

ERICSSON/CREATIVE MERGER INQUIRY

Summary of provisional findings

Notified: 27 February 2014

Background

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

6. We have provisionally concluded that if the anticipated acquisition of Creative by Ericsson completes it would result in the enterprises conducted by Technicolor and those of RBM ceasing to be distinct and, because the UK turnover of RBM exceeds £70 million, a relevant merger situation would therefore be created. The CC therefore has jurisdiction to consider if the creation of that situation may be expected to result in a substantial lessening of competition (SLC) in any market or markets in the UK.
7. We considered the situation that would have prevailed absent the anticipated acquisition (the counterfactual). We provisionally concluded that RBM would have continued to compete in the market, although most likely under an alternative owner. We provisionally concluded that Technicolor would also continue to compete in the market.
8. We provisionally concluded that the relevant market within which to assess the competitive effects of the merger was the market for the supply of outsourced linear playout services in the UK. We did not consider it necessary to widen the relevant market to include in-house supply. The majority of customers told us that they would not switch to in-house supply in response to a small but significant price rise due to the significant investment that would be required in technical expertise, the potential distraction for management and, in the case of smaller broadcasters, a lack of scale.
9. We provisionally found that the relevant geographic market was the UK. The majority of UK broadcasters told us that they would only consider buying playout services from a provider with a UK premises.
10. We considered the playout requirements of different customers. We found that customers have differing playout requirements and this may have an impact on which providers are able to fulfil those requirements. Nevertheless, we provisionally found

that these differences in requirements were not sufficiently distinct to constitute different markets.

Competitive effects

Nature of competition pre-merger

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

vider's staff when playing out channels day to day; and challenges associated with the design and implementation of a solution that meets the requirements of a broadcaster, and subsequent engineering support once it is up and running.

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

we thought that a detailed tender process with motivated participants on both sides may reduce the perceived step up and facilitate the understanding necessary for providers other than the parties to make a credible bid.

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

21. We also looked at the weight customers place on different factor(s) for selecting a playout provider and how these change during the tender process. At the outset of the process a broadcaster's focus tends to be more on the supplier's ability to provide service quality. However, once those suppliers with the requisite capability have been identified, the focus shifts to getting the most economically advantageous outcome (in terms of the overall balance of price, quality and risk).
22. We considered the extent to which the loss of a competitor in this market was likely, in practice, to affect significantly the outcome of the bidding process. We found that losing a potential supplier has the potential to reduce competition. This is likely to be most serious if it removes the closest competitive constraint. However, even if it does not remove the closest competitive constraint, it could still remove a significant competitive constraint affecting competitive rivalry overall.
23. We also provisionally found that the nature of the bidding process provides an opportunity for customers to mitigate any impact that the loss of a competitor might have on this rivalry. The extent to which this might occur will depend on whether other competitors are motivated to compete for a contract, whether they can reach the same level as the lost bidder, and how much effect the customer can have on the quality of these other bids (as perceived by the incumbent).

Assessment of competitive effects of the merger

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

BBC

25. The BBC is likely to experience any competitive effects of the merger in the near future because its current playout contract with RBM expires in March 2017. It is likely to select a provider in spring 2015. We expect the BBC's incumbent provider, RBM, to be the strongest competitor for the renewed contract due to its incumbency advantage and its strong reputation in the market.
26. We expect that the removal of a credible bidder will lead to some reduction in competitive rivalry for the next BBC contract. The significance of the reduction in rivalry will depend on the ability of the BBC to carry out an effective tender process and the ability and willingness of other providers to take this opportunity to put in strong bids, so as to offset (in whole or in part) the loss of the competitive constraint that would have been provided by Technicolor. The provisional view of the majority of the members of the panel was that the nature of the competitive process and the potential for other competitors to exert the same level of competitive constraint as Technicolor made it likely that there would be little adverse effect on the BBC.

ITV

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

uncertainty about the state of the market when the extended contract is due to expire in [a further five to ten years]—including the potential for significant changes in technology and for significant developments in the market during the lengthy intervening period—the likelihood of such a disadvantage was remote.

Channel 4

30. Channel 4's contract with RBM expires after a number of other PSBs' current contracts. As with the BBC, we thought that RBM, as incumbent, would be in the strongest position to compete for Channel 4's next contract.

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

Channel 5

32. Channel 5's playout is currently supplied by Encompass. We found that Encompass would be a strong contender for Channel 5's next contract given that it had already retained that contract in competition with RBM, and that it would benefit from its position as incumbent. Further, Channel 5 told us that it would consider a wide range of suppliers and it would seriously consider self-supply if it were cheaper than

outsourcing. It told us that it did not have competition concerns about the merger, because it believed that there were other players that could easily meet its requirements, and that new technology was appearing as a strong contender. We did not therefore have reason to believe that Technicolor would provide a significant additional competitive constraint absent the merger. We therefore provisionally concluded that the merger is not likely to disadvantage Channel 5 significantly.

Dedicated sports broadcasters

33. The two providers with recent experience of supplying outsourced playout to dedicated sports channels in the UK are RBM (BT Sport 1 and 2) and Arqiva (ESPN and British Eurosport). On this basis we thought both Arqiva and RBM would be strong competitors for any such contract. In addition, Encompass has provided sports playout to Channel 5 as part of its contract and was the runner-up to Arqiva in ESPN's last tender.

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

Broadcasters with relatively simple requirements

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

with this type of broadcaster, suggesting that its appeal was not generally stronger than those of its rivals. Therefore we provisionally concluded that the merger is not likely to disadvantage broadcasters with relatively simple needs.

Provisional conclusion on competitive effects of the merger

36. We next considered the impact of our findings in relation to the BBC, ITV and Channel 4 in the context of the overall market for linear playout in the UK. We noted that these were the three highest-profile PSBs in the UK, with very substantial audience shares, that the linear playout requirements lay at the complex end of the spectrum, that the contracts were of high value relative to those elsewhere in the market and that in aggregate they accounted for a significant part of the overall market.

37. Taking into account the low likelihood that we attached to a significant reduction in competitive rivalry for the ITV and Channel 4 contracts, our primary concern was with the BBC. We thought that a significant reduction in rivalry for the BBC contract was possible. However, we also thought that the nature of the competitive process and the potential for other competitors to exert the same level of competitive constraint as Technicolor made it likely that there would be little adverse effect on the BBC. The provisional view of the majority of the members of the panel is that this residual possibility with respect to the BBC, together with the cumulative effect on other broadcasters, does not constitute an SLC.

Provisional conclusion on the SLC test

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

Martin Cave note of dissent

39. One member of the group (Martin Cave) dissents from this provisional conclusion, notably with respect to the consequences of the merger for the forthcoming contest for the BBC payout contract, which accounts for a substantial share of the defined market. The contract will be competed for at a time when the technology is undergoing an evolution.

40. Those seeking this contract are unlikely to be equally efficient or to adopt identical strategies with respect to technology, risk assurance and price. The number of qualified providers is generally reckoned to lie between two and four. Two of these are the merger parties. In the member's opinion, it is quite possible that these two will be the strongest tenderers, or even the only qualified ones. Thus there is a risk that the merger might remove the single effective competitive constraint on the incumbent. Even if this special case does not eventuate, the harm to the BBC might still be material.

41. The member believes that in these circumstances, where the merger removes one of a small number of rivals, with possible adverse consequences for the BBC it is desirable to let competition run its full course, by preventing or remedying the resulting loss of competition. In particular, he does not think it is safe given the uncertainties of the situation to place much reliance on precise conjecture about how, following the merger, competition will unfold. In his view, it can be concluded that removing a major competitor can easily generate outcomes which are seriously adverse to the customer, especially when they lead to the loss of a technological option.

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