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

ME/3634/08

The OFT's decision on reference under section 33(1) given on 30 June 2008.  
Full text of decision published on 14 July 2008.

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**Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.**

## **PARTIES**

1. **BBC Worldwide Limited** (BBCW) is a wholly-owned subsidiary of the British Broadcasting Corporation (BBC). BBCW engages in a wide range of commercial activities in the audiovisual sector, mainly involving the commercial exploitation of material produced or commissioned by the BBC, including syndication of archived television content to video on demand (VOD) providers. BBCW is also involved in book and magazine publishing.
2. **Channel 4 Television Corporation** (C4) is a publicly-owned corporation active in the audiovisual sector. It owns and operates a number of commercial channels, including Channel 4, and a website through which VOD can be accessed ([www.channel4.com](http://www.channel4.com)). C4 also operates 4oD, a VOD platform which is accessed online or through certain closed VOD platforms (for example, Virgin Media) as a branded VOD channel.
3. **ITV plc** (ITV) has a range of activities in the audiovisual sector, including the operation of television channels, in-house content production via ITV Productions (formerly Granada Productions), advertising sales, interests in Freeview and SDN, a digital terrestrial television multiplex operator, and

various internet activities. ITV operates a website ([www.itv.com](http://www.itv.com)) through which a wide range of ITV content is available via VOD. ITV also syndicates VOD content to other VOD platforms.

## **TRANSACTION**

4. The parties propose to establish Vod[...], a joint venture [...]. The joint venture will provide an internet-based VOD service to enable users to view and own audiovisual material, sell internet advertising space, and syndicate content to third party VOD service providers.
5. Plans for the joint venture were publicly announced through a press release in November 2007. The OFT accepted a satisfactory informal submission from the parties on 29 April 2008. The extended administrative deadline is 27 June 2008.
6. The joint venture project is known publicly by the term Kangaroo, and is on occasion referred to as such below.

## **JURISDICTION**

7. As a result of this transaction the VOD activities of BBCW, ITV and C4 will cease to be distinct. The parties will transfer content, syndication rights and the technology required to operate a VOD service to the joint venture.
8. The parties' activities overlap in the supply of UK catch-up television VOD content. Catch-up content may broadly be defined as content made available via VOD within a window of zero to seven days or zero to 30 days following initial broadcast on television. The parties have indicated that the joint venture will account for more than 25 per cent of catch-up hours available on a VOD basis in the UK. Moreover, the OFT considers that where the parties continue to operate activities of the same type as those undertaken by the joint venture, such activities are taken into account for the share of supply test. In this case, the parties between them currently account for more than 25 per cent of catch-up hours available on a VOD basis in the UK, and so the OFT considers that it is or may be the case that the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met.

9. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **BACKGROUND AND RATIONALE**

### **The UK video on demand sector**

10. VOD is defined by the parties as a service or technology that enables viewers to watch audiovisual content whenever they choose to, rather than be restricted by a linear television schedule. VOD can be delivered via an open service, generally accessible on a computer over the internet, or via a closed platform, generally accessible via a television set top box (using data transmitted via a phone line or cable network).
11. As noted above, C4 and ITV currently provide internet-based VOD services which, in the case of 4oD, is also syndicated to certain television-based platforms. BBCW does not provide a VOD service at present. However, the BBC successfully launched a VOD catch-up service in December 2007, known as the iPlayer. BBCW planned activities absent the proposed joint venture are discussed further in the counterfactual section below.
12. Ofcom, in its iPlayer Market Impact Assessment,<sup>1</sup> estimated the value of the VOD market at £66 million in 2006 and that it would be expected (at least until 2011) to grow by 50 per cent per year. This would equate to £148 million in 2008 and £500 million in 2011.

### **The Kangaroo joint venture proposition**

13. Kangaroo, the working name for the joint venture, will offer an open VOD service to users through its own branded website. It will provide archive content from the BBC through BBCW and archive and catch-up content from ITV and C4. (BBC 7-day catch-up content is reserved for the iPlayer service.) In due course, it is expected that Kangaroo will acquire rights to offer content from third parties, including films. At the wholesale level, Kangaroo will also syndicate its service and content to third party VOD service providers. The parties will continue to acquire broadcast rights in regard to their own linear television channels, but will pool their VOD rights

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<sup>1</sup> Ofcom, 'BBC new on-demand proposals: Market Impact Assessment', January 2007.

through Kangaroo [...]. This provides for exclusive supply, subject to certain carve-outs giving the parties the right to syndicate content independently rather than through the joint venture in certain circumstances.

14. Kangaroo will operate a variety of business models, providing free (advertising funded) content as well as transactional content (either download-to-rent (DTR) or download-to-own (DTO)). Kangaroo will also sell internet display advertising space (static and video), both on the pages of the website and around the content (such as pre-roll video adverts).

#### **The parties' rationale for Kangaroo**

15. The parties consider that their individual ability to compete with new and current providers of VOD services, both legal and illegal, is limited. Their strong positions in the UK linear TV market and strong UK brands, they argue, provide only limited benefit with regards to VOD services when faced with competition from global companies such as Apple, Microsoft, Sony and Sky, and integrated telecoms providers such as BT and Virgin. In particular, the parties cite the competitive advantages that certain players can leverage from linking their VOD service to popular hardware, such as Apple's iPod, Microsoft's Xbox and Sony's Playstation/PSP, which may lead them to reduce the price of content to drive hardware sales. The parties note in particular the success of Apple in driving iPod sales through its provision of downloadable content. At the same time, they submit that competitors such as Sky, Virgin and BT can leverage a subscriber base derived from their triple-play (fixed line phone, broadband, TV) packages, and competitors such as Amazon from their established brand and web traffic.
16. The parties submit that the joint venture represents their best opportunity, as content providers, of creating a significant market presence in the evolving VOD sector, and limits the risks each individual party may face in circumstances where there is considerable uncertainty concerning the evolution of the VOD sector. In particular, it will benefit consumers by providing a one-stop shop for some of the most popular programming content in the UK.

## **PRODUCT MARKET**

17. The parties submit that the appropriate markets in which to consider the effect of the joint venture on competition are:

- the retail supply of VOD services
- the wholesale supply of VOD content to third party VOD service providers, and
- the supply of internet display advertising.

These candidate definitions are considered in more detail below.

### **Retail video on demand services**

18. Kangaroo will consist of a consumer-facing VOD website built on the UK-origin television programme content of the parties, though it may extend to include other content it can syndicate from other rights-holders. BBCW, which holds rights of first refusal over the BBC archive, and ITV, which owns the ITV archive including Granada Productions material, control the content for the two largest libraries of UK-origin TV content. For windows of various duration, each of BBCW, ITV and C4 also control the VOD rights for certain independently-produced UK-origin TV programming first broadcast over their respective linear TV channels. (These details are discussed further under wholesale market definition, below). For present purposes, UK TV content refers to UK-origin television content, that is, television content produced in the UK primarily for a domestic audience, rather than content, irrespective of country of origin, that is broadcast to UK television viewers. Likewise, US content refers to US-origin content.
19. As explained below, at the retail or consumer level, the narrowest candidate market, being the area of direct overlap between the parties, is the supply of UK TV content on demand.
20. While the Kangaroo platform is internet-based, the distinction between internet- and TV-based VOD is not meaningful for present purposes, as discussed below. The parties, however, submit that UK TV content delivered by internet VOD is part of the same market or closely connected to a variety of other types of content and other methods of distribution.

Various distinctions and their competitive significance are considered in turn below.

## **CONTENT TYPES AND ORIGIN**

### **Catch-up versus archive VOD**

21. The parties do not consider that archive and catch-up content should be treated as separate markets. Third parties tended to agree, with one third party service provider noting that, while there were certain distinctions, there remains a significant degree of interaction between the two, both from the demand- and supply-side. Third party production companies submitted that they perceive no relevant distinction between catch-up and archive content.
22. While for market definition purposes it may be inappropriate to segregate catch-up and archive, the ultimate assessment of competitive effects may distinguish between the two, because the parties intend catch-up television to be free, in line with current supply and consumer expectations that catch-up is free on websites and/or generally comes at no incremental cost to their TV subscription package. Moreover, the BBC's free iPlayer catch-up service is outside the joint venture.

### **VOD television content of UK versus US origin**

23. The parties submit that UK and US TV content are sufficiently substitutable such that a hypothetical VOD monopolist of UK TV content could not raise DTR or DTO prices, as sufficient customers would switch to US TV content to render a price increase unprofitable. For present purposes, the term US TV content serves as a short-hand to cover Australian and other English-language TV content produced outside the UK, because US-origin content is the dominant non-UK origin content viewed on UK television.
24. By way of proxy in a substantially more mature on demand delivery channel than VOD, the parties provided data on DVD sales of television content as evidence of substitution between UK and US TV content.<sup>2</sup> They point out that 40 per cent of the top ten selling titles between 2004 and 2006 were

of US origin, while in 2007, 58 per cent of the top 200 titles were of US origin. Further, there is no retail price differential between US and UK content of similar genre and popularity. More directly, the parties point to Apple's iTunes (UK) website, where US content accounts for 81 per cent of the top downloads, notwithstanding that iTunes has substantial UK TV content (the parties supply 450 hours of such content).

25. The parties consider that viewers make their choices by genre, such as comedy, drama, documentaries and so forth, rather than by country of origin. This is demonstrated by the fact that VOD providers and DVD retailers primarily classify content by genre and that neither generally separate UK- and US-origin content, whether for TV series or films. Consequently, the parties submit that UK viewers see US and UK TV content as substitutes, rather than complementary.<sup>3</sup>
26. Third parties, however, tended to disagree with this position, with most submitting that UK and US TV content were complements, rather than substitutes. On this issue, the most direct evidence provided to the OFT was data from one third party VOD service provider regarding the introduction of new US-origin content to its VOD service. The data indicated that while the number of viewers using VOD increased upon the introduction of a substantial amount of US VOD content, the viewing of UK TV content remained constant. VOD viewers continued to watch the same amount of UK-origin content as before but increased their overall viewing to take account of the added US content. This natural experiment suggests that UK VOD viewers' propensity to switch between UK- and US-origin TV content, in response to relative price changes (or, in this case, an expansion of US-origin TV content at the expense of UK-origin content), may be limited.
27. Further, it was noted by third parties that demand for VOD in the UK was driven by content that had been shown on linear broadcasts, which in the UK overwhelmingly consists of UK-origin content. UK content was therefore considered to have greater mass appeal to a broader range of unique VOD

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<sup>2</sup> Given the windows within which materials become available in different formats, read-across from DVD sales or rental seems likely to be more relevant to recent archive content rather than catch-up.

<sup>3</sup> The term 'complement' in the below analysis is used in the ordinary sense of the word, rather than in an economic sense.

users, while US-origin content was considered to drive deep usage among a narrower band of heavy VOD users.

28. The mass appeal of UK TV content relative to that of US and other non-domestic origin, and the parties' combined predominant share of such UK content by virtue of their strong linear broadcaster position, is consistent with data that the parties are collectively responsible for 92 per cent of investment in UK-origin first run TV programming (in 2006) and account for:
- 70 per cent of viewing across all television platforms, and
  - 63 per cent of viewing in homes with access to multi-channel platforms.<sup>4</sup>
29. Overall, the OFT considers it an open question as to whether US TV content should be considered a sufficient constraint on UK TV content to warrant inclusion in the same product market.

#### **Television versus film VOD content**

30. The parties further submit that consumers regard English language film and television content as sufficiently substitutable such that a hypothetical monopolist supplier of UK TV content could not profitably raise DTR or DTO prices because of customer substitution to English-language film (whether UK, Hollywood or other).
31. As evidence of this substitutability, the parties refer to the availability of both film and television DVDs to buy and rent side by side in stores or through internet retailers (for example, LOVEFiLM's list of all time most popular rentals includes both television and film content). Further, the parties claim that the price of DTO and DTR film content is equivalent to similar length television content (whether taken over a series or, for example, a feature length drama). Where film content is priced higher, the parties suggest that this applies to newer film content, with the price then dropping for older content. The parties cite the OFT's *BBCW/Woolworths*<sup>5</sup> decision which stated that the evidence in that case did not point towards a distinction between television and film content DVDs.

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<sup>4</sup> See Competition Commission, *Acquisition by BSkyB plc of 17.9 per cent of ITV plc*, December 2007.

32. Third party views in this case were mixed. Some considered that the typical duration of films means they are not a close substitute for a viewer intending to watch a typical television programme via VOD (that is, typically half-hour or hour long programmes rather than special feature length dramas). One third party VOD service provider submitted that television and film represent very distinct viewer experiences, while another third party submitted that VOD was currently driven by terrestrial television content to a greater extent than film content, highlighting the importance of catch-up VOD, and UK-origin content in this regard.
33. As far as premium film content is concerned, the OFT notes that previous cases have consistently established that premium film content available on pay television platforms is not closely constrained by what might be termed non-premium or mainstream free to air programming.<sup>6</sup> This was confirmed by Ofcom's consultation document for its pay television investigation, which noted that 'the retailing of premium movies has been considered on a number of occasions by economic regulators in the UK. The consistent conclusion of these investigations has been that there is a separate market (both at the retail and wholesale level) for the provision of premium movie rights.'<sup>7</sup> However, while this suggests the premium movie rights are not sufficiently constrained by viewing of mainstream content, it is quite possible that the latter could well be constrained by the former – and mainstream content best describes the parties catch-up and archive material.
34. Once again, while intuitively there are appealing arguments that a rigid TV/film distinction may not be appropriate, it is equally possible that the weight of VOD will be consumption of shorter – say, 25 minutes to one hour – programmes consistent with most TV content, rather than film content which is typically between one and a half and three hours in length, and which may primarily be viewed by other delivery means, such as linear broadcast, subscription channels, and DVD rental or purchase. Overall, the limited evidence of UK consumers' elasticity of demand in the VOD sector renders this an open question.

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<sup>5</sup> *BBC Worldwide Limited/Woolworths Group*, 19 September 2004.

<sup>6</sup> For example, *BSkyB: Alleged infringement of the Chapter II prohibition*, OFT, 30 January 2003, or *BiB*, Case IV/36.539, European Commission Decision, 15 November 1999.

<sup>7</sup> Pay TV Market Investigation Consultation, 18 December 2007.

### **Short-form versus long-form VOD content**

35. Short form content generally refers to VOD content approximately 5 to 10 minutes in duration. The primary example of this type of VOD content is user-generated content, or clips from professionally produced shows, found on YouTube ([www.youtube.com](http://www.youtube.com)). The parties submit that this form of VOD content is substitutable for long form VOD content (that is, VOD content of at least half an hour, the length of a typical television programme). The parties believe that users will make no distinction between short and long form content, considering that such a difference is merely time specific. The parties point towards the popularity of sites like YouTube, and the availability of popular professionally produced content linked to particular television programmes (such as clips of individual acts in 'Britain's Got Talent').
36. Third parties, including VOD service providers of short form content, have generally disagreed with the proposition that short form VOD is a close substitute for long form television content, arguing that the viewing experiences as completely different, particularly due to the differences between professional and non-professionally produced content.
37. In sum, the evidence available does not persuade the OFT that a hypothetical monopolist of long-form VOD content would be constrained by consumer switching to short-form content. Accordingly, the OFT does not believe that constraints from short-form content are material to the effects analysis.

### **CONTENT DELIVERY CHANNELS**

38. The following considers distinction based on how consumers engage in the viewing of content, based on different distribution channels or means by which the relevant video content is delivered on demand.

#### **TV-based VOD**

39. TV-based VOD allows users to access VOD on their television set through a set top box which downloads content through a phone line or cable. Examples of television-based VOD include Virgin Media, Tiscali and BT Vision. Television-based VOD can also provide added functionality with so-

called Push-VOD. This is where the service provider chooses various programmes it believes users may like and have missed and loads them on to the set-top box hard drive for them to watch if and when they wish.

40. An alternative form of television-based VOD put forward by the parties is so-called near-VOD. This is in fact linear television, but with a particular programme scheduled on a number of channels with staggered start times (typically every 15 minutes), which allows some measure of choice with regards to when the viewer chooses to watch. Both near-VOD and push-VOD are available from Sky.
41. The parties submit that television-based VOD constrains internet-based VOD. They cite a report by Screen Digest in the Ofcom Pay TV consultation which states that an increase in the supply of and demand for internet-based VOD services will erode the revenues of television-based VOD service providers.<sup>8</sup> Third parties in this investigation generally thought that television-based and internet-based VOD should not be considered separately in the OFT's assessment. In particular, some third party VOD service providers noted the increasing convergence in the home of various types of media hardware, including television and computers.
42. However, third parties tended not to consider push-VOD of itself to be substitutable with true-VOD, mainly due to capacity constraints with respect to how much programming can be stored on a hard drive limiting the content available: this is linked to further issues surrounding the importance of content, as is the overall level of substitutability of television-based VOD with internet-based VOD. Nor did third parties agree that near-VOD should be considered as its characteristics were too far removed from true-VOD.
43. The view of the Competition Commission (CC) in *BSkyB/ITV* was that, while television-based VOD was a constraint on broadcast television services sufficient to warrant inclusion in the CC's definition of an all-TV market in that case, internet-based VOD was unlikely to be a constraint, due, for example, to the difficulty in viewing such content on television sets and delays while downloading. The parties note in response that asymmetric market definitions may apply to products which are differentiated in quality

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<sup>8</sup> Report commissioned on behalf of Ofcom, Annex 11 to Pay TV Market Investigation Consultation, 18 December 2007.

terms, such that television-based VOD may constrain internet-based VOD without the reverse necessarily being the case.

44. In *BSkyB/ITV*, the issue was the exercise of material influence by a pay-TV broadcaster over a free-to-air TV broadcaster. In this case, in contrast, the market definition question begins from the narrowest service at hand – internet-based VOD. Given the general agreement between market participants that distinguishing between internet-based and television-based VOD is not appropriate, and given that watching VOD on television more closely corresponds to the traditional living room TV-watching habits than watching TV on a PC, the OFT concludes that the internet versus TV distinction is not meaningful for purposes of analysing retail competition in VOD.

#### **Personal video recorders (PVRs)**

45. PVRs are hard drives used to record and store television content. They can most often be found in set-top boxes which allow viewers to access digital television (Freeview, Sky+ etc). PVRs can provide a range of recording functionality, including one touch video recording via electronic programme guides and a series link which allows the viewer to set the PVR to record an entire series. As noted above, television-based VOD service providers can utilise PVRs for push-VOD.
46. The parties cite Ofcom's impact assessment report on the BBC iPlayer,<sup>9</sup> which considered the importance of PVRs in respect of the development of online services and noted that PVRs offer many of the benefits of VOD. The argument is based on the fact that PVRs can be used to mimic catch-up VOD, where users can select programmes that they want to watch and record them to watch at a time of their choosing. The parties state that PVRs are therefore an effective alternative to VOD. The parties also note that the quantity of programming available for catch-up VOD may be limited compared to PVRs, which allow users to store any programme to watch at a later time without the constraints of limited windows (that is, up to 30 days for catch-up).

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<sup>9</sup> Ofcom, 'BBC new on-demand proposals: Market Impact Assessment'Assessment', January 2007.

47. Third parties generally disagreed with the arguments that PVRs are substitutable for VOD, noting that storage capacity is relatively limited (although it should be noted that the size of hard drives continues to increase) compared to the potential amount of VOD content that could be accessed (in other words taking into account archive as well as catch-up content). In addition, it should also be considered that PVRs rely on the user to know what programmes they wish to watch, and to take steps to ensure recording. This differs from VOD which allows users to browse through content for programming they may not have considered or missed due to unforeseen circumstances.
48. Overall, the OFT considers it an open question as to whether PVR usage would constrain pricing and other retail terms offered by VOD suppliers.

### **Linear broadcast television**

49. Linear television refers to traditional scheduled television broadcasts. The parties have an interest in excluding linear broadcast television because their strong collective position would inflate their shares of whatever measure of supply, and tend to reinforce concerns that centre on UK TV content.
50. The parties argue that linear television should not be included in the relevant market in this case, citing the *SFR/Tele2*<sup>10</sup> European case, which stated that non-linear services (that is, VOD and pay-per-view (PPV)) differ significantly from conventional television channels in terms of demand, applicable legislation and prices. The parties suggest that, in particular, linear television is much more strongly driven by live content such as news and sports.
51. While the CC in *BSkyB/ITV*<sup>11</sup> found that television VOD was sufficiently substitutable to include in the wide all-TV market relevant to the overlaps in that case, the reverse proposition is at issue here, and constraints may well be asymmetric.
52. While the OFT is sympathetic to the notion that linear broadcast television lacks the on-demand character specific to VOD, nothing of substance in the competitive effects analysis turns on whether linear broadcast television is included in the market or not. The key horizontal concerns derive from the

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<sup>10</sup> M.4504, July 2007

combination of the parties' portfolios of VOD rights, and while these rights in the main derive from the parties position as broadcasters the theory of harm does not depend on inclusion of primary broadcasting – and in particular market share or concentration data – in the analysis. For present purposes, the OFT therefore excludes linear broadcast television from the analysis of video on demand. That said, however, it is important to note that given the scarcity of direct evidence of market shares, market share proxies derived at least in part from the parties' position in linear broadcasting are in some circumstances part of the limited data available when considering the relative positions of the parties and competitors in the nascent VOD sector.

### **DVD rental and retail sales**

53. Consumers can obtain audiovisual content to watch at the time of their choosing by purchasing or renting DVDs. This can be done through internet-based businesses such as LOVEFiLM or traditional bricks and mortar businesses such as Blockbuster or Zavvi. The OFT's recent clearance of LOVEFiLM's acquisition of the online DVD rental service of Amazon UK concluded that LOVEFiLM would be constrained post-merger by other suppliers supplying video content to UK consumers in other ways than the online DVD rental business model epitomised by LOVEFiLM.<sup>12</sup>
54. The parties argue that DVDs act as a constraint on VOD, particularly for DTO delivery of content and [...]. Further, the parties note that bodies such as Screen Digest and the British Video Association view the growth of VOD as coming at the expense of DVD. However, just as the parties note the potential for asymmetric substitution between TV VOD and internet VOD, while it could be the case that VOD may constrain DVD, it is not necessarily the case that the reverse is also true.
55. For example, it can be argued that insufficient consumers would switch to DVD rental or purchase in response to relative price increases for DTO and DTR because – with the exception of certain VOD services -- DVD rental pursuant to the LOVEFiLM model is not instantaneous, and bricks and mortar rental requires a trip outside the home. DVD purchases, meanwhile,

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<sup>11</sup> *Acquisition by British Sky Broadcasting Group plc of 17.9 per cent of shares in ITV plc, December 2007*

<sup>12</sup> See further, *Anticipated acquisition by LOVEFiLM of the online DVD rental business of Amazon*, OFT decision of 15 April 2007.

often relate to box sets of entire series, which are considerably more expensive (£20-£40 per set, for example) and arguably a very differentiated purchasing decision from downloading one or more TV episodes to rent for prices in the range of, say, 99p to £1.99, for example. These extra costs may limit the substitutability of DVDs for VOD.

56. Third parties did not consider DVDs to form a constraint on VOD, particularly given the later release windows, and tended to point out that DVDs utilised different pricing models (such as box sets for television series, rather than individual episodes).

## **CONCLUSIONS**

57. From the perspective of UK viewers, there are a number of candidate substitutable products to UK TV VOD services, differentiated across a number of dimensions. The parties accept that in such circumstances the relevant market may not have a clear-cut boundary, but have put forward considered arguments that it should include all types of English language content delivered by a wide variety of means other than VOD, including PVRs and DVDs.
58. Third parties offered a variety of views, but while one argued for a very broad market for the supply of audiovisual content (which would, for example, include cinemas), the majority of third parties favoured a narrower form of market definition, with some putting forward arguments to exclude all but UK-origin television content delivered by VOD.
59. Some of these third party argument suffer from the criticism that while there are various factors which differentiate all other viewing experiences from that offered by VOD, this is to some degree true of any differentiated product market sector.
60. Overall, the OFT believes that short-form and linear broadcast content can be excluded for the purposes of market definition, and that no distinction should be made between catch-up and archive content, and internet- and TV-based VOD.
61. More difficult and error-prone, not least given a lack of suitable evidence presented to the OFT, are the judgments on content substitution between UK and US TV content, and between TV and film content, and on

substitution to PVRs, and DVD online and bricks-and-mortar rental, and retail sales.

62. Ultimately, it should not be neglected that while market definition in principle considers, incrementally and in isolation, each set of constraints from differentiated content or delivery mechanism, the real question is whether the **cumulative** set of constraints imposed by other content and other delivery channels would constrain a hypothetical monopolist supplier of UK TV VOD services. It is of course entirely possible that while sufficient volume of consumers might not switch to any one substitute (content or delivery channel), they would variously and **in aggregation** switch to substitutable content or substitutable delivery mechanisms to discipline the joint venture's pricing and other aspects of its retail offer.
63. However, unlike in certain previous cases where the OFT had direct evidence of at least stated customer preferences, if not revealed consumer preferences, in this case there was little directly probative evidence on the key questions of the price-sensitivity of consumers and their relative content preferences in the nascent VOD context.
64. In the absence of compelling evidence, and given the uncertainty surrounding how this market will develop, in this investigation the OFT has adopted a cautious approach with respect to both wider content types and alternative delivery mechanisms in assessing the parties' overlap in retail VOD services. As such, the OFT concentrates on UK TV content delivered via VOD.

## **Wholesale VOD rights syndication**

### **Background and parties' activities**

65. Third party VOD service providers purchase VOD content to offer to users at the retail level. The content can either be individual programmes, a limited range of content, or take the form of a branded service (for example, 4oD is available through Virgin Media's television-based VOD service).
66. In addition to making content available at the retail level to consumers, the parties independently syndicate their content and services at the wholesale

level. This will be done exclusively by the joint venture in future, save for certain carve-outs.

67. The collective in-house production by the BBC<sup>13</sup> and ITV accounts for around 60 per cent of programming created in the UK.<sup>14</sup> In addition to the contribution of rights libraries where a joint venture party is the **rights-owner**, the joint venture also amalgamates three portfolios of VOD rights in respect of which a joint venture party is – for a significant period – the **rights-holder**.
68. For example, C4, which does not produce its own UK TV material, will, like BBCW and ITV, contribute to the joint venture, a significant portfolio of VOD syndication rights in respect of independently-produced UK content, which derives from certain exclusivity pertaining to its position as the primary broadcaster of those shows.
69. Third parties for the most part tended to view content syndicated by ITV, BBCW and C4 as substitutable and the parties themselves as close competitors (see further, horizontal effects, below). Third parties generally highlighted the importance of having a sufficiently broad library of UK TV content in order to make a VOD service attractive to UK users.
70. Given that video content is in a sense unique – because each show is different – the OFT considered the theory that there would be no merger effect from the joint venture because each party could be regarded as a monopolist in terms of the syndication of its own captively-produced content. In this sense, the parties' portfolios of rights, when broken down to the level of individual shows, rather than at the portfolio level, could be regarded as complementary: each might be necessary or desirable for creating a retail VOD library, but one will not substitute for the other in response to small but significant price differences in the acquisition price. The parties declined to make such an argument, however.
71. At the other extreme, no concerns would arise if the joint venture operated in an extremely wide market in which the parties were not important choices for customers. For example, it might be that for each joint venture party its wholesale customer's next-best alternative to syndicating rights

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<sup>13</sup> For which BBCW holds rights of first refusal in relation to commercialisation of that content via VOD (outside the iPlayer window).

from one of BBCW, ITV or C4 would be to syndicate rights from one or more of UK independent TV rights-holders for VOD outside the joint venture – thus bypassing the joint venture for UK TV content – or US TV, film or other content held by third parties. If this were true, the joint venture would not combine close substitutes from the point of view of rights syndication, as the parties would not be VOD retailers' first and second (and even third) choices for procuring content for their retail VOD services. Under this 'wide market definition' scenario, a hypothetical monopolist of UK TV syndication rights in VOD could not raise prices because wholesalers would switch to an array of other content. In such a scenario, unilateral effects arising from the merger could be dismissed on the grounds that the internalisation of lost syndication revenue between the parties would be trivial, because the joint venture parties would lose far more to rivals than they would recoup within the joint venture.

72. The parties did make arguments consistent with a broad array of competitive constraints facing the joint venture. Specifically, they submitted that the syndication of VOD content to other VOD sites and platforms is in the same market as, or closely connected to, the direct acquisition of VOD by such sites and platforms from other content producers and rights owners. These might include independent UK production companies, US television and film studios, US broadcasters, music video publishers and specialist wholesalers.

### **Substitutability of syndication of film content and US TV content**

73. The question of whether US content and film should be considered part of the wholesale market relevant to this case is inherently linked to the issue of whether such content is considered part of the relevant retail VOD market. Although VOD suppliers' preferences at the wholesale level need not be synonymous with viewers' preferences at the retail level, in this case we may expect them to be closely related.<sup>15</sup> Consequently, should film content and US TV content not be substitutable with UK TV content at the retail level, then it is unlikely to be so at the wholesale level. Consequently,

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<sup>14</sup> *Television Production Sector Review*, Ofcom, 20 September 2005

<sup>15</sup> Differences between wholesale 'wholesale' and retail 'retail' preferences are likely to be more pronounced when (i) retail demand is unitary but wholesale demand is granular (so consumers' choices are binary—that is, i.e. buy or don't buy—whereas retailers choose how many to buy) and (ii) there are capacity constraints on how much retailers can supply to consumers (so products compete for retailers' capacity). Neither seems likely in this case.

while the parties argue US content and film are substitutable for UK-origin television content, third parties tended to argue that they were not. In particular, third party VOD service providers argued that UK-origin television content was a key element for any retailer wishing to offer an attractive range of content, a concept linked to the argument made above that content on linear television channels drives demand for VOD. In addition, one third party commented that obtaining VOD rights for US content was extremely difficult, such that even in the event that US content was substitutable, the ability to obtain enough content is limited.

### **Substitutability of syndication direct from UK independent right-holders**

74. The parties argue that an alternative to obtaining content from them is to obtain it directly from independent production companies that actually make the programmes. However, third parties have argued that obtaining enough content for an attractive VOD offering is difficult for a variety of reasons.
75. Third party VOD service providers consider that independent production companies are too fragmented to provide a broad enough content offering as noted, the BBC and ITV have together accounted for 60 per cent of UK TV production.
76. Third party production companies corroborated the views of their potential rights customers (that is, VOD service providers), arguing that that they very often do not have the VOD rights to the content that they do make (or previously made). They claim that under the terms of trade negotiated by the Producers' Alliance for Cinema and Television (PACT - the representative body of the UK independent production companies) they lack the rights to exploit VOD for much of the content they produce. Each individual broadcaster has a terms of trade negotiated with PACT which will typically set out the minimum basis on which the commissioning broadcaster will obtain rights to distribute content via VOD. Third party production companies have pointed to what they see as a number of terms common to all of the parties in this case which limit the production companies' ability to exploit VOD rights for their content and therefore to supply direct to VOD service providers.
77. According to third party producers, the VOD rights covering programmes commissioned by the parties involve a number of exclusive windows whereby the primary broadcaster can exploit VOD rights for the content

while the producer cannot. For one-off programmes or non-returning series, the primary broadcaster will hold the exclusive VOD rights for a month after initial broadcast. This is then followed by a 5-month period when neither the broadcaster nor the production company can exploit VOD rights. After this period ends, the production company can then exploit the VOD rights.

78. For returning series, the situation is slightly more complicated, in that the broadcaster retains exclusive VOD rights on the first series until after broadcasting the last episode of the third series. This is done on a rolling basis, so that the second series does not then become available until the end of the fourth series and so on. Third parties noted that returning series are obviously going to be popular programmes and would thus be particularly valuable to any retail VOD service.
79. The parties maintain that their position in relation to VOD rights is not as strong as that suggested by third parties. They note, for example, that the production companies retain the ability to exploit VOD DTO rights on a similar basis to DVD box sets. However, the information the parties provided confirmed the holdback on returning series, which tend to be the most popular and successful television content and are therefore likely to be key drivers of VOD use. Further, some of the broadcasters have a right of first refusal deal over VOD rights and in many cases the current terms of trade do not cover content made prior to 2004. Production companies claim that this means they own little by way of VOD rights for content produced before that date.
80. In summary, it seems that there may be only limited potential for third party VOD service providers to obtain content from independent producers directly (four independent producers who responded to the OFT's investigation estimated that, between them, they had just 100 hours of content for which they held VOD rights), in particular with regards to the more popular and therefore valuable content.

## **Conclusion**

81. As with the retail market, the boundaries of the wholesale market are not clear cut given the product environment. Given the need of VOD suppliers for a range of attractive content, of which at least a substantial proportion may need to be based on UK-origin TV, it cannot be ruled out on current evidence that a hypothetical monopoly wholesale supplier of VOD rights for

UK TV content would possess a substantial degree of market power. Once again, given the lack of conclusive evidence and uncertainty surrounding the development of the market, the OFT has taken a cautious approach and considered the competitive effects of the transaction on the basis that UK TV content is sufficiently distinct, in substitutability terms, from other syndication alternatives, and that the OFT should adopt this narrow lens in its competitive effects analysis.

## **Rights acquisition**

82. Upstream from wholesale VOD content supply is the acquisition of the VOD exploitation rights from rights-holding production companies in the UK and the US. Acquisition of such rights varies depending on the content being acquired, and the joint venture itself is also likely to be active in acquiring secondary VOD rights from third parties in certain circumstances.
83. Many third parties have expressed concerns that the joint venture may concentrate the buying power of the parties with regards to VOD rights, and in particular may provide them with the incentive to align the terms of trade with regards to VOD rights when they are re-negotiated, and reduce competition between the parties with regards to bidding for VOD rights. The parties, however, argue that they will have no incentive to do so, particularly as their main concern is the primary broadcast rights, and that the terms of the joint venture reward those providing content for VOD exploitation. [...].
84. There are various difficulties associated with the theory that there will be merger-specific anticompetitive effects from the joint venture on the buyer power of the individual parties (that is, monopsony power). On the evidence available to the OFT, given the still predominant economic value attached to the primary broadcast rights, and the structure of revenue allocation between the joint venture parents, it is doubtful that each party has sufficient incentive, as a result of Kangaroo, to bid materially less aggressively in procuring content from independent UK producers. The parties argue that each bidder will recoup only a very small amount of revenue from VOD via its share of joint venture revenues if it loses the bid to another of the parties,<sup>16</sup> and the risk of bidding less aggressively is that

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<sup>16</sup> To this end, the parties provided a breakdown of the degree to which merger-specific profit incentives arise.

of losing the rights entirely to be the primary broadcaster in the UK of the content in question.

85. The OFT is not currently persuaded that merger-specific buyer power concerns are significant in this case, but because the OFT is in any event referring the case on other grounds, it does not propose to examine this issue further below.

### **Internet display advertising**

86. The joint venture will sell advertising space on its website, either surrounding or embedded in content. The advertising is likely to include static and moving banner or skyscraper format advertisements and moving video advertisements. The parties submit that both static and video advertising form part of an overall internet display advertising market, within which internet sites of all types compete with each other for display advertising. In addition, the parties argue, this is separate from television advertising.
87. Third parties, particularly those involved in advertising, tended to support the parties' point of view. Further, no concerns were raised with the OFT regarding advertising and consequently the OFT does not consider it necessary to conclude on market definition in this case, or to consider this aspect of the transaction further.

### **Conclusion**

88. The OFT has not in this case been able to obtain sufficient evidence to reach confident and robust conclusions on product market definition. There are a number of possible products involved in this transaction and, particularly with respect to VOD services and content, there is no clear delineation between various possible alternatives.
89. The potential for the transaction to have a substantial effect on competition very much depends on the strength of constraints from other content and distribution channels. Ultimately, the OFT has considered the closeness of competition between the parties pre-transaction and the extent to which important competitive constraints may be removed by the transaction. As far as market definition is concerned, there is a lack of sufficient evidence

to conclude with confidence and precision. In any event, as a matter of economics, unilateral effects do not turn on market definition: the OFT considers that the same concerns over unilateral effects arise whether the merger is framed as one generating high concentration in narrow retail and wholesale product markets, or as one between close competitors in wider retail and wholesale product markets.

90. Nonetheless, given the uncertainty surrounding the development of this nascent market, the OFT has taken a cautious approach and proceeded to examine competitive effects on the basis that a monopoly supplier of UK TV content may well have substantial market power to raise prices at both the retail and wholesale (rights syndication) levels.

## **GEOGRAPHIC MARKET**

91. The parties submit that the joint venture is aimed exclusively at UK-based customers and as such that the UK is the relevant geographic market. Third parties have generally agreed with this geographic definition for each of the services involved in this case. The relevant VOD rights are those for UK exploitation, and the joint venture will only be available to users with UK-located IP addresses. Syndication of the content by the joint venture will presumably relate also to UK VOD retailers; the joint venture does not cover exploitation of VOD rights in markets outside the UK.
92. The OFT is satisfied that the relevant geographic market in this case is the UK.

## **COMPETITIVE ASSESSMENT**

### **Introduction**

93. The OFT's competition review in this case involves predictive merger assessment in a nascent and rapidly developing market. In this context, and as set out in detail below, the evidence available to the OFT gives it objective grounds for concluding that the creation of the joint venture presents a risk of harm to competition at an important juncture in the development of VOD services.

94. The parties submit that the joint venture represents their best opportunity of creating a significant market presence in an evolving market, and limits the risks each individual party may face in circumstances where there is considerable uncertainty concerning the evolution of VOD services. The parties further submit that the joint venture will benefit consumers by providing a one-stop shop for some of the most popular programming content in the UK.
95. The OFT acknowledges credible arguments that the joint venture may bring benefits to consumers in providing a one-stop library of UK TV (and in due course other) content. Although not presented formally as an 'efficiency defence' within the framework of the Act or OFT guidance, these amount to claims that efficiencies will be passed directly to consumers and are arguably merger-specific, in that it may be thought unlikely that any individual retail platform would have access to all of each parties' rights library by way of contractual arrangements absent the Kangaroo joint venture. However, these claims are difficult to quantify, have not been quantified by the parties, and it is not possible to weigh the consumer benefits properly against the risk of consumer harm.
96. As to consumer harm, there are credible arguments for adverse competitive effects flowing from the creation of the joint venture. On a worst-case scenario, such effects could, given the forecast growth of VOD, be substantial and would directly impact consumers. The nascent character of the market has meant the OFT has received relatively little direct evidence compared to other retail cases, and the error cost to consumers of a mistaken clearance is potentially high (although reference of the joint venture also creates delay to launch of what might be a pro-competitive consumer proposition).<sup>17</sup>
97. This reference follows the Court of Appeal judgment, which has ruled that in carrying out its substantive assessment 'in between the fanciful and a degree of likelihood less than 50 per cent there is a wide margin in which OFT is required to exercise its judgment' provided always that the OFT's belief must be objectively justified by relevant facts, and must be more than

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<sup>17</sup> This reasoning is based on the approach taken by the OFT in the BSkyB/ITV case. *See OFT report to Secretary of State for Trade and Industry, Acquisition by British Sky Broadcasting Group plc of a 17.9 per cent stake in ITV plc*, 27 April 2007, paragraphs 78-83.

fanciful.<sup>18</sup> Put at its lowest, in this case, the risk of competitive harm arising as a result of the creation of Kangaroo is beyond fanciful. Given the lack of robust evidence on consumer VOD preferences at the retail level, and in turn the competitive choices constraining wholesale syndication prices, there is a lack of evidence on central points of the analysis, and, consistent with the OFT's post-IBA guidance on the reference test, the threshold belief for reference is lowered.<sup>19</sup>

98. Accordingly, and for the reasons given in detail below, the OFT concludes that it may be the case that the merger will result, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services for the purposes of section 33(1) of the Act.

## Counterfactual

99. Merger assessment under the Act considers whether a merger causes harm to competition and its beneficiaries. The Act therefore refers to whether a merger will result or may be expected to result in a substantial lessening of competition (see section 33(1)).
100. The OFT determines the effects attributable to the merger by comparing the predicted post-merger competitive outcome with the outcome absent the merger, referred to as the counterfactual. As the Guidance notes, this comparison is 'the core concept of the substantial lessening of competition test'.<sup>20</sup> In predicting post-merger effects, the Guidance employs a widely accepted analytical framework to predict post-merger effects; the assessment of the counterfactual is largely a question of fact.
101. The Guidance establishes that the best proxy for the counterfactual is generally the prevailing competitive conditions (including market structure and dynamics) because these are observable and subject to verification from multiple sources. The OFT guidance notes that it will also take into account 'likely and imminent changes in the structure of competition' (the likely and imminent standard).<sup>21</sup>

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<sup>18</sup> *IBA Health v Office of Fair Trading* [2004] EWCA Civ 142, Judgment of the Vice Chancellor, paragraph 48.

<sup>19</sup> See OFT Guidance 516a, October 2004.

<sup>20</sup> See paragraph 3.23 of OFT *Mergers Substantive Assessment Guidance*.

<sup>21</sup> See paragraph 3.24 of OFT *Mergers Substantive Assessment Guidance*.

102. In its decisions under the Act that have potentially turned on whether the status quo ante is appropriate as (that is, the best proxy for) the counterfactual, the OFT has in practice applied a rebuttable presumption in favour of the status quo ante, by reading the likely and imminent standard strictly.
103. In this case, ITV and C4 already offer internet-based VOD services with both catch-up and archive content through their own websites and will continue to offer catch-up content once the joint venture is operational. Both parties also currently syndicate their content to third party VOD content providers. Accordingly, the counterfactual is that they would continue to offer independent archive content services and syndicate those services and content to third parties separately in the absence of the transaction.
104. BBCW does not currently offer a VOD service for its archive content, although it does syndicate some archive content for use by other VOD sites. The BBC itself currently operates and syndicates the iPlayer for catch-up content, and will continue to do so independently of the joint venture.
105. [...].<sup>22</sup> It was also a common belief amongst a number of third parties that BBCW would develop such a service in the absence of the joint venture, whether alone or with a different partner (or partners).
106. Given the quality, volume and potential value of the BBC archive, it does not seem plausible to the OFT that the BBC's archive content would not be commercialised in the near-term, particularly given the recent and ongoing activity by ITV and Channel 4 in this regard – a view [...] held by industry participants, and was not disputed by BBCW before the OFT.
107. The OFT therefore considers that it is reasonable to conclude that the likely and imminent standard is met, and therefore that it is appropriate to move away from the status quo ante and assume that the relevant counterfactual is that BBCW would commercialise BBC archive content in the absence of the joint venture. In these circumstances, BBCW would clearly represent a significant potential competitor to the other parties' wholesale and retail VOD offerings.

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<sup>22</sup> [...]

108. To conclude on the counterfactual, absent the transaction, all three parties could therefore reasonably be expected to operate independent VOD services, and to syndicate those services and associated content to third parties in competition with each other.

### **Retail and wholesale market share proxies**

109. Given the nascent state of VOD services, historical share of supply data is limited. Rather, both the parties and third parties resorted to various proxies as a gauge for the prospective market position of the parties and their rivals in both retail and wholesale supply of VOD services. For example --

- **VOD viewing on existing VOD platforms.** Several third parties provided estimates of the volume of VOD viewing on their platforms attributable to the parties. The share that the parties' content accounted for ranged from approximately 45 per cent to 70 per cent of viewing, although this may be a function of the current outcome of that retailer's negotiations with various VOD rights-holders, rather than a good long-run indication of the parties' position in VOD in the UK.
- **UK TV production expenditure and broadcast viewing.** To the extent that non-UK, non-TV content is discounted, the parties' shares of UK television production expenditure and broadcast viewing imply high shares of VOD services. The parties collectively account for a very significant proportion of UK total programme expenditure and a similarly significant proportion of the production and commissioning of UK-originated content. In terms of total investment in programme expenditure, the parties accounted for around 80 per cent in 2006 (excluding films and sports). Their combined share of investment in UK-originated first run programming in 2006 is estimated at 92 per cent. The parties accounted for 70 per cent of viewing across all television platforms, and 63 per cent of viewing in homes with access to multi-channel platforms in the UK.<sup>23</sup>
- **DVD retail sales.** In contrast to the high proxy shares indicated above, the parties submitted data from DVD sales, which in their view are a

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<sup>23</sup> Information provided by the parties. The BBC is included here as it is the parent company of BBCW and it is likely that much of the content provided by BBCW will originate from the BBC.

superior proxy of their potential shares for the syndication of VOD content. Consistent with their view of the market, they include US content and film, resulting in a market share for DVD content owned by the parties of eight per cent. Removing film content provides a market share of 34 per cent.

110. The OFT recognises the potential weaknesses in all these proxies, but given the lack of evidence is not in a position to prefer one set as a substantially better guide to the relative market power of the joint venture over the others. On a cautious basis, and consistent with third party concerns, the prudent conclusion is that, absent the joint venture, the parties are or will be important and competing providers of VOD services to consumers and wholesale VOD syndication to retailers, given their combined post-merger portfolio position in relation to UK-origin TV VOD rights.

## **Horizontal effects in wholesale VOD syndication**

### **Syndication activities of the parties and the joint venture**

111. Each of the three parties is currently active in syndicating VOD content rights to other open and closed VOD platforms. Current content supply arrangements are relatively short ([...]) to facilitate frequent negotiation as the nascent market develops (third parties have suggested that current contract durations had also been set with an eye to the launch of the joint venture, although the parties dispute this).
112. The main parameters of negotiation include the (i) volume, (ii) range and (iii) delay since original transmission of the content, and involve a variety of pricing elements which can relate to a fixed per hour licence fee, pence per subscriber fees and/or minimum revenue guarantees.
113. Under the terms of the joint venture, the parties will supply content to the joint venture exclusively, subject to certain carve-outs that provide the parties with the right to syndicate certain content individually under certain circumstances. Other than content supplied through the carve-outs, the joint venture will assume responsibility for the syndication of its VOD service and associated content to third parties ([...]).

114. Regardless of whether wholesale supply is through the joint venture or by the individual parties via the carve-outs, the transaction raises the scope for the parties to reduce pre-transaction independence and rivalry through the parties' common interest in the success of the joint venture. This could result in a significant reduction in rivalry between the parties, which could lead to higher prices, common pricing for otherwise differentiated content or a reduction in available content.

### **Closeness of VOD syndication competition between the parties (absent Kangaroo)**

Third party claims of close pre-Kangaroo competition between the parties

115. Certain third party VOD service providers assert that the parties are close competitors in VOD rights syndication, claiming in particular that they had exploited price competition in rights syndication between the parties to hold down the wholesale cost of VOD content.

116. As discussed above, several third parties provided estimates of the volume of VOD viewing on their platforms attributable to the parties, ranging from approximately 45 per cent to 70 per cent of viewing. The general position of third parties was that the parties represent important actual and potential close competition in relation to syndication of attractive VOD content, and that the possibility to acquire US content will not be a sufficient competitive constraint to compensate for the reduced competition between the parties.

117. Third parties have highlighted other benefits to the current situation regarding the acquisition of VOD rights from the parties. One third party submitted that the separate syndication negotiations with the parties enable it to benchmark terms offered while another considered that it had been able to take advantage of the competition between the parties to keep prices down. One third party considered the competition between the parties important enough to take steps to ensure that contract durations were staggered in length to maximise its bargaining power and avoid having to negotiate with its principal VOD content suppliers at the same time.

Other proxy evidence that the parties may be close competitors

118. A survey by Ofcom suggested that ITV and the BBC are the top two choices for consumers when asked which channel they could not do

without: in response to the question as to what channel viewers would choose if they could have only one, 40 per cent said BBC1 or 2 (35 per cent BBC1; five per cent BBC2), 13 per cent said ITV, and 7 per cent said C4.<sup>24</sup> This provides some basis for the argument that the joint venture parties' broadcast content – and in turn VOD content -- represent first and second preferences for a substantial proportion of UK consumers.

119. The parties argue that they face competition from US content and film and from content generated by independent UK producers, which would limit the scope for the joint venture to obtain or exploit market power. The parties submitted data from DVD sales as a proxy of their potential shares for the syndication of VOD content. Consistent with their view of the market, they include US content and film, resulting in a market share for DVD content owned by the parties of eight per cent. Removing film content provides a market share of 34 per cent. The shares may be a reasonable proxy for transactional (DTR/DTO) material; however, there may be less read-across with regards to the viewing of individual programmes or series, whether archive or catch-up.
120. As discussed above, third parties dispute the parties' contention that US content and independent production companies are adequate alternatives for supply. It is argued that that UK content is needed to drive VOD services and that the independent UK producers are too fragmented and do not hold the rights to a sufficient level of content individually or collectively to act as strong enough competitors to the joint venture.
121. On the basis of the evidence available in this investigation, the OFT believes that there is a realistic prospect that the joint venture combines first and second (if not also third) rights syndication choices for retail VOD suppliers in the UK. Regardless of the precise boundary of the relevant product market, by combining close competitors, Kangaroo therefore raises unilateral effects concerns as the joint venture may be able to exert enhanced market power and raise syndication prices as a result.

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<sup>24</sup> *Ofcom Residential Tracker Survey*, September 2006.

## **Vertical effects – raising rivals' costs**

122. A number of third parties raised concerns that the parties would have the ability and incentive to engage in input foreclosure to third party VOD content suppliers. The joint venture will control a much wider range of content than that of any individual party, and third parties have expressed concerns about potential restrictions (price, range of content, availability windows, etc.) on the supply of that content.
123. The OFT does not for present purposes consider total foreclosure (refusal to supply, and making the joint venture the exclusive vehicle for exploitation of all the relevant rights). Given the likely high fixed cost and low marginal cost nature of rights syndication, it seems very unlikely that the joint venture would find it profitable to refuse to syndicate entirely in respect of the collective rights portfolio it controls -- perhaps with the exception of some limited exclusive content. Rather, Kangaroo plans to be in the wholesale business of syndication. [...] <sup>25</sup>
124. Accordingly, the OFT instead focuses on raising rivals' costs, known in the EC non-horizontal merger guidelines as partial foreclosure. (It is worth noting that, although Kangaroo is not a vertical merger, there may be vertical effects from such a horizontal JV. As a corollary, the OFT considers that the pro-competitive effects of vertical mergers in eliminating double marginalisation may be less relevant in this case). In brief, this would consist of charging rival VOD retail platforms higher wholesale syndication prices to dampen price competition in DTO and DTR products faced by Kangaroo at the downstream retail level.

## **Upstream market power (ability to foreclose)**

125. The above horizontal concerns are based on a lack of sufficient substitution to non-UK TV content and on significant competition between the parties absent the Kangaroo joint venture. To the extent these concerns are valid, the joint venture creates or enhances pre-existing market power at the wholesale rights syndication level, in respect of UK TV rights.
126. Downstream competitors argued that the success of their platforms is dependent to an important extent on content from the parties and that there

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are insufficient alternatives available to create a VOD service attractive to UK customers. One third party said that access to the parties' content is an essential element of a VOD offering at retail level. Third party VOD service providers have been able to operate their services with content from just two of the parties, and it has been argued that content from the other party could represent a satisfactory alternative should access to one or both of the parties currently providing content no longer be available or available on less advantageous terms.

127. The parties, in turn, submit that a significant amount of material will be available through the carve-outs, which will tend to relate to the most popular material; further, the BBC's zero to seven day catch-up content will be available via syndication of the iPlayer. The existence of carve-outs does not, however, remove potential market power concerns in relation to the bulk of the archive content contributed to Kangaroo. Moreover, with the joint venture set up in part to engage in collective rights syndication, the parties' individual incentives to supply outside the joint venture arrangements may be on terms that reflect the collective market power in rights syndication embodied in the joint venture.

128. Accordingly, there is plausible ability to foreclose from Kangaroo's upstream market power.

#### **Incentive to raise rivals' costs**

129. The parties submit that the joint venture will have every incentive to make content available for syndication since wide distribution ensures that revenue is obtained by making content available to end users that may not otherwise access it. The evidence on existing supply agreements shows a variation in the individual syndication strategies of the parties. For example, only two of the parties have signed deals with television-based VOD platforms, whereas the other appears to be more prepared to strike content supply deals with new entrant internet-based VOD platforms.

130. The parties have explained that syndication of content to internet-based VOD platforms will be particularly limited following the launch of the joint venture in order to establish the site's identity and develop it as the primary destination for the parties' content online. One third party provider of internet-based VOD services complained that it was unable to strike content supply deals with the parties and that prospects of doing so would become

more remote post-transaction. Another third party submitted that none of the parties had been willing to provide content for a planned broadband VOD service.

131. Incentives with respect to television-based VOD service providers are less clear, since television-based VOD services may be less close competitors to the joint venture internet site than other websites. The parties' internal documents generally anticipate that syndication of content to television-based platforms will be a continuing element of the joint venture's activity. One third party, however, argued that the costs to consumers of switching from television-based VOD services to the joint venture would be low, such that wholesale revenues foregone by restricting wholesale supply may be easily recouped from greater retail revenues achieved through the joint venture. Another third party provided evidence indicating that since discussions relating to the joint venture began it has experienced increased difficulties in obtaining VOD content for inclusion in its television-based VOD service, with, for example, one of the parties making the duration of a supply arrangement limited by reference to the expected launch date of the joint venture. It is argued that this clearly shows that the willingness on the part of the parties to supply content is materially affected by the establishment of the joint venture.
132. Overall, notwithstanding the array of third party concerns from competitors, the OFT is by no means persuaded on the evidence available that the incentive to raise rivals' costs is clearly present. It is not clear that foregone profits from wholesale syndication revenues (of potentially high margin, with low incremental costs per syndication) would be outweighed by increased profits downstream from revenues gained from DTO, DTR and advertisers as consumers switched from rival internet- and TV-based VOD platforms to the Kangaroo retail website offer. In particular, the OFT is unclear on the parties' cost structures upstream and downstream.
133. Finally, to the extent the horizontal effects concerns in retail are valid, and that Kangaroo has post-merger market power by combining first and second VOD viewing choices for a substantial proportion of UK consumers, the raising rivals' cost theory aggravates these concerns, because it would suggest that the joint venture could raise DTO and DTR prices in the expectation that rivals – whose cost it had inflated because it enjoys market power at the wholesale level and on whose rights syndication they depend – could not profitably undercut Kangaroo on price.

134. As the OFT is referring to the CC based on horizontal effects concerns, it is clearly open to the CC to investigate whether these vertical effect theories have any merit in reinforcing the downstream effects of the Kangaroo venture.

### **Effects in retail VOD services**

135. ITV and C4 currently offer internet-based VOD services at the retail level and will continue to do so once the joint venture is operational. While BBCW currently does not operate retail VOD services, as noted in the counterfactual section (above), BBCW is treated as an important potential competitor absent the joint venture. Third parties considered that absent the transaction the parties would have competed vigorously in the provision of retail VOD services, as they do with respect to primary broadcasting, on a range of parameters, including price.

136. Internal documents record the view that the parties' contributions to the joint venture complement each other well. The BBC and ITV provide unmatched archive content, C4 a strong brand and demographic, and ITV and C4 provide significant catch-up content and potential for cross-promotional activities.

137. In common with commercial television, internet VOD services operate in a two-sided market serving two sets of interdependent customers – users/viewers and advertisers. Success in attracting users to free content will increase the site's advertising revenues.

### **Loss of close rivalry in retail VOD**

138. The parties submit that the joint venture will face competition from a range of competitors, both internet and television-based, such as Apple, Sky, BT and Virgin, offering a range of programming (such as premium content on Sky Anytime) and functionality (such as the iPod/iPhone compatible iTunes). The parties argue that companies such as Sky, BT, Virgin, Tiscali and Top Up TV, which also offer near-VOD and push-VOD services, have strong customers bases to which they can offer VOD content.

139. The set up of the joint venture allows the parties to benefit from attracting users to their own content pages. However, a revenue sharing arrangement

will mean that all the parties will share some of this benefit which could lead to a reduction in competitive rivalry compared to the counterfactual. However, on the available evidence the OFT is unable to conclude with the required level of certainty whether that lessening of competition will be substantial and outweigh any consumer benefits, such that consumers will, on balance, be harmed.

140. While the joint venture may face a range of competitors, a key unanswered question is the extent to which VOD viewers of the parties' content would switch between the parties' content in response to small but significant relative price increase for transactional (DTO and DTR) content. As developed above in the sections on market definition, market share proxies and unilateral effects at the wholesale level, there is some basis for concluding that unilateral price effects are possible at the retail level, because the BBC (to which BBCW holds the rights) and ITV are the two most important archives of UK TV content, and because in aggregate the three parties are each contributing the rights to a substantial and competing portfolio of content.
141. It cannot be wholly discounted, therefore, that marginal price-sensitive consumers might, absent Kangaroo, have switched between transactional, that is, paid-for content of each of BBC, ITV and C4, and will now be infra-marginal and retained by the Kangaroo parties, leading to profit incentives to raise DTO and DTR prices (relative to no joint venture). With sufficient margins and a high enough diversion ratio between merging parties, such unilateral effects are possible even if many consumers would switch to other content and/or delivery mechanisms not controlled by the joint venture.

### **Price and non-price effects**

142. Given the lack of advertiser concern and the broader opportunities for internet advertising, the OFT has no concerns in relation to advertising, and no price effect concerns arise in relation to catch-up services, which are provided free of charge currently and can be expected to continue to be free once the joint venture is established.
143. As the joint venture does establish a common mechanism for price-setting across the parties' previously independent and competing VOD content, price effects in relation to transactional DTR and DTO content cannot be

ruled out at this stage. This holds true not just in relation to Kangaroo pricing but also in relation to prices charged on the parties' separate retail websites, which would no longer operate in a context of independently-set prices. While difficult to specify with precision, not least given the nascent character of VOD, the CC may also wish to explore whether the joint venture's formation would to some degree restrict output – that is, restrict the range of ways in which consumers might, absent Kangaroo, be able to view the parties' content on demand, which may reinforce the price effects in DTR and DTO.

144. As to non-price effects, the OFT assumes that providing rich functionality of a one-stop searchable library is a key value proposition of Kangaroo, and one of the consumer benefits of the joint venture. If the joint venture were to acquire durable market power at retail level, it is still difficult at present to conclude that the parties' incentives to reduce functionality and quality of the browsing or viewing experience would be profit-maximising, even with the internalisation of competition post-merger. Accordingly, the OFT places no weight on such non-price effects for the purposes of its conclusions.
145. It has also been noted by at least one third party that the reduction of such rivalry will result in reduced innovation (competition in developing markets may manifest itself as developments in hardware, software and functionality) and product or platform choice. While there are some arguments that the joint venture could restrict innovations as offered to consumers in the UK, absent better evidence of UK-specific innovation that would be developed absent the merger just for UK viewers and affected by Kangaroo, the OFT dismisses such concerns on the basis that most hardware and software innovation takes place on a global scale, in respect of which Kangaroo could not have a material impact.

## **Constraints from entry and expansion**

### **Wholesale VOD**

146. The CC noted in *BSkyB/ITV* that it might be relatively straightforward to set up a new television channel, but that acquiring or producing quality content that would be sufficiently attractive to capture a significant share of viewing would require high levels of investment. This also seems likely to be the

case with respect for VOD content, particularly in light of the potential importance of UK-origin content.

147. Further, demand for VOD content is likely to be derived from programming shown on linear television. In this context, the leading candidate new entrants for VOD content supply would be new channels holding the relevant primary broadcast and secondary VOD rights.
148. Entry by suppliers of content created specifically for VOD exploitation would be hampered by a lack of primary exposure to generate subsequent VOD demand and funding limitations due to the currently limited value of VOD rights relative to primary broadcast rights.

### **Retail VOD**

149. The parties submit that barriers to entry to set up a website offering VOD content are not high, as demonstrated by the wide range of new entrants that have emerged in recent years (for example, Joost, Babelgum). As noted, they contend there is a wide range of content producers from which operators can licence content.
150. For internet-based VOD, the principle barrier to entry may be access to, and the cost of, sufficient attractive content to offer viewers to build a successful VOD service. While foothold of entry of establishing a website may be cheap and easy, expansion into a valuable library proposition that consumers will visit is another matter. One third party has argued that the range of content available through the joint venture will increase further the content-related barriers to entry and expansion for other VOD service providers.
151. There is likely to be limited scope for non-broadcasters to commission VOD-specific quality content, since the licence fees relating to VOD content are currently far below those generated for primary broadcast rights, and the cost of producing quality programming is high (one third party also noted that producers of programming often require significant guarantee payments).
152. Achieving entry on a significant scale may be aided by possession of a strong reputation or branding, or by a significant level of marketing expenditure (which would tend to be a sunk cost). Some third parties have

argued that the parties' brand strengths and cross promotional abilities may enable the joint venture to rapidly attain a leading position, or that new and competing VOD providers may have significant difficulties in replicating similar levels of branding and promotion.

### **Constraints from buyer power**

153. Individual consumers lack buyer power. At the wholesale level, if it is correct that content other than UK TV content is not a good substitute, then wholesale customers will lack sufficient countervailing buyer power.

### **Coordinated or spill over effects**

154. The OFT notes that a general concern in the case of joint ventures involving competitors is whether the joint venture, by increasing the flow of information between parties, may serve to facilitate wider coordination beyond the scope of the joint venture's areas of activity. The OFT has not concluded on this matter given that its unilateral effects concerns are sufficient to refer this case.

### **THIRD PARTY VIEWS**

155. The OFT received 30 submissions from third parties involved in the supply of content, the supply of VOD services and advertising. Respondents involved in advertising did not raise concerns regarding the transaction.

156. The majority of third parties were concerned about the joint venture and expressed concerns about both the horizontal and vertical aspects of the transaction, anticipating that the joint venture would give rise to market power at the wholesale supply level and the potential for increased incentives to foreclose downstream rivals. It should be noted, however, that due to the confidentiality of the joint venture arrangements, third parties were not usually fully clear as to how the joint venture would operate. Consequently, the concerns put to us were based on a worst case scenario.

### **ASSESSMENT**

157. The joint venture brings together the VOD services of the three leading UK public service broadcasters. The joint venture will provide ITV, BBC and C4

archive content and ITV and C4 catch up content to computer users via the internet. The joint venture will also be responsible for the joint selling of archive and catch-up content owned by the parties to third party VOD service providers.

### **Arguments that the joint venture is neutral or pro-competitive**

158. The parties consider that the joint venture is the best way for them to compete against what they see as extremely well placed competitors, some of whom (such as Apple or Microsoft) have advantages with respect to integrated hardware offerings and can offer premium content and popular US shows. They argue, in effect, that the downstream retail market on which they compete is a broad and dynamic one, in which UK consumers could and would switch between an array of video content – including US TV content and film – and from an array of delivery mechanisms – via a website, TV subscription, PVR and/or DVD rental or purchase. If the joint venture has no prospect of market power downstream because of this broad array of choices, then unilateral price effects in transactional (DTO, DTR) content could safely be discounted at the retail level.
159. Moreover, wholesale syndication customers could arguably also do without Kangaroo-held content and switch to other content or delivery sources, or discipline the joint venture's pricing in the syndication market if it were correct that final consumers would switch between an array of content and delivery mechanisms. However, while the OFT has little evidence of consumer preferences and their willingness to pay for UK TV content controlled by the parties, the OFT has received widespread concern from wholesale customers who dispute the large majority of material points necessary to the parties' case for clearance.

### **Arguments that the joint venture may be anti-competitive**

160. While the concerns of wholesalers are those of downstream competitors to the parties, they relate not simply to foreclosure, about which rivals often complain to the OFT, frequently without merit. Rather, they relate to the horizontal unilateral effects of the merger on them as customers, because the merger may create or enhance market power at the syndication level, by combining close substitutes for VOD content rights. As insufficient evidence is before the OFT to rebut such concerns, the OFT cannot rule out a realistic prospect of a substantial lessening of competition (SLC) in VOD rights

syndication in the UK, based on the combination of the parties' rights portfolios to UK TV content. In a horizontal merger that occurs in a market upstream of end-consumers, it is sufficient for the SLC test that intermediate customers are harmed by the lessening of rivalry; that is what makes the lessening substantial, and there is no need for the OFT to establish pass-on of such harm to downstream consumers.

161. In this case, the OFT has also been unable to establish at the retail level whether the 'one-stop UK TV library of VOD' consumer benefit of the joint venture would outweigh the concerns of potentially higher transactional prices resulting from a combination of the parties' VOD retail services. The potential vertical effect of raising rival's costs – flowing from market power created by the merger at wholesale level – could aggravate retail concerns. While there are serious question marks as to whether the joint venture would have the incentive to do so, the hypothesis of downstream market power might make this concern valid, because Kangaroo may gain from inflated DTO and DTR prices which rivals could not undercut.
162. Overall, the lack of suitable evidence on consumer preferences and substitution patterns in the nascent VOD sector, including on the importance of UK TV content relative to other content, and the importance of VOD relative to other delivery channels for video content, have led the OFT to adopt a cautious approach consistent with the Court of Appeal's judgment in IBA Health, because a clearance cannot be objectively justified with relevant facts. Once a candidate VOD market based on UK TV rights and their exploitation cannot be ruled out, neither can horizontal concerns because of the parties' high collective share, and high increments created by Kangaroo, on any reasonable measure, consistent with widespread customer concerns about market power in respect of rights syndication, corroborated by the views of independent UK TV producers.
163. Consequently, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## UNDERTAKINGS IN LIEU

164. Where the duty to make a reference under section 33(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.
165. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's *Mergers Substantive Assessment Guidance* states that, 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation.' (para 8.3).
166. The parties offered two sets of undertakings for the OFT to consider, [...].
167. The OFT did not consider that these undertakings were sufficient to solve the potential competition concerns raised by the transaction. Most notably, the OFT's concerns centre around the ability of the parties to control access to content seen as desirable by VOD users and is thus considered essential by VOD service providers to create an attractive offering. [...] consequently the OFT did not consider the undertakings offered by the parties sufficient to solve the OFT's concerns and therefore avoid a reference.

## DECISION

168. This merger will therefore be referred to the Competition Commission under section 33(1) of the Act.