OFFICE OF FAIR TRADING

Anticipated merger of NTL Incorporated and Telewest Global Inc

The OFT's decision on reference under section 33(1) given on 30 December 2005. Full text of decision published 10 January 2006.

Please note that square brackets indicate information excised, or exact figures replaced by a range, for reasons of commercial confidentiality.

PARTIES

1. **NTL Incorporated (NTL)** is a US corporation that provides telecommunication, Internet access and multi-channel TV services to business and residential customers within the areas covered by its UK cable network. It supplies some services outside its cabled areas using BT lines, including the 'virgin.net' Internet service. NTL and Telewest jointly control Front Row, a near video-on-demand film service offering multiple showing of films at staggered times. NTL had a turnover of £2000 million in the UK in the year ending 31 December 2004.

2. **Telewest Global Inc (Telewest)** is a US corporation that provides telecommunication, Internet access and multi-channel TV services to business and residential customers within the areas covered by its UK cable network. Telewest also produces TV channels through its Flextech and Sit-Up Limited subsidiaries and through joint ventures with BBC Worldwide (UKTV) and NTL (Front Row). Through its Minotaur subsidiary Telewest is active in the distribution of programming and another subsidiary, Interactive Digital Sales Limited, sells TV advertising in the UK. Telewest's UK turnover in the year ending 31 December 2004 was £ [ ] million.

TRANSACTION

3. NTL and Telewest entered into a merger agreement on 2 October 2005.

4. The parties notified the transaction to the OFT on 14 October 2005. The 40 day administrative deadline has expired.

JURISDICTION

5. As a result of this transaction NTL and Telewest will cease to be distinct. The UK turnover of each of NTL and Telewest exceeds £70 million, so the turnover test in section 23(1) (b) of the Enterprise Act 2002 (the Act) is satisfied. 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.

RELEVANT MARKET

6. The parties overlap in three broad areas, the provision of pay-TV; telecommunication services; and Internet access. In relation to the first of these the parties have argued that Freeview exerts a sufficient competitive constraint for there to be a wider multi-channel TV frame of reference. In relation to pay-TV content previous OFT decisions[1] have considered the provision of premium channels (such as Premier League football and first run movies) and non-premium channels separately. On telecommunications services, we have followed Ofcom definitions, broadly looking at segments of retail residential exchange lines and retail residential calls. Finally, as concerns Internet access, separate residential and business narrowband internet access segments, and separate retail and wholesale broadband access segments were considered. All three products appear to have both national and local characteristics. However, as no issue relating to the frame of reference significantly affects the analysis, no conclusion is reached as to the relevant framework.

7. It is worth noting that some third parties have suggested that the increasing tendency to bundle all three pay-TV, telecommunications and Internet services into a single 'triple play' package may create its own frame of reference. The cable operators have been the only providers of triple play and have no obligation to open their networks to third parties, but the development of DSL (digital subscriber line) networks[2] in recent years has allowed customers outside of cable areas to access triple play services and competing services using LLU.[3]

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[1] Decision of the Director General of Fair Trading, No CA98/20/2002 - BSkyB investigation: alleged infringement of the Chapter II prohibition, 12 December 2002.

[2] DSL technology is currently the most common type of broadband technology in the UK, used to provide digital services to the homes of subscribers via the analogue telephone line provided by BT. Under the Communications Act 2003, BT is required to provide access to telephone lines through a process known as local loop unbundling (LLU).

[3] LLU involves an ISP effectively leasing the analogue telephone line from BT and installing the necessary equipment at the relevant BT local telephone exchanges and on the premises of each customer.

8. Several third parties commented that the reduced churn of triple-play customers meant that it would be hard for companies providing telecommunications services but no TV services to gain business from triple-play households. This opens up the possibility of defining a single frame of reference for all three segments. However, at present, there are many operators (including BT and Sky) that offer only a sub-set of services and Ofcom have suggested that this is unlikely to change in the near future. The OFT has therefore not treated triple play as a separate frame of reference, although it is not necessary to reach a definite view as the analysis of the merger is not significantly affected by this conclusion.

HORIZONTAL ISSUES

Existing competition

9. In its report on NTL/Cable and Wireless the CC concluded that as cable networks are geographically distinct those networks did not compete directly and since then the cable networks have not expanded so as to overlap.[4] The CC also rejected arguments on benchmark competition, policy or indirect competition in pay-TV (meaning that the parties would provide two separate competitive constraints on Sky) which were raised by some third parties in relation to this merger. We have received no evidence to suggest deviating from these conclusions on existing direct and indirect competition. There are two areas where the parties provide service beyond their cable networks and therefore do geographically overlap, warranting further consideration - wholesale telecommunications services and narrowband Internet.

10. Both parties have trunk telecommunications networks connecting up their local cable areas and allowing them to provide telecommunications services to other telecommunications operators, for which there is a degree of overlap. However, there are significant competing providers of wholesale telecommunications services, including BT, and the merged entity will not have a significant (above 10 per cent) share of supply of any such service.

11. The other area of overlap is narrowband Internet, where NTL's virgin.net service uses third party networks to reach its customers outside of NTL's cable areas to compete for narrowband Internet with Telewest in its cable areas. The shares of supply [about 5-15 per cent] and increment [about half] created by the merger are low.

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[4] Competition Commission report on the proposed acquisition by NTL Incorporated of Cable and Wireless Communications Limited, March 2000.

Potential competition

12. The issue of potential competition on all three products resulting from the parties building out their networks was also discussed in the CC report, but the cost of expansion was found to rule out a loss of potential competition. Since the report the development of DSL using LLU has reduced the cost of expansion. Although Telewest did not have expansion plans, NTL has stated that it planned to expand prior to the merger and that it stopped those plans to concentrate resources on other priorities, such as the integration of Telewest. However, internal documents show that the NTL plans were limited to infilling the network, within and on the fringes of the existing coverage area. This would be consistent with the incentive to maximise revenue by expanding in to areas where there is no (or limited) direct competition with Telewest, which is also suggested by internal NTL documents. As a result any overlap arising from the expansion was described as deminimis by the parties and by Ofcom.

13. Even if expansion plans led to competition between the parties there are a large number of other potential competitors who would offer service via DSL, identified by the parties' internal documents and industry analysts as exercising competitive constraints in varying degrees. Within the time period under which the impact of the merger can be considered even if competition would have developed on the borders of NTL cable areas, there are a number of competitors who could be expected to pose a competitive constraint on a similar scale. Homechoice and Kingston already offer DSL and the former is likely to expand. Both Cable and Wireless and Sky/Easynet have significant DSL networks that will be offering triple play and the latter has easy access to content. BT has a national network and has announced plans for a combined internet, telephony and video on demand service. Wanadoo and AOL have also announced triple play plans. Most of these also have strong brands.

VERTICAL ISSUES

14. Telewest is vertically integrated with Flextech, a channel provider, and both parties purchase a large number of third party channels. Third parties raised two vertical concerns relating to foreclosure of Flextech and third party channels to DSL competitors and the foreclosure of content providers competing with Flextech to cable. The possibility of co-ordination between the parties and Sky was also raised.

Foreclosure of content to rivals

15. The first theory of harm assumes that the cable companies see DSL as a significant competitive threat and that to compete effectively they will require

content. Third parties suggest the parties regard DSL as a competitive threat and some competitors have stated they are targeting cable customers.

16. Third parties believed that the merger increased the incentive to foreclose Flextech content as the foregone revenue from narrower distribution can be offset by the benefits of exclusivity across NTL as well as Telewest. They also fear it will create the ability to foreclose third party channels or video on demand (VoD) content as the combined buyer power will allow the parties to negotiate DSL rights that would restrict access for competitors.

17. Flextech is already not supplied to some competing DSL operators, such as Homechoice. However, the competitive impact of foreclosing one channel provider with only 5 channels is hard to characterise as substantial. Although Flextech is a 50 per cent joint partner in UK TV with the BBC, the BBC has no incentive to allow Flextech to limit the distribution of its channels and third parties cited it as having intervened to ensure DSL operators gained access to the UK TV channels.

18. Concern about Flextech was limited to one third party. It originally argued that Flextech's channels constituted an essential content for any DSL operator but subsequently changed the argument to the need for a critical mass of non-premium channels to attract customers.

19. Flextech's channels are popular, but at the narrowest frame still only have around a [10-15 per cent] share of viewing for non-premium pay-TV only channels and two or three of the top 10 most popular channels. However, UK TV, Discovery, Viacom and Sky all record similar viewing levels and there are a considerable number of basic channels available for pay-TV. Homechoice has doubled its customer base with a launch of new channels other than Flextech and BT is planning to launch a DSL service without Flextech channels. Some operators, such as AOL and Easynet, are also related to content providers (although no third party stated it was prepared to launch its own channels). No convincing survey evidence was forthcoming that the absence of these channels had impeded growth and [ ]. Limiting distribution will mean revenue forgone and reduce the value of advertising airtime as there will be fewer viewers.

20. Turning to third party content, the parties state that a rationale for the deal was to increase buyer power with a view to reducing content costs and to be able to bid against Sky for premium content. The CC considered the issue of buyer power in relation to content providers in NTL/C&W, and concluded its then share of pay-TV subscribers (27 per cent) was insufficient to result in anti-competitive effects. The parties' combined share of subscribers is virtually the same (30 per cent) and it now faces additional constraints such as Top Up TV and Homechoice. This is

diluted further if Freeview and Freesat are considered as part of a multi-channel TV household frame of reference.

21. The parties do not currently have any exclusive DSL rights for channels and they state they have not been seeking them. The parties currently have exclusive rights for VoD from two Hollywood studios but BBC VoD content is provided on a non-exclusive basis. Even if they had sufficient buyer power to change that policy, exclusivity would be limited as given the buyer power of Sky, who is entering the DSL field, it is unlikely that Sky could be excluded from access to the rights. Furthermore none of the content providers feared exclusivity and there are a wide range of channel providers and sources of content for video on demand. Not all of the DSL operators we spoke to were concerned about access to content and those that were concerned were unable to produce internal documents discussing the impact of this issue on their business plans.

22. Overall, although the parties may have an incentive to seek to withhold their own content, it would not be an effective strategy as Flextech is not irreplaceable and actual and potential competitors have successfully operated without its channels; other channels are available; many DSL operators are unconcerned by foreclosure; and internal documents do not suggest any benefit from such a strategy.

Foreclosure of rival content

23. The second theory of harm raised by a third party was that the merged entity would deny access to non-premium channels that closely competed with Flextech channels and that it would foreclose competing VoD channels in particular (as they could not use Sky instead of cable to grow distribution as Sky's DTH service cannot carry VoD). The argument was that the ability and incentive had changed on NTL's part as it would now be linked to Flextech.

24. However, there are several reasons why this theory does not amount to a substantial lessening of competition. Firstly only one of the non-premium channel providers we contacted saw this as a concern and they felt CA98 would address such behaviour. Secondly, the theory is not compatible with the concern about buyer power forcing third party providers to give exclusivity expressed above by the same third party, as unless the parties carried the channel it could not negotiate exclusivity to foreclose its DSL based rivals. Furthermore, given its closest competitor, Sky, markets itself partly on the breadth of its channel offerings the parties would be expected to wish to offer as many channels as possible. A narrower offering from cable may make Freeview a closer competitor for the cable non-premium bundle as Flextech's share of viewing is low. Finally, the incentive to foreclose third party VoD providers to access the cable system

pre-dates the merger as the parties are already in a joint venture to provide VoD and therefore is not an issue that arises as a result of this merger.

Co-ordination

25. One third party suggested that the merger might result in co-ordinated behaviour between Sky and the merged entity in the pay-TV area as it saw pay-TV as a mature, stable sector with few competitors and the merger increased the symmetry between those two competitors compared to a small competitive fringe that are seen as a threat to the stability of the oligopoly. With such an incentive, it is suggested that Sky and the parties would only cross licence each others' channels and block third party channels to rivals where possible.

26. It is debatable as to whether pay-TV could be characterised as mature and stable given the developments of DSL and Freeview in recent years. However, even if it was so characterised, there is still a marked asymmetry between the position of Sky and the merged cable companies as the latter only has Flextech content and is not characterised by third parties as a threat to Sky' premium content. Although there was some evidence of both Sky and Flextech making access to their content difficult in recent years there was no evidence to tie this directly to the merger, or any evidence of the parties seeking to foreclose third party content providers. As such there is not a realistic prospect of a substantial lessening of competition.

THIRD PARTY VIEWS

27. A number of third parties raised the concerns addressed above, predominantly on potential competition and vertical foreclosure. Others were unconcerned, in particular Ofcom. Several raised concerns unrelated to the merger, such as the cable network not being 'open access', which is not altered by the merger. Others thought there might be horizontal competition for wholesale broadband Internet as Ofcom had previously stated cable constrained BT in this area. However, this does not mean that the parties constrained each other on a national basis and Ofcom had no concerns. Some content providers were concerned that an increase in buyer power would lessen the price they could negotiate for their channels. The CC looked at this issue of transferred rents in relation to the earlier merger and dismissed it. There was also one concern relating to residential telephony, where the parties do not overlap.

ASSESSMENT

28. Although this is the merger of the remaining two cable operators in the UK, the merger does not lessening existing competition for pay-TV, internet or telecommunications services. The conclusion of the CC in 2000 that as cable

networks do not geographically overlap they do not compete directly or indirectly has not been challenged by new evidence. In the two areas where services are provided beyond the cable areas, narrowband internet and telecommunications services - there are a number of significant competitors.

29. Technology has moved on since the CC considered the issue of potential competition between cable networks, making such competition feasible. Evidence indicates however that the expansion plans of NTL are limited to in-filling such that any overlap with Telewest would have been deminimis. In addition there remains a number of competing DSL operators.

30. As the parties are the purchasers of a large number of channels and as Telewest owns such a channel provider (Flextech), third parties raised vertical issues relating to foreclosure and co-ordinated effects.

31. The first of these hypothesised that Flextech channels would not be made available to rivals. Even if they did so Flextech only accounts for [10-15] per cent of viewing on non-premium pay-TV only channels and several similar size competitors remain amongst the considerable number of channels available to rivals. There is no compelling evidence that the absence of Flextech content channels would impede growth and some operators do not have these channels in their business plans, suggesting they are not irreplaceable.

32. A similar claim was made that the merger would give the parties sufficient buyer power to force exclusivity clauses out of third party channel providers, foreclosing them to DSL operators. In 2000 the CC had rejected concerns relating to buyer power granted by a similar share of pay-TV subscribers as currently enjoyed by the parties. In addition, with respect to the proposed merger in the present case these concerns have not been supported by most third party channel providers or internal documents.

33. The second foreclosure theory raised by third parties, that the parties will not purchase third party channels that compete with Flextech, is inconsistent with the first theory's assumption that they would negotiate exclusivity with these channel providers. No channel provider saw this as an issue that required addressing by merger control.

34. Finally one third party suggested the merger increased the incentive and ability of the parties to co-ordinate with Sky resulting in refusal to supply content to rivals. Even if pay-TV exhibited the characteristics of a market suited to co-ordination, there is a considerable imbalance in market power in the supply of content between Sky and Flextech and there is no direct evidence of such behaviour being motivated by the merger.

35. Consequently, the OFT does not believe 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.

DECISION

36. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.