COMPETITION COMMISSION

BBC Worldwide Limited, Channel Four Television Corporation and ITV plc

A report on the anticipated joint venture between BBC Worldwide Limited, Channel Four Television Corporation and ITV plc relating to the video on demand sector

4 February 2009

Website: www.competition-commission.org.uk

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 Some numbers have been replaced by a range.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

Anticipated joint venture between BBC Worldwide Limited, Channel Four Television Corporation and ITV plc

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Summary

1. On 30 June 2008, the Office of Fair Trading (OFT) referred the anticipated joint venture (JV) between the British Broadcasting Corporation (BBC) through BBC Worldwide Limited (BBCW), Channel Four Television Corporation (C4C) and ITV plc (ITV) relating to the video on demand (VOD) sector to the Competition Commission (CC) for investigation and report. The reference was made under section 33(1) of the Enterprise Act 2002 (the Act). Following an extension of the original 24-week inquiry period under section 39(4) of the Act, we are required to publish our final report by 8 February 2009.

2. VOD covers a range of technologies which allow the consumer to select audiovisual content for immediate or subsequent viewing, rather than being restricted to the 'linear' TV schedule put together by the broadcasters. The VOD supply chain starts with programme production or the acquisition of rights to exploit content for VOD purposes. UK broadcasters have three main sources for their audiovisual content: in-house production; commissioning from third-party production companies; and the licensing of rights to exploit existing content. Rights owners may provide a VOD service directly to consumers or may wholesale content to retailers, who will deliver VOD to viewers. The viewer can access content over the Internet without subscription (typically referred to as open VOD) or in a variety of ways with a subscription or using dedicated hardware or connections (typically referred to as closed VOD). Closed VOD services can often be viewed on a TV set.

3. VOD services are new and are growing quickly, and business models vary. It is useful to distinguish, in particular, between free-to-air (FTA) advertising funded; subscription funded; and pay-per-view funded models. Content may be watched immediately ('streamed'); downloaded temporarily as a time-limited file (download to rent (DTR)); or downloaded permanently (download to own (DTO)).

4. The BBC is the longest-established national TV channel operator in the UK. It is a public corporation operating under its own charter, which was renewed on 1 January 2007. The BBC launched the BBC iPlayer on 25 December 2007 as part of its public service activities. This offers a catch-up service via the Internet for programmes for up to seven days after transmission (or longer for continuing series).

5. BBCW is a wholly-owned subsidiary of the BBC. Its day-to-day operations are conducted on an arm's length basis from the BBC. BBCW engages in a wide range of commercial activities in the audiovisual sector both in the UK and overseas, mainly involving the commercial exploitation of the BBC's content. It provides the UKTV suite of nine channels and is also involved in the sale of DVDs through 2 entertain. BBCW does not currently have a retail VOD presence in the UK market but licenses content to a variety of other VOD services.

6. C4C is a statutory corporation which was created by Act of Parliament in 1982. Its particular public service remit is to offer distinctive programming that the market might otherwise not provide. It is funded primarily from TV advertising revenues. C4C was the first of the parties to launch a VOD service. 4OD was launched in late 2006 on cable and broadband, offering a selection of C4C's programming on an on-demand basis via the 4OD application. 4OD has, over time, become predominantly free to viewers. Programmes can be streamed or downloaded on a DTR or DTO basis. Channel4.com offers primarily catch-up for C4C linear programming and material to complement linear programming. C4C licenses content to a variety of other VOD services.

7. ITV (and its predecessors) has been in operation for more than 50 years. It is the UK's largest commercial FTA broadcaster. ITV.com, ITV's website, allows consumers to access a wide range of ITV material, including 30-day catch-up and some archive material, on a streamed basis over the Internet. It is primarily funded by online advertising and was the first predominantly free streamed video service in the UK. Some ITV content is licensed to other VOD services.

8. On 27 November 2007, the parties signed a Short Form Agreement setting out the key terms of the transaction. They also formed a limited liability partnership (UKVOD LLP) under an interim agreement. On 29 September 2008, the parties submitted to us detailed documentation setting out the updated transaction.

9. Under the terms of the agreements, UKVOD will supply VOD content to any consumer with a personal computer (PC) and to third-party VOD retailers in the UK. Each party will hold an equal stake in the limited liability partnership, will be entitled to appoint two directors to the board, and will contribute certain VOD business activities. Subject to specified exemptions, UKVOD will be each party's principal route to market for their archive VOD content. They expect the vast majority of views to be of free, advertising-funded content.

10. Each party will make available a minimum number of hours of content to UKVOD for a minimum period including, for C4C and ITV, both archive and catch-up VOD rights. UKVOD will select content from ITV and C4C. Initial selection of BBC content for UKVOD will be made via BBCW.

11. Of the parties' existing consumer-facing VOD operations, ITV.com and Channel4.com will continue and will, in particular, provide catch-up content, focusing on content that complements their primary broadcasting business. C4C's 4OD service will cease. BBC iPlayer is a public service activity of the BBC operated separately from BBCW's commercial activities and does not form part of the BBC's contribution to the JV.

12. It is envisaged that UKVOD will be able to syndicate the whole, or substantially the whole UKVOD service (or sub-license substantial representative samples of it) to closed VOD services and, after a period of 12 months to allow for the establishment of the UKVOD website, to open VOD services. This ability will be largely exclusive to UKVOD for archive VOD content. ITV and C4C will retain the ability to wholesale rights to catch-up content separately from UKVOD.

13. The parties told us that the purpose of the JV was to create a customer proposition that could compete in the VOD market against powerful competitors who were able to leverage significant existing assets that the broadcasters did not possess. To achieve this, the parties intended to create a 'one-stop-shop' that would provide consumers with the convenience of being able to access both popular content and niche content on a single service, providing the consumer with 'a sophisticated and comprehensive user experience'. The parties said that they were also seeking to maintain control of their content, in order to avoid the 'disintermediation' faced by music companies due to the success of, for example, iTunes. They also told us that the JV would limit individual risk in an uncertain, nascent, VOD sector.

14. The parties said that, as catch-up content would still be available on ITV and C4C's own websites and on BBC iPlayer, the key element of UKVOD's proposition was to promote a wide range of UK archive content. However, archive content could not be offered in isolation. The parties told us that catch-up content was the driver for viewers consuming archive content.

15. We concluded that, in the absence of the transaction, each of BBCW, ITV and C4C would pursue its own commercial interests, either alone or in partnership with a third party, to exploit its archive VOD content rights. Such rights would be likely to form part of a retail VOD service, either in a direct-to-consumer offering or through wholesale distribution or both. We did not find it necessary to come to a conclusion as to which route to market was the most likely to be pursued by each party.

16. We concluded that two or more enterprises would cease to be distinct and that the share of supply test was met. We therefore concluded that a relevant merger situation would be created.

17. We concluded that the markets for the retail supply of VOD services and the wholesale licensing of content for VOD exploitation should be defined by reference to the supply of VOD content and should include long-form VOD content delivered by both open and closed services. We decided that catch-up and archive content should be treated as part of the same markets. The markets should exclude film VOD, short-form and user-generated content, illegal content, DVDs and the use of personal video recorders (PVRs), and the supply of linear broadcast TV. We also found that non-UK content was not a good substitute for UK content, particularly for certain genres of programmes and/or if it had not previously been broadcast on linear TV. We found that, taken together, the possible alternatives for consumers would not provide a significant constraint to a hypothetical monopolist of UK TV VOD content. We concluded that the geographic market should be no wider than the UK.

18. We looked at levels of competition in the retail supply of VOD services. We concluded that, absent the JV, the parties were, or would be in the future, each other's closest competitors for the supply of UK VOD content and that third-party VOD retailers offered a weaker competitive constraint. Third-party VOD retailers rely on content from one or more of the parties to offer any substantial volume of UK TV VOD content to their customers. We found that the parties had a substantial share of VOD content, particularly of hours of UK TV archive VOD content. Given our finding that non-UK VOD content was not, in general, a good substitute for the parties' VOD content, we did not find that VOD retailers offering non-UK content acted as an effective competitive constraint on the parties.

19. We also looked at levels of competition in the wholesale supply of VOD content rights. We examined the syndication deals between the parties as wholesalers and third-party VOD retailers as customers. We found that the most quoted source of bargaining strength was the degree of importance attached to the content under negotiation. In addition, the ability to switch, or threaten to switch, between suppliers was an important aspect of bargaining power regardless of the customers' strength in other markets. We found that, in general, the parties had greater bargaining strength than the VOD retailers to whom they supplied content.

20. Nevertheless, we were told by several third parties that it might be sufficient for them to have access to content from two of the three parties. We saw some evidence of a competitive process in which VOD retailers played one party off against another. Several existing and potential VOD retailers also told us of the importance of being able to offer both catch-up and archive content.

21. We looked at whether, in the absence of UK VOD content from the parties, third-party VOD retailers would have access to sufficient UK content to allow them to compete closely with the parties. We found that the ability to acquire VOD rights was often closely associated with holding or acquiring linear TV rights and that the linear broadcaster of that content was in an advantageous position when negotiating for VOD rights to it. According to our estimates, third-party producers were able to offer,

in total, only a small fraction of the volume of VOD content available from the parties. We thought it unlikely that third-party VOD retailers would be able to acquire sufficient UK content to offer an effective competitive constraint to the parties.

22. We therefore concluded that there were no sources of sufficient scale to provide credible alternatives to the parties' content, making it difficult for wholesale customers to switch, or threaten to switch, away from the parties as suppliers should they be unable to agree satisfactory terms. This indicated to us that, absent the JV, the parties would be in a strong position in the wholesale market.

23. We looked at entry and expansion in the VOD markets. We found that there were a wide range of existing and likely future VOD services being offered in the UK. However, it was clear to us that, in order to compete with UKVOD, any VOD retailer would need to have access to a wide range of both catch-up and archive UK content. We found it unlikely that a VOD retailer would be able to access sufficient UK VOD content to provide a VOD service which competed effectively with the parties.

24. We considered the impact of the JV on competition in the relevant VOD markets. We found that the JV was likely to result in a loss of rivalry in the supply of VOD content at the wholesale level. The parties were each other's closest competitors for the supply of UK VOD content, and other suppliers would not be in a position to offer content which would allow third-party VOD retailers to act as an effective competitive constraint to UKVOD.

25. We considered the extent to which UKVOD was likely to have the incentive to enter into syndication deals in the future. We thought it unlikely that UKVOD would have a strong incentive to enter into future syndication deals, particularly to open VOD services, which might undermine its own retail operation. If UKVOD were to enter into syndication deals, we thought it likely that these would be on terms that would make it difficult for a third-party VOD retailer to offer an effective competitive constraint to the UKVOD service.

26. We also considered whether ITV and C4C would have an incentive to syndicate catch-up content to third-party VOD retailers to which UKVOD would not choose to syndicate. We saw no reason why ITV and C4C would choose to enter into syndication deals that would be likely to undermine the success of UKVOD. We were particularly concerned that the interaction between the parties via the JV would facilitate tacit coordination and give ITV and C4C the ability to align their strategies to UKVOD's syndication strategy. We thought it more likely that, if they did enter into syndication deals with third parties, these would be on terms that would be less favourable than would otherwise have been the case.

27. We identified two ways in which a loss of rivalry at the wholesale level might affect viewers. First, third-party VOD retailers purchasing VOD content from the parties might pass on a price increase, or other adverse change in terms, to consumers. Second, the parties may find it in their interest to engage in strategies that would limit the ability of any rival service to undermine the JV, by, for example, attempting, partially or completely, to foreclose access to content or otherwise increasing the cost of this content to their rivals, or by limiting the manner in which the content could be exploited. We did not form an expectation that the parties would choose to engage in this type of strategy for all customers but thought it possible that, at some point in the future and at least for some customers, they would choose to do so.

28. We concluded that the JV was also likely to result in a loss of rivalry at the retail level. The parties were, or would be in the future, each other's closest competitors for the supply of UK VOD content and third-party VOD retailers would not act as an effective

competitive constraint. This loss of rivalry between them would enable the parties to offer less attractive terms to customers, resulting in viewers paying higher prices for some content, paying for a higher proportion of content, and/or receiving lower quality or less innovative offers. The loss of rivalry and the concentration of content in one entity could also reduce the opportunities for future initiatives or developments by third parties of alternatives to the JV.

29. We concluded that the JV would be likely to lead to a loss of rivalry between the parties, amounting to a substantial lessening of competition (SLC) in the supply of UK TV VOD content at the wholesale and retail levels. We also concluded that the JV would be unlikely to result in an SLC in the online UK advertising market or in the market for content acquisition in the UK.

30. We considered various remedy options, including:

    (a) prohibition;

    (b) access remedies;

    (c) material modifications to the terms of the JV; and

    (d) other types of remedy: restrictions on cross-promotion; restrictions on participation in the JV; and modifying the Terms of Trade.

31. We considered, in particular, a remedy package that combined limiting the JV's ability to wholesale both catch-up and archive content with the preservation of separate retail selling points under a 'farmers' market'. The parties said that structures and rules around the operation of UKVOD could be put in place in order to address possible concerns about the risks of information sharing. We concluded that given, in particular, the parties' incentives and ability to withhold content or otherwise make syndication of content at the wholesale level unattractive to third-party VOD retailers, none of these remedy options, with the exception of prohibition, was likely to be comprehensive or effective in addressing the SLC and adverse effects that we had found.

32. We concluded that prohibition of the JV as currently envisaged, or of any other transaction which would lead to a merger of VOD activities carried on by the parties, was the only effective remedy to the SLC and adverse effects that we had found.

33. We considered whether prohibition might extinguish any relevant customer benefits. However, we thought it unlikely that this JV was the only way in which customer benefits could be realized. We therefore concluded that we did not need to modify the remedy that we would otherwise put in place. We concluded that prohibition would be a proportionate remedy to the SLC and adverse effects that we had found.

34. We concluded that prohibition of the JV was the only remedy that would address the SLC and adverse effects that we had found.

Findings

1. The reference

1.1 On 30 June 2008, the OFT referred the anticipated JV between the BBC through BBCW, C4C and ITV relating to the VOD sector to the CC for investigation and report. The reference was made under section 33(1) of the Act. Our terms of reference are set out in Appendix A. Following an extension of the original 24-week inquiry period under section 39(4) of the Act, we are required to publish our final report by 8 February 2009.

1.2 In this document we refer to the JV, which is popularly known as Project Kangaroo, as UKVOD (the name of the limited liability partnership in which the JV is incorporated). This document, together with its appendices, constitutes our final report which we are required to publish under section 38(1) of the Act. Further information, including non-sensitive versions of written submissions, summaries of third-party arguments and views and our provisional findings published on 5 December 2008, can be found on our website.[1] We refer to these documents as appropriate.

2. Industry overview and the companies

2.1 In this section we outline the major features of the industry; the relevant regulatory regime; licensing of intellectual property rights; and the companies that are the subject of this inquiry. This provides the context for our assessment of the competitive effects associated with the JV.

Industry overview

2.2 VOD covers a range of technologies which allow the consumer to select audiovisual content for immediate or subsequent viewing. The consumer of VOD is not, therefore, restricted to the 'linear' TV schedule put together by the broadcasters, but instead has control over what content to watch and when to watch it.

2.3 The VOD supply chain starts with programme production or the acquisition of rights to exploit content for VOD purposes. Rights owners may provide a VOD service directly to consumers or may wholesale content to retailers, who will deliver VOD to viewers. The viewer can access content over the Internet without subscription (typically referred to as open VOD) or access the content over a cable or the Internet with a subscription, via dedicated hardware (such as a TV set-top box) or via a dedicated connection (typically referred to as closed VOD).

2.4 A wide variety of content can be viewed on demand. This includes, in particular, mainstream TV content, as well as other types of content such as films, music and live events and adult programmes. UK broadcasters have three main sources for their audiovisual content:

(a) *In-house production.* BBC and ITV have in-house production companies accounting for more than half of the content shown on their linear channels.

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[1] www.competition-commission.org.uk.

(b) *Commissioning from third-party production companies.* BBC, ITV and C4C are obliged to commission at least 25 per cent of relevant content from independent UK producers.[2]

(c) *Licensing rights to exploit existing content.* Sources of such content may be overseas producers, other UK producers, owners of sports rights or content distributors.

On average, more than 80 per cent of content that is broadcast during peak time on linear terrestrial TV has been produced and commissioned in the UK.

2.5 VOD business models vary. It is useful to distinguish, in particular, between FTA advertising funded (eg Joost); subscription funded (eg Sky and Virgin Media); and pay-per-view funded (eg iTunes) models (see paragraphs 4.45 to 4.58). VOD services may also be described as either 'push' or 'pull'. Under a push model, material is selected by the service provider and sent, often overnight, to the subscriber's storage device (for example, a PVR), for subsequent viewing as required. Pull VOD, on the other hand, involves the user selecting content from the service provider's library. Content may be watched immediately ('streamed'); downloaded temporarily as a time-limited file (DTR); or downloaded permanently (DTO).

2.6 Content may be categorized in various different ways:

(a) *Short form vs long form.* Short-form video includes clips from longer videos or short video clips uploaded by users (user-generated content). Long-form content refers to full-length material, generally made originally for TV (TV content) or cinema (film).

(b) *Catch-up vs archive.* Catch-up content is made available soon after it is first broadcast on linear TV (generally within hours and for up to 30 days). Archive content is content that is no longer available within the catch-up window.

(c) Other key categorizations include origin of content (in particular, content of UK origin vs content of non-UK, primarily US origin); and genre (including drama, entertainment, comedy, sport, news and so on).

These categorizations are considered in more detail in our discussion of market definition (see paragraphs 4.5 to 4.43).

2.7 VOD services are new and developing quickly. It is not clear which business model will prove to be the most successful in the UK, although the parties' strategy papers and third-party evidence have suggested that the advertising funded model is proving particularly popular for open VOD services whereas the subscription model is dominating for closed VOD services. We note that the distinctions in business model reflect commercial choices by the VOD retailers.

Regulatory regime

2.8 The Communications Act 2003 (CA 2003) established the Office of Communications (Ofcom) as the independent regulator and competition authority for the UK communications industry. Ofcom's principal duty in carrying out its functions is to further the interests of citizens in relation to communications matters and to further the interests of consumers where appropriate by promoting competition. Public Service

[2]As defined in The Broadcasting (Independent Productions) Order 1991 (as amended).

Broadcasters (PSBs) are subject to a variety of obligations, including, in relation to the acquisition of content, quotas on original UK productions;[3] the percentage of content commissioned from independent UK producers (see paragraph 2.4*(b)*);[4] and the percentage for 'European Works'.[5]

2.9 With the exception of content standards for BBC VOD content, which are overseen by the BBC Trust (see paragraph 2.19), VOD services are currently subject to self-regulation through the Association for Television on Demand and the Independent Mobile Classification Body. When the Audiovisual Media Services Directive comes into force, a new structure will be required to regulate VOD services in the UK.[6] Ofcom told us, however, that the European Commission's intention was for VOD services to be regulated more lightly than linear TV services since, unlike linear TV, VOD content was supplied at the viewers' request.

2.10 The BBC is governed by the BBC Trust under the terms of the BBC Royal Charter and Agreement which came into effect on 1 January 2007. The BBC Trust decides whether to authorize new services. For new public services the BBC Trust will take into account both a Public Value Assessment, which seeks to assess the broader public value of the proposed service to UK citizens and consumers, and a Market Impact Assessment, carried out by Ofcom, which seeks to assess the likely impact of the proposed services on the relevant and related markets.

Licensing of intellectual property rights

2.11 The holder of the copyright to a particular piece of content generally has the right to exploit that content in the first instance. This can be sold or licensed to allow exploitation by one or more third parties. Rights can be limited in a variety of ways including, in particular:

(a) By type of activity. In the UK broadcasting industry content rights are typically separated into core primary rights (generally linear broadcast and corresponding VOD catch-up rights) and secondary rights (those which fall outside the primary rights including, for example, VOD archive rights).[7] There may be protections accompanying primary rights relating, for example, to restriction on exploitation of secondary rights for a period of time.

(b) By method of exploitation: eg streaming, DTR or DTO.

(c) Exclusively or non-exclusively. Licences for an initial period of exploitation are often granted on an exclusive basis.

Different rights may be sold separately to one another or bundled.

2.12 Before CA 2003 came into force in 2004, the PSBs generally held the copyright to the programmes they commissioned from independent producers.[8] Since then, each PSB has been required to publish a Code of Practice and Terms of Trade (the Commissioning Agreements) which represent minimum terms under which the PSBs commission programmes from independent UK producers (see paragraph 2.4*(b)*).

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[3]See section 278 CA 2003.
[4]See section 277 CA 2003.
[5]See Articles 4 and 5 of the *Television Without Frontiers* Directive.
[6]*The Audiovisual Media Services* Directive—Department of Culture, Media and Sport consultation document, July 2008.
[7]We note that, according to PACT, the core primary rights currently represent around 90 per cent of the value in the content.
[8]The exception to this is in relation to ITV commissions from independent UK producers in the period from 1993 to 2003. ITV told us that, during this period, it generally acquired exploitation rights for a period of five years, after which the rights would revert to the producer.

2.13 Since 2006, Commissioning Agreements have allowed a short window of exclusive exploitation on VOD (catch-up) to be bundled with linear broadcasting rights. The Commissioning Agreements principally govern the acquisition by the broadcasters of rights to broadcast the content on linear public service TV channels for a period of time. The licence will generally also provide for an initial period of exclusivity for the broadcaster which restricts all other activities by the producer. This period is typically six months, or longer for returning series.

2.14 The catch-up window for streamed VOD and DTR will typically be for 30 days after the initial broadcast of a programme.[9] However, in relation to returning series, the catch-up window is generally determined by reference to the end of a series; typically, for example, the window for an episode of series 1 will be determined by reference to the initial broadcast of the last episode of series 3.

2.15 C4C and ITV have agreed additional provisions which allow them an exclusive right to negotiate for an extension of VOD DTR and streaming rights beyond the initial window, ie archive rights.[10] If there is a failure to agree terms, a six-month hold-back period (longer for returning series) applies during which neither the broadcaster nor the producer may exploit the content on VOD. After the holdback period, the broadcaster will generally retain a non-exclusive licence allowing exploitation on VOD for the remainder of the licence period.

2.16 The BBC and ITV own VOD rights to all content that each produce in-house (see paragraph 2.4*(a)*). We note that, in total, this amounts to more than half of all content made in the UK each year.[11] VOD rights to exploit existing third-party content (see paragraph 2.4*(c)*) may be acquired from a range of third parties. Further details of industry practice in licensing of VOD rights are set out in Appendix B. We discuss the impact of this in Section 4 (see, in particular, paragraph 4.100 and paragraphs 4.156 to 4.165).

The parties[12]

2.17 Paragraphs 2.19 to 2.32 give an overview of each of the parties. We note various recent or current initiatives which might, in due course, have an impact on the parties or on the VOD market more generally. In particular, Ofcom has published its review of Public Service Broadcasting and the Government is preparing a report on Digital Britain.

2.18 Ofcom's recommendations to the Government, published in January 2009, included the proposal that Channel 4 should be at the core of a strong, alternative public service to the BBC, preferably through partnerships, joint ventures or even mergers with other entities.[13] It referred to possible closer links between Channel 4 and BBCW or Five. The Digital Britain initiative, sponsored by the Department for Culture, Media and Sport and the Department for Business, Enterprise & Regulatory Reform and led by Lord Carter, aims to create 'an action plan to secure the UK's place at the forefront of innovation, investment and quality in the digital and communications industries'. The Digital Britain review will include an evaluation of the impact of digitalization and the new technologies on public sector broadcasting and will draw

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[9]The parties generally do not acquire DTO VOD rights as part of an original commission, although ITV has an option to negotiate for these.
[10]These apply in the two years following launch of the broadcasters' respective VOD services.
[11]BBC's in-house production department has a budget of approximately £1 billion and ITV's a budget of approximately £600 million a year, out of a total of £2.6 billion (source: Review of the Television Production Sector, Ofcom, 2006).
[12]In this report, where we refer to the parties we are referring to BBCW, ITV and C4C. The relationship between the BBC and its subsidiary BBCW is set out in paragraph 2.22.
[13]www.ofcom.org.uk/consult/condocs/psb2_phase2/statement/psb2statement.pdf.

on research undertaken by Ofcom, among others. The Government published its interim report in January 2009[14] and aims to publish a final report later in 2009. One of its proposed actions is to establish whether a long-term and sustainable second public service organisation can be defined and designed. It said that this would provide competition for the BBC, drawing in part on Channel 4's assets and with public service at its heart, but able to develop flexible and innovative partnerships with the wider private and public sector.

BBC/BBCW

2.19 The BBC is the longest-established national TV channel operator in the UK. It is a public corporation operating under its own charter, which was renewed on 1 January 2007. The BBC's Royal Charter and Agreement with the Department for Culture, Media and Sport provides the BBC with a wide public service remit, including the provision of a broad range of high-quality programming within its broadcasting schedule. The BBC Trust is responsible for setting the high-level strategy for the BBC, including its commercial activity, and is responsible for ensuring that new commercial service proposals comply with the four criteria set out in the charter.[15]

2.20 The BBC makes BBC1 and BBC2 available on the analogue terrestrial platform and a range of digital channels available on an FTA basis.[16] The BBC's TV and radio channels are funded primarily from the annual licence fee of around £3.4 billion (year ended 31 March 2008). The BBC is one of the largest purchasers of independent productions in the UK and its in-house production arm is the largest UK programme maker.

2.21 The BBC launched the BBC iPlayer on 25 December 2007 as part of its public service activities. This offers a catch-up service via the Internet for programmes for up to seven days after transmission.[17] Programmes can be streamed or downloaded.[18] At the end of 2008, in addition to being available on the BBC's website, the BBC iPlayer was also available through iTunes, the Nintendo Wii, Sky and Virgin Media.

2.22 BBCW is a wholly-owned subsidiary of the BBC. Its day-to-day operations are conducted on an arm's length basis from the BBC's PSB activities. BBCW engages in a wide range of commercial activities in the audiovisual sector both in the UK and overseas, mainly involving the commercial exploitation of BBC's content. It provides the UKTV suite of nine channels in conjunction with Virgin Media.[19] BBCW is also involved in book and magazine publishing, as well as in the sale of DVDs through 2 entertain.[20]

2.23 BBCW does not currently have a retail VOD presence in the UK market. It licenses content to a variety of other VOD services (see paragraph 3.32).

2.24 In the year ended 31 March 2008, BBCW had a turnover of £916 million with an operating profit of £118 million.

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[14] www.culture.gov.uk/images/publications/digital_britain_interimreportjan09.pdf.
[15] The four commercial criteria are: fit with public purpose, commercial efficiency, brand/reputation and fair trading.
[16] These include BBC1, BBC2, BBC3, BBC4, CBBC, CBeebies, BBC News 24, BBC HD and BBC Parliament.
[17] Series stacking was included within the remit of the iPlayer from 13 September 2008. This extends the availability window of selected series from seven days to up to 13 weeks after transmission of the first episode of a series. Series stacking is restricted to 15 per cent of all content offered on demand on the iPlayer.
[18] Programmes that are downloaded may be viewed for up to 30 days from the date of downloading; once viewed, the content is automatically deleted from the PC seven days later.
[19] UKTV is an independent commercial 50/50 JV between BBCW and Virgin Media.
[20] BBCW has a 60 per cent stake in 2 entertain, with the remainder being held by Woolworths Plc.

C4C

2.25 C4C is a statutory corporation which was created by Act of Parliament in 1982. Its particular public service remit is to offer distinctive programming that the market might otherwise not provide. It is funded primarily from TV advertising revenues.[21]

2.26 C4C operates Channel 4, a public service UK TV station, available FTA on analogue terrestrial TV as well as in digital format. It also provides a suite of commercial channels including E4, More4 and Film4 through its subsidiary 4 Ventures Limited.[22] Channel 4 generally attracts a relatively young audience with a high proportion of ABC1 viewers.

2.27 C4C was the first of the parties to launch a VOD service. 4OD was launched in late 2006 on cable and broadband, offering a selection of C4C's programming on an on-demand basis via the 4OD application (which must first be downloaded). Launched originally as predominantly a pay service, 4OD has, over time, become predominantly free to viewers.[23] Programmes can be streamed or downloaded on a DTR or DTO basis. Channel4.com offers catch-up for C4C linear programming, material to complement linear programming and other content including games, dating, news, music and films. C4C licenses content to a variety of other VOD services (see paragraph 3.37).

2.28 C4C's total group turnover was £945 million for the year ended 31 December 2007.

ITV

2.29 ITV (and its predecessors) has been in operation for more than 50 years. It is the UK's largest commercial FTA broadcaster. ITV was created (as ITV plc) from the merger of Carlton and Granada in February 2004.

2.30 Whilst essentially a national channel, ITV is made up of 15 regional Channel 3 licensees, broadcasting many of the same programmes simultaneously across the UK but with some regional variations. ITV commissions and schedules programmes on all the ITV channels,[24] as well as producing content through its in-house production unit, ITV Productions.

2.31 ITV.com, ITV's website, allows consumers to access a wide range of ITV material, including 30-day catch-up and some archive material, on a streamed basis over the Internet. It is primarily funded by online advertising and was the first predominantly free streamed video service in the UK. Some ITV content is licensed to other VOD services (see paragraph 3.44).

2.32 In the year ended 31 December 2007, ITV made an operating profit of £311 million on a turnover of £2.08 billion. Around three-quarters of its revenue was derived from advertising. Its market capitalization was around £1.0 billion at end January 2009.

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[21]It also derives significant revenues from other activities including the sale of programmes on DVD and online advertising.
[22]It also operates time-shifted versions of Channel 4, E4, More4 and Film4 which enable viewers to watch those channels 1 hour later than originally broadcast.
[23]Seven-day catch-up was available free from March 2007, 30-day catch-up was available free from September 2007 and the majority of archive content was available free from the end of 2007.
[24]ITV's channels include ITV1, ITV2, ITV3, ITV4, the children's channel Citv and two catch-up channels (ITV2+1 and ITV3+1). It also owns Men and Motors and 75 per cent of GMTV, the holder of the Channel 3 breakfast time licence.

3. The transaction

History of the transaction

3.1 The BBCW board first discussed digitization of archive content in March 2005, although without, at this stage, determining the business model for doing so. [✂][25] Project Kangaroo developed over the following three and a half years as follows:

(a) December 2005 [✂].[26,27]

(b) May 2006 [✂].[28]

(c) May/June 2007—the BBCW board approved the principle of the creation of the Project Kangaroo JV on 30 May 2007; the BBC Executive Board supported this on 12 June 2007; and the BBC Trust gave agreement in principle on 20 June 2007.[29]

(d) July 2007 [✂].[30]

3.2 On 27 November 2007, the parties signed a Short Form Agreement setting out the key terms of the transaction. They also formed a limited liability partnership under an interim agreement. On 29 September 2008, the parties submitted to us detailed documentation setting out the updated terms of the transaction, including substantially agreed drafts of an LLP Agreement (LLPA), Content Supply Agreements (CSAs), Technology Licence Agreement (TLA) and Ancillary Funding Agreement.[31]

Description of the JV

Overview

3.3 Under the terms of the agreements, UKVOD will supply VOD content to any consumer with a PC and to third-party VOD retailers in the UK. Each party will hold an equal stake in the limited liability partnership,[32] will be entitled to appoint two directors to the board, and will contribute certain VOD business activities (see paragraph 3.55). Subject to specified exemptions, UKVOD will be each party's principal route to market for their archive VOD content.

3.4 Each party will make available a minimum number of hours of content to UKVOD for a minimum period of [✂] (see paragraph 3.12*(b)*). UKVOD will select content from ITV and C4C. Initial selection of BBC content for UKVOD will be made via BBCW (see paragraph 3.8).

3.5 Of the parties' existing consumer-facing VOD operations, ITV.com and Channel4.com will continue and will, in particular, provide catch-up content, focusing on content that complements their primary broadcasting business. C4C's 4OD service will cease. BBC iPlayer is a public service activity of the BBC operated

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[25][✂]
[26][✂]
[27][✂]
[28][✂]
[29][✂]
[30][✂]
[31]These were submitted to us in response to our section 109 notices, requesting clarification of the key commercial terms of the agreement. [✂]
[32][✂]

separately from BBCW's commercial activities and does not form part of the BBCW's contribution to the JV.

3.6 It is envisaged that UKVOD will be able to syndicate the whole or substantially the whole UKVOD service (or sub-license substantial representative samples of it) to closed VOD services and, after a period of 12 months to allow for the establishment of the UKVOD website, to open VOD services. This ability will be largely exclusive to UKVOD for archive VOD content. BBC, ITV and C4C will retain the ability to whole-sale rights to catch-up content separately from UKVOD.

3.7 Further details are set out in paragraphs 3.8 to 3.17. Appendix C sets out, in particular, additional details on the proposed revenue-sharing arrangements.

Licensing of content to UKVOD

3.8 The parties have agreed the terms of CSAs which each will enter into with UKVOD. C4C and ITV will make available VOD rights in all content where they hold those rights, including archive and catch-up. BBCW will make available VOD rights in the bulk of the archive content for which it holds the rights, including any rights to content acquired from third parties independent of the BBC's PSB activities. However, the BBC will retain ultimate editorial control over which BBC-produced content is made available in order to comply with the BBC's PSB requirements. [✂]

3.9 In relation to ITV and C4C content, UKVOD will have first choice of archive content which it can exploit on a largely exclusive basis. [✂]

3.10 The majority of ITV's and C4C's archive material currently exploited on their home websites will be licensed to UKVOD and will no longer be available on those home websites, although they will continue to provide catch-up content (see paragraph 3.5). The parties anticipate that the bulk of content that has been available on C4C's 4OD service will be made available on the UKVOD service, as this is popular content which has already been prepared for VOD use. The parties also expect that the totality of ITV's archive content which it has made available to date on ITV.com will be available on the UKVOD service (and not on ITV.com).

3.11 There are a number of carve-outs and other provisions through which the parties may retain an interest in the content being made available to UKVOD. As well as the limitations on exclusivity described in paragraph 3.10, these include the parties retaining the ability to license DTO rights in conjunction with DVD rights and [✂]. The parties said that these carve-outs were limited and reflected specific considerations of one or more of them.[33]

3.12 The parties said that the provisions of the CSAs went beyond typical licensing agree-ments:

(a) Amount of content: the CSAs provide for minimum hours commitments of [✂] hours for each party from launch. UKVOD will receive rights to both in-house and independently-produced content where the parties hold those rights. ITV and C4C will make available VOD rights for all content which they are able.

(b) Duration: the CSAs are expected to last for a minimum of [✂], rather than a more typical duration of [✂] months.

[33] [✂]

(c) Extent of rights granted: the parties said that UKVOD would have the ability to package, editorialize and present the content largely as it decided; the ability to decide the business model and pricing; and responsibility for syndication of archive content.

3.13 The parties have also bound themselves with non-compete provisions [✄].

3.14 The parties said that in this way the rights which they held, either currently or in the future, to exploit archive content for VOD purposes were effectively transferred to the JV.

Existing VOD syndication businesses

3.15 Each of the parties' archive long-form VOD syndication activities will largely cease and it is intended that, where permitted by the relevant contracts, its existing agreements will be taken on by UKVOD. Revenue will be split between the party concerned and UKVOD [✄]. In addition, the parties will endeavour to have the UKVOD brand used when the content is offered by the relevant customer.

3.16 Any future archive syndication deals will be entered into by UKVOD.[34] The CSAs provide that UKVOD may syndicate the whole or substantially the whole UKVOD service or sub-license substantial representative samples thereof (eg of [✄] or more).[35] It is envisaged that, while UKVOD will be empowered to enter into syndication deals with closed VOD operators from the outset, it will not syndicate to open VOD retailers for the first 12 months.

Additional 4OD contributions by C4C

3.17 4OD is the most developed commercial online consumer VOD business of any of the parties. The LLPA requires C4C to take steps to migrate the 4OD customer base to UKVOD and in addition for its technology to be made available to UKVOD:

(a) C4C has a registered user list of some [✄] consumers of whom around [✄] view an average of [✄] items of content a month. The LLPA provides that C4C will contact all its customers to encourage them to become active customers of UKVOD and, on ceasing to operate its VOD service from the 4OD website, [✄].

(b) The technology and IP used by the 4OD service will be licensed to UKVOD for a fee of £[✄] pursuant to the TLA. The parties said that the 4OD technology and know-how would be used to develop significant components of the JV including [✄].

Rationale for the transaction

3.18 The parties told us that the purpose of the JV was to create a customer proposition that could compete in the VOD market against powerful competitors who were able to leverage significant existing assets that the broadcasters did not possess. To achieve this, the parties intend to create a 'one-stop-shop' that will provide consumers with the convenience of being able to access both popular content and niche content on a single service, providing the consumer with 'a sophisticated and comprehensive user experience'.[36] The parties said that they were also seeking to main-

[34] [✄]
[35] [✄]
[36] Parties' *Joint Position Paper on the Effects of the Transaction on Competition*, 2 October 2008, paragraph 3.16.

tain control of their content, in order to avoid the 'disintermediation' faced by music companies due to the success of, for example, iTunes. They also told us that the JV would limit individual risk in an uncertain, nascent, VOD sector.

3.19 The parties said that, as catch-up content would still be available on ITV's and C4C's own websites and on BBC iPlayer, the key element of UKVOD's proposition was to promote a wide range of UK archive content. They also argued that:

> no third party can be reasonably expected to attract more users with a propensity to view archive content and therefore be in a position to make available as much archive content as UKVOD. This focus will enable UKVOD to improve the economics of archive content relative to third-party VOD services and to bring a substantially greater amount of content to the market.[37]

3.20 However, archive content cannot be offered in isolation. The parties told us that catch-up content was the driver for viewers consuming archive that would not otherwise be consumed.[38]

3.21 The parties told us that none of them had the scale and scope individually to guarantee long-term success. They believed that consumers were likely to migrate towards the broadest content offering, the best user experience, and the most powerful brand, and that the JV would be such an offering. They expected the vast majority of views ([✂] per cent) to be of free, advertising-funded content, noting that consumers were generally 'extremely reluctant' to pay for any Internet- or TV-related content.

3.22 We looked separately at the rationale for each of BBC/BBCW, ITV and C4C. Paragraphs 3.23 to 3.29 outline our conclusions; further details are set out in Appendix D.

3.23 BBCW told us that its strategy in the UK on demand market [✂].

3.24 BBCW noted many positive effects of the JV for the BBC/BBCW, giving it the opportunity to 'manage content, editorially co-ordinate, build brands, strengthen its role as a content distributor, cross-promote, share content acquisition and other costs across all its UK commercial businesses and offer consumers a "joined-up" and consistent BBC experience'. [✂] (see paragraph 3.33).[39]

3.25 In its submission to the BBC Trust in June 2008, the BBC Executive Board outlined four main benefits of the JV: [✂].

3.26 In addition, the BBC Trust must satisfy itself that UKVOD complies with the commercial services criteria set out in the BBC's Charter (see paragraph 2.19). [✂] It will take a formal decision in 2009 in the context of the BBC's overall strategy.

3.27 C4C's strategic rationale seemed to us to be driven by the desire to capitalize on its first mover advantage in terms of technology and consumer base. It told us that [✂].[40]

3.28 C4C also told us that we should take into account the severe and widely publicized cuts to its core services and headcount in response both to the emerging impact of structural changes to its overall business model and the anticipated emergence of the most challenging trading conditions in Channel 4's history. C4C said that [✂].

[37] Parties' *Joint Position Paper on the Effects of the Transaction on Competition*, 2 October 2008, paragraphs 3.24 and 3.25.
[38] [✂]
[39] [✂]
[40] [✂]

3.29 ITV's strategy is to grow online revenues through increasing its share of online advertising and increasing transactional and subscription services. It envisages doing so primarily through exploiting more fully its archive content; [✂].[41]

Counterfactual

3.30 We considered the situation which would have been expected to occur in the absence of the JV (the counterfactual) both for the retail supply of VOD services and the wholesale supply of VOD content rights. We are aware that negotiations between the parties have developed over time (see paragraph 3.1) and various permutations of the structure and commercial terms of the transaction have been considered. For the purposes of the counterfactual, we did not find it necessary to consider whether some other transaction, such as a two-way JV, might have occurred between any two of the parties. No such permutation was put to us as a likely counterfactual. Any alternative transaction between the parties would have to be considered under competition rules on its merits and would not be permitted if it gave rise to competition concerns. The appropriate counterfactual could therefore only be one which did not, in itself, raise competition concerns.

3.31 We note that, as a result of the initiatives referred to in paragraph 2.18, there may, in due course, be changes to the PSB landscape. However, we were unable to form an expectation that any particular proposal was likely to be adopted in the foreseeable future. The competitive implications of any of these proposals have, in any case, yet to be considered. We therefore looked at each of the parties individually for the purposes of determining our counterfactual.

BBC/BBCW

3.32 The BBC offers seven-day catch-up only through the BBC iPlayer. BBCW does not, at present, provide its own commercial VOD service. It is primarily responsible for the syndication of (BBC and other) VOD content rights that it has acquired of commercial value to third parties and has existing syndication deals with BT Vision, iTunes, Orange, Tiscali and Virgin Media (see Appendix G).

3.33 BBCW said that, [✂].[42]

3.34 BBCW told us that it had considered alternatives to UKVOD [✂].

3.35 BBCW said that [✂].[43]

3.36 [✂] Our view is that, in the absence of the transaction, the BBC would have the incentive to exploit a substantial volume of its archive content through BBCW in some way and therefore would be likely to do so. At a minimum, this would be likely to involve wholesale distribution which would lead to retail exploitation of BBCW content in some way. Paragraphs 3.33 to 3.35 set out some of the issues associated with BBCW taking a stake in, or launching its own, retail offer. We thought it plausible that the BBCW would do this, but did not find it necessary to reach a firm conclusion.

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[41] [✂]
[42] [✂]
[43] [✂]

C4C

3.37 C4C's current retail VOD service includes 4OD and Channel4.com (see paragraph 2.27). It has existing wholesale content rights supply deals with several VOD retailers, including BT Vision, iTunes, Tiscali and Virgin Media (see Appendix G).

3.38 C4C told us that, in the absence of the transaction, it would aim to continue to provide a VOD service as part of its multi-platform public service network. In doing so, it would look for [✂].

3.39 C4C said that [✂] and C4C was facing strong pressures on its funding model (see paragraph 3.28). Its Chief Executive, Andy Duncan, has said that C4C will need an extra £100 million a year in funding to sustain its current output of original public service content, plus a further £50 million each year to strengthen the delivery of its future public purposes.

3.40 In addition, unlike those VOD services relying, at least in part, on in-house production, C4C has to pay producers for the rights to all of its VOD content. [✂]

3.41 C4C said that [✂].

3.42 Although C4C had entered into a number of VOD syndication deals, primarily to closed VOD services, it said that in its experience such partners wanted to cherry-pick the most popular content and combine this with a range of premium and other popular content from other providers. [✂]

3.43 We note that C4C currently offers around 3,000 hours of catch-up and archive content on 4OD. It has current contracts to supply between [✂] and [✂] hours of archive VOD content at any one time to a number of third parties, amounting to around [✂] hours of content on an annual basis for each third party.[44] We also note that [✂] and that C4C had considerable experience of operating a VOD service. Whilst we note the current pressures on maintaining a commercial VOD service in the absence of the JV and recognize that this might limit the number of hours of content that C4C found economic to make available, we thought it likely that it would seek to exploit VOD rights to at least the existing volume of VOD content on 4OD which has been digitized for 4OD, either alone or in partnership with a third party.

ITV

3.44 ITV offers free, streamed catch-up content (0–30 days) through itv.com, with a limited amount (around 340 hours) of archive content. It agreed a wholesale content supply agreement with BT Vision in November 2008; with Virgin Media in January 2009; and makes some content available on iTunes (see Appendix G).

3.45 ITV said that, in the absence of the JV, it would [✂].

3.46 ITV said that [✂].

3.47 ITV told us that, [✂]. ITV said that around [✂] per cent of its archive would be likely to generate successful VOD content. Even at this level, this would suggest that ITV would have around [✂] hours of potential VOD content to exploit. We note, too, ITV's strategy of exploiting more fully its archive content (see paragraph 3.29).

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[44] [✂]

3.48 We also note that in the past ITV has concluded only limited third-party syndication deals. However, it has recently concluded some significant deals. Virgin Media, in particular, has agreed to a substantial spend with ITV to obtain ITV VOD content.[45] [✂] It seems to us likely that ITV would want to exploit at least some of its VOD archive in some way.

3.49 We therefore found that, in the absence of the JV, ITV would be likely to continue to seek to exploit its VOD content rights, either alone or in partnership with a third party. We note that even a relatively low proportion of available ITV VOD content would still amount to a substantial absolute volume of hours of archive VOD content.

Conclusion on counterfactual

3.50 We therefore conclude that, in the absence of the transaction, each of BBCW, ITV and C4C would pursue its own commercial interests, either alone or in partnership with a third party, to exploit its archive VOD content rights. Such rights would be likely to form part of a retail VOD service, either in a direct-to-consumer offering or through wholesale distribution or both. We did not find it necessary to come to a conclusion as to which route to market was the most likely to be pursued by each party.

Jurisdiction

3.51 We are required under section 36 of the Act to decide whether arrangements will result in the creation of a 'relevant merger situation' such that:

(a) two or more enterprises cease to be distinct; and

(b) either the turnover test or the share of supply test is satisfied.

Enterprises ceasing to be distinct

3.52 Where a merger involves the acquisition of a company or the assets of a business, the first part of the jurisdiction question is relatively straightforward. However, it is more complicated in an anticipated JV. Enterprises cease to be distinct if they are brought under common ownership or common control. In the context of a JV, this criterion is typically satisfied by one or more parents acquiring joint control of an enterprise previously controlled by another parent.

3.53 We conclude that the LLPA gives each party the ability to control or materially influence the policy of UKVOD, as described in paragraph 3.3. Each party will therefore acquire control or material influence in any enterprise contributed to UKVOD by either of the other two parties. Any enterprise transferred to the JV by one party will therefore cease to be distinct from the other two parties.

3.54 We considered whether the assets and activities currently carried on by the parties which are being contributed to the JV constitute an enterprise and whether the manner in which the contribution is made will lead to control over those activities being conferred on the other parties. Section 129(i) of the Act defines an 'enterprise' as 'the activities, or part of the activities, of a business'.

3.55 Each party's contributions to the JV will be as follows:

[45] Virgin Media agreed a deal with ITV in December 2008 for catch-up and archive VOD content. Under the terms of the agreement, Virgin Media will pay ITV [✂].

(a) *BBC/BBCW:* BBCW will make available certain VOD rights to archive content. The BBC will retain control over which BBC-produced content is made available to UKVOD via BBCW but it is intended that UKVOD will be the principal route to market for commercially attractive BBC-produced archive VOD content and any third-party-produced content for which BBCW is able to acquire rights. BBCW's archive VOD syndication activities will largely be taken on by UKVOD.

(b) *ITV:* ITV will make available VOD rights to its archive content. This will include the archive content currently available on ITV.com (which will no longer be available on that home website). ITV's archive long-form VOD syndication activities will largely cease and it is intended that, where permitted by the relevant contracts, its existing agreements will be taken on by UKVOD. ITV will also make available VOD catch-up rights to UKVOD on a non-exclusive basis.

(c) *C4C:* C4C will contribute its existing VOD business, 4OD, to UKVOD. This will include making available VOD archive rights, technology and intellectual property, and commitments to migrate the existing customer base and goodwill. C4C's archive long-form VOD syndication activities will largely cease and it is intended that, where permitted by the relevant contracts, its existing agreements will be taken on by UKVOD. C4C will also make available VOD catch-up rights to UKVOD on a non-exclusive basis.

See paragraphs 3.3 to 3.17 for further details.

3.56 The parties said that the VOD activities of the parties each constituted an enterprise and would each be transferred to the JV. In addition, the parties said that the 4OD business, which is operated as a separate profit centre in C4C, and has assets in the form of VOD rights, technology and IP, an existing customer base and goodwill, as well as existing syndication agreements, was to be transferred to the JV in its entirety.[46]

3.57 The parties said that while the present arrangements were not as simple as a transfer of tangible assets, the CSAs contained a contractual mechanism amounting to exclusivity which effectively transferred the relevant business activities. The parties said that it would not be practical or appropriate to assign rather than license the relevant rights, in particular because the parties did not own the underlying rights in all the content.

3.58 We note that the relevant content, both archive and catch-up, for each of the parties will be made available to the JV on a contractual basis rather than by an assignment of IP rights. We also note that the parties will retain a number of controls over the sub-licensing of content to third parties and the ability to license certain VOD rights themselves (or require the JV to do so) where those are associated with other arrangements with third parties. However, these and other restrictions on the exclusivity granted to the JV are limited and the parties have expressed their commitment to making UKVOD their principal route to market for archive VOD content.

3.59 We note that BBCW and ITV currently have limited consumer-facing archive VOD activities. However, both BBCW and ITV have invested considerable resources, as well as management time and effort, in developing plans and preparing for the exploitation of archive content in one way or another. Those activities will now largely be carried out by the JV.

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[46] [✂]

3.60 It is possible that there may be practical limitations to the parties' intentions to [✂]. Nevertheless the parties are committed to trying to transfer these activities to the JV where possible [✂] (see paragraph 3.15).

3.61 The BBC will retain overall editorial control over the content licensed to the JV by BBCW. The parties said that this qualification was necessary to reflect the BBC's PSB obligations, as well as [✂]. Nevertheless, the BBC told us that it was committed to making UKVOD its principal route to market for archive VOD content with commercial value. We recognize that the BBC's PSB regulatory requirements restrict its ability to agree commercial contracts. However, to the extent that the BBC is not transferring part of its current business to the JV and wishes to retain control over it in order to [✂], there is, in our view, significant doubt as to whether the BBC can properly be said to be transferring an 'enterprise'. For the purposes of establishing jurisdiction, we did not consider it necessary to reach a decision on this point.

3.62 On the basis of the transaction described in paragraphs 3.3 to 3.17, and the arguments set out in paragraphs 3.56 to 3.61, we conclude that the existing archive VOD businesses of, at a minimum, each of ITV and C4C will cease to be distinct from those of each of the other two parties.

Share of supply test

3.63 The second question relevant to jurisdiction is whether the transaction satisfies one of the turnover or share of supply tests. The turnover of the parties in relation to the activities within the scope of the merger situation is less than £70 million,[47] so the share of supply test is relevant. Where the parents of a JV remain active in the same market as the JV, their share of supply is relevant for the calculation of the share of supply created by the merger.

3.64 Our terms of reference referred to share of supply with respect to the provision of UK catch-up TV content, available within 0–7 or 8–30 days following its broadcast on a TV channel, available online on a VOD basis in the UK. This would encompass the BBC's iPlayer, the ITV and C4C websites offering catch-up content and the JV website.

3.65 The parties said that the JV would account for more than 25 per cent of catch-up hours available on a VOD basis in the UK. We found that the parties, including the BBC iPlayer for these purposes, would have around 80 per cent of catch-up hours available on a VOD basis in the UK. If we exclude the public service BBC iPlayer from the calculation, this would fall to a little over 70 per cent. We therefore found that the share of supply test in section 23 of the Act was met.

3.66 We conclude that two or more enterprises will cease to be distinct and that the share of supply test is met. We therefore conclude that a relevant merger situation will be created.

[47] We do not have precise turnover figures for the relevant VOD businesses. However, for the financial year 2007, BBCW's Digital Media revenue stream (which includes all VOD services plus additional web services) totalled £[✂] million, C4C's 'New Media' revenue stream (which includes all VOD services plus additional web services) totalled £[✂] million and ITV's ITV.com total revenues were £[✂] million. These figures include services in addition to VOD. We can therefore be confident that turnover did not exceed £70 million.

4. Market definition and competitive assessment

Overview

4.1 In this section we analyse the competitive effects of the JV, taking into account our view of the counterfactual set out in paragraph 3.50. We look in particular at:

(a) the supply of VOD services at the retail level; and

(b) the supply of VOD content rights at the wholesale level.

4.2 We also considered the competitive effects of the JV in advertising and content acquisition.

4.3 We first look at market definition before considering underlying factors affecting competition, including, in particular, an overview of key competitors and a discussion of market shares. We then discuss existing competitive conditions at both the retail and the wholesale levels. We look at entry and exit before assessing the impact of the JV and drawing our conclusions on the competitive effects of the transaction.

4.4 We note that, as set out in paragraph 2.7, this is a new and rapidly changing market. The nascent and developing nature of the market has important implications for our assessment. It may, in particular, limit the weight that we put on existing competitive conditions as a guide to the future.

Market definition

4.5 In this section we consider the relevant markets for UKVOD's VOD services. In doing so, we focus on viewers' willingness to substitute between different types of content (demand-side substitution), cross-referring where relevant to evidence set out in our assessment of competitive effects. We thought that supply-side substitution, which would involve a firm acquiring rights to UK TV content (through production or acquisition) and supplying VOD rights quickly and with limited investment, was unlikely. We discuss entry and expansion in the supply of VOD content in paragraphs 4.111 to 4.123. Our conclusions on market definition are relevant to the supply of VOD content at both the retail and the wholesale levels.

4.6 In order to define the relevant market for the VOD services provided by BBCW, ITV and C4C, we use the conceptual framework provided by the hypothetical monopolist test. We take the narrowest overlap in the products supplied by the parties—the retail supply of UK TV VOD archive content viewed on a PC—as our starting point and consider whether a hypothetical monopolist supplier of this product would be able profitably to sustain a small but significant non-transitory increase in price (SSNIP) or a similar reduction in its competitive effort in terms, for example, of the quality of its offer.[48] In doing so, we take account of total switching away from this product. We focus on viewers' willingness to substitute between different types of content because, ultimately, viewers are the main drivers of revenue regardless of business strategy adopted, although we note that the parties also compete for advertising and that advertisers' demand is related to viewers' demand (see paragraphs 4.141 to 4.155).

4.7 The parties told us that there were a wide range of substitution possibilities available to consumers of VOD and that the aggregate effect of these would be to prevent a

[48] *Merger References: Competition Commission Guidelines, CC2,* paragraph 2.5.

hypothetical monopolist of UK TV archive content from profitably sustaining a SSNIP. They told us that consumers were willing to substitute between a range of different types of content including UK and non-UK English language content, films and made-for-TV content, long-form and short-form content and peer-to-peer (P2P) content. They also told us that consumers were willing to substitute between a variety of delivery technologies and platforms. Specifically, they told us that VOD provided over TV platforms was a close constraint on Internet (PC) VOD; that the use of PVRs provides consumers with a strong alternative to VOD; and that DVDs were a substitute for pay-to-view (transactional) VOD.

4.8 The parties submitted three empirical studies to support their views:

(a) *Analysis of consumers' viewing patterns on UK linear TV.* The parties told us that this analysis shows that almost [✂] per cent of viewers, and [✂] younger viewers, watched both UK and non-UK TV content. More than half of viewers watched both TV and film content.

(b) *Analysis of the DVD sector.* The parties analysed TNS consumer panel data for DVD purchases in 2007 and found that a very high proportion ([✂] per cent) of people who bought UK TV DVDs also bought non-UK TV DVDs; [✂] of all DVD customers bought both UK and non-UK content; and almost [✂] per cent of people who bought TV DVDs also bought film DVDs.

(c) *A consumer survey.* In August 2008 the parties conducted a survey of [✂] people to understand likely substitution patterns for VOD consumers. The parties said that the survey results indicated that, if faced with significantly higher prices for UK TV archive content, customers would be willing to substitute to US content, film, short form, DVDs and P2P services.

4.9 The first two of these studies provide useful background information on consumers' habits. They show that a fairly large proportion of viewers watch both UK and non-UK TV content, as well as both TV and film content. However, in order to understand the extent of substitutability, we need to think about how viewers of UK TV content would respond to a (small but significant) change in the price of UK TV content relative to the price of non-UK content.

4.10 The survey carried out by the parties was intended to inform our understanding of the substitutability of UK and non-UK content. However, in our view the results might overestimate actual switching for the following reasons:

(a) Consumers were asked about their likely responses to relatively large increases in the price of UK TV archive content relative to other options. They were asked how they would respond if UK TV archive content, instead of being free, cost £0.50, and how they would respond if prices increased from £0.50 to £1.50, while the price of other options (such as non-UK TV content) was variously free or cost £0.50.This makes it difficult to interpret the results of the survey within the context of the SSNIP test, which is based on proportionately small price increases.

(b) Some of the price points used for the survey exceed those that the parties propose to set for UKVOD and therefore did not reflect current or competitive prices.

4.11 In addition, we note that the consumer survey showed that VOD consumers were not particularly sensitive to increases in the price of UK TV archive VOD relative to non-UK TV archive VOD, or relative to other alternatives:

(a) although consumers switched away from UK content in response to a large increase in price from £0.50 to £1.50 while US content remained at £0.50, the proportion of respondents that would prefer UK DTR content declined by only [✂] per cent;

(b) using the results of the survey to estimate responses to smaller price increases, we find that a 5 per cent increase in the price of UK TV archive DTR content relative to US TV archive DTR content led to a decrease of only [✂] per cent in the proportion of respondents that would prefer UK TV archive DTR content;[49] and

(c) similarly, we find that, following a 5 per cent increase in the price of UK TV archive DTR content relative to all alternatives, only around [✂] per cent of respondents in aggregate would no longer prefer UK TV VOD to US TV VOD, film or DVDs.[50]

This suggested to us that the cumulative effect of these individual substitution possibilities is relatively small.

4.12 In our view, these empirical studies provide interesting background and demonstrate that content other than UK TV content is popular. However, they do not show that the aggregate constraint from consumers' willingness to substitute away from UK TV VOD content would provide a significant constraint on a hypothetical monopolist of UK TV VOD content.

4.13 We consider a number of market characteristics (types of content, catch-up and archive and type of delivery) in turn in our assessment of market definition. Finally, we look at whether the availability of TV content from sources other than VOD (linear TV, PVRs and DVDs) would provide a competitive constraint for a monopolist of UK TV VOD content.

4.14 VOD services are new and developing quickly (see paragraph 2.7) and this has implications for the evidence regarding consumer preferences for VOD. Providers are experimenting with business models, including delivery mechanisms and pricing structures, and consumer preferences are likely to develop as the industry grows. We gathered information from various different sources, focusing on consumer preferences for, and likely degree of substitutability of, content. Content is the key part of any VOD offer, although the ways of delivering VOD to viewers will be affected by technological developments. In reviewing the evidence on consumer preferences that has been put to us, and which we have ourselves gathered, we have been careful to look at evidence in the round and, ultimately, to exercise judgement in these matters.

Content

4.15 We looked at the key characteristics that make TV content attractive to VOD viewers in the UK. Many third parties told us that a key characteristic of successful VOD was that it must have previously been broadcast on linear TV and said that there was a clear correlation between success on linear TV and success as VOD content. The

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[49] This calculation is based on the assumption that demand for UK TV archive DTR content is linear. It includes switching to US TV archive DTR and consumers who prefer not to purchase anything after the increase in the relative price.

[50] We were not able to include switching to short-form content and P2P services because we could not interpolate to a 5 per cent increase from an 'infinite'' price increase (from free to £0.50). In addition, it is not straightforward to aggregate the results because the survey looked at different groups of products for different categories. The calculation includes switching from UK TV archive DTR to US TV archive DTR, plus switching from TV DTR content (including both UK and US, and catch-up and archive) to film DTR content and switching from DTR UK TV archive content to UK TV archive content on DVDs. In our view, this will tend to overestimate actual switching because it will include an element of double counting.

parties did not dispute that a series that is successful on linear TV is also likely to make attractive VOD content and said that it would be very difficult to market a programme on VOD successfully if it had not been broadcast on any UK channel. However, the parties also said that performance on linear TV could not be used as a proxy for performance on VOD. They provided evidence, including examples of programmes that had performed disproportionately well on VOD compared with performance on linear TV that, in their view, showed that there was no direct correlation between the two.

4.16 The parties submitted an analysis to support their view of the limited relationship between linear and VOD performance. It looked at the top ten TV downloads on iTunes over a ten-week period between July and September 2008, showing that only one of the top ten VOD series downloads on iTunes was also in the top ten linear ratings. The parties also submitted an analysis of the suitability of linear broadcasting for VOD, which concluded that they had exclusive rights to content that accounted for [✂] per cent of viewing of content suitable for archive VOD and they had control rights for [✂] per cent.[51] In our view, however, neither of these analyses shed light on the parties' likely VOD market share. We discuss this analysis further in Appendix F.

4.17 We found that an important characteristic of successful VOD content is that it has previously been broadcast on linear TV. Viewers prefer content with which they are familiar. We also found that performance on VOD is related to, but not necessarily determined by, performance on linear TV. We note that the parties themselves often use success on linear TV as a key indicator of likely success as VOD. We recognize that there are examples of surprise successes on VOD, and that certain genres (eg comedy and drama) tend to make more successful VOD than others (eg news, sport). We conclude that success on linear TV is an important indicator of likely success on VOD.

4.18 We looked at consumer surveys showing content preferences as well as at the parties' internal strategy documents which indicated the importance of different content types. In addition, we looked at VOD viewing data to assess consumer substitution patterns in response to changes in the range of content available (see paragraphs 4.70 to 4.84 and Appendix H). We found that, in general, the UK TV content which is produced or commissioned by each of the parties is a good substitute for one another.[52] We therefore found that all UK TV VOD content is in the same relevant economic market.

4.19 We considered whether other types of VOD content would provide a constraint to a hypothetical monopolist of UK TV VOD content. Third-party views of the importance of UK content to VOD viewers varied. Sky told us that, in its view, all types of audiovisual content, including the VOD content supplied by the parties, fulfilled the common use of providing entertainment, education and information and were therefore substitutable from the perspective of viewers. However, the majority of third-party VOD retailers told us that non-UK content was not a good substitute for UK-originated content. [✂] told us that the vast majority of demand for VOD services was for UK-originated content, which had greater appeal to a broader range of VOD

[51]The parties defined exclusive rights as being 'where either distribution rights have been acquired by one of BBCW, ITV or C4 on an exclusive basis (for a finite period of time), or the rights are controlled by one of the parties in perpetuity'. They defined control rights as being 'where either rights have been permanently acquired by one of the parties from the content producer, or the content was produced in-house so the permanent rights are automatically owned by virtue of copyright law'.
[52]For the avoidance of doubt, this finding does not suggest that all UK-originated content is a better substitute for each other than any non-UK content. However, given that UKVOD provides a broad range of UK-originated TV content, covering a variety of genres, we analysed all UK content together for the purposes of our competitive assessment.

users.[53] Another third party ([✂]) told us that there was separate and strong demand for both types of content, but that local content was critical to success for a VOD retailer.[54]

4.20 As set out in paragraph 2.4, we note that a significant proportion of programmes that have been broadcast on linear TV (particularly the PSB channels) are of UK origin. Whilst we acknowledge that this may partly be the result of the imposition of quotas for original UK productions for PSB channels, we also note that the BBC, ITV and C4C regularly exceed their quotas. This might suggest that they believe that UK viewers have a preference for UK-originated content in linear TV, which we might expect to read across into the VOD environment. We saw other evidence that also indicated that, at least for some genres, viewers prefer UK-originated content (see paragraph 4.74).[55]

4.21 The consumer surveys that we examined, together with the parties' internal strategy documents, indicated the importance of UK content for successful VOD. That evidence, as well as our analysis of VOD viewing data, showed that non-UK content is not, in general, a good substitute for the parties' content.

4.22 We found that some non-UK content might be substitutable for some UK content to the extent that, for example, it is drawn from the same genre or sub-genre, or is of a similar age to some UK content. Nevertheless, genres can be defined in a variety of ways and neither we nor the parties carried out a complete analysis by genre or sub-genre. In any case, we found that, overall, non-UK content would not be a good substitute for UK content. We found that familiarity with content was important and that non-UK content that had been broadcast on linear TV in the UK is a closer substitute than other non-UK content. Our assessment of negotiations for the wholesale supply of content also indicated that for VOD viewers, non-UK content was not a good substitute for UK content. In particular, we saw some evidence of a competitive process in which VOD retailers played one of the parties off against another but did not threaten to switch away to non-UK content (see paragraph 4.97). The evidence of consumer substitution patterns that we looked at was also consistent with this finding, although data limitations led us to place only limited weight on these results (see paragraphs 4.75 to 4.84).

4.23 The majority of third parties told us that there was a distinction between TV and film content. Virgin Media told us that, in its view, viewers distinguished clearly between the decision to watch a film and the decision to watch a TV programme. It said that most TV VOD consumption was of programmes that were shorter than films and pointed to the different charging structures for film content, which, in its view, indicated that consumers had a different willingness to pay. [✂] told us that the viewer experience was very different for films, particularly because of the length of programmes and the lead time for availability of content. [✂] also said that demand for, and the pricing structure of, film content was different.

4.24 We therefore found that film content[56] is not a good substitute for UK TV VOD content. Our analysis of viewing data was consistent with this finding (see paragraph 4.82 and Appendix H).

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[53][✂] told us that, in its view, non-UK content was not a close substitute for UK-originated content. It told us that [✂].
[54][✂] told us that, in its view, local content for certain genres (such as those relating to newsworthy events and situation-based shows (ie comedy and drama)) that have particular appeal to local cultures was critical to adoption of VOD services.
[55]In addition, we note that *Ofcom's Second Public Service Broadcasting Review: Putting Viewers First*, 21 January 2009 says that audiences value highly content that meets the purposes and characteristics of public service broadcasting and that high quality UK-originated programming plays an essential part in meeting these purposes.
[56]We include adult film content in our definition of film content.

4.25 Many third parties also told us that short-form (clips) and user-generated content were a poor substitute for long-form, high-quality professionally-produced TV content. VOD retailers pointed to the difference in the production quality and programme length as important features that distinguish short-form and user-generated content from TV content.[57] One VOD retailer ([✂]) told us that, at best, clips might generate some interest in the underlying shows, but the vast majority of viewers wanted to watch the entire show.

4.26 We found that short-form and user-generated content is not a good substitute for long-form, high-quality professionally-produced TV VOD content. The viewer experience for short-form content is very different from that of long-form TV content. Clips are much shorter in duration than TV programmes; the content is not usually similar to premium TV content; and the production quality is often relatively poor, particularly for user-generated content.

4.27 We also considered whether the provision of illegal content might offer a competitive constraint to the UKVOD service.[58] We note that, in the absence of content being available on a legal service, illegal services are widely used by certain consumers. However, we would not, in general, identify illegal provision as a competitive constraint within the relevant market given that, as a matter of public policy, both national and international governmental organizations are committed to removing such provision; a position which we understand the parties to support.[59] In addition, we note that there are risks of virus infections, criminal prosecution and issues of the poor technical quality and reliability of access to the content that is available on these services. We therefore conclude that it is not appropriate to treat illegal content provision as an effective competitive constraint to the UKVOD service.

4.28 We therefore formed the view that the relevant product market should exclude film VOD, short-form and user-generated content and illegal content. We found that non-UK content is not a good substitute for UK content, particularly for certain genres of programmes and/or if it has not previously been broadcast on linear TV in the UK.

Catch-up and archive

4.29 We looked at whether it might be appropriate to define separate markets for catch-up and archive content. We were told that catch-up and archive UK TV VOD content fulfilled different functions and that catch-up was closely related to the parties' linear broadcasting activities.

4.30 However, we note that it is difficult to distinguish meaningfully between catch-up and archive, since the same programme will move from catch-up to archive at a particular point in time. Nor is it clear to us that there is a meaningful way in which to classify catch-up and archive in respect of repeat transmissions on linear TV.

4.31 We therefore decided that it is not appropriate to segment the market for UK TV VOD content into catch-up and archive content. Where relevant, however, we distinguish between catch-up and archive content in our competitive analysis.

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[57] [✂]

[58] For these purposes, where we refer to illegal content we mean content made available without authorization by the relevant rights holder on file-sharing or P2P websites or otherwise.

[59] See also the Government's consultation on illicit file sharing (www.berr.gov.uk/files/file47139.pdf) and the Digital Britain interim report (see paragraph 2.18). The Digital Britain report includes an action plan aimed at introducing legislation to force ISPs to crackdown on Internet pirates. The Government also intends to explore the potential for a Rights Agency to provide incentives for legal use of copyright material.

Delivery mechanisms

4.32 We were told that there were distinctions between VOD retailers according to whether their offers were, for example, delivered via PC or TV, 'open' or 'closed' services, delivered by dedicated hardware or delivered via other hardware such as games consoles and mobile phones. In particular, we were told of the significant differences between existing services which were delivered via PC or TV and between open and closed services (see paragraphs 2.3 and 4.45). We looked at these distinctions and considered whether to segment the market for UK TV VOD along any of these lines.

4.33 We were told that, according to consumer research, consumers prefer to view VOD on a TV rather than on a PC. This suggests that, at least for existing services, the experience of viewing via a PC ('sit forward') can be inferior to the experience of viewing via a TV ('sit back').[60] However, we also understand that the availability and quality of devices that facilitate the viewing of VOD accessed via PC on a TV are improving. As such devices develop, the distinction between different delivery methods may become less important. We also note that, in time, VOD may become available on TV screens without subscription, accessed together with Freeview or Freesat.

4.34 There may be differences in the costs to consumers of switching between different VOD retailers with different delivery methods. For example, some providers may require the customer to subscribe to a pay-TV service (such as Sky or Virgin Media) or to purchase a dedicated broadband connection (such as BT Vision), and others require the customer to purchase dedicated hardware (for example, Apple TV). Consumers of UK TV VOD via PC that already have a subscription to a pay-TV service with VOD, or that already have dedicated hardware that allows them to view VOD, would be able to switch readily. Others may be willing to subscribe or purchase the hardware in response to a change in the relative price of the different offers. The smaller the proportion of relevant consumers that can already access VOD via other delivery methods, or that would be willing to pay for access in response to a small change in the relative price, the less the competitive constraint any alternative would exert.

4.35 It seemed to us that these distinctions reflect commercial choices driven by the providers' business models for VOD and/or their other commercial activities. Given the various different models, we found it difficult to define open and closed services meaningfully other than by reference to existing examples. We therefore decided that it is not appropriate to segment the market for UK TV VOD according to the delivery method or business model.

4.36 However, we note that the parties classify other providers as 'open' and 'closed' services and distinguish between them for the purposes of the JV's planned syndication activities. In particular, the transaction agreements describe the 'open' services which it is envisaged that the JV would not supply with VOD content during the first 12 months of the operation of its own service (see paragraph 3.16). We found that the distinctions drawn by the parties reflected differences in the JV's incentives to syndicate VOD content between the various 'open' and 'closed' services listed and this was important for our assessment of the competitive effects of the JV (see paragraph 4.126*(c)*).

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[60]A survey by [✂] found that more than three-quarters of respondents showed a preference for watching VOD content on TV. Source: [✂].

Non-VOD TV content

4.37 Finally, we also considered whether the availability of TV content from sources other than VOD (linear TV, PVRs and DVDs) would provide a competitive constraint for a hypothetical monopolist of UK TV VOD content.

4.38 All UK TV VOD catch-up content has previously been broadcast on linear TV and there are a number of linear TV channels (such as UKTV GOLD) that are dedicated to the broadcast of programmes from the UK TV archive. PVRs are a popular way of watching programmes that have previously been broadcast. Consumers may purchase and use a variety of PVRs, both FTA and through subscription services. By their nature, PVRs are likely to be more effective substitutes for catch-up VOD than for archive VOD. DVDs are also a popular way of watching previously broadcast TV. Consumers can purchase DVDs of programmes from the UK TV archive.

4.39 Although linear TV, PVRs and DVDs all allow consumers to view some of the same programmes which are also available as UK TV VOD content, there are a number of reasons why, in our view, none of them are likely to be a close substitute to UK TV VOD. All of these alternatives serve a different purpose to VOD content and currently require viewers to plan in advance what they will want to watch, restricting their flexibility and substitutability. We looked at whether it was likely that 'intelligent' PVRs that learn viewers' preferences, and that might be expected to facilitate an experience that is closer to true catch-up VOD, might be widely available in the near future, but saw no evidence to suggest that a solution which would offer equivalent functionality was likely to emerge in the foreseeable future.[61]

4.40 Several third parties told us that PVRs provided a relatively limited substitute to a VOD service. We note that the storage capacity of most PVR models is currently typically between 40 and 80 hours, limiting the choice of content available to a viewer at any one time. We understand that capacity is increasing with new technology developments. Nonetheless, PVRs depend on content that has been broadcast on linear schedules. Similarly, the content available to view via DVDs is different from UK TV VOD content. It is unlikely that all UK TV VOD content will be released on DVDs. Nor will it necessarily be available at the same time or in the same form as it is available as VOD.[62] [✂] said that the significant expense of retail DVDs, relative to VOD services, limited their substitutability for VOD.

4.41 We therefore conclude that these alternative sources of UK TV content are not, overall, sufficiently close substitutes collectively, and together with other alternatives, to provide a strong competitive constraint to a provider of UK TV VOD content.

Conclusions on market definition

4.42 We conclude that the markets for the retail supply of VOD services and the wholesale licensing of content for VOD exploitation should be defined by reference to the supply of VOD content and should include long-form VOD content delivered by both open (typically Internet-based) and closed (typically proprietary TV-based) services. Although there is a degree of differentiation between catch-up and archive content and our competitive assessment distinguishes between the two to some extent, we decided that they should be treated as part of the same markets. The markets

[61]Tivo, the US intelligent PVR system, launched the first PVRs in the UK in 2000, but withdrew in February 2003. It was announced in September 2007 that Phillips was designing a system that would allow a PVR to learn from viewing behaviour and to record programmes unprompted (see www.afterdawn.com/news/archive/10980.cfm). We have no information regarding a likely launch date.
[62]Although rights may be acquired together, DTO and DVD rights are separate and may be available at different times.

should, however, exclude film VOD, short-form and user-generated content, illegal content, DVDs and the use of PVRs, and the supply of linear broadcast TV. We also found that non-UK content is not a good substitute for UK content, particularly for certain genres of programmes and/or if it has not previously been broadcast on linear TV. We found that, taken together, the possible alternatives for consumers would not provide a significant constraint to a hypothetical monopolist of UK TV VOD content.

4.43 The parties told us that UKVOD will target customers based in the UK. It told us that the relevant VOD rights for the JV will relate to exploitation within the UK. We therefore conclude that the geographic market should be no wider than the UK.

Underlying factors affecting competition

4.44 Before assessing the levels of existing competition in the VOD market and the likely impact of the transaction, we set out some key factors affecting competition. Paragraphs 4.45 to 4.58 give an overview of key third-party VOD retailers; paragraphs 4.59 to 4.65 set out our view of market shares.

Overview of VOD retailers

4.45 Paragraphs 2.19 to 2.32 gave an overview of the parties. Paragraphs 4.46 to 4.58 outline the characteristics of some third-party VOD retailers, discussing:

(a) open VOD services (for example, iTunes, Joost and Babelgum); and

(b) closed VOD services (for example, Virgin Media, Sky, BT Vision, Tiscali, Top Up TV).

Many of these retailers provide some of the same TV content as each other and acquire some of their TV VOD content from the parties.

Open VOD

4.46 Apple Inc (Apple) (formerly Apple Computer Inc) was founded in 1976. iTunes is a digital media player application, developed by Apple, for playing and organizing digital music and video files. Apple iTunes offers TV content from a number of providers including UK content providers (BBCW, ITV and C4C) and major US studios (Universal, Warner Bros and Disney). It also offers films. Viewers pay for permanent downloads of the content. There are three price tiers for TV content (£1.19, £1.49 and £1.89 per show, or a (lower) bundle price for a series). [✂]

4.47 Joost was established in 2006 with strong financial backing and launched its VOD business in the UK in October 2007. It is an online VOD retailer with free-to-user, advertising-supported content available on its website. It offers full-length TV programmes and short-form content provided by large companies including Viacom, CBS and Universal Music Group as well as smaller third-party producers and aggregators. All of its VOD content is archive material, drawn from regional and international libraries. Joost said that around [✂] regular viewers used the site every month. Around [✂] of its audience is in the USA and about [✂] per cent is in the UK.

4.48 Babelgum was founded in 2005. It is a free Internet TV platform supported by advertising that will offer professionally produced long- and short-form content on demand to a global audience with broadband access. The site is currently being tested and Babelgum expects to launch in the UK and USA in [✂]. Babelgum will provide content around particular ‘passion areas’ like adventure sports. Its content providers include [✂].

4.49 Other significant players include the video rental chain Blockbuster which bought Movielink in the summer of 2007 to expand into the VOD area and Amazon and AOL which sell film and TV show downloads.[63] Orange offers Orange TV, available on most 3G mobile telephones.

Closed VOD

4.50 Virgin Media was launched in February 2007. It was created by the merger in March 2006 of NTL and Telewest and the subsequent purchase of Virgin Mobile. It offers customers a number of TV, broadband, fixed-line and mobile telephony services. NTL and Telewest began rolling out VOD services in January 2005; these were made available to all digital subscribers by the end of 2006.

4.51 Virgin Media offers a closed TV VOD service to subscribers to its cable TV services.[64] Virgin Media currently has three TV packages and includes VOD to its subscribers as a way of differentiating itself from its pay-TV competitors. Subscribers to the two basic TV packages get free catch-up content and can choose to pay an additional sum for archive VOD content. Subscribers to the ‘XL’ TV package get both free catch-up and archive VOD content. As at November 2008, Virgin Media had [✂] million digital TV customers.

4.52 Sky was formed in 1990 from the merger of Sky Television plc and British Satellite Broadcasting Limited. It is a leading broadcaster of sports, films, entertainment and news. Sky acquires content to broadcast on its own channels and wholesales content to other retailers. It retails channels (both its own and those of third parties) to subscribers. As at 30 September 2008, Sky had approximately 9 million subscribers.

4.53 Sky offers two VOD services: Sky Anytime and Sky Player.[65] Sky Anytime is a ‘push VOD’ service available on TV at no additional charge to existing Sky subscribers. It features about 30 hours of content from particular channel providers. Sky told us that Sky Anytime had been made available to its subscribers at no additional charge.[66] Sky told us that this was intended to drive retention of customers, to increase loyalty, and to drive acquisitions to its pay-TV service. Sky Player is a PC VOD service that offers about [✂] hours of content. It makes content available in a number of different ways, including at no additional charge to existing Sky subscribers, on a pay-per-view basis, or on a DTO basis.

4.54 BT Vision was launched in December 2006 as BT Group plc’s (BT’s) new digital-TV service available to BT broadband customers. It offers access to DTT channels through its set-top box, as well as a range of on-demand entertainment over a broadband connection.

4.55 BT Vision offers a TV VOD service that is available to BT broadband customers. BT Vision’s VOD service is available on a pay-per-programme or subscription basis

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[63]Amazon became the largest shareholder in LOVEFiLM in February 2008 and entered into an agreement to promote LOVEFiLM’s services on its sites for UK and German customers. LOVEFiLM acquired Amazon’s DVD rental business in the UK and Germany.
[64][✂]
[65]In addition, Sky told us that in July 2008 Sony Computer Entertainment Europe Ltd, in partnership with Sky, launched a VOD service called ‘Go!View’, which has been developed for use on the Playstation Portable devices. The service was launched in October 2008. [✂]
[66]Sky told us that Sky Anytime was available to Sky subscribers with either a Sky+ HD set-top box or a Sky+ set-top box acquired after November 2005.

(subscribers account for [✂] per cent of programme views). BT Vision currently has about [✂] hours of VOD content, [✂] of which is of UK origin and almost all of which has previously been broadcast on linear TV. BT Vision told us that in June 2008, [✂] million programmes were viewed in subscription packages and [✂] people viewed at least one item in its 'TV Pack'.

4.56 Tiscali UK operates a TV service over a broadband connection, Tiscali TV, previously known as Homechoice. Tiscali acquired the business in 2006 as a result of a merger with Homechoice's parent company, Video Networks.

4.57 Tiscali TV offers pay-per-view and subscription service PC VOD. It offers films, music and TV content. Tiscali TV currently offers more than [✂] hours of TV and film VOD content on subscription, pay-per-view and free to catch-up basis. As of June 2008, Tiscali had [✂] subscribers, and aims to have [✂].

4.58 Top Up TV was established in 2004. It provides pay-TV services over the DTT platform, including a push-VOD service which comprises VOD content from about 25 basic tier channels. Top Up TV also offers certain linear pay-TV channels, including Setanta Sports. It currently has a relatively small number of subscribers ([✂]) and is seeking to increase this to reach [✂] within about [✂].

Market shares

4.59 There are many reasons why market shares may not give a clear indication of the relative strength or market power of competitors in the market, particularly in a differentiated product market. There will inevitably be differences in demand for individual programmes, making market shares difficult to interpret. In addition, in rapidly changing markets such as these, market shares based on past performance may not give a good indication of future competitive strength. However, we find it useful to present several measures of market share which provide an indication of the parties' strength in VOD markets relative to their competitors. We estimated the parties' VOD content market shares in three different ways: based on share of available content, share of viewing and share of revenue.

4.60 In our view, shares of available VOD content provide the most meaningful measure of market shares although all must be interpreted with caution. Given our finding that non-UK content is not a good substitute for UK content, we looked at the availability of UK content. The parties have a large proportion of available UK archive content. On the basis of information provided by the parties, we estimate that between them they control between [✂] and [✂] hours,[67] with the BBC owning a further similar number ([✂]) of hours of content. The parties provided estimates of the proportion of these hours of content that might be suitable for commercial VOD exploitation. They said that they did not own VOD rights to all suitable hours, but estimated that between them they had [more than 50,000] hours of content that might be considered to be suitable for VOD exploitation.

4.61 We recognize that the acquisition of VOD rights was, to some extent, a commercial decision by each of the parties (see paragraph 4.100) and that some of these hours would be more valuable than others. In contrast, our best estimate of available hours

[67]This includes [✂] hours from BBCW, [✂] hours from ITV and [✂] from C4C.

of UK content from other providers that might be suitable for VOD exploitation is around 5,000 hours.[68] Further details are set out in Appendix E.

4.62 In order to estimate market shares based on share of VOD viewing, we looked at the number of views of TV VOD content by VOD retailer in the month of June 2008. The data did not allow us to distinguish between UK and non-UK content nor to identify non-UK content previously broadcast on linear TV in the UK. To the extent that we do not view non-UK content as a good substitute for UK content, the parties' market shares will tend to be understated. We also note that this is a rapidly developing market and that estimates based on viewing in June 2008 may not provide a good indication of future market shares.

4.63 We found that the parties had a market share of [✂] per cent of views of VOD content, with BBC iPlayer having another [✂] per cent and the vast majority of the remainder being provided by Virgin Media. However, this took no account of the fact that a large proportion of the content viewed on third-party VOD retailers' services (for example, Virgin Media) depended on the parties' content. We therefore adjusted the market shares to look at the shares of viewing by content provider.[69] On this basis, BBCW, ITV and C4C had a combined market share of around [✂] per cent of views, with a further [✂] per cent provided by the BBC on the BBC iPlayer and the remaining 16 per cent being provided by third parties. The parties provided [✂] of all the archive VOD content viewed, and around [✂] per cent of the archive VOD content viewed on open services alone.

4.64 The parties estimated market shares based on share of revenue. On this basis, they projected that UKVOD would have a share of [✂] per cent of transactional VOD revenue, [✂] per cent of display advertising, and [✂] per cent of Internet advertising in 2011. However, we did not think that these measures provided a good indication of market strength for a variety of reasons. Estimates of future revenues will depend on the business model adopted and this may, in any case, develop over time. In addition, these measures do not take into account the source of the content. Finally, the figures also include revenues from areas outside our market definition including, in particular, PVRs, film and adult content.[70]

4.65 We therefore conclude that, whilst market share estimates should be treated with caution, the parties' estimates of share of revenue underestimated their market share by a considerable margin. Nor did we consider that the parties' analysis of the suitability of linear broadcasting for VOD gave a good estimate of likely VOD market share (see paragraph 4.16). We found that the parties had a substantial share of UK VOD content, particularly of hours of UK TV archive VOD content.

Competitive assessment

4.66 Paragraph 4.42 sets out our conclusion that the markets for the retail supply of VOD services and the wholesale licensing of content for VOD exploitation should be defined by reference to the supply of VOD content and should include long-form VOD content (both catch-up and archive) delivered by both open and closed services in the UK. The markets exclude film, short-form and user-generated content, DVDs and the use of PVRs, and the supply of linear broadcast TV. We also did not view non-UK

[68] We believe there to be of the order of [✂] hours of content suitable for VOD exploitation for which the rights reside with third-party producers. In addition, we note that Virgin Media and BT Vision each carry several hundred hours of UK content from niche providers. ITV said that it thought it likely that independent production companies would agree more deals to supply VOD in the future.

[69] This content is provided either on the party's own website or through its wholesale deals with third-party VOD retailers. In either case, the parties hold VOD rights to the content.

[70] We were unable to estimate future revenues excluding those areas which were outside our market definition.

content as a good substitute for UK content, particularly for certain genres of programmes and/or if it has not previously been broadcast on linear TV.

4.67 In considering the levels of competition in the market absent the JV, both now and in the future, we take into account our conclusion on the counterfactual. As set out in paragraph 3.50, we concluded that, in the absence of the transaction, each of BBCW, ITV and C4C would pursue its own commercial interests to exploit its archive VOD content rights in the wholesale market either alone or in partnership with a third party. Such rights would be likely to form part of a retail VOD service, either in a direct to consumer offering or through wholesale distribution.

4.68 We first assessed the current levels of competition absent the JV, in terms of the supply of VOD at both the retail and wholesale levels. We then considered barriers to entry and expansion, before assessing the impact of the JV. As set out in paragraph 4.4, we note the relevance of the nascent and rapidly-changing nature of the VOD markets in our assessment of competition.

Levels of competition absent the JV

Retail supply of VOD services

4.69 We examined and analysed a range of evidence in order to assess the current levels of competition between each of the parties and between the parties and third-party VOD retailers in the absence of the JV:

(a) consumer surveys;

(b) empirical analysis of viewing data of existing VOD services (provided both by the parties and third parties); and

(c) the parties' strategy documents.

We also took into account the views of the parties, as well as those of third parties. We summarize the conclusions that we draw from this evidence in paragraphs 4.70 to 4.90; further details are set out in Appendices F and H.

4.70 We looked at a variety of consumer surveys to understand TV and VOD content preferences by TV broadcast channel, sources of VOD content and potential UKVOD usage.

4.71 We looked at the consumer survey carried out by Ofcom as part of the first phase of its review of Public Service Broadcasting which looked at the importance consumers placed on the main linear TV channels showing UK content.[71] The results indicated that consumers place a high value on UK content and expect the PSB to provide it. Although support for non-UK programmes had increased since 2003, consumers still place a higher value on content of UK origin. We note, however, that this survey does not provide insights into consumer behaviour or willingness to pay. The results might also mask important differences by genre. The parties' analysis of viewing patterns over a two-week period in May 2008 using BARB data showed that around [✂] of drama and entertainment viewing was of UK origin, but that UK content accounted for a [✂] of long-running series, news, sport and other programmes.

[71] *Ofcom Review of Public Service Broadcasting*, April 2008.

4.72 We looked at three consumer surveys of VOD content preferences by TV broadcast channel. The first two surveys conducted in the first half of 2008 (a survey of Virgin Media VOD customers and a survey of VOD usage commissioned by C4C and BBCW) both showed that VOD consumers had a strong preference for BBC1 and Channel 4 content in particular, and that content from other broadcasters was much less popular.[72] The third survey, which was relatively dated for a fast-developing sector, was conducted by C4C in April 2006 and asked which brands 16- to 34-year-old consumers would rely upon to bring the best entertainment.[73] The BBC and Channel 4 received [✂] with over [✂] per cent of responses each; Sky received [✂] per cent; and ITV [✂] per cent. Although we agree with the parties that this survey was likely to be dominated by consumer opinions of linear TV broadcasters, we think such views are relevant to consumer views on VOD (see paragraph 4.16).

4.73 We also looked at three consumer surveys of sources of VOD content. All were carried out in the first half of 2008 and showed that, despite the immaturity of the VOD market, the parties' VOD services, together with the BBC iPlayer, were popular sources of VOD. An online independent survey of entertainment activity showed that, at that time, the only two sources that were significantly more popular than 4OD or the BBC iPlayer were YouTube (showing primarily short clips) and Virgin Media (with a high proportion of the parties' content).[74]

4.74 UKVOD carried out a survey to understand and size the market for its offer.[75] This survey found that [✂] were the most popular channels for those interested in VOD, and concluded that '[✂] are the core genres that need to be delivered within Kangaroo'.

4.75 We conducted four empirical analyses to shed some light on the degree of VOD content substitutability and hence levels of competitive constraint in VOD markets. We looked at data from the parties and the BBC on viewer patterns on their own websites as well as data on three third-party VOD retailers. We did not have data by consumer so we were not able to observe substitution directly. Instead, we inferred substitution patterns from the effect of a change in the availability of content from one provider on demand for content from another provider.[76] Paragraphs 4.77 to 4.84 set out our high-level findings; further details are set out in Appendix H.

4.76 We recognize that we must interpret these results with caution given, in particular, the rapid growth and relative immaturity of the market. We also recognize that there are limitations on the data that we have been able to collect which has, in particular, led our analysis to be based on inferences of consumer behaviour in response to changes in non-price aspects of the retail offer.

4.77 We collected data on daily viewing figures for each of BBC iPlayer, ITV.com and 4OD since launch. We looked at the effect of changes in the number of hours of content provided by one VOD service on demand for the other VOD services. Some of the results showed that an increased supply of content on one service was associated with a fall in demand for another, consistent with these VOD services being in close competition. However, we also found some statistically significant results that were not consistent with substitution (see Appendix H).

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[72] [✂], January 2008, and [✂], July 2008.
[73] [✂], April 2006.
[74] [✂]
[75] *Understanding and sizing the market for Kangaroo*, November 2007.
[76] If an increase in content available from provider X is associated with a fall in provider Y's demand, we interpreted this as being consistent with customers substituting between the two—from Y to X. On the other hand, if an increase in content available from provider X is associated with no change in provider Z's demand, we viewed this as being inconsistent with customers substituting between the two.

4.78 We also analysed the data to look at viewer substitution patterns between UK and non-UK content. We found, in general, that UK content was a good substitute for non-UK content but that non-UK content was not a good substitute for UK content.

4.79 We looked at data from three third-party VOD retailers ([✂]). The most complete dataset that we had ([✂]) looked at daily viewing figures by content provider for a period of ten months. We analysed viewing data to infer customer substitution patterns in response to changes in the content available.

4.80 We were able to identify the effects of changes in content from individual providers more easily in the [✂] data than we were in our analysis of viewing on each of BBC iPlayer, ITV.com and 4oD, since [✂]. In addition, our analysis is not affected by other aspects of competition between retailers including, for example, the quality of the customer interface, the reliability of delivery and the level of site traffic. We controlled for other factors that affect demand on any given day in order to isolate the relationship between VOD providers.[77]

4.81 In general, the results were consistent with the parties' content being better substitutes for one another's content than other providers' content.[78] We found one result that was not consistent with our general finding. [✂][79] We also found that some content from two other providers was a good substitute for some of the parties' content. [✂] (see Appendix H).

4.82 We also looked at the effect of the launch of films on revenue from the parties' programmes.[80] We found that the launch of film did not have an identifiable effect on revenue from [✂] programmes. This suggested to us that film was not a good substitute for TV content.

4.83 The second dataset that we looked at was monthly data for the first half of 2008 for the parties and other significant providers of archive content on that service ([✂]). [✂] we looked at changes in demand as some content became less attractive over time. The changes in demand that we found were consistent with a pattern of substitution between the parties ([✂] gained as [✂] fell away), whereas there was no apparent corresponding change in demand for non-UK content.

4.84 Finally, we looked at monthly data over a nine-month period from a third VOD retailer ([✂]) and daily data over a two-month period when popular US content ([✂]) was first introduced on to a primarily UK-content-based VOD service. The monthly data showed no apparent change in the percentage of audience viewing UK content before and after the introduction of the US content. The more detailed daily data showed no apparent identifiable impact on demand for UK content from the launch of US content.

4.85 Our review of internal strategy documents also suggested to us that the parties consider themselves to be close competitors, both currently and in the future. For example, [✂] said that [✂]. One of the parties' [✂] comments that [✂]. This was [✂] analysis of the market and the competitor landscape. [✂]

[77] Our data covered the period [✂]. We controlled for weekends and Bank Holidays, as well as including a time trend to control for underlying trends in the data over the period.
[78] This was based on finding that the relationships between the parties were, in general, statistically significant whilst the relationship between the parties and other third party VOD retailers were, in general, not statistically significant. We discuss the exceptions in this paragraph and in Appendix H.
[79] [✂]
[80] [✂]

4.86 The majority of third parties told us that the parties were now, or were likely to be in the future, close competitors in the supply of VOD services. One third party ([✂]) said that the parties were 'very major players and direct competitors'. [✂] said that the parties were each other's closest competitors for a wide range of content supplied on a VOD basis. It told us that, in its view, the JV would remove the prospect of competition between the parties in retail VOD. A number of retailers of open VOD services ([✂]) said that each of the parties individually is a significant rival to them.

4.87 The parties challenged the view that they were close competitors to one another. They told us that users would have a choice of alternative VOD providers for much content that was available through UKVOD, including the parties' own websites and third-party open and closed VOD services (see paragraph 4.137).

4.88 The parties also told us that, in their view, customers were willing to substitute between UK and non-UK content. They advanced a number of arguments to support this view. They said that content on VOD services was classified by genre rather than by country of origin; there was no difference in price of VOD content by country of origin; that linear TV broadcasters were increasingly scheduling US content in prime time; and that US content was popular for DVD sales and for iTunes downloads.[81] They also gave us three empirical studies in support of their views (see paragraphs 4.8 to 4.11).

4.89 The parties told us that there were several successful VOD services (iTunes, Sky Anytime and Sky Player, Virgin Media and Joost) that offered primarily US content. We considered each of these examples in the light of the competitive constraint that each might offer UKVOD. [✂] told us that it was not possible to have a credible TV VOD service without content from local broadcasters; [✂]. Virgin Media launched its VOD service with film and largely UK TV content and [✂]. The parties' content accounts for a significant proportion (about [✂] per cent) of VOD views on Virgin Media,[82] with the BBC iPlayer accounting for another [✂] per cent. Virgin Media told us that, without the parties' content, its VOD service would be '[✂] less attractive'. We note that the Sky VOD services have not attracted high levels of viewing to date and, in any event, we estimate that [✂] of views on Sky Anytime are of UK content. Joost told us that without access to well-known UK content, the majority of which is controlled by the parties, it would be likely to focus its attention and investment on other territories where it was better able to build an attractive local offering.

4.90 Based on the evidence that we have examined, we therefore conclude that, absent the JV, the parties are, or will be in the future, each other's closest competitors for the supply of UK VOD content and that third-party VOD retailers offer a weaker competitive constraint. Third-party VOD retailers rely on content from one or more of the parties to offer any substantial volume of UK TV VOD content to their customers. Given our finding that non-UK VOD content is not, in general, a good substitute for the parties' VOD content (see paragraph 4.27), we do not find that VOD retailers offering non-UK content act as an effective competitive constraint on the parties.

Wholesale supply of VOD content rights

4.91 We examined the syndication deals that have been agreed between the parties as wholesalers and third-party open and closed VOD retailers as customers, to gain an

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[81] The parties told us, for example, that [✂]. We note that, according to the parties' analysis, [✂] per cent of the shows in the iTunes top 10 series between July and September 2008 were supplied by UK providers.
[82] [✂]

understanding of the determinants of bargaining power and the strength of the competitors in the wholesale market.

4.92 BBCW considered [✂].

4.93 C4C considered, [✂]. ITV said that [✂].

4.94 The parties also told us that their wholesale customers were powerful media conglomerates, often with linear carriage deals with the parties. They said that these customers were able to control access to their viewers and therefore held a strong negotiating position.

4.95 The details of the syndication deals agreed between each of the parties and third-party VOD retailers are set out in Appendix G. We found that the most quoted source of bargaining strength was the degree of importance attached to the content under negotiation. In addition, the ability to switch, or threaten to switch, between suppliers is an important aspect of bargaining power. We were not persuaded that the parties' wholesale customers had significant buyer power since the customers' strength is not in the VOD market (see Appendix G). Having examined a number of syndication deals, we found that, in general, the parties had greater bargaining strength than the VOD retailers to whom they supply content, although this was mitigated to some extent when they were negotiating with new, but potentially powerful, platforms (eg [✂]). We found that BBCW generally had superior bargaining strength to C4C or ITV.

4.96 Nevertheless, we were told by several third parties that it might be sufficient for them to have access to content from two of the three parties. [✂] told us that it had been able to offer a successful VOD service with content from [✂] and [✂], but without content from [✂]. Similarly, PACT told us that, in order to succeed, a VOD retailer probably needed to offer content from at least two of the terrestrial broadcasters.

4.97 We saw some evidence of a competitive process in which VOD retailers played one party off against another. Several third parties told us that they would be prepared to deal with only two out of three of the parties if the terms offered by one party were not satisfactory. [✂], for example, said that it was relatively comfortable provided it had agreements with the BBC plus one other, whether that was C4C or ITV, and [✂] suggested that it might be able to manage without archive content from BBCW if it had access to the BBC iPlayer and ITV content. [✂] commented that any one of the parties' content became marginally more valuable to the extent that a customer lacked agreements for the provision of content from the other two parties, although others ([✂]) said that the value of each was strengthened through being offered in combination with the others. One of the parties ([✂]), however, said that, in practice, it had not observed any VOD retailer playing one of the parties off against another.

4.98 Several existing and potential VOD retailers also told us of the importance of being able to offer both catch-up and archive content. [✂], for example, told us of the importance of catch-up content in attracting viewers to its site on a regular basis, and [✂] said that catch-up was the biggest single driver of a VOD business for TV content. This was supported by evidence from the parties (see paragraph 3.20).

4.99 As set out in paragraph 3.15, the parties individually would cease to wholesale archive VOD content under the JV and this role would be taken on by UKVOD. We therefore considered the credibility of third-party VOD retailers threatening to use alternative sources of UK archive VOD content when negotiating wholesale deals. We looked specifically at whether, without access to the parties' archive content, third-party VOD retailers would have access to sufficient UK archive content from third parties to allow them to compete closely with UKVOD. We note that, as set out in paragraph 2.4, more than half of UK content is produced in-house by the BBC or ITV. They will hold the VOD rights to this content. Of the remainder, the majority of pre-2004 archive content will be owned by the parties (see paragraph 2.12). Third-party producers in the UK will have VOD rights for some content produced since the Terms of Trade were introduced in 2004, but this is likely to be relatively limited (see Table 6, Appendix E). The broadcasters retain the rights to exploit content for VOD for ongoing series for a number of years and this is some of the most popular VOD content.

4.100 We were told more generally that each of the BBC/BBCW, ITV and C4C had a strong position in the acquisition of content rights, including primary and/or secondary rights. We found that the ability to acquire VOD rights was often closely associated with holding or acquiring linear TV rights and that the linear broadcaster of that content was in an advantageous position when negotiating for VOD rights to it. This was confirmed by one of the parties ([✂]).

4.101 We looked in more detail at the likely volume of content that might be available from third-party producers. According to our estimates, third-party producers were able to offer, in total, only a small fraction of the volume of VOD content available from the parties (see paragraph 4.60 and Appendix E). This was supported by evidence from [✂] third-party producers, who told us that they had met to discuss the possibility of offering aggregated VOD content to retailers or viewers, but had concluded that they had insufficient content to be credible. It was also supported by the limited number of hours of content included in the deals between third-party producers and VOD retailers. They told us that this was, in part, because of the extensive rights to content that linear broadcasters acquire when they purchase the linear TV broadcasting rights from them (see Appendix G).

4.102 We also note that, regardless of the volume of content available, the third-party production sector remains relatively fragmented. Despite some consolidation in recent years, we were told that it would be likely to involve a large amount of resource and effort to conclude agreements with a substantial number of producers. The BBC, for example, commissioned content from a large number ([✂]) of third-party production companies in 2007 and C4C had concluded agreements with a similar number of third-party production companies in order to offer the 4OD service. UKVOD also told us that it would take significant staff resources to conclude agreements with a wide variety of third-party production companies.

4.103 We also considered whether aggregators of VOD website links (such as www.123webtv.com) might be able to offer a service which would act as an effective competitive constraint to the parties' control of VOD content. Such websites function in a similar way to search engines but include a user interface to help customer navigation. We note, however, that since the aggregator website simply directs customers to the content providers' websites, the VOD content provider retains the ability to exploit the content as it chooses.

4.104 The other significant sources of UK content are Sky and Five. The parties told us that, since both were subsidiaries of very large media groups, they would have sufficient resources to produce, commission or acquire UK content for VOD exploitation. However, third-party producers told us that it was rare that Sky and Five were able to compete with the parties in this way, in large part because they could not expect to receive the same size of audience as the parties for the same content when broadcast on linear TV.[83]

4.105 Most existing VOD retailers told us that it was difficult to access a sufficient range of content from third-party production companies. Potential entrants also told us of the limitations of acquiring a wide range of VOD content from third-party production companies. One possible new entrant, Hulu, told us that it had held very productive discussions with many of the largest third-party producers in the UK. However, it judged that the content available from these companies was insufficient in total to represent the critical mass needed to launch a successful online offering in the UK.

4.106 We considered whether third-party VOD retailers were likely to set up their own production businesses in order to compete with the parties. However, without access to widely-viewed linear TV channels on which to broadcast such productions, we believe it unlikely that investment to produce a sufficient range of content would be made in the foreseeable future.

4.107 We therefore found that the parties were each other's closest competitors in the provision of UK VOD content rights to the wholesale market. Other wholesalers were unable to offer sufficient UK content to provide an effective competitive constraint.

4.108 The parties told us that several strong VOD services had been launched with non-UK content (see paragraph 4.89). We note that the most popular non-UK VOD content is that which has previously been broadcast on linear TV in the UK (see paragraph 4.15). Several third parties told us that VOD rights to non-UK (particularly US) content tended to be expensive and difficult to obtain. These parties said that any VOD service offering mainly US content would offer little or no constraint on the parties' ability to set the price of their content. They had not considered replacing the UK content they acquired from the parties with US content in the course of their content negotiations. This informs our view that non-UK content is not, in many cases, a good substitute for UK content (see paragraph 4.21).

4.109 We therefore found that there were no sources of sufficient scale to provide credible alternatives to the parties' content, making it difficult for wholesale customers to switch, or threaten to switch, away from the parties as suppliers should they be unable to agree satisfactory terms. This indicated to us that, absent the JV, the parties would be in a strong position in the wholesale market. This analysis was also relevant to our analysis of barriers to entry (see paragraph 4.123).

4.110 We recognize that this assessment is based primarily on existing levels of competition in the market. We therefore also looked at the extent to which third-party VOD services could expand or enter to offer an effective competitive constraint in the VOD market (see paragraphs 4.111 to 4.123) before discussing the impact of the JV.

Entry and expansion

4.111 We looked at the experience of entry and expansion before assessing the likely barriers to entry and expansion. Further details are set out in Appendix I.

[83]The parties provided us with an analysis by BARB of the top programmes among 25- to 44-year-olds that showed that the most popular programmes on digital channels were watched by a [✂] than those on terrestrial channels. All of the top-80 programmes on terrestrial channels were watched by [✂] viewers; the most popular programme for 25- to 44-year-olds in the preceding 12 months on digital channels was watched by [✂] viewers. The parties also broadcast the most popular programmes on digital channels.

History of entry and expansion and likely future players

4.112 The supply of VOD in the UK is a relatively recent phenomenon and is growing rapidly. We looked not only at past entry and expansion experience in the UK, but also at experience in the USA, where there are a number of existing VOD services in operation, as well as at likely future entry and expansion.

4.113 Closed VOD services were first offered in the UK in 2005 by ntl and Telewest, which subsequently merged to form Virgin Media. Virgin Media's VOD service is outlined in paragraphs 4.50 and 4.51. Several other open and closed VOD services have since been launched in the UK, including Tiscali TV (see paragraphs 4.56 and 4.57) and BT Vision (see paragraphs 4.54 and 4.55), which are both available to respective broadband customers, as well as iTunes (see paragraph 4.46), Sky Anytime and Sky Player (see paragraph 4.53) and Joost (see paragraph 4.47). The parties also offer VOD services (see paragraphs 2.27 and 2.31 for a description of ITV.com, 4OD and Channel4.com); the BBC offers catch-up content on BBC iPlayer; and RTL launched Demand Five in July 2008.

4.114 Apple and Microsoft both have successful VOD services in the USA operating over the Internet on a transactional basis. Both use VOD to complement their existing hardware businesses (the Apple iPod and the Microsoft Xbox 360 respectively). Hulu was launched in the USA in March 2008. It is a partnership between NewsCorp and NBC to offer a variety of content, including TV and films, on a free advertising-funded basis.

4.115 We have been told of several new VOD services that are planned for the UK market. In particular, Hulu told us that [✂]. Microsoft has told us that [✂]. In October 2008, Sony Computer Entertainment Europe Ltd and Sky launched Go!View, offering consumers the opportunity to download TV and film content to a Sony PlayStation portable device. Sky also told us that [✂]. Babelgum, which will offer free-to-view, advertising-funded niche content on the PC, is expecting to launch a VOD service in [✂] (see paragraph 4.48). Tesco said that it planned to launch VOD services on a DTR and DTO basis to UK customers through Tescodigital.com in early 2009. [✂]

4.116 We found that there was a wide range of existing and likely future VOD services being offered in the UK. These were all at a relatively early stage, and offered a range of different business models and approaches to pricing, as well as different content aggregation strategies. It was not yet clear which of these strategies would be successful, but, given UKVOD's business model, it was clear to us that, in order to compete with UKVOD, any VOD retailer would need to have access to a wide range of both catch-up and archive UK content.

Barriers to entry and expansion

4.117 We looked in particular at three possible barriers to entry and expansion—technology, promotion and access to content.

4.118 In order to offer a successful VOD service, a retailer must create a technical platform that manages both the back-office library and the front-end consumer interface. We were told that it was important for consumers to be able to stream content directly, rather than have to download an application on the PC. Third parties told us that, in general, there were no significant technological barriers to entry. The parties told us that a basic technical platform could be built relatively cost-effectively, but that it would cost more to develop a sophisticated website. C4C, for example, told us that it had invested a considerable amount [✂] in 4OD since its launch at the end of 2006. One third party told us that sophisticated technology was required to embed advertising tailored by individual. Overall, we found that there were no significant technological barriers to developing a VOD service.

4.119 We also considered whether the ability to promote and market a new VOD service would constitute a significant barrier to entry and expansion. The parties said that it was important to be able to win sufficient customers to attract advertisers, to drive transactional sales and to achieve sufficient scale to justify investments in technology and functionality. However, they told us that the availability of powerful search engines meant that it was relatively easy to attract users and that promotion was available to any new entrant that was prepared to place advertisements and seek other promotional opportunities. Some third parties said that the ability to promote and market a VOD service might act as a significant barrier, and raised concerns about the much greater ability of the parties to do so given their strength in linear TV.[84] However, we were told of a wide variety of ways in which sites could be promoted,[85] and we thought it unlikely that this would constitute a significant barrier to entry.

4.120 We looked in some detail at the third possible barrier to entry—access to UK content. We found that non-UK content is not a good substitute for UK content and that other wholesalers were unable to offer sufficient UK content to compete closely with the parties. We were told by several VOD retailers that access to attractive UK-originated content was the key to successful entry and one existing retailer ([✂]) told us that without access to the parties' content it would be likely to focus its attention and investment on other territories where it was better able to build an attractive local offering.

4.121 The parties, however, told us that content could be readily sourced. They said that there was a wide range of sources of attractive VOD content, including US studios, other content producers and content aggregators. Third-party producers and US studios were able to sell most VOD rights in TV content separately to linear broadcast rights, with the exception of catch-up rights. In their view, the low threshold for entry was demonstrated by the wide range of entry of VOD services that had occurred over recent years (see paragraphs 4.113 to 4.115).

4.122 The parties told us that successful entry was linked, in particular, to companies able to leverage existing strengths: a link to popular hardware and/or software (eg Apple iTunes, Microsoft Xbox); a link to a strong existing Internet brand (eg Google); a connection to an existing online retail proposition (eg Apple iTunes); cross-promotion to an existing subscriber base (eg Sky, Virgin Media, BT Vision); or experience in 'first-mover' markets and the ability to conclude global agreements (eg Apple iTunes). The parties told us that, in the absence of one of these advantages, the chance of launching a successful VOD proposition would be significantly reduced.

4.123 We agree that there may be the potential to develop an attractive VOD service based on content from sources other than the parties. However, we found it unlikely that a VOD retailer would be able to access sufficient UK VOD content to provide a VOD service which competed effectively with the parties. We take this into account in our assessment of the impact of the JV.

[84] The commercial PSBs are subject to Ofcom's cross-promotion code which aims to ensure that such cross-promotion does not prejudice fair and effective competition. The BBC Trust has its own, parallel cross-promotion code. The associated BBC Fair Trading Guidelines confirm that cross-promotion must either be for editorial reasons or to meet the BBC's Public Purposes.
[85] These might include, for example, the use of aggregators such as blinkx, purchasing key words from search engines, celebrity endorsements and encouraging URL sharing.

Impact of the JV

4.124 We next considered the impact of the JV on competition in the relevant VOD markets. We took into account our view of the counterfactual (see paragraph 3.50) as well as our findings that the parties themselves offer the closest competitive constraint to one another in the absence of the JV, and that there is a high barrier to entry and expansion in the form of access to attractive UK VOD content.

Wholesale supply of VOD content rights

4.125 We found that the JV was likely to result in a loss of rivalry in the supply of VOD content at the wholesale level. The parties were each other's closest competitors for the supply of UK VOD content, and other suppliers would not be in a position to offer content which would allow third-party VOD retailers to act as an effective competitive constraint to UKVOD. In particular, we found that VOD retailers would not be able to get sufficient attractive UKVOD content from third-party producers. Even if they were able to secure attractive non-UK content, this would not be a good substitute for UK content and would not allow third-party VOD retailers to compete closely with UKVOD.

4.126 Appendix G sets out details of the existing agreements between the parties and third-party VOD retailers. We note that it is the parties' intention to transfer these agreements to UKVOD where possible (see paragraph 3.15). We considered the extent to which UKVOD was likely to have the incentive to enter into syndication deals in the future. We noted the following points:

(a) As set out in paragraph 3.16, the CSAs provide that UKVOD may syndicate the whole, or substantially the whole, UKVOD service or sub-license substantial representative samples thereof. The precise terms on which content is syndicated, including editorial and other controls, would determine the scope of activities of any licensee. We note that the different VOD retailers currently have very different business models from that proposed for UKVOD itself which may not be compatible with these syndication options.

(b) UKVOD's incentive to syndicate will depend on the relative profitability of an additional syndication deal compared with the additional profitability earned by exploiting content on an exclusive, or more exclusive, basis.

(c) UKVOD may have less of an incentive to syndicate content to open VOD services which are likely to compete most closely with UKVOD. Closed VOD services may offer the opportunity to access customers who would not otherwise be accessed. The transaction envisages that UKVOD will not supply content to open VOD services for the first 12 months following launch of the UKVOD service.

(d) The parties told us that UKVOD had a particular incentive to syndicate content to closed VOD retailers. However, we note that customers of closed VOD retailers would be able to access UKVOD over the Internet, provided that they had an appropriate connection. Of those that did not, many would have access to Freeview or Freesat. We note that, in time, VOD may become available on TV screens without subscription (see paragraph 4.33).

For these reasons, we thought it unlikely that UKVOD would have a strong incentive to enter into future syndication deals, particularly to open VOD services, which might undermine its own retail operation. If UKVOD were to enter into syndication deals, we thought it likely that these would be on terms that would make it difficult for a third-party VOD retailer to offer an effective competitive constraint to the UKVOD service.

4.127 We also considered whether ITV and C4C would have an incentive to syndicate catch-up content to third-party VOD retailers to which UKVOD would not choose to syndicate. We note that ITV and C4C will be motivated to maximize profits for their VOD activities, and that the profitability of UKVOD will be important to them. We saw no reason why ITV and C4C would choose to enter into syndication deals that would be likely to undermine the success of UKVOD.[86] We were particularly concerned that the interaction between the parties via the JV would facilitate tacit coordination and give ITV and C4C the ability to align their strategies to UKVOD's syndication strategy. We therefore thought it more likely that, if ITV and C4C were to enter into syndication deals with third parties, these would be on terms that would be less favourable than would otherwise have been the case.

4.128 We also considered whether the parties were likely to have the incentive to syndicate DTO rights under the agreed DVD carve-out (see paragraph 3.11). The parties said that the significant size of each of their DVD businesses would give them a strong commercial incentive to bundle DTO and DVD rights in their negotiations with third parties. They also said that DVD retailers who, in their view, have significant buyer power were increasingly demanding [✂].

4.129 We note that the syndication of DTO rights together with DVD rights remains a decision for the parties. They would have to set the additional wholesale revenue earned from syndication against the potential loss of revenue from UKVOD for each potential deal. We could not form an expectation that the parties would decide to syndicate a wide range of DTO rights to close competitors. Nor were we persuaded that the retailers had significant countervailing buyer power, given the range of potential DVD retailers in the market. In addition, we note that the parties told us that these carve-outs were limited (see paragraph 3.11).

4.130 Evidence from internal documents suggested that [✂]. For example, C4C said that [✂].[87] BBCW strategy documents note that, [✂].[88] Several third parties (including [✂]) said that they expected that collective syndication of VOD rights was likely to raise input costs for third-party VOD retailers.

4.131 We identified two ways in which a loss of rivalry at the wholesale level might affect viewers. First, third-party VOD retailers purchasing VOD content from the parties might pass on a price increase, or other adverse change in terms, to consumers. This might take the form of higher transaction costs or subscription prices for closed platforms such as Virgin Media's. It could also involve, for example, a reduction in the range of VOD content offered or the offer of less attractive content, as well as a generally lower quality of service or lower levels of innovation.

4.132 The parties said that, since retailers' VOD costs were unlikely to play a significant part in a bundled retail offer (such as, for example, digital TV, broadband, voice telephony and mobile), retailers would be unlikely to pass any increases in VOD costs on to consumers. In our view, this would be a commercial decision for the retailer. If the retailer faced higher costs per subscriber, we would expect them to pass those on to the consumer in some way.

[86] [✂]
[87] [✂]
[88] [✂]

4.133 We also identified a second mechanism through which consumers may be harmed as a result of a reduction of rivalry at the wholesale level. The parties are vertically integrated and are present at both wholesale and retail levels. They supply content to their competitors at the retail level. The parties may find it in their interest to engage in strategies that would limit the ability of any rival service to undermine the JV by, for example, attempting, partially or completely, to foreclose access to content or otherwise increasing the cost of this content to their rivals, or by limiting the manner in which the content could be exploited. We note, in this context, that the transaction agreements envisage that UKVOD will not syndicate free or DTR VOD content to open VOD services for 12 months (see paragraph 3.16). In response to publishing the details of the revised transaction on our website, [✂] all noted this absence of syndication to open VOD retailers. [✂] said that this demonstrated that the parties expected that a strategy of withholding content from rival service providers would drive customers to UKVOD.

4.134 We could not form an expectation that the parties would choose to engage in this type of strategy for all customers but thought it possible that, at some point in the future and at least for some customers, they would choose to do so. It would, for example, depend on the extent to which this might lead to a reduced competitive constraint from third-party VOD retailers on the parties' retail offer. More specifically, the incentives for the parties to foreclose would be higher if the parties' wholesale customers imposed a significant constraint on UKVOD's retail offer. The parties' ability to foreclose would be higher if their customers' competitiveness at the retail level depended significantly on the terms on which the parties' content is available to them. We thought it possible that the increase in UKVOD's profitability would more than compensate for any reduction in profits earned at the wholesale level as a result of this strategy, particularly in relation to open VOD retailers. If this were the case, the parties might be expected to engage in strategies leading to some form of foreclosure.

Retail supply of VOD services

4.135 We concluded that the JV was also likely to result in a loss of rivalry at the retail level. The parties were, or would be in the future, each other's closest competitors for the supply of UK VOD content and third-party VOD retailers would not act as an effective competitive constraint. This loss of rivalry between them would enable the parties to offer less attractive terms to customers, resulting in viewers paying higher prices (either through more expensive subscriptions or higher transaction costs on pay per view) for some content, paying for a higher proportion of content, and/or receiving lower-quality (for example, less recent or less popular content) or less innovative offers.

4.136 The loss of rivalry and the concentration of content in one entity could also reduce the opportunities for future initiatives or developments by third parties of alternatives to the JV. For example, it could limit the development of alternative business models and commercial innovations that might otherwise benefit customers, or could jeopardize the continuation of existing business models (see paragraph 4.126*(a)*). In response to publishing the details of the revised transaction on our website, both [✂] and [✂] noted that UKVOD's syndication strategy would be likely to reduce the opportunities for alternative VOD offers to continue or develop in the future.

4.137 As set out in paragraph 4.87, the parties told us that UKVOD would not have exclusive rights to much of the TV content for which consumers were willing to pay. They said that, whilst [✂] per cent of archive content would be exclusive, only [✂] per cent of DTO content would be exclusive to UKVOD, thus limiting UKVOD's ability to impose price rises as a result of the JV. However, in our view, the fact that the parties had the ability to wholesale DTO rights under the DVD carve-out does not mean that DTO prices would exercise an effective competitive constraint on UKVOD's pricing.[89] The commercial terms on which such rights would be sold would be determined by the parties. As set out in paragraph 4.129, the parties would have to consider their incentives to wholesale DTO rights on a case-by-case basis.

4.138 The parties told us that a large proportion of demand would be for free-to-view content and that UKVOD expected that free content would account for over 90 per cent of views and approximately three-quarters of content on its website. It also told us that consumers were generally reluctant to pay for transactional content. However, we note that UKVOD expected paid transactions to become more important over time and that iTunes currently charges successfully for content. The parties propose to charge for some archive content from soon after launch ([✂]). By 2012, UKVOD expected to generate [✂] of its revenue from online transactions. [✂] said that this was a business choice, and suggested that UKVOD could modify its business model in the future to reflect changes in market conditions (such as, for example, a fall in advertising revenue).

4.139 We note that retail pricing is, ultimately, a commercial decision. One factor that will influence future pricing levels will be customers' willingness to pay and the strength of competitive constraints. If these are reduced as a result of the JV, this would be likely to lead to charges for content that might otherwise have been supplied free-to-view. In any case, UKVOD would, in our view, be free to exploit its market power by lowering the quality of its offer or reducing levels of commercial innovation, rather than necessarily by raising prices.

Conclusions on competitive effects

4.140 We therefore conclude that the JV would be likely to lead to a loss of rivalry between the parties, amounting to an SLC in the supply of UK TV VOD content at the wholesale and retail levels.

Other areas

4.141 We considered the competitive effects of the JV in advertising and content acquisition.

Advertising

Market definition

4.142 TV advertisers target segments of the population by placing advertising in or around content to appeal to those target audiences. In effect, broadcasters sell access to viewers. The advertising on UKVOD will be non-search, direct advertising. The JV will sell two types of advertising—static display or non-video ('banner' and 'skyscraper' format advertisements) and video (moving advertisements). Pricing may be based on a 'cost per click', where the advertiser pays only when the user clicks on the advertisement, or on a 'cost per thousand impressions', where the advertiser pays when a specific number of advertisements are displayed to users.

[89]UKVOD's 'launch list' consisted of [✂] hours of content. The JV had DTO rights for [✂] hours, of which [✂] hours were held exclusively. However, as a result of the DVD carve-out in the agreement, [✂] of these hours are co-exclusive to the JV. That is, the parties will continue to supply these rights to existing licensees.

4.143 We considered whether online video advertising should be considered to be a separate market from online static advertising. Next we considered whether online VOD advertising (both video and static advertising) was a relevant market. Finally, we considered whether the relevant market was wider than online advertising, and specifically whether TV advertising was in the same relevant market as online advertising.

4.144 We looked at whether online static display advertising was a good substitute for online video advertising for advertisers. The parties told us that websites commonly carried both static display and video advertising and that the distinction was becoming increasingly blurred. They said that advertisers regarded these as largely interchangeable. We were also told by third parties that suppliers switched readily between different advertising formats.[90]

4.145 The majority of third parties told us that it was not appropriate to define a separate market for online video advertising. Google told us that, in its view, no distinction should be made according to the type of advertisement. [✂] told us that online video advertising was a more 'impactful' and premium format than static, and that they were often sold together as a package. We note that the European Commission, in its decision in the Google DoubleClick merger, did not distinguish a separate market according to format. It said that advertising inventory was rarely, if ever, restricted to a specific type of advertising.[91]

4.146 We also considered whether it was appropriate to distinguish online advertising on VOD websites from other online advertising. If online VOD retailers could offer the advertiser the opportunity to target their advertising more effectively than other websites, online VOD advertising might be worth monopolizing. We note that the parties considered online VOD advertising to be a premium part of online advertising. In our view, however, the ability of online VOD retailers to target particular audiences is not unique and other websites offer similar targeting capabilities.[92] In addition, we have seen no evidence that the targeting capability of UKVOD is valued by advertisers over and above the targeting capabilities of other websites, and no third parties have raised this concern with us.

4.147 We considered whether the relevant market should be defined more widely than online advertising, and whether, in particular, it should include TV advertising. The parties told us that online advertising was a distinct market from TV advertising. It said that this was consistent with our findings on the BSkyB/ITV inquiry[93] and that, in addition, advertising agencies had separate buying teams, budgets and pricing models for TV and online advertising. Some third parties supported this view.[94]

4.148 A number of third parties, however, told us that advertisers found online VOD advertising and TV advertising to be similar. For example, [✂] told us that from an advertiser's point of view, VOD would be seen as a variant of TV, possibly making use—at least in the early days—of material developed for mainline TV campaigns. Google told us that, in its experience, all forms of advertising, in all types of media, competed with one another.

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[90]Google said that website publishers did not typically have a preference for any format. In addition, Google told us that online advertisements were created according to standard layout formats and could be placed interchangeably on the same spot of the webpage.
[91]European Commission decision *Case No COMP/M.4731—Google/DoubleClick*, 11/03/2008, paragraph 13.
[92]At the most basic level, simple demographic criteria (such as postcode) can be revealed by the IP address of the computer used. At a more sophisticated level, the targeting characteristic of other (non-VOD) types of online advertising differ for search and non-search advertisements.
[93]*Acquisition by British Sky Broadcasting Group plc of 17.5 per cent of the shares of ITV plc*—final report, December 2007, www.competition-commission.org.uk/rep_pub/reports/2007/535itv.htm.
[94]For example, Aegis Media PLC told us that the JV would operate in the 'Internet display advertising' sector, though it noted that digital media was blurring the distinction with traditional media.

4.149 In the BSkyB/ITV inquiry, we were told that online advertising was the closest substitute for TV advertising, but that it was generally used for different purposes. The IPA told us, for example, that while large fast-moving consumer goods companies advertised extensively on TV, they had yet to do so on the Internet. The Internet is more often used for gaining product and pricing information and for making transactions and had not been used successfully to date to build a non-Internet brand in the same way as TV. We also note that online advertising has specific targeting capabilities compared with other media. The parties told us that online advertising could be targeted more specifically at particular audiences than TV advertising.

4.150 In its investigation of the Google/DoubleClick merger, and consistent with previous decisions, the European Commission found that there was a distinction between offline and online advertising. The European Commission pointed to differences in the purposes of online and offline advertising because of differences in targeting capabilities. It also noted differences in measurement of effectiveness and in pricing mechanisms. It concluded that there was a separate market for online advertising. We reached the same conclusion in our market investigation into Classified Directory Advertising Services.[95]

4.151 Based on the evidence set out in paragraphs 4.142 to 4.150, we conclude that for the parties' advertising customers, the relevant market is online advertising, including both video and non-video advertising in the UK.

Competitive assessment

4.152 Both ITV and C4C currently carry some advertising on their existing websites. Appendix C sets out the arrangements for advertising in the JV. The parties told us that they would compete with each other for the sale of advertising in and around their content on the JV website. They said, therefore, that UKVOD would simply create additional advertising opportunities for agencies.

4.153 Table 10 in Appendix E shows the parties' forecast revenue and market shares in online advertising to 2011. It shows that the JV expects its advertising sales to achieve less than a [✄] per cent market share of total online UK advertising revenue by 2011. It estimated that, within total online UK advertising revenue, it might achieve [✄] per cent of display advertising. We therefore thought it unlikely that the JV would lead to a reduction in rivalry in the market for online advertising.

4.154 We considered whether the strength of the parties in advertising on linear TV might impact on online advertising. We thought this unlikely. First, to the extent that the parties already enjoy market power in the sale of TV advertising, this is not affected by the creation of the JV. Second, while the parties may choose to tie the sale of online advertising on the JV website to the sale of TV advertising, this would only have an adverse effect on online advertising if, by so doing, the parties could exclude competitors from online advertising. We think this is unlikely to be the case, given UKVOD's likely low market share of online advertising.

4.155 We therefore conclude that, although the JV would be likely to lead to a reduction in rivalry in VOD retailing, advertisers would be unlikely to pay higher prices than would otherwise be the case.

[95] *Classified Directory Advertising Services Market Inquiry*—final report, December 2006, www.competition-commission.org.uk/rep_pub/reports/2006/521cdas.htm.

Content acquisition

Market definition

4.156 UK broadcasters have three main sources for audiovisual content: in-house production; commissioning from third-party production companies; and licensing rights to exploit existing content in the UK (see paragraph 2.4). The BBC and ITV have in-house production companies. The BBC, ITV and C4C are obliged to commission at least 25 per cent of relevant content from independent UK producers.

4.157 The relationships between broadcasters and UK independent production companies are governed by the Codes of Practice. Since 2003, each PSB has been required to publish minimum terms under which they commission programmes from UK independent producers (see paragraph 14, Appendix B, and paragraph 2.12). The Terms of Trade are negotiated with each PSB by PACT on behalf of the UK independent producers.

4.158 On the basis that third-party production companies in the UK compete with in-house production, we found that third-party production in the UK is likely to be in the same relevant market as in-house production and that the geographic scope of the market is not likely to be wider than the UK.

Competitive assessment

4.159 The BBC, ITV, C4C and Five together account for almost 90 per cent of expenditure on new content produced in the UK for broadcast on TV.[96] We found that the ability to acquire VOD rights is often closely associated with holding or acquiring linear TV rights (see paragraph 4.100).

4.160 Following the transaction, each party will continue to negotiate independently for both primary and secondary rights. PACT told us that it was concerned that the JV could undermine its ability to negotiate Terms of Trade with the PSBs because it would create a strong incentive for the parties fully to align their position with respect to VOD rights, thereby worsening the Terms of Trade with independent producers. A number of other third parties were also concerned that the JV might affect the negotiations of the Terms of Trade or might lessen competition between the parties to acquire rights more generally.

4.161 In our view, the JV might reduce competition between the parties to acquire VOD rights if it lessened the cost to one of the parties of failing to win VOD rights for particular content. Under the proposed UKVOD revenue-sharing agreements, the cost of a particular party failing to win VOD rights is reduced if one of the other parties wins the rights, because the failed bidder shares some of the value of the VOD rights.

4.162 However, PACT told us that the primary broadcast rights currently represented around 90 per cent of the content's value. This would suggest that the parties' incentives would be driven by the acquisition of primary rights. It therefore seemed unlikely to us that one of the parties would take the risk of bidding less aggressively for VOD rights if this might impact on its acquisition of primary broadcast rights. We saw no evidence to suggest that the JV would affect the parties' incentives to compete for primary rights.

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[96] *PSB Review Phase 1: The Digital Opportunity*, Ofcom, p56.

4.163 We also noted that, under the current agreements, the share of revenue for the failed bidder would be relatively low. The parties would face significant penalties for consistent failure to meet content supply commitments. The CSAs provide that the parties receive a revenue share of around [✂] per cent from the exploitation of transactional or advertising-funded content respectively. Each party's share of the variable profit pool will be determined in large part by [✂]. The parties will therefore, in our view, continue to have financial incentives to win rights in the content rights acquisition market.

4.164 Finally, we noted that the Terms of Trade will be negotiated between PACT and each of the parties separately and the negotiations will be subject to Ofcom's regulatory oversight.

4.165 For the reasons set out in paragraphs 4.161 to 4.164, we conclude that the JV would be unlikely to alter the incentives for content acquisition and would therefore be unlikely substantially to lessen competition in the market for content acquisition in the UK.

Conclusions on the SLC test

4.166 We therefore conclude that the JV would be likely to lead to a loss of rivalry between the parties, amounting to an SLC in the supply of UK TV VOD content at the whole-sale and retail levels. We also conclude that the JV would be unlikely to result in an SLC in the online UK advertising market or in the market for content acquisition in the UK.

5. Remedies

5.1 This section of our report discusses possible remedies to the SLC identified in paragraph 4.166.

5.2 Under section 36 of the Act, we are required to have regard to the need to achieve 'as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it'.[97] We first identify remedies that are effective in addressing the SLC and its resulting adverse effects. We then consider proportionality, seeking to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects. We will also have regard to any relevant customer benefits arising from the merger.[98]

5.3 In general, we prefer one-off remedies that restore or maintain the structure of the market (structural remedies) to remedies designed to regulate or constrain the behaviour of the parties (behavioural remedies). This is because structural remedies are likely to deal with the SLC or consequent adverse effects at source by restoring rivalry in a horizontal merger and do not normally require ongoing monitoring and enforcement. Behavioural remedies, on the other hand, may be difficult to specify or easy to circumvent; may lead to market distortions; and are likely to require significant monitoring and enforcement.

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[97] Section 36(3).
[98] Section 36(4).

The remedy options

5.4 We considered various remedy options set out in our Notice of possible remedies or put to us in response to the Notice:

(a) prohibition;

(b) access remedies;

(c) material modifications to the terms of the JV; and

(d) other types of remedy: restrictions on cross-promotion; restrictions on participation in the JV; and modifying the Terms of Trade.

Effectiveness of remedy options

5.5 This section of our report discusses the effectiveness of each remedy option in addressing the SLC and the consequent adverse effects.

Prohibition

5.6 As set out in paragraph 5.3, we have a preference for structural remedies. The prohibition of the JV would maintain the competition that is expected to be lessened as a result of the transaction.

5.7 The parties said that prohibition would be disproportionate and would deny customers a number of benefits. They also said that any prohibition should apply only to the current JV and should not extend to any other arrangements. They recognized that any new, different arrangements may be subject to a separate competition law review.

5.8 PACT also said that it was not in favour of prohibition. It said that it would slow the development of VOD in the UK, lessen consumer choice, undermine the network TV model in the on-demand age and undermine investment in UK content. It said that it would prefer an alternative remedy, based on modifying the Terms of Trade (see paragraphs 5.69 to 5.74).

5.9 Virgin Media, Joost and Babelgum, on the other hand, favoured prohibition. Virgin Media said that prohibition was the simplest and most clear-cut remedy; the only remedy that would be effective in restoring the competitive *status quo ante* at both the wholesale and retail level; the most practicable remedy to implement; and would not involve any costly monitoring or enforcement. Joost said that allowing the JV to proceed would be likely to have a detrimental effect on the market, in particular through the ability to control prices and foreclose against competitors at the wholesale level. Babelgum said that prohibition was the only remedy which adequately addressed all our competition concerns and resulted in the lowest costs to third parties and/or the market.

5.10 We note the parties' submission that a prohibition should extend only to the current JV. In our view, a prohibition should relate to the arrangements that we were asked to consider and any other transaction which led to a merger of VOD activities carried on by the parties. In the event of a prohibition, the parties would be free to consider alternative arrangements which might fall for separate assessment under competition law.

5.11 We conclude that prohibition of the JV as currently envisaged, or of any other transaction which would lead to a merger of VOD activities carried on by the parties, would be an effective remedy to the SLC and adverse effects that we found. In paragraphs 5.20 to 5.58 we consider variations to the form of the JV, including those put to us by the parties.

Access remedies

5.12 We invited views on possible access remedies which would require UKVOD to offer content to third-party VOD retailers on agreed terms.

5.13 The parties said that access remedies would not be feasible, due to the complexity involved in specifying and monitoring them. In particular, the remedy would need to specify the content to which it would apply, be reconciled with the VOD rights held by the parties (some of which may, for example, restrict the parties' ability to license or sub-license content); and establish appropriate principles for terms of supply and pricing structure (including advertising). It would also need to establish which sites and platforms should have access to the content and how such content would be used. In particular, the parties said that the remedy would have to allow for effective BBC editorial control in order to be consistent with the BBC's public service obligations. They also told us that if an access remedy were imposed, they would not consider it to be commercially viable to proceed with the JV.

5.14 Virgin Media agreed that it would be difficult to design, monitor and enforce an access remedy and it would be ineffective in addressing the SLC. It said that an access remedy would also be significantly more risky than prohibition because it could not be designed with sufficient certainty, simplicity and clarity; UKVOD and the parties would have the incentive to work around it; and there was a very significant risk that it would influence the shape and future development of the nascent and fast-growing UK VOD market. PACT told us that access remedies were overly complex, given the nascent state and the likely level of vertical integration and service bundling across the UK VOD market.

5.15 However, some third parties thought that access remedies, while complex, might be effective, particularly if accompanied by an adjudication process. Joost told us that, in the event that the JV was not prohibited, fair, reasonable and non-discriminatory (FRND) access terms with a clear and rapid mechanism for dispute resolution would be 'an absolute minimum requirement'. [✂] told us that it would be difficult to protect effectively against a margin squeeze but that, if a wholesale price could not be negotiated within a specified period, the matter could be referred to an adjudicator paid for by the parties. [✂] told us that the JV or the parties should be required to supply third parties on FRND terms, based on a Contract Rights Renewal (CRR)[99] type assessment, and that an adjudicator would be required.

5.16 Ofcom is currently considering what are commonly called 'wholesale, must offer' provisions in the context of its inquiry into pay-TV. Ofcom acknowledged that such access remedies were complex, though certainly not impossible, to design and implement and would be simpler to apply in other circumstances, for example in relation to distinct channels or products.

[99]The CRR remedy, put in place following the CC Carlton Communications Plc/ /Granada Plc merger inquiry, sets out a number of rights that advertisers and media buyers have when buying advertising time from ITV, and in particular, gives advertisers and media buyers the right to renew their contracts on a rolling annual basis, adjusted for changes in ITV's audiences, with no reduction in the discounts they receive.

5.17 We believe that an access remedy would present significant specification risks. To be effective, an access remedy would need to specify a number of different aspects, including the content involved (specified by, for example, recency of transmission, genre and/or a minimum number of hours that must be made available), the standard of picture quality provided, the rights being conferred and the terms on which content rights must be offered. Such requirements would need to be specific enough to avoid circumvention risks. On the other hand, if the requirements were highly specific, they would run the risk of being overtaken by market developments, particularly in a market which is liable to be subject to significant change.

5.18 We also found that it would be difficult to design an appropriate pricing regime. In the absence of clear benchmark costs or prices, a price control would probably have to be based on a more general requirement that the parties would have to offer content rights on FRND terms. But these too would be hard to agree and would be likely to give rise to disputes. We thought it unlikely that previous contract terms could be used to assess proposed new terms, as had been the case in the CRR remedy, since VOD retailers were still evaluating business and pricing models and it would be inappropriate to lock in previously negotiated terms.

5.19 We therefore conclude that, in this case, access remedies would be likely to give rise to specification, circumvention, monitoring and enforcement risks and it would be necessary to establish a complex and costly regulatory regime to accompany such a remedy. There was also a risk that any access remedy might distort the future shape of this developing market. We therefore conclude that access remedies would be unlikely to be effective in addressing the SLC and adverse effects that we found.

Material modifications to the JV

5.20 We considered several possible modifications to the terms of the JV:

(a) limitations on the JV’s ability to retail ITV and C4C catch-up content;

(b) limitations on the JV’s ability to wholesale ITV and C4C catch-up content;

(c) limitations on the JV’s ability to wholesale both catch-up and archive content (‘the wholesale remedy’); and

(d) limitations on the JV’s ability to wholesale both catch-up and archive content coupled with the preservation of separate retail price points (‘the farmers’ market’).

Limitations on the JV’s ability to retail ITV and C4C catch-up content

5.21 This proposal would limit the JV’s ability to retail ITV and C4C catch-up content. Instead of hosting ITV and C4C catch-up content itself, for example, the JV could be restricted to providing links to itv.com and channel4.com. This might incentivize ITV and C4C to maintain their catch-up services, in competition with each other and iPlayer, rather than relying on UKVOD’s joint catch-up service.

5.22 [✄]

5.23 Virgin Media said that this remedy would focus UKVOD on the supply of archive VOD content. It did not consider that it would address the loss of competition in both the wholesale and the retail markets in relation to the supply of archive VOD content. Nor, it told us, would it address the vertical concerns we had identified. It said that the parties would continue to have an incentive to refuse to supply Virgin Media with archive VOD content, or to do so only on uneconomic terms, in order to promote the JV's retail archive VOD service.

5.24 We conclude that, while this remedy may incentivize ITV and C4C to maintain their own catch-up services in competition with each other and the iPlayer, it would not be comprehensive and therefore is unlikely to be effective in addressing the SLC and adverse effects that we found.

Limitations on the JV's ability to wholesale ITV and C4C catch-up content

5.25 Under the arrangements as currently proposed, UKVOD would only be able to wholesale catch-up content where it was wholesaling the whole or a significant representative sample of the parties' VOD content. We considered whether, if UKVOD were prevented from wholesaling catch-up content rights in all circumstances but the parties retained the ability to do so, this would address the SLC. This would allow the parties to supply wholesale content in competition with each other. It might also remove the retail concerns if competition between the parties at the wholesale level resulted in other platforms obtaining access to the parties' content, enabling them to compete with UKVOD in the retail market.

5.26 The parties said that this remedy proposal would effectively address the SLC. They told us that catch-up is an important driver of platform VOD competition, and platforms that have access to the parties' catch-up content would be in a strong position to attract users and compete with UKVOD. We discuss the parties' incentives to syndicate VOD content in paragraphs 5.31 to 5.39 as part of our assessment of the remedy which proposes limitations on the JV's ability to wholesale both catch-up and archive content.

5.27 Virgin Media said that, following the creation of the JV, if the parties were to enter into syndication deals, these would be on less favourable terms than would otherwise be the case. It was therefore not clear how limiting the JV's ability to wholesale the parties' catch-up content could address the SLC identified. Nor could the remedy, in its view, address, directly or indirectly, the loss of rivalry in relation to the wholesale or retail supply of archive content. PACT also said that the parties would still have an incentive to offer more favourable terms to UKVOD, compared with third-party VOD retailers.

5.28 [✂] agreed that catch-up was the principal driver of VOD use but said that VOD remains in its infancy in the UK. It told us that in the more mature US market, Hulu had reported that around 50 per cent of its views were now of archive content and that the share of viewing of archive content was growing. Joost said that catch-up rights are closely associated with primary broadcast rights and are therefore not widely available to independent VOD services. Joost said that the parties should be required to maintain their catch-up services separately and independently of the JV, and allow the JV to compete on the basis of its archive content only.

5.29 We note that the parties supply VOD retailers such as Virgin Media and BT Vision with archive content for which these retailers are willing to pay significant sums. This indicates to us that, whilst catch-up may have greater value, archive content is nonetheless important to VOD retail providers. Given its focus on catch-up content, we conclude that this remedy would not be comprehensive and therefore is unlikely to be effective in addressing the SLC and adverse effects that we found.

Limitations on the JV's ability to wholesale both catch-up and archive content

5.30 Under this remedy proposal, UKVOD would be prevented from wholesaling content generally (including both archive and catch-up content) while the parties themselves retained the ability to do so. This might remove the SLC that we found in the wholesale market. It might also impact on the SLC that we found in the retail market if other VOD retailers' access to the parties' content enabled them to compete with UKVOD in the retail market. However, this would depend on the parties competing with each other to wholesale content to third-party VOD retailers on terms which would allow those retailers to compete with the JV.

5.31 The parties told us that a wholesale remedy in respect of both catch-up and archive would fully address the SLC in the wholesale market and, because competing retail platforms would have access to content at the wholesale level, it would also address our concern about competition in retail markets. The parties said that they would have an incentive to syndicate content on competitive terms. In particular, in relation to catch-up content, they told us that:

(a) ITV and C4C would each gain access to a wide range of viewers that UKVOD would not otherwise attract by syndicating their catch-up content;

(b) ITV and C4C would also each expect to gain viewer share, and so advertising revenues, at the expense of the other UKVOD partners; and

(c) the syndication of advertising-funded catch-up content would not depress UKVOD's advertising rates since we had found there to be other competitive constraints acting in relation to advertising.

5.32 The parties said that the syndication of catch-up content could divert some transactional revenue away from UKVOD. However, they said that [✂] this would not remove their incentive to syndicate catch-up content. [✂]

5.33 The parties said that the incentives to syndicate advertising-funded archive content were the same as those described in relation to catch-up content. They also said that each of them would have a unilateral incentive to syndicate advertising and transactional funded content to third-party VOD retailers that primarily accessed new viewers. There might also be unilateral incentives to syndicate content to other third-party VOD retailers where doing so would steal business from the other JV partners. The parties said that these incentives would outweigh the reduction in revenue expected to result from the syndication of transactional funded content.[100] The parties provided some stylized examples using a number of assumptions to support their conclusions. These examples showed that, under certain assumptions, the parties would individually have an incentive to syndicate content.

5.34 The parties also submitted further analysis which concluded that the parties were unlikely to have the incentive and ability tacitly to coordinate on a strategy of withholding content from third-party VOD retailers. This was based on the following:

(a) There are significant asymmetries between the business models of each of the parties. In particular, BBCW's focus is exclusively on archive and its archive offer is stronger than that of ITV and C4C.

[100] Such a reduction might result both from customers switching away from UKVOD and from a reduction in UKVOD's prices.

(b) The rapidly expanding and evolving VOD market would make it difficult to distinguish between syndication deals that expanded the market and deals that resulted in stealing business from UKVOD.

(c) The parties already have a number of syndication deals in place with third-party VOD retailers for different periods. The parties do not know the length or the terms of each other's existing syndication contracts and renewal decisions will be taken at different times. This would create uncertainty as to whether a party had cheated on a coordinated strategy and make any punishment strategy less effective.

(d) Syndication deals would be irreversible over the duration of the contract. The relatively long duration of many contracts would make any punishment strategy less effective as a syndicating party would be unable to respond quickly to punishment.

(e) The parties may, in addition to their incentives to syndicate, have individual contractual obligations to exploit content which push them to syndicate.

5.35 Virgin Media said that the creation of the JV led to the parties facing a different trade-off when deciding whether to syndicate content. Each of the parties, when deciding whether to syndicate VOD catch-up rights, would have to consider the trade-off between the following:

(a) the additional revenue available from syndicating catch-up rights to third parties;

(b) the loss of revenue (or other benefits) obtained from fewer viewers watching the content on rival VOD services; and

(c) the loss of revenue (or other benefits) resulting from fewer viewers switching to watch their content (and other content) on UKVOD.

5.36 In addition to a short-term revenue trade-off, Virgin Media said that the parties would have longer-term strategic incentives to favour the UKVOD service over competing downstream third-party VOD retailers.

5.37 Virgin Media said that this remedy proposal could only address the horizontal loss of rivalry in relation to the syndication of catch-up and archive content. It would not address the vertical concerns that arise due to the parties' incentives not to syndicate catch-up and archive content to third parties (or to do so on uneconomic terms) due to their involvement in the JV. It said that, theoretically, its concerns might be addressed by combining each of the major modifications proposed in our Notice with a wholesale access remedy. However, as set out in paragraph 5.14, Virgin Media considered that it would be very difficult to design such a regime and, even if possible, would be neither practicable nor cost effective. PACT told us that it considered that the wholesale remedy proposal would not be effective in that, even if the parties wholesaled their own catch-up and archive content, they would still have an incentive to favour UKVOD over competing offerings.

5.38 We considered carefully whether, under this remedy, other VOD retailers would be likely to have access to the JV parties' content on competitive terms. We looked at the examples provided by the parties. We had no reason to think that their assumptions were unreasonable. We note, however, that the parties' unilateral incentives to syndicate are complex and depend on many different parameters and are therefore difficult to assess. In our view, the parties are likely to have a unilateral incentive to syndicate content to third-party VOD retailers that primarily access new viewers, since the gain in revenue from these new viewers would be likely to outweigh any decrease in revenue. However, the incentives to syndicate content to other third-party VOD retailers would be much weaker and we could not form an expectation that syndication would occur. The parties' incentives to syndicate might, for example, be affected if UKVOD's website became available via alternative delivery platforms (for example, if UKVOD became widely available to view on TV).[101] The possible benefit to the parties of ensuring a strong VOD service in a nascent market may also limit their short-term incentive to syndicate content.[102]

5.39 We are also concerned that the parties would have the incentive and ability tacitly to coordinate on a strategy of withholding content from third-party VOD retailers where this would not have been the case in the counterfactual. This might involve either total or partial foreclosure. Alternatively, the parties might coordinate to raise prices or to reduce quality rather than to withhold content. In order to be satisfied that this remedy is effective, we would need to be able to form an expectation that the parties would not have the ability and incentive to coordinate their commercial strategy with regard to particular third-party VOD retailers.

5.40 We considered the arguments put forward by the parties:

(a) We agreed that the parties have significantly different business models and strategies and that this may be expected to weaken their incentives to coordinate. However, we note that the parties were able to overcome these issues to agree the nature and terms of the JV and we could not be confident that asymmetries alone will ensure that coordination does not take place.

(b) Long inflexible contracts might make it difficult for the cheating party to respond quickly to punishment. However, the length of contract is a matter for the parties and some deals have been relatively short. In addition, the rapidly-changing characteristics of the market may allow parties flexibility within an agreed contract.[103]

(c) Uncertainty over whether a party had cheated on a coordinated strategy could reduce the parties' ability to coordinate on a strategy of withholding content from certain third-party VOD retailers. However, under this remedy the parties will still set retail prices and strategy jointly for the JV. In the course of so doing, they will consider the strength of the competing third-party VOD retail offers. This will therefore reduce uncertainty as to which third parties compete closely with UKVOD and which primarily expand the market, making it easier for the parties to detect when one deviates by syndicating content to a third party to whom they should, under a coordinated strategy, withhold content.

5.41 Finally, we note that the wholesale remedy does not address the fact that the parties have combined their retail offer (in terms of agreeing, for example, price levels, price models or innovative approaches to content and service delivery) within the JV framework.

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[101]The parties told us, for example, that selling all the content in a one-stop shop would increase demand for each of the parties' content. Editorial links between the parties' content could lead to customers buying content that would not otherwise have been purchased (see paragraph 5.78). Parties will therefore have to assess the indirect effect on demand for their content that might arise from a decision to syndicate content to a third party VOD retailer.
[102]We note that the JV proposal set out in Section 3 envisaged that UKVOD would not syndicate to open VOD retailers for the first 12 months.
[103]We also note that even if long inflexible contracts were to become standard, the strength of the punishment that is implied by this inflexibility would itself discourage any deviation in the first place. As such, it is not clear that this necessarily makes it more difficult to sustain a coordinated outcome.

5.42 We therefore conclude that this remedy would be unlikely to be effective in addressing the SLC and adverse effects that we found.

The wholesale remedy plus the farmers' market

5.43 The parties said that either of the wholesale remedies previously discussed should be sufficient to remedy the SLC at both wholesale and retail levels. However, were we to decide that this was not the case, the parties proposed an alternative remedy which could be put in place by further modifications to the JV agreements. This remedy package incorporates the wholesale remedy and, in addition, preserves three separate retail selling points under a 'farmers' market'. Each party would establish its business model independently and, where relevant, the price and mechanism by which its content would be offered to consumers. UKVOD would retain discretion to editorialise and organize the site to enhance the user experience, drawing links, for example, between items of content by genre or talent, as well as selling site advertising and collecting and distributing customer payments. UKVOD would also acquire, and make available to consumers, other content such as film and non-UK content. The revenue-sharing arrangements would not change. There would continue to be a minimum hours' commitment to ensure that the platform had a sufficient volume of content. Structures and rules around the operation of UKVOD could be put in place to address possible concerns about the risks of information sharing.

5.44 In this proposal, the parties said that the UKVOD board would act as an investment oversight body. Responsibility for the operation of the business would be given to a relatively autonomous UKVOD management. In order for the board to operate effectively, it would be sufficient to define a set of high level financial and non-financial key performance indicators (KPIs) which would be measured against an annual budget and business plan prepared by UKVOD's management.[104] Where the parties were required to make specific decisions relating to substantial new investment or other one-off expenditure, it might be necessary for UKVOD to provide more detailed relevant data, in compliance with the agreed principles.

5.45 The parties set out the main principles that they would adopt in relation to the availability of commercially sensitive information at board level:

(a) No information would be provided to, or exchanged through, UKVOD which is not necessary for the purpose of carrying on UKVOD's business or the management of investments in it.

(b) The parties would not disclose to UKVOD any information about competing third-party VOD activities.

(c) No party would have access to commercially sensitive information relating to another party through its involvement in UKVOD. Party-specific commercially sensitive information would only be exchanged between a party and UKVOD on a bilateral basis.

(d) Information based on party-specific commercially sensitive information would only be provided to the parties collectively in aggregated form.

(e) Such aggregated information would only be provided to the parties in order for them to be able to manage their investments in UKVOD, according to a defined set of investment criteria and key performance indicators.

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[104]The parties said that the KPIs might include, for example, [✂].

5.46 The parties would incorporate these principles in the JV agreements to create a defined set of governance rules, guidelines and protocols. UKVOD staff, management and directors would undergo relevant training and would commit to comply with such rules. UKVOD would be required to confirm compliance to the parties on an annual basis. It would also appoint a compliance officer with sufficient standing and experience to exercise independent judgement. The compliance officer would monitor compliance and ensure that appropriate action was taken in the event of any breach. The parties and UKVOD would provide the OFT with an annual statement of compliance and other material in response to any reasonable requests.

5.47 The parties said that this remedy package would address the SLC that we identified by providing for each party to wholesale content independently and eliminating all platform exclusivity; providing for competition between the parties on business model and pricing at the retail level; and preserving the incentive to syndicate content to third-party VOD retailers as compared with the counterfactual. The parties said that there would be even less likelihood of tacit collusion compared with the wholesale remedy. There would be no incentive tacitly to coordinate on a strategy to withhold content from third-party VOD retailers since there would be effective competition between the parties at the retail level. The parties told us that they would not have an incentive to increase wholesale prices to third-party VOD retailers who compete with UKVOD since third-party VOD retailers would not be able to pass on price increases in competition with UKVOD.

5.48 The parties said that the information-sharing rules would address concerns both about sharing of specific data and sharing of the broader understanding of the JV's strategy.[105] They also said that the information-sharing rules would limit their ability to reach a common understanding on competitive threats at the retail level and hence tacitly to collude in the provision of content at the wholesale level. The parties said that, in any event, they would be likely to be better informed about the competitive strengths of third-party VOD retailers through their own activities in the VOD market than through the activities of UKVOD. Nor did the parties consider that there would be a risk of tacit collusion at the retail level, since they would not have the ability to coordinate retail content prices. This was because there would be a very large number of titles on UKVOD and content would be highly differentiated; each party could have different pricing models and retail price points; and there were significant asymmetries between the parties' business models.

5.49 The parties told us that the remedy package would preserve a number of the customer benefits of the UKVOD site as originally envisaged. Customers would have the opportunity to access a wide range of UK and other content from a single site with good functionality, a distinct identity and the ability to take advantage of efficiencies by providing promotional offers and discounted subscription packages. This would enlarge the market for VOD services by offering consumers an attractive proposition which would support the exploitation of a broad range of archive content. However, competition within the market would be preserved. They said, however, that the farmers' market proposal removed the certainty of a 'coherent' price proposition and a clear editorial position that the original proposal (and the wholesale remedy) offered to consumers. We discuss relevant customer benefits in paragraphs 5.76 to 5.86.

5.50 Virgin Media told us that the wholesale remedy element of the remedy package was likely to be ineffective in addressing the SLC at the wholesale level, that the significant commercial links between the parties would be expected to mute competition between them and that the parties' incentives to compete with one another would be

[105] The parties note that, in their view, the sharing of understanding of the JV's strategy would not be a significant concern in any event given the much more limited scope and activities of the JV's management under the farmers' market proposal.

less than in the counterfactual. Given the potential prize of being the dominant VOD supplier in the UK, the parties might align their retail behaviour in a way that prioritized the interests of the JV over their individual VOD interests.

5.51 Virgin Media said that the parties would be able to use the JV as a forum for exchange of information relating to the wholesale and retail supply of VOD content rights. It said that this raised serious concerns regarding the flow of confidential information between competing VOD service providers, which may be expected to facilitate unilateral effects. It also said that the increased commercial links between the parties under this proposal would result in an increased likelihood of coordination.

5.52 [✂] said that the separate setting of prices and price models was a weak modification to the JV. It said that it was clear both internationally and in the UK that the online market would only support an advertising-funded VOD model. It said that the parties would still be in a position to build a dominant position in UK long-form VOD and impose commercially prohibitive terms on third-party suppliers [✂].

5.53 We considered this proposal carefully. We discussed the wholesale element of this proposal in paragraphs 5.30 to 5.42. We note the parties' view that the addition of the farmers' market proposal, as well as maintaining competition between the parties on price at the retail level, would reinforce the parties' incentives to syndicate their content at the wholesale level. The parties said that by maintaining separate retail price points they would remove any incentive that the parties may otherwise have had to protect additional retail profit arising from the JV by foreclosing rival VOD retailers at the wholesale level. However, we note that maintaining separate retail price points would not, on its own, eliminate the additional retail profit that might arise to each party from its participation in the JV. We found that the parties might, under this proposal, still have an incentive to favour UKVOD over syndication of content to some rival VOD retailers.

5.54 We would also have to be satisfied that the parties' proposals would operate to ensure that there was no coordination of retail pricing. Given, for example, the transparency of retail pricing, the interdependencies between the parties and the parties' preference to set prices jointly (as envisaged in the JV agreements put to us in September 2008), we cannot form an expectation that such coordination would not occur.

5.55 The farmers' market provides the parties with the ability to set pricing strategies independently within the JV framework in a way that would not have occurred under the original proposals. We note that, when compared with the wholesale remedy alone, there would be less scope for information exchange that may facilitate coordination at the wholesale level. We also note that the parties have set out principles for safeguarding commercially sensitive information and monitoring compliance against a set of rules.

5.56 Nevertheless, we remain concerned that, even under this proposal, the JV itself will operate as a forum for the exchange of a range of commercially sensitive information including, in particular strategic insights into the activities of the JV and the other parties. Since the JV was set up for the mutual benefit of the parties, it was difficult for us to be satisfied that UKVOD management would be able to operate sufficiently autonomously in all situations. Any exchange of commercially sensitive information might give rise to a softening of competition between the parties in their other VOD activities.

5.57 Whilst we recognized the steps that the parties had taken to draft suitable safeguards in relation to information sharing, we could not be satisfied that all aspects of commercially sensitive information would be appropriately safeguarded in all situations. We thought that, for example:

(a) it would be difficult to specify all commercially sensitive information appropriately;

(b) there were inherent difficulties arising from the provision of aggregated data when there were only three JV partners; and

(c) whilst the safeguards might operate reasonably effectively for the information that they covered in the normal course of events, they were likely to be less effective in the event of major investment decisions or particular performance issues.

Nor could we be satisfied that the monitoring arrangements would be effective. Third parties would not be in a position to identify non-compliance and it would be difficult to be confident that compliance was effective.

5.58 We conclude that the parties are likely to retain to some degree both the incentive and the ability to withhold content or otherwise to make syndication of content at the wholesale level unattractive to third-party VOD retailers. We therefore conclude that, despite the additional proposals regarding the protection of commercially sensitive information, we could not be satisfied that this package of remedies would be effective in addressing the SLC and adverse effects that we found.

Other types of remedy

5.59 We also considered several remedy proposals put to us by third parties:

(a) restrictions on cross-promotion;

(b) restrictions on participation in the JV; and

(c) modifying the Terms of Trade.

Restrictions on cross-promotion

5.60 The BBC, ITV and C4C have a large share of the linear TV audience. They may be able to foster usage of the UKVOD service by promoting it on their linear channels, to the detriment of third-party VOD retailers. Restricting cross-promotion by the BBC, ITV and C4C could prevent them from leveraging their strong position in linear broadcasting into the VOD sector.

5.61 [✂] and Joost both said that they were concerned about the BBC, ITV and C4C's ability to cross-promote UKVOD on their linear channels. They said that it might be appropriate to put in place a remedy to limit the BBC, ITV and C4C's ability to cross-promote UKVOD. Joost said that promotional arrangements should only be allowed on an arm's length basis using paid advertising inventory.

5.62 We noted that the commercial PSBs are subject to Ofcom's cross-promotion code[106] and other restrictions on the way they provide advertising. These restrictions apply to their ability to promote other services, including their VOD services. The BBC Trust has its own, parallel, cross-promotion code[107] which constrains the circumstances

[106] www.ofcom.org.uk/tv/ifi/codes/bcode/crosspromo/.
[107] www.bbc.co.uk/bbctrust/assets/files/pdf/regulatory_framework/fair_trading/competitive_impact_code.pdf.

in which the BBC can promote its commercial services via its public service channels.[108]

5.63 We conclude that restrictions on the parties' cross-promotion of UKVOD would not be effective in addressing the SLC and adverse effects that we found.

Restricting participation in the JV

5.64 The parties between them own VOD rights to a very large library of content. Reducing the number of partners in the JV could facilitate entry and expansion by third-party VOD suppliers.

5.65 Joost suggested that the JV might be allowed to go ahead on condition that one party ceases to be involved, ie UKVOD would become a partnership between two of the existing three partners.

5.66 [✂] suggested that we might consider restricting the shareholders in UKVOD to companies which represent no more than a defined percentage of the broadcast market. For example, UKVOD would not be allowed to have shareholders representing more than 40 per cent of total viewing share in the broadcast market. This would not allow any combination of ITV and BBCW in a shared VOD service in which rights are sold collectively in a wholesale market to third parties, but would allow other broadcasters to join together and third parties to enter into partnerships with at least two broadcaster-associated VOD portals.

5.67 We considered these remedy proposals. The parties to a modified JV, and the terms of such a JV, are uncertain. It was therefore difficult for us to reach a conclusion as to the likely effect of these remedy proposals. In any event, given the amount of time that it has taken to agree the form of the current JV, it seems clear that negotiating a wholly new agreement with new partners would be a protracted process and, to all intents and purposes, impracticable.

5.68 We conclude that remedies to restrict participation in the JV would not be effective in addressing the SLC and adverse effects that we found.

Modifying the Terms of Trade

5.69 Broadcasters may retain exclusive rights to VOD exploitation of content commissioned from independent producers beyond the catch-up window. Allowing independent producers the right to exploit this content after the catch-up window would increase the number of suppliers of VOD content.

5.70 PACT said that, under this remedy, the broadcast partners associated with UKVOD would not automatically be able to retain exclusive control over the exploitation of VOD rights for independently-made content beyond the catch-up window. The exclusive catch-up window should, in its view, be limited to a seven-day period. After this, independents would be free to make direct deals with third-party VOD retailers for VOD rights. PACT told us that this remedy would maximize the number of retailers making UK content available to the public on an on-demand basis and would thereby deliver competition, innovation and choice in on-demand delivery for the UK public. It would also set a benchmark price for UK VOD content.

[108]The associated Fair Trading guidelines confirm that trailing of programme-related materials via the BBC's public service activities must either be for editorial reasons or to meet the BBC's Public Purposes.

5.71 The parties, however, told us that there were already significant opportunities for third-party platforms to acquire content rights from producers. They said that the Terms of Trade restrict the ability of independent producers to supply VOD content to parties other than the primary broadcaster in order to protect the primary broadcast rights which are the main drivers of content acquisition decisions. They said that a remedy that removed such restrictions could therefore have a significant impact on the value of primary rights and the incentives to bid for such rights with a consequent influence on the range and quality of independently-produced content. They said that this remedy would therefore have a disproportionate impact in markets outside the JV.

5.72 The parties told us that, in any event, the remedy would have only a limited impact in changing current conditions of supply. Content produced in-house by ITV; content produced in-house by the BBC and acquired by BBCW; independent content acquired by BBCW and all existing archive content would be outside the scope of such a remedy. They also thought that the remedy was imprecise, uncertain in impact and of limited if any relevance in addressing the SLC. In view of the serious impact that such a remedy would have on primary rights acquisition, the parties said that they would not proceed with the JV if this remedy was put in place.

5.73 We note that, whilst the proposed remedy may address the adverse effects of the SLC to some extent, it would apply only to some of the parties' VOD content and would not, therefore, be comprehensive. In addition, we are unclear precisely what consequences it may have for the market overall. We were concerned, in particular, that it may introduce distortions into the market by attempting to make independently-produced content more attractive to VOD retailers but perhaps making it less attractive, in financial terms, to broadcasters.

5.74 We conclude that a remedy to modify the Terms of Trade would not be effective in addressing the SLC and adverse effects that we found.

Conclusion on effectiveness of remedy options

5.75 We conclude that prohibition is the only remedy option that would be effective in addressing the SLC and adverse effects that we found.

Relevant customer benefits

5.76 Relevant customer benefits[109] are limited by the Act to benefits to relevant customers in the form of:

(a) 'lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom … or

(b) greater innovation in relation to such goods or services'.[110]

5.77 The Act provides that a benefit is only a relevant customer benefit if it accrues to, or is expected to accrue to, relevant customers within the UK within a reasonable period from the merger and would be unlikely to accrue without the merger or a similar lessening of competition.[111]

[109] Section 30.
[110] *Merger Remedies: Competition Commission Guidelines, CC8*, November 2008, paragraph 1.14.
[111] Section 30(2) and 30(3).

5.78 The parties told us that the key to the UKVOD proposition is that it will offer a wide range of UK archive TV content, together with film and non-UK TV content, which is organized in a manner that is coherent and attractive to users through an innovative use of editorial arrangement.

5.79 They said that no third party by itself, or in partnership with one of the parties, would be able to match the range and choice of content that UKVOD will offer. They told us that there are substantial incremental costs associated with making an additional hour of content available on a VOD service, including the costs of digitizing the content and clearing the rights with the rights' owners. Their analysis, for example, suggested that it would be profitable for 4OD to supply [✂] hours of archive content. This might suggest that, if there were three VOD services similar to 4OD, the parties should between them supply only around [✂] hours of archive content to UKVOD, rather than the c. [✂] hours that are currently proposed.

5.80 Whilst VOD retailers might find it profitable to make available catch-up and popular archive content, the parties said that third-party VOD retailers would be unable to offer less popular archive content on an economic basis. They said that third parties would, instead, look to offer only the most popular archive content, and that, in any case, there would be a risk associated with seeking to obtain large volumes of VOD content from the parties.

5.81 The parties also said that, whereas the wholesale remedy on its own would not extinguish any relevant customer benefits, certain benefits would be forgone under the farmers' market remedy. They said that the benefits forgone were associated with UKVOD being able to offer a more coherent retail platform with a consistent business model across all content and common pricing points for transactional material which would be likely to enhance the user experience and make the platform a more attractive destination.

5.82 Virgin Media told us that it did not consider that UKVOD would give rise to any material benefits to consumers that would not otherwise arise. It said that most of UKVOD's claimed benefits arose out of the creation of a single VOD supplier with significant market power. It said that the benefits claimed by the parties would accrue in any event if the parties' content were to be wholesaled to downstream VOD service providers. In addition, it said that the 'one-stop-shop' benefits of the JV were overstated in that there were virtually no search or switching costs for consumers in using the VOD services provided on different websites/platforms, and that search engines such as Google enabled archive and catch-up content to be located quickly and easily.

5.83 We examined the parties' arguments in the light of both the requirements of the Act and our guidance. We considered the benefits that the parties claimed would result from the JV as originally envisaged. We note that, despite the parties' analysis, C4C, ITV and BBCW have, for a variety of reasons, already digitized and cleared [✂] of content and are digitizing more each week.[112] As set out in paragraph 3.50, we thought it likely that, in the absence of the JV, each of BBCW, ITV and C4C would pursue its own commercial interests, either alone or in partnership with a third party, to exploit its archive VOD content rights.

5.84 In general, we would expect VOD retailers to compete to make their sites as attractive and user friendly as possible in order to attract viewers. Whilst we were not persuaded that search engines could easily be used to replicate the full functionality

[112] [✂]

of UKVOD, we decided that, in the absence of the JV, other third-party VOD retailers, or one of the parties, either alone or in partnership, could be expected to acquire a significant volume of archive content from the parties and insert editorial links between content so as to create a similar offer to that proposed by UKVOD.

5.85 We also looked at the benefits that the parties claimed would be preserved under the wholesale remedy but forgone under the farmers' market. These included common pricing points for transactional material. We do not consider that common pricing is a relevant customer benefit, as defined by the Act. Nor do we consider 'a consistent business model across all content' necessarily to be a benefit, still less a relevant customer benefit. The essence of rivalry is that firms will seek to differentiate their own from their competitors' offerings, including the business model they choose to adopt.

5.86 We therefore conclude that the customer benefits outlined were unlikely to be specific to this JV[113] and, in any case, whilst difficult to quantify, were unlikely to be significant.

Cost of remedies and proportionality

5.87 We considered the proportionality of the prohibition remedy that we had decided would be effective in addressing the SLC and adverse effects that we found. We take into account our discussion of relevant customer benefits in paragraphs 5.76 to 5.86.

5.88 In general, the prohibition of an anticipated merger is unlikely to result in high costs. There are no distortions to market outcomes or ongoing compliance costs. We note that, in this case, the parties incurred certain costs in the process of preparing for UKVOD's launch.[114] However, in accordance with our guidelines, we do not take these costs into account in considering proportionality, since the parties were aware of the risks in incurring such costs ahead of our decision.

5.89 We considered whether prohibition might extinguish any relevant customer benefits. However, as set out in paragraph 5.86, whilst we found that the JV would be likely to result in some customer benefits, we thought it unlikely that this JV was the only way that these benefits could be realized. We found that, in the absence of the transaction, each of BBCW, ITV and C4C would pursue its own commercial interests, either alone or in partnership with a third party, to exploit its archive VOD content rights, resulting in benefits to customers. We therefore conclude that prohibition was unlikely to extinguish any relevant customer benefits.

5.90 We looked more generally at the proportionality of the remedy in relation to the SLC and adverse effects that we found. It would be an inherently difficult exercise in this developing market to quantify the detriment associated with the SLC and we did not attempt to do so. However, since we had only identified prohibition as an effective remedy, and given the nature of the SLC and adverse effects that we had found, we formed the view that prohibition was a proportionate response.

5.91 We therefore conclude that we did not need to modify the remedy that we would otherwise put in place to take account of any relevant customer benefits, and that prohibition is a proportionate remedy to the SLC and adverse effects that we found.

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[113] [✂]
[114] These include, for example, [✂].

Conclusion on proposed remedies

5.92 We conclude that prohibition of the JV is the only remedy that would address the SLC and adverse effects that we found.