC told us that when the RFI was issued in autumn 2012, there was a strong likelihood that the scope of its playout procurement would be widened to include Central Circuits & Apparatus (CCA) and Centralised Coding Mux (CCM) activities upstream and downstream of linear television playout. Consequently, the playout RFI responses were assessed against the Technology division's prevalent principles at the time. It subsequently decided that its playout procurement would not include CCA or CCM services.

<sup>86</sup> It also negotiated an extension for BBC Global News, a non-UK channel played out from within the UK.

<sup>87</sup> However, as indicated above, [§].

decision driven by Discovery's expansion of its channel portfolio rather than a failure on Ascent/Encompass's part).

- 8.85 Arqiva, another rival provider, has been successful in renewing and obtaining playout contracts for sports channels. It won a playout contract for ESPN that used to be partially provided by RBM, and renewed the British Eurosport contract. It was short-listed but lost to RBM in the tender for the [§] contract. Its most recent wins were the playout for [§], and for Turner's channels, which used to be provided in-house. However, these are both [§] broadcasters with relatively straightforward requirements. Arqiva does not have experience with, and has not been shortlisted for, any PSB contract.<sup>88</sup>
- 8.86 In summary, the recent history of playout tenders provides limited evidence on competitive strength in the more complex segments of the market. No playout contracts for PSBs have been awarded in open competition since Channel 4 in 2008. In tenders to supply sports channels, Arqiva and RBM have won contracts, whilst Encompass has been shortlisted and Technicolor's best achievements [§]. At the less complex end of the spectrum, where more suppliers appear to be active, Technicolor has been unsuccessful. Since this evidence is limited, we have not tried to draw strong conclusions, but reflect on it when we assess the effects of the merger below (from paragraph 9.58).
- 8.87 The main parties said that Technicolor could not be said to offer a uniquely strong competitive constraint to RBM; and that Arqiva and Encompass (among others) were

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<sup>88</sup> It does, however, provide playout of ITV's time-shifted channels, which we understand is a very simple operation and is part of the distribution service.

strong, credible competitors, more than capable of bidding for contracts for the BBC and ITV.<sup>89</sup>

- 8.88 Encompass said that it would view a combined RBM and Technicolor post-merger as a formidable competitor for highly reactive customers. However, pre-merger Encompass did not perceive itself to be at a disadvantage against Technicolor when bidding for customers with multi-channel requirements. Aside from Technicolor, Encompass said that it considered RBM to be its main competitor for reactive customers, followed by Arqiva and Globecast which both had less experience and a bias towards distribution rather than channel origination. It said that both Arqiva and Globecast did not have the track record in serving complex reactive clients such as ITV and the BBC.<sup>90</sup>
- 8.89 Arqiva viewed RBM, Technicolor and Encompass as its main competitors in the bespoke environment (ie the highest level of complexity). Encompass was credible as it held the Channel 5 playout contract and had a large presence in the USA. It said that Encompass could use this to leverage its position in the UK and could offer credibility with reference to its US-based clients.<sup>91</sup>
- 8.90 We also asked a number of suppliers for internal documents that might reveal how they perceive the competitive strength of other suppliers, but found little evidence.
- [☒]

### ***Provisional conclusion on competition pre-merger***

- 8.91 Overall, we provisionally found that customers' requirements vary and that some are more complex than others. We found that, along the spectrum of complexity, the

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<sup>89</sup> Initial submission, paragraph 1.8.

<sup>90</sup> [Encompass hearing summary](#).

<sup>91</sup> [Arqiva hearing summary](#).

BBC and ITV's requirements were most complex (taking into account both operational requirements and design, implementation and ongoing support requirements), but that Channel 4, Channel 5 and specialist sports broadcasters also exhibited considerable complexity. Other broadcasters generally had relatively simple playout requirements.

- 8.92 We provisionally found that we would expect incumbency to provide an advantage in bidding, and was likely to be most significant at the higher end of the complexity spectrum, and relatively small at the less complex end.
- 8.93 We found that broadcasters at the complex end of the spectrum were more risk-averse when considering potential providers,<sup>92</sup> and for them, a demonstrated reputation for handling similarly complex broadcasters was an important factor in choosing a supplier. The BBC and ITV perceived that their requirements were more complex than those of other broadcasters, and [§].<sup>93</sup>
- 8.94 For these reasons, we thought that RBM and Technicolor would be likely to be perceived initially as each other's closest rivals for the BBC and ITV contracts if they were to be tendered today, and as close rivals for Channel 4's. We noted Technicolor's lack of success in recent tenders but did not think that this necessarily demonstrated that it would not be viewed as a strong bidder for the larger PSBs, given that experience was viewed as an important factor (and for reasons detailed above, tender data was not strongly informative on this issue).
- 8.95 However, in each case there would be a long and complex bidding process, and we did not rule out the possibility that when competing for some broadcasters, other providers might turn out to be equally strong competitors (especially if customers

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<sup>92</sup> See paragraph 8.67.

<sup>93</sup> See Appendix D, paragraphs 4–6.

were proactive in helping suppliers to understand their requirements). We discuss this in more detail below (from paragraph 9.58).

- 8.96 We thought that other broadcasters with complex requirements (Channel 5 and sports broadcasters) did not consider their requirements to be unique, and so they took a wider view of what qualified as a reference customer, with Arqiva and Encompass viewed as potential suppliers. We would still expect both merging parties to be viable competitors too.
- 8.97 We thought that broadcasters with relatively simple playout requirements had greater choice of provider and greater flexibility to trade off the considerations of quality (broadly defined) and cost, as demonstrated by both the number of playout providers already supplying them and the record of those suppliers in recent tenders. By contrast, Technicolor had a poor recent record in such tenders. We therefore did not think that the merging parties were particularly close competitors for this category of broadcaster.

## **9. Assessment of competitive effects of the merger**

- 9.1 In this section, we assess the competitive effects of the proposed merger. We first consider whether customers can exert competitive pressure in a tender or renegotiation other than through the existence of credible alternative suppliers, including self-supply, or other sources of buyer power (paragraphs 9.17 to 9.28). We then consider whether there are barriers to expansion that would prevent suppliers from supplying more complex customers than they currently serve, or barriers to entry that would prevent potential suppliers from exerting a constraint (paragraphs 9.29 to 9.34). We thought that these were factors that would be most appropriately assessed in the context of each tender, rather than as potential countervailing factors separate from these assessments.

- 9.2 In order to establish our framework for exploring the effects of the merger, we then consider the likely effect on outcomes of a reduction in the number of bidders according to economic principles, and what factors specific to this case might cause outcomes to diverge from those predictions (paragraphs 9.35 to 9.57). Taking all of these factors into account, we assess the likely effects of the merger on particular broadcasters and types of broadcaster (paragraphs 9.58 to 9.110). We then use that assessment to conclude on the effects of the merger on competition (paragraphs 9.111 to 9.116).

### ***Can customers self-supply?***

- 9.3 The parties argued that in-house supply was a significant competitive constraint. They said that every broadcaster took ‘make or buy’ decisions on an ongoing basis, that most broadcasters had self-supplied linear playout in the past before making an outsourcing decision, and that several were still in their first generation of outsourced contracts. They also said that insourcing would be facilitated by the operation of TUPE, in combination with hiring from a pool of freelancers if required.<sup>94</sup>
- 9.4 The parties noted that [☒].
- 9.5 The parties told us that ITV had maintained a team of approximately [☒] technical staff with relevant experience and skills, and maintained a model for bringing playout back in-house.<sup>95</sup> They also said that [☒].
- 9.6 The parties also pointed out that a number of broadcasters performed playout in-house. [☒] and Discovery had decided to keep playout in-house after performing tenders; and Sky, which played out a number of complex channels, had always performed playout in-house.

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<sup>94</sup> Initial submission, paragraph 5.32.

<sup>95</sup> See first footnote to paragraph 9.10.

- 9.7 Sky is the largest UK broadcaster with an in-house playout operation. It plays out its own sports channels, which have similarly complex requirements to BT, ESPN and Eurosport. It has always played out its own channels and has developed expertise in-house. Sky said that it would not consider outsourcing unless a playout provider developed a new technology that was considerably cheaper, which could not replicated in-house by Sky.<sup>96</sup> It said that when it acquired channels from Virgin Media, it decided to bring playout of those channels in-house because [§].
- 9.8 We believe that it is possible, in theory, for any broadcaster to self-supply, as demonstrated by the fact that almost all broadcasters had done so at some point. We also understand that outsourcing is more common in the UK than in most other countries. However, in order for the possibility of self-supply to be considered a significant competitive constraint, we would need to be convinced that it is a good enough alternative to outsourcing such that it would constrain outsourced prices and quality if the merger removed an important competitive constraint.
- 9.9 [§]<sup>97</sup>
- 9.10 ITV told us that bringing playout back in-house [§].<sup>98</sup>
- 9.11 Channel 4 told us that insourcing would be an option when its current playout contract ended in [§]. It had taken this into account when planning its disaster recovery (DR) facility, having made choices that would enable it to be the basis of self-supply if necessary. [§]

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<sup>96</sup> Sky also told us that it played out a number of third party channels, but these were all channels in which Sky held or formerly held a stake, apart from Fox's channels, where Sky had a relationship with the parent company. [§]

<sup>97</sup> [§]

<sup>98</sup> [§]

- 9.12 Channel 5 told us that it was in the fortunate position of having an existing playout centre within its Group. The facility's central services—the building space, staff and infrastructure etc—would be available to Channel 5 and it would therefore seriously consider self-supply if it were cheaper than outsourcing. Channel 5 also told us that during its recent tender for DR services, it had quite a good understanding of the costs of providing the DR service in-house after developing internal estimates of the capital expenditure and operational expenditure required to build and run a DR system. In the end, it agreed on an outsourced contract [☒].
- 9.13 BT told us that [☒].
- 9.14 Encompass said that it did not recall a process where the option to take playout in-house was evident as part of the selection process. However, Encompass also said that it attended [☒] presentation in the last two years, during which [☒] indicated that there was a chance it might bring playout services in-house.
- 9.15 In general, broadcasters with less complex requirements told us that they would not consider bringing playout in-house. For many smaller broadcasters with fewer channels and simpler playout requirements, it seems unlikely that they would have sufficient scale for self-supply to be an economic alternative to outsourcing. However, it appears that some international broadcasters with relatively simple playout requirements and a large number of channels have the necessary scale to make it feasible, as Discovery has done. Disney said that it did not consider it a viable option to insource linear playout services, because performing linear playout required continuous technical investment and training of specialist staff (although it had not fully evaluated the costs involved in insourcing playout).

### *Provisional conclusion on self-supply*

9.16 We thought it might be possible for most of the larger broadcasters (including broadcasters with simple requirements but a large number of channels, especially those that also had international channels) to take playout in-house, or credibly threaten to do so, if they could not achieve the commercial terms they wanted in tenders. However, we thought this would involve some risk in an area of operations where major broadcasters with high-profile channels appeared to be risk-averse and wish to avoid disruption. All switching involves some risk, but we thought it would be higher if the broadcaster did not have the requisite technical skills in-house or experienced staff to manage the transition. Building up such in-house capability would also require significant upfront investment. We therefore take this into account for each broadcaster in our competitive effects assessment below (from paragraph 9.64).

### ***Buyer power***

- 9.17 We considered whether any broadcasters who might otherwise be adversely affected by the proposed merger may have sufficient buyer power to prevent any such effects. In considering this, we note that buyer power that exists pre-merger may no longer exist post-merger. This is because buyer power generally derives from the alternatives available to the customer, and the credibility of a customer's threat to use them. If the merger removes that ability, then the customer will no longer have that source of buyer power.
- 9.18 We also note that the buyer power possessed by any one customer will not typically protect other customers from any adverse effect that might arise from the merger, since prices and other aspects of services are negotiated individually.
- 9.19 We considered that the following sources of possible buyer power were unlikely to protect a customer who would otherwise be made worse off by the merger:

(a) *The threat of self-supply.* We discussed this above.<sup>99</sup> This may be used by some broadcasters; but if a supplier does not believe this to be a plausible threat in the case of a particular broadcaster, it cannot be a source of buyer power.

(b) *Being a ‘must-have’ customer.* Certain customers may come with a ‘halo effect’, eg being selected to supply the BBC may confer credibility on a supplier and mean that the BBC contract is worth more than simply the margin on that contract. Alternatively, a particular customer may be so large relative to the size of the market or to the size of its existing supplier that there would be negative consequences of not winning a tender. These are factors that may increase buyer power, and lead to a lower price or better quality, if the customer has credible alternatives. However, they again ultimately depend on the existence of credible alternatives. We would not expect them to improve substantially the bargaining position of a broadcaster with no genuine alternative and no credible threat not to purchase at all.<sup>100</sup>

(c) *Transparency over costs/‘open book’ pricing.*<sup>101</sup> Both the BBC and [§] said that they would seek a transparent view of costs in their next tenders. We thought that this might help broadcasters in negotiations, if they could get a clear view of costs and if competing providers provided costs in a comparable way. However, they again depend for their effectiveness on the existence of a credible alternative rather than being a source of buyer power in their own right.

9.20 We thought that there were two possible ways in which a buyer might be able to protect itself even if the merger reduced the constraint of competition: financially

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<sup>99</sup> Paragraph 9.3.

<sup>100</sup> Even where the market is characterized by customers who are larger than the suppliers, it does not necessarily follow that there will be countervailing buyer power. See CC2, paragraph 5.9.4.

<sup>101</sup> Several broadcasters told us that their contracts called for changes to requirements to be priced on an ‘open book’ or cost plus basis. However, we viewed this as a standard way to prepare for foreseeable changes rather than something that would help broadcasters to get better terms on the contract agreed based on a tender process.

sponsoring entry or expansion,<sup>102</sup> or leveraging other services. We consider in turn below whether either of these was likely to be viable.

#### *Financially sponsoring entry or expansion*

- 9.21 The parties claimed that in the BBC's recent access services procurement, it 'sponsored' the entry of Deluxe in order to stimulate additional competition. The BBC, however, contradicted this. It told us that it did not sponsor Deluxe (or any other party) in the sense of favouring it, nor would it be able to do so under EU procurement rules.<sup>103</sup> It told us that it attempted to level the playing field by ensuring that all bidders, including Deluxe, had a clear understanding of its requirements. We would expect broadcasters with complex requirements to have an incentive to do this with or without the proposed merger.
- 9.22 If broadcasters have to spend significant sums to bolster bidders that may or may not be successful in constraining the merged company's price to pre-merger levels, they will be worse off than pre-merger even if successful. Therefore, while we would expect that other broadcasters may try to create a level playing field by sharing information, we would expect that providing financial assistance to bidders would lead to a worse overall outcome for a broadcaster.

#### *Leveraging other services*

- 9.23 We understand that many broadcasters buy more than one service from the same broadcast services provider. For example, apart from linear playout, RBM supplies the BBC with creative services, media logistics, disaster recovery (for playout), digital media services, access services and metadata services (not all under the same

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<sup>102</sup> Here we distinguish financial sponsorship from helping potential suppliers to understand the customer's requirements so that they can put in the best possible bid. We would expect all customers to do the latter if it would sharpen competition, as we have already discussed.

<sup>103</sup> Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts as transposed into UK law by The Public Contracts Regulations 2006.

contract), and supplies Channel 4 with a variety of digital media and playout-related services.<sup>104</sup> Technicolor supplies ITV with ingest services (ie the digitization of content prior to the point of transmission) as a component of their playout service offering, and disaster recovery service (for playout). These represent, respectively, the full scope of services that RBM and Technicolor currently supply to broadcasters in the UK,<sup>105</sup> and therefore broadcasters would have the option to try to include some or all of these services in a linear playout procurement to try to extract better terms from a merged RBM/Technicolor.

- 9.24 Given that the BBC has just begun its next procurement process, we have looked at how it intended to conduct this process. It told us that it was restricted by EU procurement rules, which meant that (a) it had to conduct formal tender processes, fairly conducted and objectively scored, and therefore it could not either commit to award a future contract or threaten not to award it; and (b) it could remove components of a service from an ongoing tender, but could not add further components. This suggested that the BBC may be limited in its ability to leverage other services other than by including them in a joint procurement process. The scope of its procurement has been limited to playout.<sup>106</sup>
- 9.25 In general, we thought it unlikely that leveraging other services could be a source of buyer power on its own in a situation where a customer had limited choice in linear playout (regardless of possible restrictions imposed by procurement regulations). First, we did not think that risk-averse broadcasters with complex requirements would be willing to compromise the quality of their playout by selecting a supplier with

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<sup>104</sup> Post Production Services, Media Management Services, Non Linear and Streaming Services, Interactive Services, Playout Services, Media Services, MCR and Technical Support Services.

<sup>105</sup> [Parties' reply to issues statement, Annex 6](#).

<sup>106</sup> It includes a fully managed service for the playout of all the BBC's network television channels which currently include BBC One, BBC One +1, BBC Two, BBC Three, BBC Four, CBBC, CBeebies in their SD and HD variants, broadcast red button services and updates to BBC television and radio metadata services within a live broadcast environment; and an option for the BBC to buy services and infrastructure to deliver transmission of the BBC's Nations (ie Northern Ireland, Scotland and Wales) television channels within the UK and any other playout services. It does not include any other regional variants.

limited or no experience of complex playout. And secondly, we did not think it likely that the customer would be able to make savings across the bundled services, for the following reason. If the playout provider also had an advantage in the other service (eg because there were advantages to the customer of procuring them from the same supplier or because it had market power), then the customer would struggle to make a credible threat to switch supplier of the other service. Conversely, if there were effective competition for supply of the other service, we would expect the playout provider to earn a low economic margin in that service, and the provider would rather sacrifice that margin than reduce its price for playout to the competitive level.

- 9.26 So, for example, if other playout providers cannot match the merged entity's quality (or quality-adjusted price) for playout, it is unlikely that a joint procurement would keep the overall outcome for the BBC at the level it could achieve absent the merger (unless there was close integration between linear playout and the other services, which we understood to be a possibility in the future but unlikely in the timescale of this tender). Either the merged entity would be fully competitive in the other market, in which case it could expect effectively to get the same terms in playout as if it were procured separately, or the merged entity would be an inferior competitor in the other market, in which case the BBC would have to accept a suboptimal outcome in one market or the other.
- 9.27 For these reasons, we did not think leverage was likely to be a source of buyer power on its own. It is, however, a factor that may increase buyer power, and lead to a lower price or better quality, if the customer has credible alternatives.

#### *Provisional conclusion on buyer power*

- 9.28 For the reasons above, our provisional view is that customers affected by the merger are unlikely to be able to exert buyer power to prevent the merger leading to worse

outcomes unless they have other credible potential suppliers. If they do have other credible suppliers, then the halo effect in particular may help customers such as the BBC and ITV to encourage those suppliers to bid keenly and to achieve good value in their contracts. We therefore take this into account for each broadcaster in our competitive effects assessment below (from paragraph 9.58).

### ***Entry and expansion***

- 9.29 We have also considered whether barriers to expansion may prevent a playout provider from competing effectively to supply customers with requirements more complex than the provider's existing experience. Our evidence and views on this are set out in further detail in Appendix E. We summarize it below in paragraphs 9.30 to 9.33. We then discuss possible entry by firms not currently supplying linear playout (paragraph 9.34).
- 9.30 There do not appear to be significant barriers to playout providers that wish to invest in their capability in order to enhance their chances of winning complex customers. If they have access to the requisite finance they should be able to secure the right premises and technology. Further, the great majority of the investment to finance this expansion will only be necessary if the bid is successful. It should also be possible to identify and recruit staff with the necessary skill and experience both to construct a bid and to design and implement a playout system for a broadcaster with more complex requirements than its current customers.<sup>107</sup> We did not think any of these factors would prevent a provider from being able to enter a tender within a reasonably short timescale.

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<sup>107</sup> Arqiva told us that certain types of staff needed to bid for the BBC contract did not exist on the open market. However, we thought that these specific staff may not be necessary for a bid if the customer were providing enough information about its requirements and experience. See Appendix E.

9.31 The most significant barrier we identified is being able to demonstrate sufficient understanding and expertise to deliver the needs of more complex customers, and in particular the importance to broadcasters of a provider's track record in providing playout services of similar complexity.<sup>108</sup> A number of providers told us that not having previous experience of providing playout services for a broadcaster with requirements of similar complexity is a significant competitive disadvantage—particularly when competing against rivals that do have such experience. We thought that it would be possible to overcome this barrier over time by moving up the 'ladder' of complexity by winning new customers and gradually demonstrating experience with greater complexity, and therefore it would be possible for suppliers to broadcasters such as Channel 5 and British Eurosport to have some credibility when competing for broadcasters who perceived themselves to be at the highest end of the spectrum of complexity (ie the BBC and ITV). We also thought that this barrier may to some extent be mitigated if it is possible to recruit personnel with experience of playout for the broadcaster in question (either from the broadcaster or the incumbent playout provider), and thus demonstrate understanding—although we thought that availability of such personnel would be limited and therefore this may not always be possible. In other words, we thought a supplier would be able to enter a tender but the level of credibility of the bid would depend on its ability to recruit from a limited pool of personnel with relevant experience.

9.32 However, we thought that requirements for experience would be a genuine impediment to supplier credibility in the short term, and so we would not expect a provider with experience of only the simplest customers to be a credible competitor for a customer at the highest end of the spectrum of complexity. We also thought that the lack of frequency with which contracts were tendered might be an impediment to moving rapidly up the ladder.

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<sup>108</sup> See paragraph 8.67.

- 9.33 On the basis of this evidence we concluded that barriers to expansion are not insurmountable, and it would be possible for a provider to compete to supply a customer with more complex requirements than its current customers, but that there would be obstacles to moving quickly from the simplest end of the market to the most complex end.
- 9.34 We also considered de novo entry into the market for linear playout. Again, we did not think that the barriers in terms of investment in premises, technology or staff were insurmountable, and therefore a new entrant might be able to supply linear playout services in relatively short order. However, as with existing suppliers of broadcasters with less complex requirements, we thought experience and reputation was the main barrier to competing at the upper end of the complexity spectrum.<sup>109</sup> We would not expect a new entrant to be a credible competitor for a customer with complex requirements in the short term—especially given the risk aversion of such broadcasters—even if the supplier already provided other services to broadcasters.

### ***Effects of the loss of a bidder on outcomes***

- 9.35 Economic principles suggest that the loss of a bidder from a tender process will affect outcomes in a number of ways, including:
- (a) If the bidder lost is one of the two most credible bidders, we expect that the outcome will be worse for the customer because the winning bidder is not subject to the same degree of competitive pressure.
- (b) If there is a chance that the lost bidder would have put in one of the two strongest bids (even if it was not expected to do so), there may still be a worse outcome because of the reduction in rivalry overall.

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<sup>109</sup> See paragraph 8.67.

- 9.36 In the case of tenders for complex linear playout services, as we have explained above, we believe that there is a significant incumbency advantage which is likely to make the incumbent the front runner in the tender process. The incumbent will have to work out how keenly it needs to bid to avoid a risk of losing (given the value of the contract and the reputational effect of the outcome of tenders for complex contracts). Removing the closest rival to the incumbent<sup>110</sup> can therefore be expected to lead to a less economically advantageous outcome for the customer (which would be reflected in a higher price, lower service levels, less innovation or higher risk).
- 9.37 The intuitive significance of having more than one credible challenger to the incumbent is that rivalry is generally enhanced: in particular, where different bidders have different ideas as to how best to meet a customer's requirements, and different estimates of the likely cost, the greater the number of bidders, the greater the choice for the customer and the stronger the incentive for both the incumbent and the closest rival to bid keenly.
- 9.38 In the context of a potentially costly tender for a bespoke service, the importance of the constraint that a competitor may impose depends on its initial credibility (experience, reputation etc) and its willingness to commit fully to the competitive process. It also depends on other factors which include:
- (a) how confident the customer and bidders are in advance about who will deliver the strongest bids (see paragraphs 9.42 to 9.43);
  - (b) the importance of competition in promoting ideas and innovation (see paragraphs 9.44 to 9.47); and

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<sup>110</sup> We assume that if one of the merging parties is the incumbent, the merged firm would be viewed as the incumbent post-merger; and so the merger can remove a competitor but not an incumbent. There may occasionally be complex customers who do not have an incumbent supplier, eg BT which recently became a new broadcaster. The analysis can be generalized to refer to the two bidders who turn out to be strongest. Similarly, if a broadcaster were to have such a serious problem with its playout provider that incumbency advantage no longer existed, the analysis could be generalized in the same way.

(c) the ability of the broadcaster to enhance the understanding and credibility of non-incumbent bidders and to promote competitive tension through multiple iterations (see paragraphs 9.48 to 9.51).

- 9.39 The parties argued that tenders for playout services were ‘bidding markets’. In economics, that term is generally used to refer to markets where price and quality for a customer are determined only by competition between the two best bidders, and it does not matter whether there are additional bidders. In such a market, a reduction in the number of major suppliers would not affect customers provided that at least one remaining third party supplier was, or could quickly become, as close a competitor to the merged firm as the merging parties would be to each other absent the merger.
- 9.40 It is unusual to see bidding markets in this strict sense; the conditions are laid out in a paper by Professor Paul Klempnerer.<sup>111</sup> One of the necessary features of a bidding market is that ‘competition begins afresh for each contract, and for each customer’. In other words, there is no incumbency advantage, and the existing supplier does not have an advantage in the next tender for that customer. We found that (at least for customers with complex requirements) there was likely to be an incumbency advantage, and therefore this market was not likely to be a bidding market in that sense.
- 9.41 We therefore considered whether the loss of a competitor was likely, in practice, to affect significantly the outcome of the bidding process, in terms of the outcome for the customer (taking into account price, quality and risk). We could not infer this from outcomes due to the small number of tenders that have taken place (especially at the complex end of the spectrum) and the changes in the industry (such as a general

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<sup>111</sup> *Bidding Markets*, Paul Klempnerer, CC, June 2005.

downward trend in prices due to improved technology and falling costs).<sup>112</sup> Therefore we began by examining potential effects based on economic principles, and then considered the extent to which this could be modified by particular characteristics of this market and the behaviour of buyers.

### *Uncertainty about the source of the strongest bids*

- 9.42 We have been told that different customers have different requirements and that one of the most important things for a bidder is understanding a customer's requirements and demonstrating that understanding. This means that a customer, and indeed the incumbent, cannot be entirely confident in advance how strong a given supplier's bid will be, in terms of meeting the customer's needs at a good price. Two suppliers with similar capabilities and experience may not construct equally strong bids, if one understands the customer better than the other. We thought that, based on the experience and track record of suppliers and the varying needs of customers, some customers would have a good idea who would be the strongest competitor to the incumbent; while for others, there may be several suppliers on a roughly equal footing.
- 9.43 Given that it is not possible to be certain who will put together a strong bid, the removal of a potential supplier reduces the chances of there being a good bid to rival the incumbent. The incumbent can take this into account and adjust its bid accordingly, potentially bidding less keenly.<sup>113</sup> The significance of this effect will vary with

<sup>112</sup> See Appendix B, paragraph 13.

<sup>113</sup> To illustrate the issue, suppose that there are initially two rivals to the incumbent, and the incumbent thinks that each of them has a 50 per cent chance of understanding the customer well enough to put in a strong bid rather than a weak bid. The table below shows the possible outcomes first pre-merger and then post-merger (with Rival B removed).

Pre-merger		<i>Is there a strong rival bid?</i>	Post-merger	
Rival A	Rival B		Rival A	<i>Is there a strong rival bid?</i>
25%	Strong	Strong	Yes	50%
25%	Strong	Weak	Yes	Strong
25%	Weak	Strong	Yes	Yes
25%	Weak	Weak	No	50%
				Weak
				No

the number and quality of potential suppliers: if some have a better chance of a strong bid than others, then losing a ‘stronger’ bidder will have worse effects than losing a ‘weaker’ bidder. Therefore, the more likely it is that the lost bidder would have put in a strong bid, the greater the likely effect of the merger. Conversely, the more likely it is that remaining bidders can put in a strong bid, the smaller the likely effect of the merger (and hence broadcasters may be able to mitigate the effects of the merger, as we discuss at paragraphs 9.48 to 9.50).

*The importance of competition in promoting ideas and innovation*

- 9.44 We did not see evidence to suggest that the merger may harm technological innovation. Playout is a worldwide industry and hardware and software are provided on an international basis. Our concern was whether particular customers would not benefit from new ideas and innovation in the ways to best meet their requirements as a result of the merger, and consequently arrive at a worse overall outcome.
- 9.45 We understand that there is rarely a single best way to provide playout and many customers are open to different ways of meeting their requirements. We have heard that customers may take good ideas proposed during an early procurement round and build it into their requirements.<sup>114</sup> This suggests that having a range of bidders may lead to new ideas of value to the customer.
- 9.46 The likely effects of this depend on both the number and identity of bidders. By a similar logic to the previous section, the loss of a bidder reduces the chance of new

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So, in this stylized example, removing Rival B reduces the chances of a strong bid from 75 to 50 per cent. The intuition is simple—in the event that Rival A does not produce a strong bid, there is a chance that Rival B will. Therefore the incumbent’s chances of winning would increase, so it would not have to bid so keenly. The example can be adjusted to illustrate the importance of the chance of a strong bid. So if the customer commits to work with suppliers to develop their understanding (as we discuss below), and raises the chances of each one making a strong bid to 90 per cent, there would be a 99 per cent chance of at least one strong bid pre-merger and a 90 per cent chance post-merger, so the effect of the merger is smaller. In other words, the larger the probability of a strong bid, the smaller the effect of the merger.

<sup>114</sup> For example, the BBC told us that one objective of its RFI process was to gain insight and expertise from the market and use that information to inform the sourcing and procurement strategy, and inform project planning (see Appendix C, paragraph 5).

ideas being proposed: the more bidders there are, the greater the range of experience and the more chance that one of them will produce an idea of value to the customer.

- 9.47 As to the identity of the lost bidder, we were concerned that, for the BBC and ITV (and possibly Channel 4) in particular, the merger may remove one of the two best sources of ideas since they are the only two suppliers with experience of setting up and operating systems to handle a large number of regions, and coordinating with in-house playout staff. For broadcasters with less complex requirements, we did not have reason to believe that Technicolor was likely to be a particular source of innovation, due to its small number of clients. We also took into account that the merging firms may internalize a lot of knowledge, which may mean that any ideas either would have generated individually get put in front of the customer anyway, if there is enough competition to incentivize this.

*The ability of the broadcaster to promote competitive tension*

- 9.48 Based on the considerations above, we would expect the loss of a rival to reduce competition in a way that we would expect to make the customer worse off overall (a loss of the best ideas, the worsening of some other aspects of quality or a higher price). However, we believe that, to some extent, the impact of a loss of a competitor might be mitigated depending on the way that the tender process operates.
- 9.49 First, we discussed above a concern that the incumbent does not know who will put in the best bid, even if its rivals are at a similar level, and so losing a rival reduced the likelihood of there being a strong bid. In a single stage process, the incumbent would be expected to bid more keenly the more competitors it faced. If the tender were a one-shot process, we would be more likely to expect a worse outcome because the incumbent would bid based on its expectations about its rivals, rather than having to

compete against actual bids. In practice, tenders are a discovery process with multiple rounds<sup>115</sup>—the customer learns incrementally about the bidders, the bidders may get feedback and revise their bids, and the incumbent may learn about the strength of the other bidders. The multi-stage nature of the tender process helps to focus the attention of the incumbent on the *actual* best competitor (ie the best other bid) rather than just its expectation of what the best competitor/bid would be. This suggests that what really matters is whether one of the remaining suppliers can, by the end of this process, bid as strongly as the lost competitor would have. If so, the reduction in the number of bidders will be of limited impact.

- 9.50 Secondly, the multi-stage nature of the process may help the customer to generate ideas and to get the strongest possible bid from a rival (*if* the customer is motivated to work with the bidder and *if* the rival is sufficiently motivated to engage seriously). When assessing the best/closest competitor, in our view it is important to look at the point when the incumbent makes its final bid in competition with other bidder(s)—rather than at the start of the tender process. So, for example, if a bidder puts in a weak bid due to not understanding the customer's requirements, the customer can try to educate it to get a stronger bid in the final round. The customer can also demonstrate to the incumbent that it is doing this and so make the incumbent expect stronger rival bids.<sup>116</sup> (This may lead to extra effort for the customer—although we would expect the customer to be prepared to put this effort in anyway, ie the merger leads to a higher probability of extra effort.)
- 9.51 We note that these are ways in which the loss of a rival could in theory be mitigated, and that we assessed them against the available evidence (paragraphs 9.52 to 9.55).

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<sup>115</sup> For example, the BBC said that it went through five ITTs in its Access Services procurement before it published the final one.

<sup>116</sup> See footnote to paragraph 9.43.

*How does this fit with evidence on the tender process?*

- 9.52 Some broadcasters with complex requirements (including the BBC, Channel 4 and [✉]) said that they would ideally like to have three bidders (the incumbent and two alternatives), although they also said that they would typically knock one out before drawing up a final shortlist. Channel 4 said that it would ideally like to have a minimum of three bidders initially to have confidence in its tender process. It said that three bidders would help to it to get a better sense of what the price should be, allowing it then to focus on the expertise of those suppliers. Once it was confident that it had two bids in the correct ‘ballpark’, then it would go down to the two most competitive bids, because the amount of resources needed to go through the process for three bidders was much larger than for two. UKTV was concerned that a reduction from three to two bidders would reduce its negotiating strength. The BBC told us that [✉].
- 9.53 This is consistent with the idea that a customer does not know who will put in a strong bid. By having two outsiders, a customer increases the chances of getting a good bid early on and having less work to do to get the best alternative bidder up to a level where it can be a genuine option and/or a strong constraint on the incumbent.
- 9.54 It is also consistent with a view that the competitive constraint is strongest at the final competitive stage, ie the stage at which a bidder puts forward its best ‘ballpark’ price/quality combination to become preferred bidder (although fine details may be negotiated later). The customer needs to have a strong outside bid at this stage but does not appear to need to have two outside bids (at least for customers with complex requirements, where price appears to have less weight than lower down the complexity spectrum). [✉]

9.55 Looking at the tender process, we understand that at the RFI/longlist stage, as described in paragraph 8.7, a customer is focused on establishing capabilities and checking that prices are broadly in line with the market. For example, Encompass said that the price had to be in the right ballpark but that most customers expected there to be price negotiation in the final stages. Further, a number of customers including the BBC, ITV, Channel 5 and [§] also told us that price negotiation took place at the shortlist stage.<sup>117</sup> Based on what we have been told by market participants, it does not appear that customers have to be among the two or three cheapest providers to reach the shortlist stage. We have seen examples where more expensive firms reach the shortlist at the expense of firms with lower initial quotes, such as [§] and [§].

#### *Conclusion on the effects of the loss of a bidder*

- 9.56 We would normally expect the loss of one of a small number of competitors to reduce competition. This is likely to be most serious if the closest competitor to the incumbent were to cease operating in the market. If the incumbent does not know which of a set of rivals will put in the best bid, then the loss of any of this group of rivals could remove a significant competitive constraint (although given that not all bidders are likely to be equally credible, the effect will depend on the strength of this competitor and of its rivals). We would generally expect that to lead to a worse outcome for the customer even where there is a strong incumbency advantage (and even if it does not affect who wins).
- 9.57 However, the nature of the bidding process provides an opportunity for customers to mitigate this *to some extent*. The extent will depend on whether other competitors are motivated to enter, whether they can reach the same level as the lost bidder, and

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<sup>117</sup> In some cases further negotiation also took place after a 'preferred bidder' had been selected, but we understood that this was generally around the detail whereas the overall level of price and quality had been determined through competition.

how much effect the customer can have on the quality of these other bids (as perceived by the incumbent). We take this into account when we evaluate the effects of the merger on individual broadcasters, from paragraph 9.64 below.

### ***Effects of the merger***

- 9.58 In order to consider whether there would be an SLC in the market for the supply of outsourced linear playout services for channels broadcast in the UK as a result of the merger, we have begun by considering the effect of the merger on individual contracts and types of broadcaster—in terms of both the likelihood of a loss of competitive rivalry and its impact on the broadcaster were it to occur. We have then gone on to consider the cumulative effect on the market as a whole.
- 9.59 The effect of the merger for each broadcaster depends on the extent to which the merging parties are important rival providers for the broadcaster's linear playout services. The credibility of a provider as a bidder for a broadcaster's linear playout services depends on the complexity of the broadcaster's requirements. Therefore in this section we consider the impact of the merger on each of the main broadcasters we consider to have particularly complex requirements.<sup>118</sup> We also consider the likely effect on those with relatively simple requirements.
- 9.60 As we have discussed above, our concern is that the loss of a credible provider of linear playout to a customer would reduce competition and result in the broadcaster paying a higher price or receiving a lower quality or less efficient or innovative linear playout service. The effect on the customer depends on the extent to which the lost competitor is a credible provider. We therefore considered whether the merger was likely to remove a significant competitive constraint. We have also considered the extent to which there are factors that could offset the adverse effects of a reduction in

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<sup>118</sup> We looked at sports broadcasters together since we thought their positions and requirements were similar.

competition (eg the nature of the bidding process and the behaviour of the customer).

Given our finding that there are likely to be significant incumbency advantages, particularly for broadcasters with more complex linear playout requirements,<sup>119</sup> in each case we focused on the constraint that rivals would impose on the incumbent absent the merger and post-merger.

- 9.61 We took into account the evidence we have discussed above as it relates to each broadcaster, including the relative complexity of the broadcaster, the extent to which providing a service for another broadcaster with similar requirements affects a provider's credibility, the broadcaster's ability to take steps to enhance competitive tension, and the extent to which the broadcaster can use self-supply as a competitive threat. We also drew on each broadcaster's views and assessments of the relative credibility of alternative providers and evidence on this from recent tender exercises.
- 9.62 In assessing the competitive effect of the merger on each broadcaster, we first considered the incumbent's position. In general, given our conclusions on incumbency advantages for broadcasters with complex requirements, we thought it likely that the incumbent would be a strong contender and the key question was the strength of competition it would face in the next tender. We also considered which other suppliers were likely to bid. We then considered which bidders would be sufficiently credible to exert some degree of competitive constraint on the incumbent, and the likelihood that the merger would remove the best alternative to the incumbent, which we would expect to lead to the customer receiving a less economically advantageous bid from its incumbent; and if so, whether the customer could take actions to mitigate the likelihood of such an outcome.

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<sup>119</sup> See paragraph 8.62 above.

9.63 Finally, we went on to consider whether a reduction in the number of potential suppliers might affect outcomes for the customer even if the merger did not remove either of the best two suppliers, for the reasons discussed in paragraphs 9.35 to 9.57, again taking into account the customer's potential to mitigate this. As part of this, we considered whether there were other alternatives, notably in house supply, that might affect bidders' behaviour and thus outcomes.

### *The BBC*

- 9.64 The BBC's contract with RBM expires on 31 March 2017. It published a notice in the OJEU in January 2014 and expects to award a contract in March 2015, with a two-year transition period. Therefore the BBC is likely to feel any effects of the merger almost immediately (albeit that financial implications may be deferred until the start of the contract). The BBC told us that the merger could result in potentially unfair exertion of power by the merged entity and that from a procurement perspective, [⊗]. It was less concerned in the medium to long term as it thought that the market would open up, technology would evolve and it believed that there would be lower barriers to entry into the market. It also saw positive benefits from the merger, particularly if RBM had access to new capital and investment enabling it to be more innovative and competitive, and to develop its R&D function.
- 9.65 As we outlined in paragraph 9.62 above, we began by considering the general view of industry participants that RBM and Technicolor were likely to start the BBC tender process as each other's closest competitor, and a presumption based on economic principles that removing the closest competitor, or one of a small number of close competitors, could be expected to lead to worse outcomes for the BBC, unless there were countervailing factors specific to this case.

- 9.66 We thought that, financial terms being equal, RBM would be the clear choice as the BBC's preferred supplier. It is likely to benefit from an incumbency advantage and even without that, it has the strongest track record in playout provision in the UK, in terms of keeping other major clients, winning new clients and more generally its reputation for quality. Although we were not certain who would own RBM absent the merger, we thought it extremely unlikely that under any ownership RBM would not bid to renew the contract of its largest client.
- 9.67 We considered who was likely to bid in competition with RBM in the absence of the merger:
- (a) Technicolor told us that [§§].
  - (b) Encompass told us that it was keen to bid for the BBC contract and had board approval to do so.<sup>120</sup>
  - (c) Arqiva told us that [§§].
- 9.68 We thought it was likely that, given the attraction of having the BBC as a client for both financial and reputational reasons, Technicolor, Encompass and Arqiva would all enter the early stages of the BBC tender process, and that the BBC would encourage at least the stronger contenders to participate seriously in the whole process. Therefore, absent the merger, we thought that Technicolor would participate at least in the early stages of the tender process. We also thought that if the merger took place, the BBC would have a strong incentive to encourage at least one of Encompass and Arqiva to take the opportunity seriously;<sup>121</sup> and suppliers would perceive a greater opportunity to at least reach the shortlist due to the merging of two

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<sup>120</sup> [§§]

<sup>121</sup> We noted above that the BBC would in any case have an incentive to encourage other bidders (up to the point where the marginal benefit of an extra bidder exceeds the cost, in management time, of encouraging that bidder). The merger would be likely to increase the marginal benefit of each bidder other than RBM/Technicolor, and therefore strengthen this incentive if anything.

firms perceived as strong shortlist candidates.<sup>122</sup> The BBC said that it would welcome [☒] stepping forward to take part in the procurement for its linear playout contract.

9.69 We considered which bidders would be sufficiently credible to exert some degree of competitive constraint on the incumbent, and the likelihood that the merger would remove the best alternative to the incumbent. There is some evidence to suggest that Technicolor may be the best alternative to RBM, absent the merger. As playout provider to ITV, it provides linear playout services to the broadcaster that is perceived by the industry to have the most similar requirements in terms of complexity, and therefore the perception of most industry participants was that Technicolor would have certain advantages over third party providers in bidding for the BBC contract.

[☒]

9.70 [☒]

9.71 On the other hand, Technicolor's recent record in retaining clients is poor (as discussed in paragraphs 8.79 to 8.81 above): in the last three years it has lost [☒] major linear playout contracts that it had held (although none of these contracts were for particularly complex playout requirements) and it has not been successful in winning significant new business since winning NBCU in 2008 (although, as noted, we place less weight on performance in tenders for customers less complex than the BBC and on Technicolor's record prior to the Ericsson takeover). We also noted that even for a customer where it was the incumbent, [☒], Technicolor's proposals did not demonstrate an understanding of [☒] current and future needs, even though there had been discussions on new developments with Technicolor during its tenure.

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<sup>122</sup> If a supplier were to perform strongly in that tender, it would acquire valuable knowledge and experience, and might well be able to enhance its reputation. For example, Encompass told us that it believed that there was prestige and stature attributable in putting in a strong bid for a brand such as the BBC or ITV, and that a provider that did so would expect some positive impact commercially.

- 9.72 Another likely constraint on RBM for the BBC playout service is Encompass, which is the only other supplier to serve a PSB (Channel 5). While Channel 5 has fewer regional requirements than the BBC, it still offers experience of most of the complexities that the BBC has. [X] Encompass retained the Channel 5 contract in competition with RBM (although we understand that a unique situation with existing contracts may have influenced that decision<sup>123</sup>) and was runner-up for the Channel 4 contract ahead of [X].<sup>124</sup>
- 9.73 [A broadcaster] suggested that Encompass might also be able to draw upon its experience of complex playout in the USA to enhance the credibility of its bid. Encompass said that although it was able to call upon staff from its other global facilities and operations, it believed that the BBC and ITV networks were unique in their make-up and requirements and as such it expected to have to use external expertise in the UK to assist in the preparation of its response to a tender for those broadcasters.
- 9.74 We also considered whether Arqiva might credibly impose a constraint on RBM. Arqiva has current and past experience in supplying complex playout services for live sports channels. It also has an existing relationship with the BBC to which it provides distribution services. However, its experience providing complex playout is limited to sports broadcasters, which is widely perceived as being less relevant (or only partially responsive) to the needs of PSBs.
- 9.75 We thought it unlikely that bidders other than Technicolor, Encompass and Arqiva would be perceived as a major competitive threat, given their lack of complex clients in the UK, and that, at best, they were likely to be no more credible than Arqiva. The parties suggested that [X] would also be a strong contender due to its relationship

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<sup>123</sup> See Appendix C, paragraphs 24–28.

<sup>124</sup> See Appendix C, paragraphs 17–20, for discussion of the factors involved in this decision.

with the BBC, but we thought its lack of experience with playout would be likely to count against it (especially since the BBC has not bundled playout procurement with that of other services). [☒]

- 9.76 Therefore we thought that the credible bidders for the BBC playout contract were RBM, Technicolor, Encompass and Arqiva. We found that the merger would remove, in Technicolor, one of the three credible competitors to RBM. Therefore we went on to assess (a) whether the merger would remove the closest competitor to RBM (paragraphs 9.77 to 9.81), and (b) even if it did not, whether the removal of a credible competitor could be expected to result in a worse outcome for the BBC (paragraphs 9.82 to 9.84).
- 9.77 In our view, the evidence summarized above suggests that Technicolor would begin the BBC's process being viewed as RBM's closest rival by both the BBC and other bidders.
- 9.78 We therefore considered and took into account the ways the BBC told us that it would conduct the tender process—in particular, the steps that it would take to try to level the playing field between the incumbent and its rivals—and whether this would affect the identity of the closest competitor. We thought that the BBC would try to do so whether or not the merger took place, and hence the merger would not place a substantial extra burden on it. We noted that the BBC is an experienced user of the OJEU procurement process, and it told us that it had recently achieved a successful outcome to a tender for access services. [☒]
- 9.79 The BBC told us that it was taking a number of steps to optimize its chances of exerting some competitive pressure on RBM during the tender process within the rules of the OJEU process. [☒]

- 9.80 [☒] Given the prestige associated with the BBC contract, we thought that companies such as Encompass and Arqiva, which may have ambitions to expand into providing the most complex UK playout contracts, could take steps to recruit or contract with people with relevant experience. We discuss the costs and issues involved in bidding for contracts of this type in Appendix E.
- 9.81 As we noted above, we thought that it would be operationally feasible for suppliers with experience of other PSBs and sports channels to provide playout for the BBC, and we did not find significant barriers to expansion apart from the need to demonstrate understanding of the customer's needs. We believe, based on what the BBC told us and its track record in access services, that the BBC will be able to educate serious bidders on its requirements, which is likely to reduce, to some extent, any advantage that Technicolor may derive from its experience with ITV. We thought it would be able to do so in such a way as to make the incumbent provider aware that other bidders would be in a position to make a strong bid. When considering who would be the closest constraint on RBM, we had to balance the evidence that Technicolor had the strongest starting position (in terms of its reference customer, understanding of regional variations, and [☒]) against its poor record in bidding—even for customers where it was the incumbent. We also took into account the BBC's ability to level the playing field by helping bidders with less experience to understand its needs, and thus the possibility that Encompass or Arqiva would turn out to be equally effective or more effective constraints.
- 9.82 We also considered whether the effective removal of Technicolor as a bidder would harm the BBC even if it were not the uniquely closest competitor, ie the effects of reducing the already small pool of likely credible bidders by one. As discussed in paragraphs 9.35 to 9.57, we would normally expect the loss of one of a small number

of competitors to reduce competition. The question is to what extent this may be mitigated by the nature of the bidding process and the behaviour of the customer.

- 9.83 Nevertheless, overall, we thought that the removal of a credible bidder is likely to lead to some reduction in competitive rivalry for the next BBC contract.
- 9.84 The BBC said that it needed a minimum of [X] bids to have an effective competition. We thought that the main competitive constraint for the BBC would come at the final ITT stage (after which the BBC must choose a supplier). The process up to that point would have focused on bringing bidders up the learning curve and educating them to put in the best bid possible (in terms of qualitative aspects), and to make that threat seem as strong as possible to the incumbent (to motivate it to put forward the most economically advantageous bid). We did not know how many bidders would be taken forward to the final ITT stage absent the merger, but we did think the merger would give the BBC an added incentive to work hard with at least one third party supplier. We could not therefore rule out the possibility that the merger would reduce the number of credible bidders at the final ITT stage and thus reduce the competitive constraint on RBM in a way that could worsen the outcome for the BBC (whether or not it removed the strongest competitor). We thought that the BBC had some ability to influence this outcome but was partly dependent on the ability and willingness of suppliers to enter the tender and put in strong bids.
- 9.85 We also considered whether the BBC could use the possibility of in-house supply to get stronger bids. Although the BBC retained some expertise in-house and conducted playout of some of its channels, which could be a starting point for bringing operations in-house, we did not think it would be able to use self-supply as a nego-

tiating tool. The main reason for this is that we understood the BBC had told playout providers that it had committed to outsourcing.<sup>125</sup>

- 9.86 We thought that other third party rivals may not turn out to be as strong a competitive constraint as Technicolor would have been, which may lead to a significant reduction in rivalry. The significance of this reduction in rivalry depends on the ability of the BBC to carry out an effective tender process and the ability and willingness of other providers to take this opportunity to put in strong bids.
- 9.87 Overall, we could not rule out that the merger may lead to a significant reduction in rivalry. The provisional view of the majority of the members of the panel is that the nature of the competitive process and the potential for other competitors to exert the same level of competitive constraint as Technicolor made it likely that there would be little adverse effect on the BBC.

#### *ITV*

- 9.88 ITV has a contract with Technicolor which expires [☒] (after the result of the BBC's tender will be known). However, ITV and Technicolor have been negotiating an extension since March 2013 as part of a technological refresh; and on 11 February, we were provided with a letter setting out a conditional agreement between Ericsson and ITV. The agreement would vary ITV's current playout agreement with Ericsson in a number of aspects, most significantly extending it [by a further five to ten years].<sup>126</sup> The variations to the current contract between ITV and Ericsson set out in the letter of agreement will come into effect if the following conditions are satisfied:
- (a) it is approved by the ITV board;

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<sup>125</sup> We also thought that regulatory restrictions on its procurement process might make this threat more difficult to use.

<sup>126</sup> It also includes a variation [☒].

(b) the CC approves the proposed acquisition by Ericsson of Creative Broadcast Services Holdings (2) Limited (the ‘Proposed Acquisition’) without any requirement for Ericsson to sell or otherwise dispose of any material part of its existing playout business or of the Red Bee Media playout business; and

(c) completion of the Proposed Acquisition.

- 9.89 The contract was approved by the ITV board on 24 February. We therefore expect that ITV and Ericsson will agree this extension to their current playout agreement. ITV told us that the new arrangements would deal with its concerns about the proposed merger.
- 9.90 We considered the effect that this agreement, if concluded, would have on our assessment. The primary effect is the extension of the contract term [by a further five to ten years]. Although it was possible that ITV would seek to renegotiate the contract mid-term, we thought that the primary role of competition here would stem from the anticipated state of the market [in a further five to ten years].<sup>127</sup>
- 9.91 Our starting point in assessing the effect on ITV was to consider the current state of the market, but then to take into account how the market may change [in a further five to ten years] and the ways in which this would affect our assessment of the merger. Therefore, we first provide an overview of the current situation (paragraphs 9.92 to 9.97), and then consider how the extension [☒] affects this (paragraph 9.98).
- 9.92 ITV said that [☒]. In general, it was in favour of the merger as it thought it would bring potential scale benefits; however, it could lead to difficulties with [☒], and therefore said that there would need to be some form of price controls (and related constraints) through behavioural undertakings.

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<sup>127</sup> As we discussed at paragraph 8.20.

- 9.93 ITV told us that if it were making a decision today, financial terms being equal, [§].
- 9.94 ITV said that, from an operational point of view, it would rather insource than [§], as it would have more control and confidence in its own people. It said that service quality may dip in the interim [§], which it did not consider acceptable. However, it also said that this operational view had to be balanced against the technology and investment requirements of self-supply.
- 9.95 In our view, the merger would disadvantage ITV unless another provider can reach approximately the same level as the likely second choice supplier by the time ITV makes a decision. Overall we thought that the evidence on tenders and current contracts held suggested that RBM was the most successful supplier at the complex end of the market, with by far the best experience providing playout to broadcasters who with complex requirements would be viewed as relevant by ITV. We also found that RBM was viewed by most industry participants [§] as the strongest challenger to Technicolor for this customer. Although there were steps that ITV could take to enhance the competitive constraint that Encompass or Arqiva could impose, we thought it unlikely that either would impose such a strong constraint.
- 9.96 Even if Encompass or Arqiva were able to strengthen to the level of RBM, the effective removal of RBM as a bidder could still be expected to harm ITV. As discussed in paragraphs 9.35 to 9.57, we would normally expect the loss of one of a small number of credible competitors to reduce competition even if it does not remove the uniquely strongest rival to the incumbent; although this may be mitigated by the nature of the bidding process and the behaviour of the customer.
- 9.97 Overall, we thought it was likely that the merger would significantly weaken competitive rivalry for the next ITV contract if that contract were to be contested in

the near future, because RBM was likely to be the strongest competitor to Technicolor absent the merger, and at least an important competitive constraint.

- 9.98 We considered whether this conclusion would continue to hold in [a further five to ten years]. This is a developing market: technology is changing and, although we did not think that major changes suitable for PSBs would come into play before the end of ITV's current contract, there was considerable scope for change [in a further five to ten years]. By [☒], the requirements of ITV (and other broadcasters) may change in their complexity. Also, we found that credibility and reputation were important factors in competing for customers with complex requirements and that by [☒], we expect that every complex contract other than ITV's may have been contested at least once, potentially changing the experience and reputations of providers that can currently credibility compete for those contracts (for example, the merger would be expected to create opportunities for other playout providers to at least reach the shortlist on more occasions). We have also been told that influential people can move between different competitors and bring a certain level of customer understanding and credibility with them, which could affect the competitive strength of suppliers. Further, we thought that over that period of time, significant entry and expansion would be possible.
- 9.99 Overall, while we could not rule out the possibility that the merger may disadvantage ITV, we provisionally concluded that, taking into account its contract extension and the significant uncertainty about the state of the market in [a further five to ten years], the likelihood of such a disadvantage was remote.

#### *Channel 4*

- 9.100 Channel 4 has a contract with RBM until [☒]. There is, therefore, considerable uncertainty around the competitive conditions it would face when it next tenders,

either with or absent the proposed merger. [§] Therefore we assessed both the effects on Channel 4's next tender and on [§].

- 9.101 Most parties told us that Channel 4's requirements were less complex than those of ITV or the BBC, but more complex than those of Channel 5. As with the BBC, we thought that RBM, as incumbent, would be in the strongest position to compete for Channel 4's next contract, and the relevant questions were (a) whether Technicolor would be the strongest competitive constraint absent the merger and (b) whether the reduction in the number of serious bidders would disadvantage Channel 4. As we noted above, we thought that it would be operationally feasible for suppliers with experience of other PSBs and sports channels to provide playout for Channel 4, and we did not find significant barriers to expansion apart from the need to demonstrate understanding of the customer's needs.
- 9.102 When assessing whether Technicolor would be a stronger competitive constraint than other potential options, we note that Encompass was shortlisted [§] when competing for Channel 4's current contract [§].<sup>128</sup> We have also taken into account that Encompass's position as supplier to Channel 5 gave it a reasonably strong reference client, albeit that Channel 4 views itself as being slightly more complex. We viewed Arqiva as a potential supplier (for reasons discussed above with respect to the BBC and ITV). Channel 4 told us that [§]. Channel 4 also has some potential to use self-supply as a constraint.
- 9.103 We also note that Channel 4 was not strongly concerned by the merger (although it said that it might have been more concerned if its contract expired sooner) and told us that there were already a number of alternative suppliers at the moment that it thought would be able to provide competing services and scope for new entrants to

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<sup>128</sup> See Appendix C, paragraphs 20 & 21.

come into the market. We thought that Channel 4 was in a stronger position with regard to in-house supply, [§§].

9.104 We also note that there was considerable uncertainty over the likely state of the market at the time of Channel 4's next tender, for the reasons discussed in relation to ITV in paragraph 9.98 above—although in this case we are not looking as far ahead and so there is less uncertainty—and in particular:

- (a) Technology may evolve. Channel 4 said that it had a reputation for using new technologies and wanted to innovate (although reliability was extremely important) and wanted the flexibility to take advantage of the continuous improvement in playout technology. It said that it would ensure that its supplier was able to adapt quickly to technological changes. This may widen the field of credible suppliers by the time of its tender.
- (b) Other PSBs are likely to have decided on new contracts before then and, assuming that some or all are contested, this will provide an opportunity for other third parties to gain experience of competing for and even winning complex contracts and thus gaining credibility to supply Channel 4.
- (c) Channel 4 said that it could be possible for a playout provider to graduate to the level of complexity required by Channel 4 if it purchased the technical expertise and project and design teams of a competitor.

9.105 Overall, we could not rule out the possibility that, by removing a credible bidder, the merger could reduce competitive rivalry to some degree, and that Channel 4 would therefore face a worse outcome as a result. However, there were a number of factors that led us to find that the likelihood of the merger significantly reducing competitive rivalry was low. The most important of these factors were: Technicolor may not currently represent a stronger competitive constraint on the incumbent than other potential suppliers because Channel 4's requirements were not as complex as those

of the BBC or ITV, and therefore other suppliers may have good relevant experience; and there is considerable uncertainty around the competitive conditions Channel 4 would face when it next tenders, given that it will take place after other PSB contracts end. We also note that Channel 4 was not strongly concerned by the merger and the view that Channel 4 was in a stronger position with regard to in-house supply.

9.106 [☒]<sup>129,130</sup>

### *Channel 5*

9.107 Channel 5's playout is currently supplied by Encompass, and its contract runs until [☒]. It told us that it did not have competition concerns about the merger, because it believed that there were other players that could easily meet its requirements, and that new technology was appearing as a strong contender. We would be concerned if we thought that RBM and Technicolor would be the two strongest contenders for the next Channel 5 contract absent the merger. We thought this unlikely, because we thought that Encompass would be a strong contender for Channel 5's next contract—it had already retained that contract once in competition with RBM—and would be in a position of incumbency advantage. We therefore considered whether the loss of a competitor might nevertheless affect the terms that Channel 5 would be able to achieve (in effect, whether removing whichever of Technicolor and RBM would be the weaker bidder). Channel 5 told us that it would consider a wide range of suppliers, including RBM, Technicolor, Encompass, Arqiva and Globecast. We therefore had no reason to believe that both of RBM and Technicolor would provide a significant additional competitive constraint absent the merger. Channel 5 also told us that it had quite a good understanding of the costs of providing the DR service in-house and had an existing playout centre within its Group, and it would therefore

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<sup>129</sup> [☒]  
<sup>130</sup> [☒]

seriously consider self-supply if it were cheaper than outsourcing. We thought this may act as an additional competitive constraint, which would further lessen the importance of bidders outside the best two. Therefore we provisionally concluded that the merger is not likely significantly to disadvantage Channel 5.

#### *Dedicated sports broadcasters*

9.108 The two providers with recent experience of supplying outsourced playout to dedicated sports channels in the UK are RBM (BT Sport 1 and 2) and Arqiva (ESPN and British Eurosport). [☒]<sup>131</sup> On this basis, both Arqiva and RBM would be strong competitors for any such contract. In addition, Encompass has provided sports playout to Channel 5 as part of its contract and was the runner-up to Arqiva in ESPN's last tender.<sup>132</sup> Technicolor has also provided sports playout to ITV (albeit its reputation in this segment may be tarnished by at least two high-profile errors during sports playout), and [☒].

9.109 This evidence suggests that for any sports playout contract there would remain at least three credible competitors post-merger, with Encompass and particularly Arqiva being as strong competitors to RBM pre-merger as Technicolor was. We thought that there might be potential for other providers to expand into providing playout for these types of contracts. Further, we note that these providers did not express concern about the merger. Therefore we provisionally concluded that the merger is not likely significantly to disadvantage sports broadcasters.

#### *Broadcasters with relatively simple needs*

9.110 There appeared to be widespread competition for this class of broadcaster, including Encompass, Arqiva, Globecast, WRN Broadcast and several others. Only one

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<sup>131</sup> See Appendix C, paragraph 35.

<sup>132</sup> See Appendix C, paragraphs 53 & 47.

broadcaster that we perceived to have relatively simple needs ([☒]) expressed a competition concern about the merger.<sup>133</sup> Technicolor did not appear to be a particularly strong competitor for these types of customer, as evidenced by its recent record in tenders. RBM has had some limited success with this class of broadcaster, suggesting that its appeal was not generally stronger than those of its rivals. Therefore we provisionally concluded that the merger is not likely to disadvantage broadcasters with relatively simple needs.

### ***Provisional conclusion on competitive effects of the merger***

9.111 After considering the effect of the merger on each individual contract or type of contract, in terms of both the likelihood of a loss of competitive rivalry and its impact were it to occur, we have gone on to consider the effect on the market as a whole.

9.112 We thought that there were currently four serious potential suppliers for broadcasters with complex requirements, and that the merger would remove one of those. We therefore thought that there would be, to some extent, a lessening of competition, which could lead to the possibility of worse outcomes for broadcasters with complex requirements.

9.113 Looking at individual broadcasters and types of broadcasters, we thought that:

(a) The merger is likely to lead to a reduction in competitive rivalry for the next BBC contract. The significance of the reduction in rivalry will depend on the ability of the BBC to carry out an effective tender process and the ability and willingness of other providers to take this opportunity to put in strong bids, so as to offset (in whole or in part) the loss of the competitive constraint that would have been provided by Technicolor. The provisional view of the majority of the members of

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<sup>133</sup> [A multichannel broadcaster] said that it perceived its needs as being more complex based largely on late schedule changes across a large number of channels and its high SLAs, and thought that the merging parties could best offer the same scale of media management and breadth of services and SLAs across a large number of services.

the panel is that the nature of the competitive process and the potential for other competitors to exert the same level of competitive constraint as Technicolor made it likely that there would be little adverse effect on the BBC.

(b) We could not rule out the possibility that ITV and Channel 4 would face a worse outcome as a result of this reduction in competition, although we thought that the likelihood of the merger significantly reducing competitive rivalry for the next ITV or Channel 4 contract was low.

9.114 We did not attach great weight to the possibility that other broadcasters with complex playout requirements (Channel 5 and sports broadcasters) could be significantly disadvantaged, and we did not think there was likely to be any significant effect on broadcasters with relatively simple playout requirements.

9.115 We therefore considered the impact of our findings with reference to paragraph 9.113 in the context of the overall market for linear playout in the UK—taking into account our conclusions on the likelihood of a loss of competitive rivalry for each broadcaster and its impact were it to occur. We noted that these were high-profile PSBs in the UK, with substantial audience shares; that their linear playout requirements lay at the complex end of the spectrum; that the contracts were of high value relative to those elsewhere in the market; and that in aggregate they accounted for a significant part of the overall market (as set out in Table 2 above).<sup>134</sup>

9.116 Taking into account the low likelihood that we attached to a significant reduction in competitive rivalry for the ITV and Channel 4 contracts, our primary concern was with the BBC, where we thought that a significant reduction in rivalry was possible. However, we also thought that the nature of the competitive process and the

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<sup>134</sup> We also considered whether there could be wider effects in the market, either because of knock-on effects on other customers' prices or because the BBC and ITV appear to be commonly viewed as 'gold standard' reference customers. Our provisional view is that such wider effects were unlikely.

potential for other competitors to exert the same level of competitive constraint as Technicolor, made it likely that there would be little adverse effect on the BBC. The provisional view of the majority of the members of the panel is that this residual possibility with respect to the BBC, together with the cumulative effect on other broadcasters, does not constitute an SLC.

## **10. Provisional conclusions on the SLC test**

- 10.1 Based on the evidence set out above, we have provisionally concluded that the proposed merger is not expected to give rise to an SLC in the market for the supply of outsourced linear playout services for channels broadcast in the UK.