



**Acquisition by British Sky Broadcasting Group plc
of a 17.9 per cent stake in ITV plc**

**Report to the Secretary of State for Trade
and Industry**

27 April 2007

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I OVERVIEW

CONCLUSIONS

1. The Office of Fair Trading (**OFT**) hereby reports to the Secretary of State for Trade and Industry (the **Secretary of State**) in relation to the completed acquisition by British Sky Broadcasting Group plc (**BSkyB**) of a 17.9 per cent stake in ITV plc (**ITV**) on 17 November 2006 (the **transaction**). On 26 February 2007 the Secretary of State, in exercise of his powers under section 42(2) of the Enterprise Act 2002 (the **Act**), gave a public interest intervention notice (the **Notice**) to the OFT and required it to investigate and report on the transaction in accordance with section 44 of the Act within the period ending on 27 April 2007 (see Annex 1 for the Notice).
2. As required by section 44(4) of the Act the OFT's report contains three principal "decisions". These are that the OFT believes that it is, or may be, the case that:
 - a relevant merger situation has been created;
 - the creation of that merger situation has resulted, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services, including the respective UK-wide markets for (1) all TV; (2) premium pay TV; (3) television advertising; and (4) acquisition of premium sports rights, such that further inquiry by the Competition Commission (**CC**) is warranted; and
 - the undertakings in lieu of reference to the CC offered by BSkyB are insufficient to remedy, mitigate or prevent the substantial lessening of competition or any adverse effects which have or may have resulted, or which may be expected to result, from the creation of that situation pursuant to paragraph 3 of Schedule 7 to the Act.
3. The OFT accordingly reports and advises in accordance with sections 44(3) and (4) of the Act that the test for reference to the CC on competition grounds contained in section 22 of the Act is met.

MERGER JURISDICTION

4. The OFT believes that it is or may be the case that a relevant merger situation has been created because:
 - B SkyB and ITV have come under common control for the purposes of section 26 of the Act as a result of B SkyB having acquired material influence over the policy of ITV; and
 - the UK turnover of ITV exceeds £70 million,¹ so the turnover test in section 23(1)(b) of the Act is satisfied.
5. The principal grounds for the OFT's belief that B SkyB has, or at least may have, acquired material influence over ITV is the evidence of attendance and voting at recent ITV shareholders' meetings. This evidence indicates that B SkyB is likely to represent more than 25 per cent of the votes cast at ITV shareholders' meetings and, as a result, that B SkyB may have the ability to block special resolutions at such meetings. Guidance issued by the OFT, which accords with the long established practice of the OFT and CC in relation to material influence, indicates that in such circumstances, B SkyB may be presumed to have material influence in relation to ITV.
6. This conclusion is supported by the OFT's assessment of a number of other factors, including the possibility that B SkyB may obtain board representation as a result of its shareholding in ITV.

SUBSTANTIVE COMPETITION ASSESSMENT

7. The OFT's competition review in this case involves a predictive merger assessment of dynamic markets undergoing technological transformation. For instance, digital switchover commencing in 2008 could well culminate in an equilibrium shift in the balance – and competitive interaction – between the UK's free to air and pay TV platforms. As a result, there is an inherent margin of error in any prospective analysis undertaken by the OFT.
8. However, this transaction has no plausible efficiency enhancing effects, and the cost of inadvertently leaving competitive harm unchecked could, given the dynamic nature of competition, directly harm the welfare of much of the UK television audiences representing tens of millions of consumers in sectors which

¹ For the year ended 31 December 2005, ITV's total turnover was over £2.1 billion.

generates revenues in the region of ten billion pounds. Consequently, the OFT considers it appropriate to take a cautious approach in this case.

9. The counterfactual against which the OFT has assessed this transaction is an ITV independent of BSkyB's partial ownership. The OFT's main concern is that BSkyB's stake in ITV poses a risk of a material reduction in strategic competition between, on the one hand, BSkyB, which is dominant in certain pay TV markets, and on the other, ITV, which is the leading commercial free to air player. This concern arises in particular by virtue of the actual or threatened exercise of veto power on ITV's corporate strategies with regard to its competitive direction. The OFT also considers that there will be a dampening effect on ITV's incentives to engage in strategic rivalry with BSkyB.
10. The key considerations supporting this concern can be summarised as follows:
 - As a result of BSkyB's material influence over ITV, the two can no longer be considered independent strategic rivals;
 - BSkyB holds its stake in ITV at a time when digital switchover is likely to result in an equilibrium shift in the balance between free to air and pay TV;
 - An independent ITV free to strengthen its digital free to air offering, presents a materially greater threat to BSkyB's market power in premium pay TV markets; and
 - There is evidence to suggest that an independent ITV could be an important potential entrant into pay TV in direct competition with BSkyB's business model.
11. In relation to the sale of TV advertising, the OFT considers that the acquisition will provide the parties with the ability and incentive to share sensitive information and coordinate their behaviour in order to reduce future discounting and/or to reduce innovation within the advertising sector.
12. In relation to acquisition of premium sports rights, the OFT has not been able completely to dismiss concerns that third parties may be deterred from partnering with ITV to bid jointly for sports rights in competition with BSkyB, due to the deterrent effect of the fact that BSkyB might obtain sensitive information relating to the bid (or other activities of the third party) as a result of the structural link with ITV. This is an area of particular sensitivity given the evidence that joint bidding in relation to a small number of key rights – and in particular rights to the FA Premier League – may be central to any future attempt by ITV to challenge BSkyB's long standing market power in premium pay TV.

The concern is therefore that the transaction raises entry barriers for ITV into retail premium pay TV, and is thus linked to other concerns set out above in relation to the impact of the transaction on strategic competition between BSkyB and ITV. This concern would be reinforced if BSkyB were to have board representation.

13. Third parties also raised concerns that the acquisition would result in a reduction in competition for the supply of news and other premium content; and that BSkyB's shareholding in ITV will provide it with an increased incentive to foreclose access to BSkyB's rivals to the DTT multiplexes and ITV's content. On the evidence available, the OFT considers these concerns too speculative to warrant reference.

REMEDIES

14. BSkyB has indicated to the OFT that, in order to seek to resolve any substantial lessening of competition identified by the OFT, it would be prepared to offer undertakings in lieu of reference in accordance with paragraph 3 of Schedule 7 of the Act.
15. The OFT is of the view that the proposed remedies are insufficient to address the competition concerns identified. []. The OFT does not believe that [] the remedies offered are sufficiently clear cut.
16. Accordingly, it would not be appropriate for a decision on reference to the CC to be suspended pending negotiation of suitable undertakings in lieu of reference pursuant to paragraph 3 of Schedule 7 to the Act.

II PROCEDURAL OVERVIEW

17. On 17 November 2006 BSkyB acquired a total of 696 million shares in ITV from several significant ITV shareholders, representing a total stake of 17.9 per cent of the issued share capital of ITV.
18. During the course of November 2006 the OFT received complaints from third parties regarding the acquisition.
19. In early December 2006, the OFT requested a merger submission from BSkyB. Following this request, BSkyB provided a number of representations in relation to the issue of material influence.
20. On 12 January 2007 the OFT issued a provisional statement that it believed that it may be the case that the transaction qualified as a relevant merger situation under the Act and issued a public Invitation to Comment (**ITC**).
21. Upon receipt of further information from BSkyB, BSkyB was deemed to have made a satisfactory submission on 7 February 2007.
22. On 26 February 2007 the Secretary of State issued a Notice requiring the OFT to investigate and report in accordance with section 44 of the Act within the period ending on 27 April 2007. The Notice also required Ofcom to report on the impact of this transaction on public interest issues, with regard to the plurality of the media.
23. The statutory deadline for the Secretary of State to decide relevant issues relating to this case expires on 26 May 2007.

III PARTIES AND TRANSACTION

THE PARTIES

BSkyB

24. BSkyB is a holding company for subsidiaries whose principal activities relate to television broadcasting and retailing in the UK and Ireland. BSkyB operates the direct-to-home satellite platform in the UK and Ireland, and retails pay TV services over this platform and over digital subscriber line networks and mobile networks. BSkyB also distributes a number of its channels on a wholesale basis to cable (and other) operators who act as retailers to its UK and Irish customers.
25. BSkyB largest shareholder is News Corporation (**News Corp**) with a 39.02 per cent stake,² along with several directorships, which is sufficient to confer control over BSkyB. News Corp's position in UK broadcast media (via BSkyB) and its substantial UK newspaper interests trigger the media cross-ownership rules of the Communications Act 2003.³ As a consequence of these rules, BSkyB cannot raise its stake in ITV beyond 19.9 per cent.
26. BSkyB's turnover in the year ending 30 June 2006 was around £4.1 billion.

ITV

27. ITV was formed in 2004 by the merger of Carlton Communications plc and Granada plc and it is active in a number of sectors primarily related to television production and broadcasting.
28. ITV's in-house content arm (Granada Productions, renamed ITV Productions) principally produces a range of light entertainment and drama TV programming with mainstream audience appeal in the UK.
29. ITV distributes its own and third-party content via a wide range of wholly-owned free to air television channels broadcast on a range of platforms, and sells advertising on behalf of all 15 Channel 3 regional licences in the UK, 11 of which it controls (these 15 channels are referred to below collectively as the

² As at 31 October 2006.

³ See paragraph 2, Part 1, Schedule 14 to the Communications Act 2003.

ITV1 channel). ITV also holds a controlling 75 per cent share in GMTV, (which holds the national Channel 3 licence for breakfast television); a 40 per cent stake in the news provider Independent Television News (**ITN**); and interests in two of the six digital terrestrial television multiplex platforms.⁴

30. ITV's annual turnover was close to £2.2 billion in each of the calendar years 2005 and 2006.

OVERVIEW OF PLATFORMS AND THE PARTIES' COMPETITIVE POSITIONS

UK television broadcasting platforms

31. The UK broadcasting sector may be divided into several business models and technological platforms for content delivery, as follows:
- "Free to air" – that is, funded publicly and/or by advertising
 - **Traditional analogue** terrestrial broadcast channels – these are BBC1 and BBC2 (publicly-funded via the TV licence fee regime) and ITV1, Channel 4 and Five (each advertiser-funded). Analogue broadcasts will be progressively "switched off" during the period of digital switchover from 2008 to 2012;
 - **Digital terrestrial television (DTT)** – the DTT platform carries the "Freeview" branded TV service, comprising numerous free to air channels including digital versions of the five main analogue channels;
 - **Digital satellite** – a planned free to air satellite service led by the BBC, designed to cover the 25 per cent of UK homes that will not be reached by DTT broadcasts until digital switchover occurs and potentially to provide free to air High Definition services to all homes in the future. The service will be marketed as **Freesat**. BSkyB already offers a "Freesat from Sky" service, which involves an initial set up charge but no monthly fee.
 - "Pay TV" – that is, subscription-funded
 - **Direct to home satellite (DTH)** – the BSkyB service, whose digital satellite broadcasts were introduced in 1998;

⁴ ITV owns SDN Limited, a UK DTT multiplex operator, which holds a licence to broadcast channels over specified bandwidths on Multiplex A. ITV has 48.5 per cent of the capacity on Multiplex 2.

- **Cable** – the former ntl and Telewest networks now branded as Virgin Media;
- **DTT** – a number of basic pay TV channels are also available on DTT, via the Top-Up TV service, and basic and certain premium sports content via Setanta Sports.⁵ BSkyB have announced plans to launch a pay TV service on the DTT platform, which is currently subject to review by Ofcom.
- Digital subscriber line (**DSL**) networks – these provide broadcast and TV services over the internet. The main provider, Tiscali/Homechoice, is subscription-funded.

BSkyB's market power in premium pay TV

32. BSkyB is the leading pay TV broadcaster in the UK. As at 30 June 2006, there were 8 million DTH subscribers to BSkyB's television services⁶ paying a monthly premium to receive a package of Sky channels featuring sport, film and other content, as well as third party channels.
33. In December 2002, the OFT in its *BSkyB investigation: alleged infringement of the Chapter II prohibition* (the **BSkyB Chapter II case**) concluded that BSkyB enjoyed a dominant position for the purposes of Chapter II of the Competition Act 1998 (**CA98**) in the supply of paid-for premium sports and film content at the wholesale and retail levels in the UK.⁷ BSkyB is also the third largest player in the overall supply of TV advertising airtime in the UK, with particular appeal for advertisers targeting the male 16-34 demographic.

ITV's leading role in free to air TV

34. ITV is the UK's leading analogue commercial broadcaster of free to air TV and one of the leading UK providers of content. Its revenue model is advertiser-driven and its core value proposition lies in reaching a wide audience attracted by its premium position in entertainment content on free to air TV: its flagship ITV1 channel accounts for around 40 per cent of advertising revenues¹.

⁵ Setanta will commence broadcasting Premium sports (FA Premium League) in Autumn 2007.

⁶ BSkyB Annual Report 2006

⁷ Decision of the Director General of Fair Trading (DGFT), *BSkyB investigation: alleged infringement of the Chapter II prohibition*, No CA98/20/2002, Case CP 01916-00, 17 December 2002. The DGFT is referred to hereafter as the OFT for convenience.

35. This competitive strength confers market power in TV advertising with the ability to charge premium rates (the **ITV1 premium**). This market power reflected by the ITV premium was created by the formational ITV merger⁸ and is constrained by the “Contract Rights Renewal (**CRR**) remedy” imposed by the Secretary of State as a condition of merger approval in 2003.⁹ ii
36. ITV also produces a package of digital channels, including ITV 2, ITV 3, ITV 4, ITV Play, CITV and Men & Motors (referred to collectively as the **ITV digital channels**) which are available free to air on DTT, DTH and via a subscription on cable and DSL platforms. ITV2 is currently the most successful of a long tail of small channels available on the DTT platform via Freeview.

TRANSACTION RATIONALE AND BENEFITS

37. On the day of its acquisition of the 17.9 per cent stake in ITV, BSkyB issued a public statement which reads in part:
- BSkyB wishes to explore options to create value in the interests of both BSkyB’s and ITV’s shareholders. BSkyB believes that ITV’s content arm is one of Europe’s premier broadcasting assets and production businesses, and holds substantial potential for long-term value creation. This acquisition of shares has taken place without the prior knowledge of ITV’s board of directors, but BSkyB has today communicated to ITV’s board its intention to be a supportive shareholder.¹⁰
38. Notwithstanding this statement, the transaction led to widespread commentary by the media, analysts and other industry players that BSkyB’s motivation was in fact to block the acquisition of ITV by ntl Telewest (since renamed Virgin Media), who had tabled a bid for ITV in early November 2006, or acquisition by other speculated potential bidders, such as RTL.
39. The OFT sought further confidential comment from BSkyB on its rationale for the transaction and requested production of relevant BSkyB documents, particularly those at board level. The documentary evidence presented [].

⁸ That is, the merger between Carlton Communications plc and Granada plc which resulted in the formation of ITV plc.

⁹ *Carlton Communications Plc/Granada Plc, 2003 CM 4781..*

¹⁰ BSkyB press release, 17 November 2006.

40. []¹¹.
41. [].
42. [].¹²[].¹³
43. [].¹⁴
44. [].
45. It is equally clear that, while the internal documentary evidence discloses no anti-competitive rationale, there is also no evidence to support the view that BSkyB projected any efficiency-enhancing or otherwise pro-competitive benefits. Nor has BSkyB sought to claim any such customer or consumer benefits during the OFT's investigation. For example, there is no suggestion of transaction-specific efficiencies suggestive of greater innovation, increased quality or lower prices, such as may arise with business integration and collaboration in the context of joint ventures, mergers and acquisitions.

¹¹ [].

¹² [].

¹³ [].

¹⁴ [].

IV JURISDICTION

SUMMARY

46. The OFT believes that it is or may be the case that a relevant merger situation has been created because:
- BSkyB and ITV have come under common control for the purposes of section 26 of the Act as a result of BSkyB acquiring material influence over ITV and, as a consequence, BSkyB and ITV have ceased to be distinct for the purposes of section 23 of the Act; and
 - the UK turnover of ITV exceeds £70 million (for the year ended 31 December 2005, ITV's total turnover was £2,177 million), so the turnover test in section 23(1)(b) of the Act is satisfied.
47. As set out in more detail below, the OFT considers that BSkyB has (or at least may have) acquired material influence over ITV on the basis that:
- BSkyB's shareholding is likely in practice to give it the ability to block special resolutions at ITV shareholders' meetings (annual general meetings, **AGMs**; or extraordinary general meetings, **EGMs**). In such circumstances, material influence can be presumed to exist; and
 - There are a number of other factors which support (or at a minimum do not undermine) the conclusion that BSkyB may have acquired material influence over ITV, including that BSkyB may obtain board representation as a result of its shareholding.

EXISTENCE OF MATERIAL INFLUENCE

Ability to block special resolutions

48. The main grounds for the OFT's belief that BSkyB has (or at least may have) acquired material influence over ITV is the evidence of attendance and voting at recent ITV shareholders' meetings.¹⁵ Voting turnout at these meetings has

¹⁵ There have only been three AGMs since the creation of ITV, all of these meetings are considered recent.

varied between 63 per cent and 70 per cent.¹⁶ As a result, a shareholder with the equivalent of BSkyB's 17.9 per cent stake in ITV would have exercised more than 25 per cent of the votes cast at each of these meetings and would, as a result, have had the ability to block special resolutions.¹⁷ ITV has endorsed this analysis and has submitted that it believes that BSkyB may in future be able to block special resolutions in relation to ITV.¹⁸

49. The ability to block special resolutions at shareholders' meetings has historically been used as an important criterion underpinning policy on material influence in CC and OFT case practice.¹⁹ This is reflected in the OFT's *Mergers Substantive Assessment Guidance* (the **Guidance**),²⁰ which indicates that:
- a shareholder with 25 per cent or more of the voting rights in a company generally has the ability to block special resolutions, and, as a result, is likely to be presumed to have the ability to exercise material influence; and
 - patterns of attendance and voting at recent shareholders' meetings are of particular relevance to the assessment of material influence.²¹
50. Reading these two propositions together, the OFT concludes that a shareholding below 25 per cent may give rise to a presumption of material influence where patterns of attendance and voting at recent shareholders' meetings indicate that the relevant shareholder is likely to have the ability to block special resolutions.

¹⁶ ITV's three previous AGMs took place on 19 April 2004, 26 May 2005 and 10 May 2006. Votes cast at these AGMs represented the following approximate percentages of all voting rights: 63% (2004), 70% (2005) and 66% (2006). There was also an EGM held on 7 February 2005. Votes cast at this EGM represented approximately 66% of all voting rights.

¹⁷ Under UK company law, special resolutions require the support of at least 75 per cent of votes cast at a shareholders' meeting for approval, see Companies Act 2006, section 283.

¹⁸ ITV's reply of 30 March 2007 to the OFT's issues letter of 30 March 2007, para 2.2.

¹⁹ See for instance *Government of Kuwait/BP*, 1988 Cm 477; *Vivendi SA/ British Sky Broadcasting Group plc*, 2000 Cm 4691.

²⁰ OFT 516, May 2003.

²¹ Para 2.10, first bullet of the Guidance gives the reason why a 25 per cent + 0.1 shareholding is likely to be seen by the OFT as presumptively conferring the **ability** to influence policy: because a 25 per cent + 0.1 holding generally enables a company to block special resolutions, even when all the remaining shares are held by only one person. The second bullet sets out the other factors relevant to assessing the shareholding in question (including in assessing a shareholding below 25per cent + 0.1), and specifically refers to patterns of attendance and voting at recent shareholders' meetings.

51. The OFT considers that this approach reflects commercial realities. It finds support for this proposition in the documents prepared by BSKyB's expert advisers in relation to this transaction, which note:

A 25 per cent stake provides significant blocking powers ... Acquisition of a 25 per cent shareholding in a company enables a shareholder to block a special resolution proposed at a shareholder meeting

- Ability to take a company private
- Create new classes of capital or vary existing rights
- Amend articles of association / disapply pre-emption rights / change company name
- Implement whitewash procedures and granting of financial assistance

Possible to block outright takeovers implemented via scheme of arrangement. **In practice, the fact that many shareholders do not turn up at meetings gives effective blocking power to holdings of less than 25 per cent.**²²

52. ITV has also submitted that BSKyB has acquired material influence over it as a result of its ability to block special resolutions[].²³ ITV's executive chairman Michael Grade has stated publicly that, as a result of the transaction, "BSkyB could theoretically and practically block any major move".²⁴
53. BSKyB has disputed the OFT's conclusions in relation to its ability to block special resolutions. First, it has argued that it is only the right (and not therefore the mere ability) to block special resolutions that gives rise to a presumption of material influence. The OFT believes that this argument runs contrary both to the wording of the Guidance and to the general principle that the purpose of UK merger control is to enable the authorities to consider the commercial realities and results of transactions and that the focus should be on substance and not legal form.²⁵

²² Morgan Stanley, *Project India – Tactical Considerations*, 21 November 2006, p.3 (emphasis added).[]

²³ ITV submission of 12 January 2007.

²⁴ *Grade urges vigilance over BSKyB's stake in ITV*, The Guardian, 8 March 2007.

²⁵ *Stagecoach Holdings PLC/Lancaster City Transport*, 1993 Cm 2423, para 6.21.

54. Second, BSKyB has argued that the OFT should not limit its analysis to an examination of attendance and voting at recent ITV shareholders' meetings, but should also take account of a comparative assessment of voting patterns across a range of other companies. BSKyB has commissioned such a comparative analysis, on the basis of which it concludes BSKyB would expect to hold only 24 to 24.9 per cent of votes cast at future ITV shareholders' meetings.²⁶
55. While the OFT does not query the good faith nature of the comparative analysis submitted by BSKyB or of the estimates based on it, the OFT nonetheless concludes, for a number of reasons, that on balance the evidence supports the conclusion that BSKyB has or may have the ability to block special resolutions at ITV shareholders' meetings. First, the prediction of attendance and voting at shareholders' meetings is complex. It involves the analysis and assessment of a wide range of factors – including the identities of the relevant shareholders, financial performance and perceived management performance – many of which will be company-specific. Consequently, inter-company comparisons are inherently difficult and uncertain. All other things being equal, the OFT considers that patterns of participation at recent shareholders' meetings of a particular company are likely to be a better indication of future participation than a comparison based on past participation rates for other companies.²⁷
56. Second, BSKyB has not pointed to any compelling reasons why, in this case, comparative evidence should be preferred to the evidence of participation at recent ITV shareholders' meetings. BSKyB has suggested that the increased concentration in the overall shareholding in ITV as a result of BSKyB's acquisition of a 17.9 per cent stake may result in increased participation in ITV shareholders meetings. However, the OFT notes that BSKyB's 17.9 per cent stake has effectively replaced the 11.4 per cent stake held by ITV's previously largest shareholder, Fidelity. The OFT is not persuaded that the increase in the concentration of ITV's shareholder register resulting from this 6.5 per cent increment in the size of stake held by the largest shareholder would, on its own, significantly change future voter turnout.

²⁶ Report on voting patterns produced by Lintstock, corporate advisory firm, on behalf of BSKyB, dated 30 January 2007 (the Lintstock Report), as well as the further report produced by Lintstock on behalf of BSKyB, dated 9 March 2007 (the Second Lintstock Report).

²⁷ The Second Lintstock report also argues that on contentious resolutions, BSKyB would have to anticipate a sharp increase in voting turnout rates such that its share of the vote would fall well below 25 per cent of all the votes cast, including in respect of any attempt by BSKyB to gain board representation. However, Lintstock's argument is speculative.

57. Finally, and most importantly, the OFT must take account of the inherent margin of error in BSkyB's predictions of future attendance and voting patterns.²⁸ BSkyB's own estimates suggest that it may hold up to 24.9 per cent of the votes at future ITV shareholder meetings. It would not be appropriate for the OFT to conclude that it does not have jurisdiction over this transaction on the basis of one estimate from an interested party which, on its own terms, produces a range falling within one tenth of one percent of the relevant threshold for blocking special resolutions.
58. On the basis of evidence relating to attendance and voting at shareholders' meetings alone therefore, the OFT considers that BSkyB has the ability materially to influence the commercial policy of ITV to the requisite level of belief.

Other factors

59. The OFT has also had regard to a range of other factors that have historically been considered relevant to the assessment of material influence by the CC and OFT. In particular:
- that BSkyB may obtain board representation as a result of its current shareholding;²⁹
 - that BSkyB is the only significant trade shareholder and has substantial industry expertise;³⁰
 - that BSkyB is the largest shareholder in ITV, and ITV corporate governance policy is to hold frequent discussions with major shareholders;³¹

²⁸ On average 66.3 per cent of shareholders have voted at previous ITV AGMs/EGMs, on this basis BSkyB's shareholding of 17.9 per cent would give BSkyB 27.0 per cent of votes cast. The Lintstock Report suggested that the voting turnout will increase as BSkyB would be expected to always vote. We considered this proposition, but the majority of BSkyB's shareholding was acquired from Fidelity who also voted 100 per cent of the time. We therefore calculated a pre-acquisition, non-Fidelity average voter turnout rate and applied this to the post-acquisition, non-BSkyB shareholders. On this basis BSkyB would be expected to have acquired 26.03 per cent of votes cast. It is not possible to continue this methodology to its logical conclusion without knowing the voting records of every shareholder. However, we consider on the evidence available to us both methodologies support the conclusion that BSkyB at least may have acquired material influence over ITV's policy.

²⁹ *Eurocanadian Shipholdings Limited/Furness, Withy & Company, Limited/Manchester Liners Limited*, 1976 Cmnd 639; *Pleasurama PLC/Trident Television PLC/Grand Metropolitan PLC*, 1983 Cmnd 9108; *Scottish Radio Holdings/Kingdom FM Radio*, DGFT advice, dated 11 March 2002; OFT's Mergers Substantive Assessment Guidance, para 2.10, 3rd bullet.

³⁰ *Scottish Radio Holdings/Kingdom FM Radio*, DGFT advice, dated 11 March 2002.

- the fragmented nature of the remaining shareholdings in ITV;³² and
 - the number of other ITV shareholders that have cross-shareholdings in both BSkyB/News Corporation and ITV.
60. As regards the possibility that BSkyB may obtain board representation as a result of its 17.9 per cent shareholding, the OFT has had regard to third party data for FTSE100 companies (of which ITV is one) suggesting that more than 41 per cent of shareholders with a minority stake of more than 10 per cent in such companies also have a directorship. Similar data provided by BSkyB in relation to FTSE350 companies suggests that 28 per cent of shareholders with a stake of 10 per cent or more in such companies also have a directorship. The OFT believes that the evidence in relation to FTSE100 companies is likely to be of more relevance. However, in either case, the OFT considers that the possibility that BSkyB could obtain a directorship as a result of its shareholding in ITV is significantly greater than fanciful.³³
61. Given that BSkyB's obtaining board representation could have a material impact on the substantive analysis, and that the risk is significantly more than fanciful, the OFT considers it appropriate to have regard to this risk in relation to both its substantive and jurisdictional assessments.³⁴
62. The OFT believes that the additional factors set out above support the conclusion that BSkyB has or may have acquired material influence over ITV. At a minimum, these factors do not undermine the presumption that BSkyB has or may have acquired material influence over ITV as a result of its likely ability to block special resolutions at ITV shareholders' meetings and the OFT has not identified any other factors which might undermine that presumption.

³¹ *SMG/Scottish Radio Holdings*, DGFT advice, dated 21 June 2001; OFT's *Mergers Substantive Assessment Guidance*, para 2.10, 2nd bullet.

³² *Pleasurama PLC/Trident Television PLC/Grand Metropolitan PLC*, 1983 Cm 9108; *P&O/European Ferries*, 1986 Cm 31; *Government of Kuwait/BP*, 1988 Cm 477.

³³ BSkyB has also identified a subcategory of 'corporate investor' shareholders which it submits are more closely analogous to BSkyB, in relation to its stake in ITV, than the general class of investors. There are two such investors with a minority stake of more than 10 per cent in FTSE100 companies – both have directorships. Again, this appears to support the conclusion that it is significantly more than fanciful that BSkyB could obtain a directorship as a result of its shareholding in ITV. (Second Lintstock Report).

³⁴ See by analogy, *Government of Kuwait/BP*, 1988 Cm 477, para 8.109.

IMPLICATIONS FOR THE SUBSTANTIVE ASSESSMENT

Material influence is not equivalent to de facto or de jure control

63. In the context of the substantive assessment, the OFT takes the view that, it is not appropriate to treat the acquisition of material influence as equivalent to the acquisition of full control (de facto or de jure). This conclusion is in line with the scheme of the Act. The Act recognises three different levels or qualities of control – material influence, de facto control and de jure control – and provides that the OFT may treat a change in the level of control (e.g. from material influence to de facto control) as a new merger situation. This indicates that the OFT should recognise the differences between the various qualities of control in its substantive analysis.
64. The OFT's conclusion on this issue is also consistent with the approach of the CC in cases involving acquisitions of material influence such as *Icopal Holdings A/S/Icopal a/s*, where the CC specifically recognised in the context of its substantive analysis that "the acquisition is not a full merger creating a single pricing unit".³⁵

BSkyB board representation is assumed

65. For the reasons set out at paragraphs 60 and 61 above, the OFT has concluded that BSKyB may obtain board representation in relation to ITV and that it is appropriate to take this into account in its substantive assessment.
66. In addition, in the context of the substantive analysis, it is appropriate to assess not only the impact of BSKyB's current shareholding, but also the impact of the maximum level of material influence it could acquire. The OFT considers that the scheme of the Act justifies this approach. Once the acquisition of material influence has been permitted, the Act does not provide for the OFT to examine increments to material influence. In contrast, as noted above, a subsequent change in the level of control may be treated as a new merger situation.
67. As set out above, the OFT believes that BSKyB already has or may have material influence in relation to ITV. As a result, BSKyB's acquisition of board representation in relation to ITV would not give rise to a change of control and, thus, would not create a new merger situation reviewable by the OFT. The OFT has therefore assumed that BSKyB will have a board member in the context of our substantive analysis on this ground, as well as on the grounds of its factual

³⁵ 2001 Cm 5089, para 2.131.

assessment that BSkyB may obtain board representation as a result of its current shareholding.³⁶

Impact of material influence

68. As a result of the acquisition, BSkyB, as ITV largest shareholder, may be expected to have a closer relationship with ITV, than would otherwise have been the case. There is good evidence to show that, in general, listed companies regularly meet with large shareholders to discuss the business and their investment. Good corporate governance would generally appear to dictate that:

Non-executive directors should be offered the opportunity to attend meetings with major shareholders and should expect to attend them if requested by major shareholders.³⁷

69. Third parties have submitted, that in practice, active minority shareholders, and in particular the largest single shareholder in a company, will almost invariably seek to impose their views and wishes through the mechanism of regular contact (whether by meetings or telephone calls) with the management of the companies in which they have invested. By way of example, through frequent contact with management and other shareholders, they have access to information about (and often the ability to comment on) company strategy. One third party further submits that this is supported by empirical research. In particular, a study has shown that in the UK "shareholder activism is predominantly executed through private interventions as opposed to shareholder proposals at a company's annual meeting."³⁸

70. Furthermore, ITV's own statement regarding corporate governance indicates that:

The Board attaches a high priority to communications with shareholders. In addition to the preliminary and interim results presentations and the Annual General Meeting, a series of meetings between institutional shareholders, the

³⁶ BSkyB would be entitled to increase its stake by a further 2 per cent up to 19.9 per cent, the maximum allowable under the Communications Act 2003, in the event that the transaction were not referred to the CC. The OFT could not review such an acquisition of a further 2 per cent. A further 2 per cent stake would increase the possibility of BSkyB's obtaining board representation. This tends to confirm the view that the OFT should take board representation into account in the substantive assessment.

³⁷ Financial Reporting Council, *The Combined Code on Corporate Governance*, June 2006.

³⁸ Becht, Franks, Mayer & Stefano, *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes U.K. Focus Fund*, Working Paper N^o. 138/2006, 4 December 2006, p.7.

Chairman, the senior independent director and the Chief Operating Officer and Finance Director are held throughout the year. **In fulfilment of the Chairman's obligations under the Combined Code, the Chairman gives feedback to the Board on issues raised with him by major shareholders ...**

The Company has frequent discussions with institutional shareholders on a range of issues affecting its performance. These include meetings following the announcement of the annual results with the Company's largest institutional shareholders. In addition, the Company responds to individual ad hoc requests for discussions from institutional shareholders.³⁹

71. Having reviewed ITV's investor relations programmes over the recent past, it is clear to the OFT that ITV adheres to this policy of active consultation of shareholders in practice.
72. Mechanisms by which BSkyB may be able to apply leverage in relation to ITV decision-making include:
- blocking unrelated special resolutions, calling EGMs and putting forward resolutions;
 - ceasing to be a "supportive shareholder", for instance by publicly voicing criticism of and opposition to the ITV board and its strategic decisions. It is alleged that such a move by ITV's largest shareholder, who also has significant industry experience, might lead to a depression in ITV's share price;
 - choosing not to offer, withdrawing from, or worsening the terms of, any cooperative arrangements with ITV;
 - seeking to block strategic initiatives (either on its own or by lobbying for the support of other shareholders).
73. []. In addition, some third parties have suggested the possibility that BSkyB may threaten to sell down ITV stock, which could result in a significant drop in ITV's share price as other investors followed suit. However, this latter option is clearly not a recurring threat, and in practice, could probably only be deployed once; as it would reduce BSkyB's voting power, and if it depresses ITV's share price, may bring with it significant financial harm to BSkyB. As a result, we

³⁹ See ITV's website, Corporate Governance – Relationships with shareholders, <http://www.itvplc.com/itv/about/governance> (emphasis added).

have placed limited weight on this threat in considering the leverage that BSkyB might exercise in relation to ITV.

74. It follows from all the above that BSkyB may use its shareholding in ITV to influence ITV's behaviour and may also have access to strategic information which it could use to its advantage.
75. In the event that BSkyB were to obtain board representation, any potential impact on competition resulting from access to information could be materially enhanced. Board representation provides a structured forum, which by definition entails routine discussion of competitively-sensitive information of the company. Contact at board level may also facilitate or give rise to greater contact at lower levels. As a result – where the board includes a representative(s) of an important competitor in relation to given subject matter – this gives rise in and of itself to material coordinated effects concerns.
76. In this case, a BSkyB representative on the ITV board may provide a conduit for the transfer to BSkyB, or exchange between the parties, of competitively-sensitive information relating to ITV's or each parties' strategies which could include sports rights procurement, TV advertising strategy and pricing policy, including in relation to individual customer accounts (or may facilitate such exchanges and/or transfers at below board level).

V THEORIES OF COMPETITIVE HARM JUSTIFYING REFERENCE

INTRODUCTION

77. The OFT's report to the Secretary of State must include a decision as to whether the OFT believes that "it is or may be the case that" the relevant merger situation "has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom" (section 44(4)(b) of the Act).

Predicting merger effects in a dynamic sector

78. The OFT's competition review in this case involves predictive merger assessment in dynamic markets undergoing technological transformation. BSkyB's strategic acquisition comes at a time when the UK television broadcasting sector is readying itself for digital switchover commencing in 2008. This event could well culminate in an equilibrium shift in the balance – and competitive interaction – between free to air and pay TV platforms. In this context, and as set out in detail below, the evidence available to the OFT gives it objective grounds for concluding that BSkyB's long-term partial ownership of ITV presents a risk of strategic harm to competition at an important juncture in the industry's development and over the long term.
79. The OFT recognises the inherent margin of error in all predictive merger assessment, not least when the markets are dynamic and possible effects are not all short-run in character. However, particularly where an equilibrium shift appears likely within the near future, the costs of error, and particularly of a mistaken clearance, are potentially high.
80. In the circumstances, the OFT has reviewed practice by UK and peer agencies in merger enforcement. One helpful analogue is as follows. In early 2000, the Antitrust Division of the U.S. Department of Justice (the **Division**) evaluated the competitive impact of the proposed acquisition by AT&T Corp. of MediaOne Group, Inc. At the time of that transaction, internet access in U.S. residential homes was in the early stages of transition from dial-up "narrowband" to broadband.
81. AT&T controlled the largest residential broadband supplier, Excite@Home. The Division concerns arose because the transaction would result in AT&T acquiring,

via MediaOne, a partial ownership stake⁴⁰ in the second largest broadband competitor, Road Runner. The Division filed a complaint seeking an injunction against the acquisition on the grounds that the acquisition might “substantially lessen competition ... in the market for the aggregation, promotion and distribution of residential broadband content” due to AT&T’s monopsony or “gatekeeper” power.⁴¹

82. The Division noted that:

Naturally, in emerging markets such as these, predictions about the way the market may develop in the future are far from certain. Nevertheless, the predictions and assumptions required to conclude that the proposed merger would present serious anticompetitive problems in the future are very reasonable ones. Moreover, the risks to the development of the broadband industry posed by this merger are sufficiently grave that appropriate relief is warranted.⁴²

83. The OFT’s overall approach to dynamic competition in this case is similar, but the relevant statutory test and evidentiary standards, discussed below, are different.

A stringent standard: error costs and risk of competitive harm

84. The Court of Appeal has ruled that in carrying out its substantive assessment “in between the fanciful and a degree of likelihood less than 50 per cent there is a **wide margin in which OFT is required to exercise its judgment.**”⁴³ Put at its lowest, in this case, the risk of competitive harm arising as a result of the

⁴⁰ Specifically, a 34 per cent equity interest (including a 25.51 per cent direct stake), as well as a significant management interest.

⁴¹ The Division’s theory of harm was that AT&T, through its control of Excite@Home and its substantial influence or control of Road Runner, would substantially increase its leverage in dealing with broadband content providers, enabling it to extract more favourable terms for such services. AT&T’s ability to affect the success of individual content providers could be used to confer market power on individual content providers favoured by AT&T. By exploiting its “gatekeeper” position in the residential broadband content market AT&T could make it less profitable for disfavoured content providers to invest in the creation of attractive broadband content, and reduce competition and restrict output in that market. See *United States v. AT&T Corp.*, Amended Complaint, 26 May 2000, available at <<http://www.usdoj.gov/atr/cases/f4800/4840.htm>>. The Division and the parties ultimately reached a settlement by which the parties would divest the entirety of the relevant equity and management interests in the Road Runner business.

⁴² *United States v. AT&T Corp.*, Competitive Impact Statement, 25 May 2000, available at <<http://www.usdoj.gov/atr/cases/f4800/4842.htm>>.

⁴³ *IBA Health Ltd v Office of Fair Trading* [2004] EWCA Civ 142, Judgment of the Vice Chancellor, paragraph 48 (emphasis added).

transaction is beyond fanciful. In exercising its judgment in this case, the OFT has taken into account not only an assessment of the probability that harm would arise, but the relative “error cost” in exercising its judgment to reach a belief one way or the other.

85. Inevitably, the calculation of error cost is a balancing exercise between so-called “false positives” and “false negatives” by weighing –

- the risk and downside of an unnecessary in-depth inquiry, that is, imposing needless costs by referring a benign merger to the CC;

against

- the risk and downside of a mistaken clearance, that is, failing to refer a problematic merger in respect of which the CC would have imposed remedies.

86. In this case, the downside risks are sharply skewed and lie largely in relation to mistaken clearance. This is a relatively unusual transaction from a merger control perspective in that it is a straightforward acquisition of partial ownership in a strategic competitor, in circumstances where such action is not a step towards acquisition of de facto or legal control. Unlike most merger situations – for example, mergers, acquisitions or joint ventures – this transaction has no plausible efficiency-enhancing effects, and BSkyB has not claimed that any exist.

87. The downside risk of a mistaken clearance is inadvertently leaving competitive harm unchecked. Such harm could, given the strategic implications in the context of digital switchover, endure over the long term and would directly impact the welfare of much of the UK television audience representing tens of millions of consumers in sectors worth in the region of ten billion pounds (the parties’ combined UK turnover alone exceeds £6 billion annually). In economic terms, therefore, the error cost of a mistaken clearance is unusually high in this case and the consumer exposure sufficiently grave that the cost of CC inquiry is easily proportionate to the benefit of further risk evaluation and, if appropriate, remedial action.

Conclusion

88. In the circumstances, given that the error costs in this case are unusually skewed and arise overwhelmingly in the case of mistaken clearance, the OFT considers it appropriate to adopt a stringent standard and make a reference in this case where it believes, on reasonable grounds, that a beyond fanciful risk of a substantial lessening of competition arises towards the lower end of the “wide

margin” referred to by the Court of Appeal in its *IBA Health* judgment (see above).

89. Against this standard, and for the reasons given below, the OFT concludes that it is or may be the case that the merger has resulted, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services for the purposes of section 44(4)(b) of the Act.

THE COUNTERFACTUAL

General principles applied by the OFT

90. Merger assessment under the Act considers whether a merger causes harm to competition and its beneficiaries. The Act therefore refers to whether a merger **has resulted** or may be expected to **result** in a substantial lessening of competition (see section 44(4)(b) and section 22(1)(b)).
91. The OFT determines causation – the effects attributable to the merger – by comparing the predicated post-merger competitive outcome with the outcome absent the merger, referred to as the counterfactual. As the Guidance notes, this comparison is “the core concept of the substantial lessening of competition test”.⁴⁴ In predicting post-merger effects, the Guidance employs a widely accepted analytical framework to predict post-merger effects; the assessment of the counterfactual is largely a question of fact.
92. The Guidance establishes that the best proxy for the counterfactual is generally prevailing competitive conditions (including market structure and dynamics) because these are observable and subject to verification from multiple sources. The OFT guidance notes that it will also take into account “likely and imminent changes in the structure of competition” (the **likely and imminent standard**).⁴⁵
93. In its decisions under the Act that have potentially turned on whether the status quo ante is appropriate as (that is, the best proxy for) the counterfactual, the OFT has in practice applied a rebuttable presumption in favour of the status quo ante, by reading the likely and imminent standard strictly when the risk of speculation applies to critical finding of the case – notably (i) market exit by a merging party and (ii) possible transactions involving one or more third parties.

⁴⁴ Guidance, paragraph 3.23.

⁴⁵ Guidance, paragraph 3.24.

94. The prime example is the OFT's "failing firm" line of cases⁴⁶ featuring arguments by merging parties that prevailing conditions are not the appropriate benchmark to assess merger effects, because the target would have exited the market absent the merger. The issue has also arisen in the stock exchange sector, where the OFT considered claims that it should treat the market as more concentrated than the status quo, taking into account possible industry consolidation not involving the merging parties.⁴⁷
95. The OFT has adopted a stringent approach out of recognition that counterfactuals are easily the subject of self-serving speculation – relatively easily alleged but difficult, given the information asymmetries, to verify independently (such as claims that a target company would have exited the market absent the merger).

Proposed counterfactual involving alternative acquisition of ITV

96. In this case, it has been put to the OFT that the transaction blocks the acquisition by Virgin Media (formerly ntl Telewest) of ITV, and that a "major part" of BSKyB's rationale was its desire to frustrate and block the formation of a more aggressive competitive rival and foreclose greater competition from an alternative acquirer of ITV. Unlike the stock exchange cases, this involves a rival bid for the target, rather than a parallel merger between two third parties.
97. In proposing this as a relevant change to market conditions but for the BSKyB/ITV transaction at hand, this argument effectively posits a counterfactual that takes into account a Virgin Media/ITV transaction. To do so would seem to require a comparison of the competitive merits of the transaction on the one hand, and a merger between Virgin Media and ITV on the other.
98. The OFT's consistent caution in relation to potentially outcome-determinative counterfactuals applies here. There is an inherent risk of speculation associated with claims that a rival transaction is pro-competitive relative to prevailing conditions because it is generally far from certain that (i) the rival transaction would in fact proceed but for the merger before the OFT; and (ii) such a transaction would in fact be pro-competitive. The OFT would generally want to exercise caution before deciding it would conduct merger analysis by comparing

⁴⁶ See further *Thermo Electron Manufacturing Limited/GV Instruments Limited*, OFT decision, dated 15 December 2006 citing previous OFT "failing firm" cases under the Act.

⁴⁷ See OFT decisions in *NYSE Inc./Euronext NV*, dated 12 October 2006 and *Nasdaq Stock Market Inc./London Stock Exchange plc*, dated 18 January 2007.

a transaction before it with one, alleged to be pro-competitive, that it is not before it.⁴⁸ Hence the reliance on a likely and imminent standard.

99. This is not only because competitors or rival bidders generally have a self-interest in this context in claiming a merger is anticompetitive (and their own as pro-competitive) but because the claim – like merging parties’ failing firm claims – is easily alleged and difficult to verify. The OFT has no ability on the facts to evaluate the comparator transaction and test its competitive implications, including by way of evidence-gathering from other market participants.⁴⁹ Even where a target is subject to more than one contemporaneous “live” bid, the OFT and CC have in recent well-known cases – the bids for Safeway plc and for the London Stock Exchange plc (**LSE**) – not indulged in a “beauty contest”; that is analysis by comparing the competitive merits of one transaction against the other. Rather, the authorities have quite properly evaluated each proposed merger against the status quo ante. In other words, in the example of the LSE cases, the counterfactual was an independent LSE.⁵⁰
100. The evidence considered by the OFT in evaluating whether to consider such a counterfactual as appropriate includes evidence from BSkyB and ITV internal documentation and third party submissions. This present evidence does not support the view that an acquisition of ITV by Virgin Media or indeed another acquirer should qualify in this case as either likely or imminent, nor that such a transaction would generate a more competitive outcome than the prevailing conditions of competition.
101. Finally, a third party has relied on the Monopolies and Mergers Commission (**MMC**)’s report in the case of *Stora Kopparbergs Berslags AB\Swedish Match NV, and Stora Kopparbergs Bergslags AB\The Gillette Company (Swedish Match)*.⁵¹ That case concerned a transaction which resulted in Gillette, the world and UK leader in wet-shaving, obtaining material influence over its largest

⁴⁸ If an alternative transaction does not materially affect prevailing competitive conditions, then substituting a counterfactual that features such a transaction adds nothing to the default approach adopted by the OFT.

⁴⁹ Only in the exceptional circumstance of the failing firm defence does this occur, but cases only turn on this defence where a merger appears to be anticompetitive relative to prevailing conditions. Under this defence, the requirement of no less anti-competitive purchaser is a necessary limb to establish the overall proposition of the failing firm defence – that the merger itself does not result in competitive conditions worse than that absent the merger, including an alternative acquisition. See further OFT substantive assessment guidance paragraph 4.37 and OFT decision in *Thermo/GVI*, citing previous cases.

⁵⁰ *Deutsche Börse AG/Euronext N/London Stock Exchange plc*, CC report, dated November 2005; *Deutsche Börse/London Stock Exchange plc*, OFT decision, dated 29 March 2005; and *Euronext N.V./London Stock Exchange plc*, OFT decision, dated 29 March 2005.

⁵¹ 1991 Cm 1473.

and closest rival, Wilkinson Sword. The MMC concluded that, as a result, Wilkinson Sword would be a less effective competitor to Gillette. As part of the transaction, Gillette obtained an effective veto right over the identity of any future purchaser of the Wilkinson Sword business. The MMC also concluded that this would reduce potential competition in the wet-shaving market. However, the MMC reached this conclusion against the background of Gillette's existing anti-competitive influence over Wilkinson Sword. The MMC was not required to consider either whether the acquisition of the veto rights in isolation would be detrimental to competition or whether the counterfactual should be switched from the status quo ante. In the circumstances, the OFT is not persuaded that the Swedish Match case requires it to deviate from its standard approach to counterfactual issues.

102. Accordingly, the OFT does not believe the available evidence in this case nor the claimed precedent value of the Swedish Match case make it appropriate to depart from its starting presumption that prevailing conditions of competition are the best proxy for the outcome absent the merger.

The OFT's counterfactual – ITV independent of BSkyB's partial ownership

103. It follows from the above that there are no circumstances meeting the likely and imminent standard in this case, and that the appropriate counterfactual is the prevailing competitive conditions. The counterfactual adopted by the OFT is therefore an ITV independent of BSkyB's partial ownership (hereafter referred to for convenience as "independent ITV").⁵²

⁵² An "independent ITV" should not be understood in terms of any specific pattern of shareholding in ITV, only in terms of a pattern of shareholding that does not give rise to material influence (or any greater degree of control) on the part of BSkyB or any other entity in relation to which competition concerns might arise.

REDUCTION OF STRATEGIC RIVALRY BETWEEN BSKYB AND ITV

Introduction

104. It has long been recognised in UK⁵³ and international⁵⁴ merger enforcement and economic literature⁵⁵ that acquisition of partial ownership and the creation of structural links between significant competitors – such as BSKyB and ITV – can raise serious competition issues worthy of close scrutiny and possible intervention, without the need for one to enjoy de facto or de jure control over the other. The same risks hold true of interlocking directorates between important competitors.⁵⁶
105. On the evidence available to the OFT, the **mechanisms** by which BSKyB's leverage over or influence upon ITV decision-making could occur include:
- blocking unrelated special resolutions, calling EGMs and putting forward resolutions;
 - ceasing to be a "supportive shareholder", for instance by publicly voicing criticism of and opposition to the ITV board and its strategic decisions. It is alleged that such a move by ITV's largest shareholder, who also has significant industry experience, might lead to a depression in ITV's share price;

⁵³ See for example *Government of Kuwait/BP Plc*, 1988 Cm 477; *Elders IXL Ltd/Scottish & Newcastle Breweries plc*, 1989 Cm 654; *Stora Kopparbergs Bergslags AB/ Swedish Match NV and Stora Kopparbergs Bergslags AB/ The Gillette Company*, 1991 Cm 1473; *Stagecoach Holdings plc/Mainline Partnership Ltd*, 1995 Cm 2782; *Stagecoach Holdings plc/S B Holdings Ltd*, 1995 Cm 2782.

⁵⁴ In the media sector, see for example, *U.S. v. AT&T*, cited above; *U.S. v Univision Communications Inc.* (D.D.C. 2003) (divestment by acquirer of 30% equity and 7% voting stake in radio competitor of merger target); *U.S. v. Clear Channel Communications* (D.D.C) 2000; divestment of target's 28.6% equity interest in competitor to acquirer in out-of-home advertising (billboard, posters); *U.S. v Primestar, Inc.* (U.S. seeks injunction against transaction giving News Corp/MCI a 20% stake in main joint venture between cable TV companies in return for transfer of direct satellite broadcasting capacity) (D.D.C. 2000). See also the Irish Competition Authority Case M/03/033 – *Proposed acquisition by Scottish Radio Holdings plc of Capital Radio Productions Limited*, 23 February 2004 (divestment of 8% equity interest creating information-sharing risk between two largest radio competitors).

⁵⁵ A leading article is D. O'Brien and S. Salop, 'Competitive Effects of Partial Ownership Interests: Financial Interest and Corporate Control' (2000) 67 *Antitrust LJ* 559.

⁵⁶ For example see *British Airways plc/Sabena*, 1990 Cm 1155. See also Section 8 of the U.S. Clayton Act, which, in effect, prohibits interlocking directorates between horizontal competitors that, if merged, would result in substantially lessened competition.

- choosing not to offer, withdrawing from, or worsening the terms of, any cooperative arrangements with ITV;
- seeking to block strategic initiatives (either on its own or by lobbying for the support of other shareholders).

106. The OFT's **theory of harm** is that BSkyB's stake risks reducing strategic rivalry between BSkyB, which has been found to be "dominant" in certain pay TV markets,⁵⁷ and ITV, the leading commercial free to air player, to the detriment of UK consumers. This concern arises in particular by virtue of:

- **the actual or threatened exercise of veto power on ITV corporate matters relevant to its strategic competitive direction.** This concern derives from BSkyB's potential ability to veto, frustrate or at a minimum critically delay actions that ITV has an incentive to pursue in its own best interests, but which put it at conflict with BSkyB; and
- **a dampening effect on ITV's incentives to engage in aggressive strategic rivalry with BSkyB.** This derives in part from the common sense notion that management of a company has a disincentive to engage in strategic competitive combat with a large – indeed the largest – owner of shares in that company. In other words, strategic options that might otherwise risk frustration by BSkyB are never actively developed at or past the "drawing board" stage within ITV and a more passive and stable "live and let live" equilibrium may develop. At the extreme, it could result in a tacit (or explicit) understanding that ITV will not "attack" BSkyB's position in pay TV (alone or in partnership). Such strategic initiatives are of a different character than tactical "everyday" competition within current business models, for example, in TV advertising.

107. The issue before the OFT is the impact of the transaction on rivalry with reference to the counterfactual – that is, the pre-merger situation of an independent ITV. The issue is not, however, limited to a simple comparison of the degree to which free to air constrains pay TV today. The counterfactual analysis also involves a dynamic assessment of the current trends in rivalry – that is the manner in which rivalry was developing pre-merger. On the facts of this case, this means that the OFT must take account of the degree to which the constraint that ITV imposes on BSkyB has grown (or not) in the last five years, and, critically, how it would have increased with an independent ITV in future.

⁵⁷ See the BSkyB Chapter II decision.

Market definition (and its limits)

108. The Guidance makes clear that while market definition is an important step it should not be seen as an end in itself:

Proper examination of the competitive effects of a merger rests on a sound understanding of the competitive constraints under which the merged firm will operate. The scope of those constraints, if any, is identified through a market definition analysis. It is important to emphasise that market definition is not an end in itself. It is a framework for analysing the direct competitive pressures faced by the merged firm (paragraph 3.11).

109. This has also previously been recognised by BSKyB. In the 2000 case involving Vivendi's material influence over BSKyB, the latter it argued that "the appropriate market definition for an inquiry depended on ... the mischief that was being investigated" citing the OFT's 1999 Guidelines on market definition to the effect that "market definition is not unique and can vary depending on the competition problem under investigation".⁵⁸
110. As mentioned above the UK television broadcasting sector is readying itself for digital switchover commencing in 2008. This event is likely to be a point at which there is an equilibrium shift in terms of the structure of the sector and in particular the balance between free to air and pay TV platforms. The mischief therefore being investigated is a dynamic and strategic one: the impact of the transaction on strategic rivalry between pay TV and free to air TV as driven by, respectively, the "dominant" player and the leading commercial player in the sector.
111. More broadly, this rivalry takes place in a context in which delivery of media content and communications remains in a state of dynamic evolution that includes acquisitions, partnerships and alliances among industry players that can bring consumers benefits of new packages of products or services, or bring them to market more quickly or cheaply. This makes the material influence exercised by BSKyB over ITV a particular concern in this case, since competitive strategies of this type are particularly likely to be subject to shareholder consents that BSKyB may be able to frustrate and/or veto through blocking special resolutions or otherwise.

⁵⁸ *Vivendi SA/British Sky Broadcasting Group plc*, 2000 Cm 4691, at paragraph 6.237 and generally at 6.227 to 6.245. OFT's Guideline on Market Definition, OFT 403, March 1999 (current version dated December 2004).

Increasing interaction between pay TV and free to air TV

112. In the OFT's BSkyB Chapter II case, BSkyB referred to an OFTEL survey that it stated showed that the five most important reasons for not taking a pay television subscription "are all related to the issue of existing free to air services being of sufficient value that the extra value offered by pay television services does not warrant the extra cost".⁵⁹
113. In that case, the OFT accepted that free to air imposed a degree of price constraint on BSkyB's pay TV packages. It concluded that "free to air channels impose only an indirect constraint on the price of packages including premium film channels ... and do not constrain the prices of [the latter] to the competitive level." (para 243, 245). In other words, the OFT concluded that pay TV was constrained by free to air, but that it did not follow that it was inappropriate to identify pay TV as a separate product market. (This approach avoids both the so-called "binary fallacy" that treats competitive constraints as either perfect or nil and the so-called "cellophane fallacy".)⁶⁰
114. Other decisions at the UK and EC levels have noted that while pay TV and free to air TV form separate markets, there is some blurring of the distinction. For example. In July 2000, in a report on three proposed mergers,⁶¹ the CC accepted that there were two separate markets for free to air and pay TV, but said 'there are some significant similarities and overlaps/interactions between the two...', blurring the distinction between the two markets. This is also true in other EC Member States. In its 2003 decision in *Newscorp/Telepiu*, the EC recognised that the continuing digitisation of free to air TV could lead to the distinction between the markets for free to air and pay TV becoming increasingly blurred (at least in Italy).
115. The recent rapid growth in the uptake of Freeview and consequently the proliferation of channel numbers possible on DTT (currently 44 free to air and 19 pay TV) has further blurred the distinction between free to air and DTH pay TV in the UK, and is likely to have increased the degree of, and scope for, competitive interaction.
116. In this context, it is important, as noted by the OFT and BSkyB, to recognise that market definition may appropriately vary depending on the issue under investigation. In a merger context, the primary question at issue is whether

⁵⁹ BSkyB Chapter II decision, para 238.

⁶⁰ See further, Guidance at paragraph 3.19, note 16.

⁶¹ *Carlton Communication Plc/Granada Group Plc/United News and Media Plc*, 2000 Cm 4781.

existing competitive constraints may be relaxed by that merger to a degree that results in a substantial lessening of competition relative to absent the merger. Market definition must be framed to capture that issue. In the context of a retrospective Chapter II investigation, the primary question at issue is different – that is, whether existing competitive constraints (as they stand) are sufficient to constrain the pricing (or other competitive behaviour) of an undertaking to the competitive level (or something approaching it), in other words whether the undertaking at issue had significant market power at the time of an alleged abuse. Market definition must be framed accordingly, and may be different to that in a merger control context.

117. Here, there are existing constraints between free to air and pay TV which may be reduced as a result of the transaction. It is appropriate to take account of this in market definition.
118. This conclusion is not in conflict with the fact that in the BSKyB Chapter II case, the OFT determined that rivalry from free to air did not constrain BSKyB's pricing to the competitive level and defined separate pay TV markets, including premium pay TV markets. Indeed, discussed further below, that finding is relevant in the merger context when considering loss of rivalry through loss of potential entry into premium pay TV.

Pay TV and premium pay TV as separate product markets from free to air

119. Past decisions at both the UK and EC levels have consistently defined pay TV and premium pay TV as constituting separate markets to free to air TV, in accordance with the issues before them.⁶²
120. For example, in *NTL/Cable & Wireless* the CC described pay TV as 'significantly different' from free to air TV, notably because of its focus on films and sport, two types of content whose exclusive rights are attractive to subscribers to the extent of encouraging them to pay subscription fees over and above the basic costs of television viewing. The CC also noted the ways in which a particular service (free to air vs pay TV) was financed, pricing differentials between premium channels and basic channels, the number of channels available on pay TV compared to free to air, and the types of content/channels available on pay TV vs. free to air (earlier release windows for movies, more specialist programming, etc) as reasons that the markets were separate.

⁶² *BSkyB/Manchester United*, 1999, Cm 4305; *ntl/Cable & Wireless Communications Plc* 2000 Cm 4666; *Carlton Communications Plc/Granada Group Plc/United News and Media Plc*, 2000 Cm 4781; *BSkyB Chapter II decision*; *Newscorp/Telepiu*, 2003, COMP/M.2876, 2 April 2003.

121. Past decisions have also highlighted separate markets within pay TV. In the BSkyB Chapter II case, the OFT defined separate markets for each of premium sports and premium movies. In *Vivendi/BSkyB* the CC found that sports channels “may be characterised as either ‘basic’ (low cost, low viewing appeal) or ‘premium’ (high cost, high viewing appeal).”⁶³
122. The existence of separate pay TV markets, including premium pay TV markets, is relevant in the context of this case when considering the potential loss of ITV as a potential entrant into premium pay TV.

Conclusions

123. In light of the above, the OFT concludes that its inquiry should be framed to examine the loss of rivalry between BSkyB and ITV in two critical respects: both **across** TV revenue models (free to air vs. pay TV) and **within** the premium pay TV model. In order to analyse properly the direct competitive pressures faced by the relevant parties, for the purpose of this case, both may be thought of as markets:
- the TV sector as a whole covering both free to air and pay TV (**All TV**) – within which BSkyB's pay TV activities (including its activities in premium pay TV) are constrained, at least to some extent, by free to air; and
 - **premium pay TV** – where BSkyB has long-standing market power.

Reducing strategic rivalry in all TV and premium pay TV

A. Introduction

124. The OFT's theory of harm is that BSkyB's stake risks distorting strategic rivalry between BSkyB, which has long-standing market power in certain pay TV markets, and ITV, the leading commercial free to air player, to the detriment of UK consumers. This may also in part be thought of in summary terms as reducing platform competition between ITV/Freeview and BSkyB/DTH pay. The key considerations supporting the OFT's concerns are as follows.

⁶³ 2000 Cm 4691, at para 4.62.

B. All TV

Pre-merger the parties were independent strategic rivals: this is no longer true

125. As noted above, BSkyB has been found dominant in certain premium pay TV markets in the UK, while ITV is the principal commercial force in free to air TV. It is reasonable to characterise the parties as strategic rivals pre-merger, []⁶⁴
126. Post-merger, as a result of the material influence that BSkyB has the ability to exercise in relation to ITV, the two can no longer be considered independent strategic rivals.

ITV is at a crossroads and the sector is undergoing dynamic transformation

127. BSkyB had [] reasons for acquiring its stake and its position should be assumed to be []. This comes at a time that ITV, BSkyB and other players are positioning themselves to emerge as competitive victors as digital switchover occurs.
128. ITV, meanwhile, has recently appointed new management, in the form of executive chairman Michael Grade, to revitalise ITV and review its strategic options. Even prior to the Grade appointment, [], as discussed below.
129. As Mr Grade has publicly noted, BSkyB's stake limits ITV's ability to engage in strategic mergers and acquisition activity. He is quoted publicly as saying:

What is unarguable about this is that Sky has invested £1bn of shareholder's money in ITV and they did not do that to lose money ... BSkyB could theoretically and practically block any major move. We have, in the interests of all our non-Sky shareholders, pointed this out to the regulator.⁶⁵

Loss of an independent ITV free to strengthen digital free to air may present a materially greater threat to BSkyB's market power in premium pay TV

130. ITV's principal business is operating analogue and digital free to air TV channels, in contrast to BSkyB's pay TV model, built around exclusive premium content. The evidence available to the OFT supports the logical proposition that the smaller the qualitative differences between content available free to air and that available on pay TV, the smaller the pay TV premium that BSkyB can charge to existing and new household subscribers.

⁶⁴ [].

⁶⁵ 'Grade urges vigilance over BSkyB's stake in ITV', *The Guardian*, 8 March 2007.

(a) ITV's internal documents on digital free to air versus pay TV rivalry

131. [].

132. [].⁶⁶ [].

133. [].

134. []

135. [].

136. [].

137. [].

(b) Concerns from market participants regarding past conduct relating to Freeview and Freesat

138. []. Third parties also raised concerns that BSkyB would be able to use its shareholding to block or delay an ITV strategy to commit to further investment in Freeview.

139. Similar concerns were also raised in relation to BSkyB's ability to restrict ITV's involvement in Freesat (a direct alternative to BSkyB's own 'Freesat from Sky' product). The BBC is the main party behind Freesat, and has indicated to the OFT that ITV's backing was not essential for the project to go ahead. However, third parties, and in particular ITV, raised concerns that the success of Freesat would be diminished without ITV's support given its ability to provide financial, content and marketing assistance.

(c) Forthcoming developments in free to air digital

140. The free to air offering may also be strengthened by the acquisition of additional electromagnetic spectrum in the upcoming (2008) spectrum auction which may lead to the provision of High Definition (**HD**) channels on the DTT platform. [It has been alleged] that BSkyB has made it clear that it opposes proposals from the BBC, ITV, Channel 4 and Five that an allocation of released spectrum should be made available for the provision of HD services. BSkyB's announcement that it intends to launch a pay TV service on the DTT platform suggests it may also wish to compete for spectrum rights, further increasing its incentives to try to

⁶⁶ [].

prevent ITV, and other free to air service providers, from obtaining the additional spectrum capacity. BSkyB would therefore have the incentive to frustrate ITV's involvement in any joint bids with other public service broadcasters for spectrum rights.

Entry and expansion

141. BSkyB alleged that barriers to entry in the TV industry were low as content providers are numerous and gaining access to a distribution channel is relatively easy. This is evidenced by the number of new channels that have launched in the last five years. However, this was strongly disputed by the majority of third parties who suggested that (i) the high upfront cost of acquiring quality programming rights makes entry by new players very difficult; and (ii) while finding a channel for content distribution may not be impossible, finding one that reaches a critical audience mass was much more difficult.
142. In light of these comments, the OFT concludes that barriers to entry in supplying audio visual programming to end-users and distributors appear to be relatively high in relation to entry of sufficient size to provide any competitive constraint on the parties.
143. The OFT has also had insufficient evidence to suggest that expansion by existing players in the TV sector, alone or in tandem, would be sufficient to replicate the strategic rivalry reduced by the transaction. Individually, among commercial competitors, Channel 4, Five and other suppliers lag substantially behind ITV's 16-17ⁱⁱⁱ per cent share of viewers, and there is a lack of evidence that the BBC, as a publicly-funded broadcaster, would replace the competitive constraint that ITV would have placed on BSkyB, but for the transaction. Furthermore, ITV's position is supported by its market power in the provision of TV advertising and its unrivalled strength as a domestic content provider making it very unlikely that other existing free to air TV providers will be able to replicate its constraint on BSkyB.

Conclusions regarding all TV

144. In summary, for the reasons set out above, the OFT believes that, in relation to all TV, it at least may be the case that:
 - BSkyB and ITV were independent strategic rivals in all TV;
 - as a result of BSkyB's acquisition of the ability to exercise material influence over ITV, that rivalry may be reduced;

- the loss of rivalry will not be replicated as a result of entry or expansion because:
 - barriers to entry into both pay and free to air TV are high;
 - ITV's position as the leading player in commercial free to air TV is supported by its market power in the provision of TV advertising and its unrivalled strength as a domestic content provider making it very unlikely that other existing free to air TV providers will be able to replicate its constraint on BSkyB within the time-frame relevant to merger control; and
 - ITV will play an important role, possibly the "swing vote" in the context of the likely equilibrium shift in the structure of the sector and in particular the balance between free to air and pay TV.

145. The OFT therefore concludes that the transaction may result in a substantial lessening of competition in all TV.

C. Premium pay TV

146. As set out further below, an independent ITV may have entered premium pay TV at the retail level in direct competition with BSkyB's business model.

The premium sports rights gateway and upstream effects

147. [].

148. []

149. As set out further below, the transaction potentially reduces the willingness of third parties to partner with ITV [] and, as a result, reduces ITV's ability to move into premium pay TV [].⁶⁷

150. []. It is equally clear that such action would be perceived as a competitive threat to BSkyB and it has the incentive – and the ability in at least some respects – to frustrate or delay such action.

151. At the same time, an effect of the transaction may be to dampen ITV's incentives to pursue this option; [] strategic thinking would, on this theory, be

⁶⁷ This evidence in relation to competition at the retail (downstream) level raises linked concerns in relation to the procurement of sports rights (upstream). These concerns form part of the OFT's strategic theory of harm justifying reference to the CC. The issue of the transaction's effect in premium sports rights acquisition as such is dealt with in more detail below.

put on hold or retired in lieu of pursuing other (potentially less ambitious) options and adopt a strategy less antagonistic to its major shareholder. As noted earlier, in future such proposals may not be actively developed at or past the “drawing board” stage within ITV and a more passive and stable “live and let live” equilibrium may develop between these key players. At the extreme, it could result in a tacit (or explicit) understanding that ITV will not “attack” BSkyB’s position in pay TV (alone or in partnership).

152. Although it cannot be excluded that there may be other potential entrants who could challenge BSkyB’s market power in premium pay TV, as the largest commercial player in free to air TV in the UK and with a strong recognisable brand, ITV would be at or very near the top of the list of candidates and may be the most likely potential entrant. The OFT takes the view that it is too early to conclude that this position has changed as a result of Setanta’s success in acquiring certain Premier League rights. It is not clear that this will result in a successful and durable challenge to BSkyB’s position in premium pay TV by Setanta or indeed that firms in Setanta’s position are likely to mount such a challenge.

ITV’s other entry avenues into pay TV

153. Although the concern is more muted, it is conceivable that concerns may also arise because an independent ITV may have entered the pay TV sector (basic and premium) through acquisition of an existing service provider. BSkyB would have a clear incentive to use its shareholding to prevent ITV’s purchase of a direct competitor, where ITV’s investment would be expected to strengthen that competitor. [].

Conclusions on premium pay TV

154. In summary, for the reasons set out above, the OFT believes that, in relation to premium pay TV, it at least may be the case that:
- BSkyB holds long-standing market power in relation to premium pay TV;
 - entry is unlikely from a player not currently operating in the UK TV industry and within the UK TV industry ITV, as the largest commercial player and with a strong recognisable brand, would be at or very near the top of the list of candidates and may be the most likely potential entrant into premium pay TV; moreover, the transaction may raise entry barriers into premium pay TV by deterring potential partnerships between ITV and third parties;

- the transaction significantly reduces the likelihood of entry into premium pay TV by ITV, by dampening its incentives to do so and reducing its ability to pursue strategies involving partnering with third parties; and
- for the reasons summarised above, ITV's position is unlikely to be replicated within the timeframe relevant for merger control purposes as a result either of entry or expansion (in free to air TV).

155. The OFT therefore concludes that the transaction raises a realistic prospect of a substantial lessening of competition in premium pay TV.

Conclusion

156. For the reasons set out above, and in light of the standard of substantive assessment applicable in this case, the OFT believes that it is or may be the case that the transaction may result in a substantial lessening of competition due to:

- a loss of strategic rivalry in all TV between BSkyB as a pay TV operator and ITV as a free to air TV operator; and
- a reduction in the competitive threat to BSkyB's long term market power in relation to premium pay TV as a result of a reduction in the ability and incentive of ITV, which may be the most likely potential entrant, to enter premium pay TV.

ACQUISITION OF PREMIUM SPORTS RIGHTS

Market definition

Product market

157. The market for the acquisition and sale of programming content has been examined in a number of cases by the EC, OFT and CC.⁶⁸ In *Vivendi/BSkyB* the CC found that different types of content are not considered to be ready substitutes for other types of TV rights or content on either the demand or supply side. Therefore, the CC concluded that sports rights constituted a separate economic market, albeit with close links to the market(s) for other content.

⁶⁸ For example see *NTL Incorporated /Cable & Wireless Communications Plc*, 2000 Cm 4666; *British BSkyB Broadcasting Group Plc/ Manchester United Plc*, 1999 Cm 4305; *Proposed joint venture between Hilton Group Plc and British BSkyB Broadcasting Group Plc*, Director General's advice, 27 September 2001; Decision of the Director General of Fair Trading, *BSkyB investigation: alleged infringement of the Chapter II prohibition*, No. CA98/20/2002, Case CP 01916-00, 17 December 2002.

158. The majority of past cases have also made the distinction between premium and non-premium content at both the retail and wholesale levels. For example, in *NTL/Cable & Wireless* the CC distinguished between non-premium and premium channels, with premium channels being dedicated to either sports or movies to which the channel providers have exclusive rights. Similarly, in its *BSkyB* Chapter II decision, the OFT noted the importance of premium film and sport content.
159. Third parties generally submitted that different genres of content are not entirely substitutable, on the demand side due to customer preferences and on the supply side due to the wide variability in the cost of production. News was considered the most clearly defined genre, but sport, film, drama and comedy were also believed to each form a relatively distinct genre.
160. On the supply side it appears that there may only be limited scope for supply side substitution in the short-term. For example, one third party stated that there were significant lead times in shifting production and there was a limited supply of skills and talent in the UK, therefore although it could shift production in the short-term it would be likely to reduce the quality of programming. In addition, the use of long-term contracts and exclusive rights contracts are common, therefore it would be difficult to enter into the provision of content in the short-term. This is particularly the case in relation to the provision of sports rights, news, films and other forms of premium content.
161. On the evidence available it appears that retail content providers find it relatively difficult to switch between producing different content. On the demand side consumer preferences are important, and this is particularly the case where content is unique and there are few substitutes. We therefore consider that there are likely to be distinct frames of reference for news content, sports content, premier film content and potentially other premium content. For broad entertainment content we consider it unlikely that further categorisation is necessary.
162. A further distinction can also be made between premium and non-premium sports rights. In *Vivendi/BSkyB* the CC noted that there was a wide diversity of sports programme material and also differing standards quality or popular appeal. A distinction was therefore drawn between either "basic" (low cost, low viewing appeal) or "premium" (high cost, high viewing appeal) sports rights. This view was supported by third parties.

Geographic market

163. In *Vivendi/BSkyB* the CC found that:

Different bidders in a given territory may want the exclusive rights for subscription-based pay TV; or the non-exclusive rights for PPV broadcast; or want rights to only particular films. Moreover, some will be interested in the rights in only a single country or language territory, whilst others may be seeking the broadcasting rights for a 'package' of other countries. In general, bidders that require the widest combination of the rights available and also have access to the largest subscriber base are the most likely to be successful in acquiring the main and most valuable rights.⁶⁹

164. This suggests that in some cases the market will be wider than the UK depending on the nature of the content and the level of its international appeal. However, although the amount of content produced outside the UK is increasing, broadcasters such as BSkyB and ITV generally own the broadcasting rights only for the UK. We have therefore taken the cautious approach and considered the UK as the correct geographic market for content.

Non-coordinated effects

Reduced bidding competition between the parties

165. Third parties submitted that ITV and BSkyB are significant acquirers of premium sports content following head-to-head competition against each other and the other major acquirers, such as the BBC. This was supported by bidding information supplied by third parties which showed that the parties often bid against each other for sports rights.
166. Third parties raised concerns that following the acquisition BSkyB would compete less vigorously against ITV as any rights lost to ITV (assuming the acquisition of the rights increases the profitability of ITV) may be reflected through an increase in ITV's share price and/or shareholder dividend. As discussed above, in reality, any benefit to BSkyB through its shareholding may be uncertain and could also result in a strengthening of ITV competitive offering against BSkyB. Furthermore, premium sports rights form a crucial part of BSkyB's pay TV offering and by bidding lower (or not at all) BSkyB would run the risk that the rights would be won by another bidder.
167. ITV's incentives to unilaterally reduce its bidding against BSkyB would also appear to be limited. A number of third parties have argued that ITV will be strongly influenced by the wishes of BSkyB as its new largest shareholder. However, the board of ITV is obliged to take in to account the best interests of

⁶⁹ *Vivendi SA/British BSkyB Broadcasting Group Plc*, 2000 Cm 4691, para 4.108.

all its shareholders including the holders of the 82.1 per cent of shares not held by BSkyB.

168. Therefore the only circumstances in which ITV may be willing to change its behaviour in order to benefit BSkyB would be those situations where ITV is indifferent with regard to a particular course of action favoured by BSkyB. Given the importance that ITV places on major sporting events to attract large advertising audiences, especially the hard to reach 16-34 male demographic, there are likely to be few, if any, circumstances where ITV would be indifferent about acquiring sports rights. Furthermore, BSkyB would only derive a benefit from ITV's decision not to bid if, absent the acquisition, ITV would have either won the auction or submitted the second highest bid. In circumstances where a third party rival would have won or come second in the auction, a reduction in competition from ITV would not allow BSkyB to win the auction with a lower bid than absent the merger. Cases where (i) BSkyB and ITV are the highest and second highest bidders and (ii) ITV is indifferent as to whether or not its bid is successful would be rare.

Increased joint bidding between the parties

169. Third parties raised a concern that the parties may be more likely to bid jointly for sports rights as a result of the transaction, and that this may both (i) preclude third parties from jointly bidding with ITV and (ii) create a strong offer across pay and free to air TV with which other providers would not be unable compete effectively.
170. However, the acquisition is very unlikely to significantly change the incentives (or the ability) of the parties to bid jointly with each other. Each party will still choose to bid with the partner that leads to the most profitable outcome. The positive feedback that BSkyB receives through its shares in ITV is limited and subject to significant uncertainty. In the context of decisions with important strategic implications, such an effect is very unlikely to have a significant impact on decision making.
171. Furthermore, sports rights holders (particularly in relation to premium sports) are sophisticated sellers and may be able to incorporate sufficient flexibility into the bidding system to overcome the concerns raised. For example, they could prohibit joint bidding between the parties and encourage or actively co-ordinate complementary bids between other competitors.

Reduced joint bidding between ITV and third parties

172. A further concern expressed to the OFT is that third parties may be deterred from partnering with ITV to bid jointly for sports rights in competition with BSkyB. The basis for this concern is the risk that BSkyB might obtain sensitive information relating to the bid (or other activities of the third party) as a result of its structural link with ITV. If such joint bidding is deterred, it could result in a significant reduction in the competitive constraint faced by BSkyB, particularly in relation to the small number of key rights, such as the FA Premier League, where joint bidding appears to be a real possibility.
173. The recent successful bid by ITV and Setanta for the FA Cup rights potentially provides evidence against suggestions that competitors such as Setanta will be put off by BSkyB's connection to ITV. It may also demonstrate some ability on the part of sports rights sellers to maximise the profitability of the bidding process by encouraging complementary bidding between two previously unconnected buyers. However, the value of Setanta's 'joint bid' with ITV as evidence must be understood in the context of (i) the ongoing merger review in relation to BSkyB's stake in ITV, which currently limits both the likely impact and durability of the structural link and (ii) the active efforts of the FA to encourage cooperation between ITV and Setanta. Given this background, it is uncertain whether such a situation would be repeated in future.
174. Moreover, given the evidence that joint bidding in relation to a small number of key rights, and in particular rights to the FA premiere league, may be central to any future attempt by ITV to challenge BSkyB's dominance in premium pay TV, the OFT takes the view that it would need to reach a high level of confidence that there was no reasonable basis for concerns in this area before concluding that a reference was not appropriate.⁷⁰
175. In light of the above, the OFT has not been able to completely dismiss concerns regarding the transaction's deterrent effect on joint bidding between ITV and third parties. As a result, and in light both of the potential strategic importance of this issue and the assessment standard being applied in this case, the OFT has concluded that there may be a substantial lessening of competition. It should

⁷⁰ The OFT notes the recent success of Setanta in obtaining FA Premier League rights. However, the OFT takes the view that it is too early to conclude that Setanta's success in this regard will result in a successful and durable challenge to BSkyB's position in premium pay TV or indeed that firms in Setanta's position are likely to mount such a challenge. In the circumstances, the OFT remains of the view that it is more than fanciful that the loss of ITV's independence will result in the loss of a strong source of potential competition and possibly the most likely potential entrant.

be noted that concerns in this regard would be materially enhanced given the presence of a BSkyB related board member.

Coordinated effects

176. A number of third parties expressed concerns that, by virtue of BSkyB and ITV's close relationship post-acquisition, the two may seek to coordinate their bidding behaviour tending towards a monopsony outcome that drives down future payments to rights-holders of premium sports content rights. This could take the form of declining to bid head-to-head or to bid passively and may result in competitive harm by deterring or reducing the rights-holders' ability and incentive to invest and innovate, to the ultimate detriment of consumers.

Ability to reach terms of coordination

177. It should be noted that the lumpy and infrequent nature of many sports rights sales would affect the ability of the parties to achieve and sustain coordination. This is compounded by the long-term nature of the contracts awarded, which makes bidding for some sports rights more akin to a one shot game than a repeated game. The differentiated nature of the rights, specifically the differing values of rights to different events, also makes coordination harder.

Incentives to maintain coordination

178. To the extent that the parties would benefit from acquiring sports rights at lower prices, both would have an incentive to coordinate their bidding prior to the acquisition. As with non-coordinated effects, both BSkyB's and ITV's incentives to coordinate are likely to be somewhat increased by the acquisition. In terms of the parties' ability to coordinate post merger, the position of BSkyB as ITV's largest shareholder may lead to increased contact between the parties, which would provide a platform for coordination that did not exist pre-acquisition. This may allow the parties a forum in which to agree terms of coordination, including market sharing and/or bid rigging.

Sustainability of coordination

179. In the event that the parties were able to coordinate their bidding for sports rights, it is clear that even with knowledge of the other party's intentions, offering a lower bid would be a risky strategy in cases where there were other bidders present. Since the parties could not know the true valuations of other bidders, they would run the risk of losing rights which they could have paid more for and still made a profit. Therefore, the only circumstances where the parties could win rights at lower prices than pre-acquisition would be where the parties were aware that they were either the only two bidders – or they were the

bidders with the two highest valuations with a clear gap between themselves and the third bidder.

180. Sports rights sellers already have an incentive to ensure that the number of bidders and the value of their bids are kept confidential. In particular, upon requesting bidding information from the parties and other competitors, several responded that they were unaware of who else had bid and what the value of the winning bid was. In these circumstances, it would appear particularly difficult for the parties to discern exactly which sport rights auctions would be amenable to coordination, as they would have a limited knowledge of who else was bidding and how much they were willing to pay.
181. Furthermore, given this lumpy nature of bids and the importance of sports rights to both of the parties in attracting viewers (in particularly the 'hard to reach' 16-34 male demographic), the incentive for the parties to cheat would appear to be strong.

Barriers to Entry

182. The evidence suggests that entry will only occur at the procurement level if the entrant can be assured of an ability to monetise that content downstream – ie retail pay or free to air TV. All major TV operators already participate in this market. As a result, effective entry in relation to the acquisition of sports rights will likely need to be linked to new entry in free to air or pay TV. The links with participation in the downstream market are particularly important in this case, given the OFT's concerns that access to premium sports rights may be key to entry in premium pay TV. Downstream, barriers to entry in all TV and premium pay TV are high (see above discussion).
183. The importance of the link to downstream entry is relevant in the context of the recent success of Setanta in obtaining FA Premier League rights. The OFT takes the view that it is too early to conclude that Setanta's success in this regard will result in a successful and durable challenge to BSkyB's position in premium pay TV or indeed that undertakings in Setanta's position are likely to mount such a challenge.

Seller Power

184. In the context of sports rights, concerns relate to the buying activity of the parties and third parties. Thus, the relevant countervailing issue is potential seller power (rather than, as would usually be the case, buyer power).
185. As set out above, sports rights sellers appear to be sophisticated in their approach to selling rights and can take steps to maximise the level of

competition for rights. However, there may be little that rights sellers can do in the event that the structural link between ITV and BSkyB deters third parties from bidding jointly with ITV. As a result, seller power does not alleviate the OFT's concerns.

Conclusion

186. The incentive for either or both of the parties to unilaterally decrease the price paid for sports rights would appear to be limited. This would also appear to be a risky strategy given that they could potentially lose the rights to a third party.
187. With respect to concerns about joint bidding between the parties, the transaction is very unlikely to have a significant impact on the existing and overriding incentives of the parties to pair up with the partner most likely to lead to a successful bid. In addition, sports rights sellers appear to be sophisticated in their approach to selling rights and can take steps to maximise the level of competition for rights.
188. It would also appear that, although the parties may have an increased ability and incentive to coordinate post-acquisition, there are a limited set of instances in which coordination would be successful, and it is not immediately apparent that the parties would be able to identify those auctions susceptible to coordination. Furthermore, given the lumpy and infrequent nature of sports rights auction, the parties may also have a strong incentive to cheat on any coordination strategy. That said, barriers to coordination could be significantly decreased if BSkyB were to obtain board membership.
189. However, the OFT has not been able to completely dismiss concerns that third parties may be deterred from partnering with ITV to bid jointly for sports rights in competition with BSkyB due to the risk that BSkyB might obtain sensitive information relating to the bid (or other activities of the third party) as a result of the structural link with ITV. This is an area of particular sensitivity given the evidence that joint bidding in relation to a small number of key rights, and in particular rights to the FA Premier League, may be central to any future attempt by ITV to challenge BSkyB's long term market power in premium pay TV. The concern is therefore linked to other concerns set out above in relation to the impact of the transaction on strategic competition between BSkyB and ITV.
190. In the circumstances, the OFT takes the view that it would need to reach a high level of confidence that there was no reasonable basis for concerns in this area before concluding that a reference was not appropriate. The OFT is not satisfied that this is the case. Indeed, the concerns here would clearly appear to be

greater than fanciful, whether or not BSkyB holds a board seat (although board representation would materially increase the level of risk).

191. On this basis, the OFT considers that the transaction may give rise to a substantial lessening of competition in relation to the acquisition of sports rights.

POTENTIAL ADVERSE EFFECTS IN TV ADVERTISING

Summary

192. The OFT considers that the acquisition gives rise to competition concerns in the provision of TV advertising for the reasons below.
193. The parties are major competitors in the supply of TV advertising space and the acquisition provides them with the ability, and may increase their incentive, to share sensitive information and coordinate their behaviour to reduce discounting and/or innovation in this sector.
194. Explicit coordination of information, for example detailed contract information, would give the parties the ability to detect deviation and, given the strong incentive to coordinate, limited punishment mechanisms could be expected to be sufficient to maintain coordination.
195. External constraints such as entry, expansion and buyer power do not appear sufficiently strong to prevent coordination between the parties being sustained.
196. These concerns would be materially heightened in the event that BSkyB was to gain a seat on the ITV Board.

Market definition

197. Both of the parties are active in the sale of TV advertising airtime. The advertising sector was considered by the CC in *Carlton/Granada*,⁷¹ in which it considered the relevant market to be that of the sale of TV advertising in the UK. The parties suggested that other forms of advertising, in particular internet-based advertising, provide an increasing constraint on TV advertising and therefore the scope of the market may have widened. However, they provided no evidence to support this assertion and third party comments disagreed, with some suggesting a narrower market definition.
198. Given the potential for suppliers of TV advertising to price discriminate in respect of "impacts" reaching certain demographics, it may be appropriate to consider

⁷¹ *Carlton Communications Plc/Granada Plc*, 2003 Cm 4781.

narrower candidate markets (because of the inability of customers to substitute sufficient volume to other TV advertising competitors to render a price increase unprofitable under the SSNIP test).⁷² However, given the concerns identified in this sector apply equally on either this narrow or wider definition, the market definition adopted does not materially impact on the competitive effects analysis. Therefore, consistent with the CC's approach in *Carlton/Granada*, the sale of TV advertising in the UK is considered the appropriate market in this instance.

Parties' position

199. As noted above, both BSkyB and ITV sell TV advertising on their suite of channels. BSkyB also sells advertising on behalf of 25-30 other channels. ITV is the largest supplier of TV advertising in the UK, with around 46 per cent share of revenue, and BSkyB is the third largest supplier, with around a 12-13 per cent share. Across the different demographics the parties' combined shares of TV advertising range from 38-58 per cent.^{iv}
200. Third parties have indicated that they consider ITV and BSkyB to be close competitors and that together the parties offer advertisers a "must have" advertiser proposition which customers cannot buy around: specifically, ITV for rapid, mass coverage to a wide audience, and BSkyB for certain demographics such as 16-34 males and ABC1 males.

Non-coordinated effects

201. Third parties raised concerns that the acquisition would enable BSkyB to offer lower discounts in the knowledge that it would recoup, either through dividend payments or an increase in ITV's share price, 17.9 per cent of the value of any of its lost sales that were captured by ITV.
202. Based on ITV's share of supply, if BSkyB were to increase its prices, 45-50 per cent of lost sales would be expected to be captured by ITV. However, BSkyB's 17.9 per cent stake in ITV dilutes its ability to recoup these lost sales, compared to that which would arise under a full merger, to less than 10 per cent. Furthermore, the benefit derived by ITV as a result of BSkyB's actions may not be fully reflected in ITV's share price and benefits flowing to BSkyB through ITV share dividends are by no means certain. As a result, the incremental incentive on BSkyB to increase prices unilaterally is limited, especially as it is not considered that the benefit to BSkyB flowing from its share in ITV would be sufficiently large as to offset its overall loss of revenues as a result of customers

⁷² See the OFT decision in *ITV/GMTV*, dated 17 September 2004. SSNIP is short for small but significant non-transitory increase in price.

shifting their spend elsewhere. It may also be the case that BSkyB would be further deterred by the fact that the shareholding is in one of its major competitors, therefore the value of any BSkyB sales lost to ITV following a price rise may be reinvested by ITV to strengthen its competitive offering.⁷³

203. Looking at specific demographics, several third parties raised strong concerns in relation to 16-34 men and ABC1 men, which are considered particularly valuable demographics for media buyers and advertisers. Whilst BSkyB has a notably higher share of audience for these demographics (18.7 per cent and 18.2 per cent compared to 12.4 per cent across all individuals), ITV's audience shares are lower, suggesting BSkyB's ability to recoup the value of lost sales following a price rise, and therefore its incentives to unilaterally raise prices for advertising to these demographics, would be lower than for across all TV advertising.
204. On this basis, the OFT does not consider BSkyB's 17.9 per cent share⁷⁴ in ITV would give the parties sufficient incentive to unilaterally raise the price of their advertising.

Coordinated effects

205. Third parties raised concerns that, post-acquisition, the parties may seek to share strategic information between them to the detriment of competition in TV advertising. Specifically, concerns were raised that the acquisition provides the parties with the ability and incentive to coordinate their behaviour to raise the price of TV advertising – relative to absent the acquisition, for example, by reducing future discounting – and/or to reduce innovation as it relates to the advertising sector.
206. The theory of harm in this case is not based on industry-wide explicit or tacit coordination. The concern relates to the risk of coordination between the two parties to the extent that they may seek to align their behaviour in such a way as to replicate the effects of a full merger between them. In order to assess the likelihood of coordination between the parties we considered their ability to

⁷³ This argument relies on the asymmetry between ITV and BSkyB in terms of their reliance on advertising income: advertising is ITV's primary revenue stream but is only a secondary source of income for BSkyB (which relies primarily on subscriber revenues); as a result ITV is likely to benefit disproportionately from any increase in advertising rates in terms of its strength as a competitive constraint on BSkyB.

⁷⁴ It is worth noting that BSkyB is prohibited from increasing its stake in ITV to 20 per cent or higher.

reach terms of coordination, the incentives to maintain coordination and the sustainability of coordination.⁷⁵

Ability to reach terms of coordination

207. As ITV's largest shareholder, and only material trade shareholder, BSkyB is in a relatively privileged position to attend or request meetings with senior management and/or board members of ITV. Strategic contacts of this type between shareholders and management are not uncommon, and raise no concerns when the shareholder is not a rival. However, where an important competitor becomes a major shareholder, such contact provides a ready rationale for a meeting between competitors and a conduit for exchange of sensitive information relating to strategic innovations or pricing policy and/or terms and conditions in relation to specific customers. One route for achieving this would be the exchange of customer contracts. However, the OFT was not able to completely exclude the possibility that disclosure of somewhat less detailed and/or different information would be sufficient. This is an issue that the CC will be better placed than the OFT to examine in depth.
208. The CRR provides some transparency in the market in terms of calculating the average 'cost per thousand' (CPT) impacts for each demographic on ITV1. However, the market is characterised by bilateral negotiations on price as well as other terms and conditions and often involves an element of price discrimination between customers. As such coordination may require the disclosure of reasonably detailed information, for example customer contracts. Nonetheless, as this may only be across a relatively small number of large media buyers, it does not necessarily preclude coordination terms being reached.
209. The parties asserted that the CRR would prevent the parties coordinating on price on the basis that ITV had no ability to negotiate with media buyers as it is fully constrained by the CRR and therefore there would be no benefit to ITV to sharing sensitive information. However, several third parties indicated that they have been able to negotiate better terms in their contracts since the 2003 CRR regulations were introduced. Whilst the degree of negotiation on discounting appeared to be limited in some cases to the commitment of spend over and above the amount committed under CRR or be related to terms and conditions other than the discount received, third parties expressed strong concerns that this ability to negotiate would be lost if the parties agreed to share sensitive information. On this basis, the OFT does not consider that the CRR regulations prevent the scope for competitive harm arising through coordination.

⁷⁵ These factors are of particular concern in the context of tacit collusion. However, they are also of relevance to issues of explicit collusion with respect to this case.

210. The OFT therefore believes that the shareholding creates a vehicle for transparency that may create (or increase) an ability to reach terms of coordination in relation to TV advertising between the parties.

Incentives to maintain coordination

211. The OFT considers that pre-acquisition the parties would have an incentive to coordinate their behaviour. Competition within TV advertising does not result in a “winner-takes-all” outcome, as the advertising sales houses compete for only a portion of media buyers spend. Media buyers also have a strong incentive to purchase airtime across a wide portfolio of sales houses and channels in order to maximise impacts and as such demand is fairly inelastic. In addition capacity is constrained as the supply of airtime is relatively fixed. Together these factors suggest that there would be no large volume gains from aggressive pricing and therefore the parties already have a clear incentive to coordinate.

212. The OFT’s Guidance notes that “it may be sufficient for coordinated behaviour that participating firms have a strong incentive not to deviate from the coordinated behaviour, rather than that there is a particular punishment mechanism”.⁷⁶ In this case, as BSkyB and ITV may already have the incentive to coordinate their behaviour, coordination may be expected to be easier to maintain.

213. The structural link may enhance, and certainly will not diminish, incentives to maintain terms of coordination as both parties would benefit from higher advertising prices. In addition, third parties have submitted that the parties offer a “must-have” advertising proposition to media buyers which they cannot replicate by buying around the parties. As such neither can sufficiently rapidly win enough of the other's volume to make a policy of undercutting each other significantly more profitable than cooperation.

214. Without full disclosure of contracts, the parties may be unable to detect cheating due to the natural variability of year-on-year spending by each media buyer with each advertising sales house and due to lack of information on the pricing and strategies of other advertising sales houses. However, full disclosure of contracts would overcome the detection problems increasing the likelihood that coordination could be maintained.

215. Furthermore, BSkyB may be able to punish ITV if it were to deviate from a coordination strategy by use of its “corporate leverage” (for example, by deploying or merely threatening credible veto power in all strategic matters for

⁷⁶ Guidance, para 4.15.

which ITV management would require a special resolution, including merger and acquisition activity involving ITV). ITV's only punishment threat is to return to the pre-agreement competitive outcome. Whilst the punishment mechanisms may be asymmetric as both parties would be expected to benefit from coordinating to reduce discounts this would not necessarily prevent coordination being maintained by the parties.

Sustainability of coordination

216. Whilst the TV broadcasting market is growing and developing, BSkyB's share of adult commercial impacts has remained constant for the last five years. ITV's share of adult commercial impacts has been steadily declining over the period, but this was widely anticipated by the industry, suggesting that there is a degree of stability/predictability within the industry at least in the short-term, which could facilitate coordination.
217. Other players, such as Channel 4, Five and IDS, are relatively capacity constrained and as such would not be able to absorb a significant amount of additional share of spend if customers tried to switch away from BSkyB and ITV. Furthermore, each customer that is able to switch away from the parties, for example to Channel 4, may displace a current Channel 4 advertiser with a lower advertising valuation. As a result the average price paid per impact across Channel 4 may also rise.
218. The OFT, therefore considers that disruption by third parties is insufficient to remove concerns that the parties may seek to coordinate their behaviour in relation to TV advertising.

Countervailing constraints – expansion, entry, buyer power

219. The evidence available to the OFT does not suggest that entry, expansion or buyer power, alone or in tandem, would be sufficient to disrupt coordination between BSkyB and ITV in TV advertising.
220. BSkyB contended that barriers to entry and expansion were low. However, third parties universally disagreed. Whilst small scale entry into niche channels may be feasible, new entry or expansion into the broader provision of viewing services appears to be much more difficult. The costs of establishing a channel, acquiring content and establishing an advertising sales house are significant and it would take a number of years to recoup such costs.
221. A number of third parties have submitted that Channel 4 is the only existing alternative for reaching mass TV audiences. However, given the relatively fixed supply of airtime, Channel 4 is unlikely to be able to expand or otherwise absorb

sufficient customer volumes from BSkyB and ITV to disrupt and defeat a coordinated price rise.

222. BSkyB submitted that the media buyers had a high degree of buyer power. However, it is not clear how strong buyers are, given the “must have” position offered by the parties. No buyer regarded themselves as wielding sufficient buyer power to resist any coordination that could flow from the acquisition.
223. On this basis, constraints external to the parties do not appear timely, likely and sufficient in scale to destabilise coordination or otherwise offset any loss of competition between the parties.

Conclusion

224. The OFT therefore believes that the acquisition may provide the parties with the ability and incentive to share sensitive information and coordinate their behaviour in order to reduce future discounting and/or to reduce innovation within the advertising sector. Full disclosure of contracts with media buyers would give the parties the ability to detect deviation and, given that the parties have an incentive to coordinate, the punishment mechanisms could be expected to be sufficient to maintain coordination. Furthermore, the OFT was not able to completely exclude the possibility that disclosure of somewhat less detailed and/or different information would be sufficient. External constraints such as entry, expansion and buyer power do not appear sufficiently strong to prevent coordination between the parties being sustained.
225. The above concerns may arise purely by virtue of BSkyB's status as the only major industry shareholder in ITV. In the event that BSkyB was to gain a seat on the ITV board, these concerns would be materially heightened as the board would represent an additional regular and more detailed forum for exchange of sensitive information.

VI OTHER HORIZONTAL THEORIES CONSIDERED BY THE OFT

226. In relation to the media content supply chain, third parties have raised concerns regarding news and other content, in addition to sports right issues addressed above.
227. On the basis of the evidence before it the OFT considers these theories of harm to be speculative. As no competition concerns arise, this report does not explicitly set out the relevant market definitions.

NEWS CONTENT

228. Third parties raised concerns that the acquisition would result in a reduction in competition for the supply of news content resulting in BSkyB as the sole commercial news content provider in the UK.
229. Specifically, one third party argued that the transaction would give rise to a substantial lessening of competition through BSkyB's ability to seek to ensure that when the ITV news contract comes up for renewal in 2008, the contract is awarded to BSkyB instead of ITN.
230. ITV has a 40 per cent share in ITN, which has a contract to 2008 to supply news to ITV and a contract to provide Channel 4's news to 2010. BSkyB produces Sky News and currently has a contract to provide the Five news service (which it won from ITN in 2004). According to third parties, the BBC is the only other primary producer of news content in the UK and BBC news content is exclusively produced for BBC channels.
231. The OFT considers these concerns speculative for two principal reasons. First, there would appear to be limited incentive for ITV actively to weaken ITN, in which it holds a 40 per cent shareholding, particularly when this may result in ITV facing higher costs in the future. Second, Ofcom has informed the OFT that under the Communication Act 2003 and the Channel 3 licensing regime, BSkyB is currently prohibited from becoming the news provider to ITV.⁷⁷ v

⁷⁷ Section 281 of the Communications Act 2003 states that a body cannot be the appointed news provider for Channel 3 (i.e. ITV) if the ownership restrictions in the Communications Act would be breached should that body hold a Channel 3 licence. Therefore, as the situation currently stands, BSkyB could not be appointed the news provider of Channel 3

232. The OFT has also considered the possibility that BSkyB and ITV might seek to align their behaviour in relation to the sale of news content to third parties, for example, by agreeing to share the market. However, the characteristics of the market make coordination difficult to sustain.
233. In this case there are only two television news contracts that the parties appear to be competing over, Channel 4 and Five, which are asymmetric in value (the Channel 4 News contract is almost [] times larger than the Five News contract - £100 million compared to approximately £[] million) which creates incentives for the supplier in the Channel Five contract (currently Sky News) to cheat and tender for the Channel 4 contract as well. Given the lumpiness of these contracts and the relative values involved, it is unclear that the link between the parties would outweigh this strong incentive to win both contracts as they become available.
234. It is worth noting that non-explicit side payments⁷⁸ could help sustain coordination. However, given that these contracts last several years, they are to a substantial degree a “one-shot” rather than repeated game, which raises further commitment issues in relation to when such payments would be made. In addition, the high fixed costs of news production, means winning further contracts would be likely to raise the profitability of ITN/Sky News, which would make deviating from the coordination strategy even more valuable.
235. Therefore, based on the evidence available, in particular the size of the benefit derived from deviation of any coordination, the OFT does not consider that competition concerns arise in relation to the supply and production of news content.

OTHER CONTENT

236. Third parties raised parallel concerns to procurement of sports rights in relation to the acquisition of other types of non-news content, notably movies and premium U.S. TV series. Most of the arguments detailed above in sports rights – other than, critically, the transaction’s impact on joint bidding between ITV and third parties, which is not relevant here – also apply to these other types of content. However, there are a number of factors which would suggest that

as it could not hold a Channel 3 licence under the Communications Act 2003. It may be possible, under certain circumstances, for BSkyB to hold the Channel 3 news contract if did so as part of a consortium.

⁷⁸ For example, adjustments to the carriage rates BSkyB charges ITV.

there is an even smaller risk of harm to competition in the acquisition of rights to other content than in the acquisition of sport rights.

237. There is evidence that for **film** content at least, the parties do not tend to compete for the same rights. For instance, evidence suggests that BSkyB normally bids for the pay TV window of rights while ITV normally bids for the free to air window of rights. Further, in relation to film content, the CC determined in *Vivendi/BSkyB* that free to air channels are only limited actual or potential competitors to BSkyB, in that they show fewer feature films and the films they do show are less recent than those shown on pay TV.
238. In the case of **first-run films** and **premium U.S. TV series**, such as *Lost*, *24*, and *Desperate Housewives*, there are a number of other strong alternative bidders such as Channel 4, Five, BBC and Virgin Media already present who are capable of destabilising any efforts to decrease the prices paid for rights. Moreover, the relevant U.S. rights-holders exploit these rights largely domestically and throughout the world; the value of the UK rights are a small proportion of total rights value. As such any harm to upstream investment and quality caused by coordinated bidding following the acquisition would appear to be insubstantial, not least in relation to effects in the UK itself. This is in clear contrast with the case of certain sports rights, such as FAPL rights, where the rights have the highest valuation in the UK and where any effects on upstream investment and innovation effects are also likely to be felt downstream.
239. Overall, the above considerations, particularly the lower level of head to head competition between ITV and BSkyB in the case of movies, and the presence of greater numbers of strong alternative bidders in the case of premium U.S. TV series, leads the OFT to conclude that the transaction does not raise material competition concerns specific to these areas.

VII VERTICAL THEORIES CONSIDERED BY THE OFT

240. Both parties are vertically integrated and concerns have been raised by third parties that this may provide the parties with the incentive and ability to foreclose rivals from accessing their distribution platforms and/or content.

FORECLOSURE OF ACCESS TO PLATFORMS

241. ITV controls 48.5 per cent of DTT Multiplex 2, and through its ownership of SDN all of Multiplex A. Third parties raised concerns that BSkyB's shareholding in ITV will provide it with an increased incentive to foreclose access to BSkyB's rivals to these DTT multiplexes.
242. However, any incentive to foreclose access to these platforms would need to be weighed against ITV's strategy to improve the overall offering of the Freeview and the DTT platform. As a free to air broadcaster, ITV future is inevitably entwined with the success of the DTT platform, especially given the forthcoming digital switchover. This, coupled with the fact that ITV1 viewing figures on Freeview are 21.7 per cent compared to 16.5 per cent on BSkyB,⁷⁹ provides ITV with a strong incentive to promote and strengthen Freeview, and thus the DTT platform.
243. ITV's ability to foreclose the DTT platform is also limited as it only control access to less than one and a half of the six multiplexes. Therefore, prospective users may be able to get access to the DTT platform through the other multiplexes, undermining ITV's incentives to pursue a foreclosure strategy. Further the licenses for Multiplexes A and 2 contain a condition which prohibits conduct prejudicial to fair and effective competition and Multiplex A also contains a condition that the capacity is leased on Fair Reasonable and Non-Discriminatory (FRND) terms. Therefore ITV's ability to discriminate between retail service providers is restricted.
244. Post acquisition, BSkyB's incentives to foreclose access to ITV's rivals on the DSAT platform are unlikely to change substantially as BSkyB's ability to recoup any benefits that might flow to ITV, would be expected to be relatively low. Furthermore, BSkyB's provision of platform services are regulated by Ofcom,

⁷⁹ Ofcom, *The Communications Market 2006*.

such that BSkyB is required to offer technical platform services to retail service providers on FRND terms.

245. Therefore the OFT does not consider the acquisition materially changes either party's incentives or ability to foreclose access to their distribution platforms.

FORECLOSURE OF CONTENT

Existing platforms

246. Third parties raised concerns that BSkyB, through its shareholding, may be able to influence ITV's incentive to supply its content to third parties and in particular other multi-channel broadcasters.
247. ITV's incentives to foreclose its content may be limited by its free to air, advertising revenue based business model, which provides ITV with a strong incentive to ensure that its content is viewed by as wide an audience as possible.
248. ITV's ability to foreclose the ITV1 channel to other platform providers is also restricted by the 'must-offer' provisions contained in sections 272 to 276 of the Communications Act 2003 which oblige public sector broadcasters to offer their services on all the main platforms before and after digital switchover.
249. With respect to the ITV digital channels, the OFT does not consider that, even if BSkyB were to persuade ITV to foreclose these channels to other retail service providers, this would result in a substantial lessening of competition (by weakening the Freeview offering) as the ITV digital channels have a low combined audience share (4.4 per cent⁸⁰) and do not appear to comprise sufficiently unique content to confer significant market power.
250. The OFT therefore does not consider that there the parties could successfully foreclose access to ITV's content to existing platforms post-acquisition, such that it would give rise to competition concerns.

New distribution channels

251. It has also been put to the OFT that ITV may improve its competitive offering by launching services on new media platforms, such as IPTV, Mobile TV etc. Third parties, including ITV, raised concerns that BSkyB may use its blocking stake to prevent ITV from pursuing options it may otherwise have wished to explore [].

⁸⁰ BARB Figures, February 2007

252. []. Particularly where BSkyB has similar intentions to provide a service across a new platform, it would have a strong incentive to reduce potential competition, by preventing or delaying a strategic alliance or joint venture between ITV and another third party who combined would create a relatively stronger constraint on BSkyB.
253. However, to the extent the transaction circumscribes ITV's freedom to pursue projects – including partnerships with third parties – in new distribution platforms, it is not clear that such any such effects raise a realistic prospect of a substantial lessening of competition. In particular, it is not clear that ITV1 content, despite its value in the traditional broadcasting and advertising sector, is critical content to the success of new distribution platforms.

VIII SUMMARY OF VIEWS OF INTERESTED PARTIES

BSKYB

254. BSKyB does not consider that the acquisition of its 17.9 per cent shareholding in ITV has conferred upon it the ability materially to influence the policy of ITV to the requisite level of belief. Further it contends that, in any event, it does not consider the impact of any material influence acquired (which it refutes) would be sufficient to alter ITV's behaviour in any way which could result in competition concerns arising.

ITV

255. ITV stated that it believed the acquisition of a 17.9 per cent share did confer on BSKyB the ability materially to influence its competitive strategy and therefore policy to the requisite level of belief. In relation to the OFT's substantive assessment, ITV considered that the CRR acts as a sufficient constraint on its behaviour such that coordinating on television advertising contracts would not be beneficial to it, or detrimental to consumers.

256. [].

257. ITV stated that its main concern was that BSKyB's acquisition of material influence over ITV's policy may []. Notably, that these options could involve a combination with a third party, but in particular could involve [].

OFCOM

258. Ofcom provided the OFT with a detailed factual background on the UK television industry. Ofcom raised five main areas which it considered warranted further investigation. ^{vi}

259. Firstly, that there may be a concern in wholesale markets if the two parties are able to pursue a joint strategy. However, Ofcom considered this was more likely in relation to premium channels and therefore that it was not clear that this concern would be exacerbated by the acquisition. Secondly, that as a result of

the acquisition there may be increased incentives for the parties to coordinate their strategic behaviour in relation to key rights, such as sports content.

260. Thirdly, that post acquisition the parties may have the incentive to foreclose competition from third party retail service providers, however, Ofcom considered that it was likely that sufficient regulatory frameworks were in place to safeguard against a joint strategy to discriminate between third parties. Fourthly, that the parties may be able to restrict retail television service competition by influencing the marketing strategy of the Freeview consortium, but it did not consider it was clear that the parties, even if the acquisition allowed them to pursue a joint strategy, would have sufficient influence over Freeview strategy. And finally, the parties may have the incentive to engage in joint and/or conditional selling in relation to TV advertising to the detriment of customers.

THIRD PARTIES

261. In addition to receiving unsolicited complaints about the acquisition prior to commencing its investigation, the OFT also received number of responses to the ITC and its own inquiries of third parties.
262. The majority of third parties expressed concerns that the acquisition would give rise to competition concerns and in particular enable BSkyB, and in some cases ITV, to raise price or reduce input costs to the detriment of consumers. A number of third parties also expressed significant concerns regarding BSkyB's increased influence over the viability of Freeview and the DTT platform going forward; its potential to limit ITV's ability to explore opportunities for exploiting its content using new technologies; and ITV's participation in joint ventures with other broadcasters.
263. The competition concerns raised by ITV, Ofcom and third parties, and referred to above, have been discussed in greater detail in sections V to VII.
264. One third party raised concerns regarding the provision of interactive TV betting services, and alleged that BSkyB would seek to foreclose other betting service providers partnering with ITV. However, ITV is not the only vehicle through which providers can enter the interactive TV betting sector, and the OFT considers that TV gambling is constrained by forms of betting and gaming such as on-line gambling.
265. Another third party raised concerns that BSkyB and ITV would seek to diminish competition between them for audience share, by targeting different demographics and/or seeking to co-ordinate their programming and scheduling.

However, there was limited evidence to support this theory of harm, with both ITV and BSkyB indicating that once schedules are announced, competitors can adjust their own schedules and therefore coordination would not provide significant benefits. Furthermore, broadcasters have strong incentives to maintain the structure of their weekly schedule so major changes to the scheduling of key programmes only happen rarely and changes remain in place for long periods of time.

266. Several third parties also raised concerns about BSkyB's behaviour in the sector in general, for example, in relation to the negotiation of carriage rights and access to the DTH platform. However, these concerns are pre-existing and do not arise (or become enhanced) as a direct result of the acquisition. Therefore, such concerns are outside the scope of the OFT's investigation in this instance.

IX REMEDIES – UNDERTAKINGS IN LIEU

RELEVANT PRINCIPLES

267. Where competition concerns have been identified, section 44(4)(f) of the Act requires that the OFT’s report includes a “decision” on whether it believes that it is or may be the case that it would be appropriate to deal with the matter (disregarding any public interest considerations mentioned in the intervention notice concerned) by way of undertakings under paragraph 3 of Schedule 7 to the Act. Namely, whether the OFT considers that instead of making a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, the Secretary of State should accept from such of the parties concerned undertakings as he considers appropriate.
268. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT’s Mergers Substantive Assessment Guidance states that, “undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation” (paragraph 8.3).

UNDERTAKINGS OFFERED

269. In lieu of reference to the CC, BSKyB indicated that it would be prepared in principle to undertake [].
270. [].
271. [].

ASSESSMENT

272. The OFT is of the view that these proposed remedies are insufficient to address the competition concerns identified in relation to strategic rivalry between BSKyB and ITV.

273. In particular, the OFT does not, at this stage of inquiry, accept that [].
274. On the contrary, given that the OFT's strategic concerns relate to the risk of BSkyB's corporate leverage having an influence on ITV's competitive strategy, it is not clear that [].
275. This assessment is consistent with bright-line practice of peer enforcement agencies, where competition concerns arising from minority ownership have arisen [].⁸¹
276. Accordingly, the OFT does not believe that the proposed undertakings resolve the competition concerns raised in a clear-cut manner. The OFT therefore advises that reference to the CC should not be suspended pending negotiation of suitable undertakings in lieu under paragraph 3 of Schedule 7 to the Act.

⁸¹ See above notes at Chapter V for U.S. examples; see also the Irish Competition Authority Case M/03/033 – *Proposed acquisition by Scottish Radio Holdings plc of Capital Radio Productions Limited*, 23 February 2004, paragraph 55 citing divestiture as in line with international best practice.

X ASSESSMENT AND REPORT

ASSESSMENT

277. As required by sections 44(3) and (4) of the Act the OFT hereby advises and makes the following decisions.

278. The OFT believes that it is, or may be, the case that:

- a relevant merger situation has been created;
- the creation of that merger situation has resulted, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services, including the respective UK-wide markets for (1) all TV; (2) premium pay TV; (3) television advertising; and (4) acquisition of premium sports rights, such that further inquiry by the CC is warranted; and
- it is not appropriate to deal with the matter (disregarding any public interest considerations) by way of the undertakings in lieu of reference under paragraph 3 of Schedule 7 to the Act.

ADVICE

279. The OFT accordingly reports and advises the Secretary of State under section 44 of the Act that the test for reference is met on competition grounds.

John Fingleton
Chief Executive
27 April 2007

Ainslee Wilton	Principal Case Officer, Mergers
Laura Phaff	Economist, Mergers
Matthew Johnson	Economist, Mergers
Philip Brentford	Legal Adviser
Sean-Paul Brankin	Legal Director
Bob Gaddes	Deputy Director, Mergers
Simon Pritchard	Director, Mergers

ANNEX 1

INTERVENTION NOTICE GIVEN PURSUANT TO SECTION 42 ENTERPRISE ACT 2002

Whereas the Secretary of State has reasonable grounds for suspecting that it is or may be the case that a relevant merger situation, as defined in section 23 of the Enterprise Act 2002 ("the Act"), has been created in that:

- (a) enterprises carried on by or under the control of British Sky Broadcasting Group plc ceased to be distinct from enterprises carried on by or under control of ITV plc on 17th November 2006; and
- (b) the value of the turnover in the United Kingdom of the enterprise taken over exceeds £70 million;

Whereas the Secretary of State believes that it is or may be the case that the media public interest consideration specified in section 58(2C)(a) of the Act may be relevant to a consideration of the relevant merger situation concerned;

Now, therefore, the Secretary of State in exercise of his powers under section 42(2) of the Act, hereby gives this intervention notice to the Office of Fair Trading and requires it to investigate and report in accordance with section 44 of the Act within the period ending on 27 April 2007.

26 February 2007

David Saunders
[AN OFFICIAL OF THE DEPARTMENT OF TRADE AND INDUSTRY]

Erratum

- ⁱ This paragraph contained a factual error indicating that ITV1 had a 40 per cent share of 'TV viewers', however, this should have stated that they had a 40 per cent share of 'advertising revenues'.
- ⁱⁱ Footnote 9 contained an incorrect reference to *Carlton Communication Plc/Granada Group Plc/United News and Media Plc*, 2000 Cm 4781. This has been amended to reflect the correct reference: *Carlton Communications Plc/Granada Plc*, 2003 Cm 4781.
- ⁱⁱⁱ The share of viewers figure was incorrectly stated and has therefore been amended to reflect the latest BARB figures (Mar – Apr 2007).
- ^{iv} This paragraph contained an error in drafting. The shares of supply figures had been incorrectly stated and have therefore been amended. In addition, the words 'or impacts' has been removed from the forth line of the paragraph (following the word 'revenue').
- ^v The additionally wording 'and the channel 3 licensing regime' has been inserted to the text of the paragraph, and the sentence 'It may be possible, under certain circumstances, for BSkyB to hold the Channel 3 news contract if did so as part of a consortium' inserted into the footnote. This has been done to ensure that the paragraph is factually accurate.
- ^{vi} To ensure factual accuracy in reporting of Ofcom's representations, paragraphs 258-260 should be read in the context of the following statement:
Ofcom considered that the extent to which potential competition concerns may arise would depend on the extent to which the parties pursued a joint strategy or coordinated behaviour. Ofcom's analysis concluded that the main areas of potential concern are:

 - wholesale content and channel provision by BSkyB and ITV plc where the content is likely to be considered to be in narrow content markets; and
 - wholesale rights acquisition by BSkyB and ITV plc where the acquisition may result in coordinated behaviour in the purchase/bidding of content rights.