BT response to Ofcom's supplementary consultation of 27 July 2015 in relation to the review of the pay TV wholesale must-offer obligation

21 September 2015

NON CONFIDENTIAL VERSION

1. EXECUTIVE SUMMARY

1.1. BT welcomes Ofcom's supplementary consultation, published on 27 July 2015, in connection with Ofcom's review of the pay TV wholesale must-offer obligation[1] ("**WMO"**) ("**Ofcom's Second Consultation"**) and, in particular, as to the issue of 'reciprocity'. BT has expressed its serious concerns about Sky's insistence upon a grant back condition[2] ("**GBC"**) for more than two years and, indeed, submitted a Competition Act 1998 complaint (Case CW/01106/05/13) (**"Competition Act Complaint"**) to Ofcom in this regard on 24 May 2013, which Ofcom has yet to determine.

1.2. BT considers that effective wholesale access to the full Sky Sports proposition is required if Ofcom is to begin to address the competition issues associated with Sky's entrenched market position across the pay TV value chain (BT's position is set out in detail in its response to Ofcom's Consultation Document ("**First Response"**)).[3] It is evident that fair and effective competition (**"FEC"**) in the pay TV sector has not emerged since Ofcom's intervention in 2010,[4] and Sky's market position in the wholesaling and retailing of premium sports channels (and more widely) has become increasingly deep-seated.[5] FEC will not emerge unless and until there is effective wholesale regulation of the Sky Sports proposition.

1.3. In order for wholesale regulation of the Sky Sports proposition to be effective, Ofcom must adequately address each of the practices which it identified in its First Consultation Document as prejudicial to FEC, namely:

> *"(i) failure to supply key sports channel(s) or important parts of the service offered on those channels, on either a wholesale or self-retail basis; and,*
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> *(ii) supply on terms that would not allow a rival retailer to compete effectively, or which would undermine those retailers' incentives or ability to compete in other parts of the value chain".*[6]

BT refers to these practices as the first limb of limited distribution and the second limb of limited distribution respectively; both limbs are problematic and Sky limits the wholesale distribution of Sky Sports in each of these ways in practice, as evidenced in BT's First Response.[7]

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[1] Commenced in December 2014 through Ofcom's consultation document: "Review of the pay TV wholesale must-offer obligation"; published on 19 December 2014. **"First Consultation Document"**.
[2] For the reasons set out at section 2 below, BT does not consider that Ofcom should refer to this condition as one of 'reciprocity'.
[3] BT's First Response, section 3.
[4] BT's First Response, section 2.
[5] BT's First Response Section 4.
[6] As summarised at paragraph 2.1 of Ofcom's Second Consultation Document.
[7] See Sections 5 and 6 of BT's First Response.

1.4. In addition to being an anti-competitive term (for the reasons explained in detail in BT's outstanding Competition Act Complaint), Sky's insistence upon the GBC is also a practice that prejudices FEC in the pay TV sector. As explained further in this response (**"Second Response"**), the GBC can be seen as a first limb practice as well as a second limb practice. In sum and as set out in detail in section 3 below:

(i) it is not economically rational for BT to accept the GBC (as evidenced by BT's economic theory model and verified by the choice modelling exercise conducted, as well as the outcome of commercial negotiations between BT and Sky to date[8]);

(ii) Sky 's insistence on the GBC creates a binary 'choice' – absent regulatory intervention prohibiting the GBC BT must accept the GBC or it cannot have wholesale access to Sky Sports 1 and 2. Given that BT cannot rationally accept the GBC as formulated by Sky to date, in reality there is **no choice** and hence the effect of the GBC is that BT does not obtain wholesale access to any of the Sky Sports channels. That is to say, Sky's insistence on the GBC is tantamount to Sky *effectively* withholding these sports channels from BT on a wholesale basis; absent regulatory intervention there is no fall back for BT refusing to accept the GBC other than non-supply.[9] In this case, the static effects of the GBC mean that consumers are worse off and the dynamic effects of the GBC are the same as those for the first limb of limited distribution, which were rehearsed in detail in Ofcom's First Consultation Document, and in BT's First Response[10] because ultimately, the GBC results in BT not having wholesale supply of Sky Sports;

(iii) the alternative, BT accepting the GBC, is only ever a hypothetical option as opposed to a real choice. In any event, were BT to act irrationally and accept the GBC that Sky insists upon, the effects of such acceptance would also be material consumer harm and the preclusion of the emergence of FEC. In the short term price competition would be impeded and in the long term non-price competition would be detrimentally impacted. Acceptance of the GBC would further reinforce Sky's upstream bidding advantages and market position at each of the retail and wholesale levels of the value chain.

1.5. In addition to the GBC, there are other significant 'second limb' practices which Sky engages in and which preclude FEC emerging in the pay TV sector. These are set out at paragraph 5.4

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[8] See section 3 below.

[9] Moreover, self-retail by Sky via Now TV is not an adequate alternative in order to address the lack of FEC in pay TV. As BT outlined in BT's First Response NOW TV is a Sky retailed service across multiple platforms, which therefore does not contribute to increased competition between pay TV retailers, it is merely Sky 'competing' with Sky.

[10] See BT's First Response Section 5.

of BT's First Response.[11] Ofcom needs to tackle each of these practices in order to adequately mitigate the competition problems associated with Sky limiting the wholesale distribution of Sky Sports, and the resultant effects in the pay TV sector and the knock on effect to triple play services.[12]

1.6. Competition concerns with the limited wholesale distribution of sports channels arise solely in relation to Sky Sports. As evidenced in detail in BT's First Response, [redacted] BT's content in isolation (or in aggregate on its channels) is not key to driving competition.[13] As BT also explained in its First Response, in the course of the WMO consultation to date, Ofcom has overlooked the important distinction between the majority and minority FAPL rights[14] and has significantly overstated the importance of UEFA Champions League rights in absolute and relative terms.[15] Third parties have made incorrect statements about the nature of BT Sport in their responses to Ofcom's First Consultation Document, which BT addresses at Annex 1 to this response in order to clarify the factual position and explain why these comments grossly exaggerate the importance of BT Sport in the competitive process. Moreover, BT has neither the incentive nor ability to limit the distribution of its channels, as evidenced by BT's conduct in practice.[16] There is, therefore, no basis for Ofcom to regulate BT Sport.

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[11] For convenience, these are set out here, and include:

- wholesaling the Sky Sports proposition at rate-card prices that are too high to allow a rival retailer to become an effective competing retailer of those channels. As Ofcom found in the Pay TV Statement, Sky's rate-card prices are set at a level which is too high to ensure fair and effective competition;
- limiting wholesale supply in a way that reduces the value of the Sky Sports proposition to consumers. This includes wholesaling only a subset of the Sky Sports proposition, (such as a restricted range of the channels that make up the Sky Sports proposition, or non-supply of important additional services like HD, interactive, on-demand content, multi-room or the ability to offer the service across multiple in-home devices), such that a rival's retail proposition is weaker than that available from Sky itself;
- including terms and conditions for wholesale supply that are anti-competitive or limit a retailer's ability to compete effectively either at the retail level, or in other parts of the value chain. As well as the GBC, this would also include, for example, an insistence on high minimum revenue guarantees;
- introducing terms that place restrictions on the kinds of marketing that rivals can undertake using the Sky Sports brand or logos, or restrict the kinds of propositions that rivals can offer (for example, preventing them from offering Sky Sports for free or bundled with certain propositions); and,
- self-retailing the Sky Sports proposition at high retail prices in order to manage cannibalisation in such a way as to ensure no effective competition with its own retail proposition, or denying its rivals the opportunity to innovate and create new or different bundles incorporating Sky Sports which might otherwise have increased competition.

[12] See Section 2 of BT's First Response.

[13] See Section 5 of BT's First Response, and Annex 1 to this submission.

[14] Paragraphs 3.70 to 3.75 of BT's First Response.

[15] See paragraph 1.6 and footnote 5 of Ofcom's Second Consultation for Ofcom's definition of 'key sports content' and paragraphs 3.76 to 3.89 of BT's First Response in relation to this issue.

[16] See Sections 5 and 6 of BT's First Response. In a meeting with Ofcom on 7 September 2015, BT also provided details of the extent of its commercial agreements to date.

1.7. Equally, there is no basis for Ofcom to permit Sky to circumvent the WMO remedy by imposing terms such as the GBC which effectively require BT to wholesale its channels or be denied the protections afforded by the WMO. Given that BT Sport does not contain 'key content', nor is there a competition concern that BT limits the distribution of BT Sport, there is no foundation for Sky demanding access to these channels on a 'reciprocal' basis and holding BT to ransom in order to obtain Sky's channels (which are necessary for a rival, such as BT, to be able to compete). As such, while the terms of the GBC are anti-competitive under any circumstances, the GBC is particularly problematic if imposed by Sky as a way to circumvent regulation expressly designed to introduce competition to Sky.

1.8. In contrast to BT, as the evidence in BT's First Response clearly demonstrated, wholesale access to the Sky Sports proposition is essential, it does drive consumer choice and Sky does have both the incentive and ability to limit the wholesale distribution of these channels (and has manifestly done so in practice). Addressing the fact that the GBC as currently formulated (or any delineation which has equivalent effect) is prejudicial to FEC is essential if Ofcom wishes to ensure the emergence of FEC in the pay TV sector and the retailing of premium sport channels in particular.

1.9. In this submission, BT addresses the specific points raised by Ofcom in its Second Consultation Document:

(i) Section 2 addresses the scope and characterisation of the GBC, and why it is inappropriate to refer to the terms that Sky insists upon as 'reciprocal supply';

(ii) Section 3 explains why Sky's insistence on the GBC is a practice that is prejudicial to FEC;

(iii) Section 4 addresses Sky's fallacious arguments that its insistence upon the GBC is 'fair and reasonable'; and,

(iv) Section 5 briefly concludes.

1.10. As discussed above, BT has also provided a detailed annex (Annex 1) to address the incorrect and misleading statements made by third parties about the nature of BT Sport in their responses to Ofcom's First Consultation Document.

2. SCOPE AND CHARACTERISATION OF THE GRANT BACK CONDITION

2.1. BT notes that Ofcom's Second Consultation is seeking to understand whether "*Sky's insistence on reciprocal supply of key sports content (i.e. making supply of its key sports channels conditional on a rival supplying its own key sports content to Sky) is a practice which may be prejudicial to fair and effective competition*."[17] However, BT considers that it is inappropriate for Ofcom to accept Sky's characterisation of the GBC as 'reciprocal supply' for three main reasons:

(i) Firstly, whilst Sky refers to 'reciprocal supply', the condition which Sky is seeking to impose is in reality more akin to a grant back condition in patents and the technology sector (given the parallels with this case and the intersection between intellectual property rights and competition law). In particular:

(a) Grant back conditions typically arise in connection with the licencing of technology rights; they involve a licence back to the licensor of the licensee's improvements to the licensed technology. Grant back clauses are seen as problematic from a competition law perspective because they can prevent the licensee's ability to exploit the improvement, diminish the licensee's incentives to innovate and reduce future competition. This is particularly the case where the licensor has a strong market position.[18]

(b) It is clear, given the effects which would arise,[19] that Sky's insistence upon receiving BT Sport in exchange for Sky Sports 1 and 2 is, in reality, much more analogous to a grant back condition than 'reciprocity'. A requirement on BT to wholesale BT Sport to Sky in exchange for Sky Sports expropriates BT's investment in content rights, reducing future investment incentives, removing competitive pressure in respect of innovation and chilling static and dynamic competition, and these effects are exacerbated owing to Sky's high and persistent market shares.[20]

(c) It is also well established that a dominant company cannot make the supply of an essential input conditional upon the reciprocal supply of non-essential inputs. For example, the owner of standard essential patents ("**SEPs**") would infringe competition law if it made the licensing of its SEPs conditional upon the reciprocal licensing of non-SEPs owned by a potential licensee. In fact,

[17] Second Consultation Document, about this document section.
[18] See Commission Regulation (EU) No 316/2014 of 21 March 2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements – exclusive grant back clauses do not fall within the technology transfer block exemption regulation.
[19] As to which, see section 3 below.
[20] See section 4 of BT's First Response.

such behaviour is also considered to violate the FRND commitments that a SEP owner is required to make in order to ensure their patent is adopted by standard setting organisations.[21]

(d) In this case, Sky has wholesale and retail market shares at levels generally considered to be consistent with dominance[22] and it is seeking to make the supply of part of an essential input (Sky Sports 1 and 2 – not even the whole of the Sky Sports proposition) contingent upon the supply of a non-essential input (BT Sport).

(ii) Secondly, as BT explained in detail in its outstanding Competition Act complaint, the term 'reciprocity' implies an equivalent exchange between two parties. This is not the case in respect of Sky's delineation of the GBC:

(a) The scope of the GBC is defined in a narrow and imbalanced way by Sky. Prior to the Competition Appeal Tribunal ruling providing interim wholesale access to Sky Sports 1 and 2 on BT's YouView platform in December 2014,[23] [redacted][24, 25]

(b) As such, Sky selectively determines which channels must be 'reciprocally' supplied – Sky seeks to deprive a new entrant (BT) of its differentiator whilst retaining its own i.e. were BT to accept the GBC Sky would still have Sky Sports 3, 4, 5 and F1, as well as Sky Sports 1 and 2, and wholesale access to all of BT Sport whereas BT would only have BT Sport and wholesale access to Sky Sports 1 and 2. Sky would also retain all of its other points of differentiation

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[21] Indeed, the failure to comply with a FRND commitment given to a standard setting organisation may also be an abuse of a dominant market position. See the Commission Decision in the case COMP/38636 RAMBUS.

[22] See Section 4 of BT's First Response.

[23] On 5 November 2014, an amendment to the Interim Relief Order issued by the Competition Appeal Tribunal (**"CAT"**) was granted which provided wholesale supply of Sky Sports 1 and 2 to BT on BT's YouView platform; this came into effect in December 2014. 1152/8/3/10 (IR) *British Sky Broadcasting Limited v Office of Communications (Interim relief)* [2014] CAT 17 (the "**IRO"**).

[24] BT's Competition Act Complaint contains a detailed timeline of BT's correspondence with Sky in relation to the GBC, which clearly demonstrates this to be the case. Moreover, as is clear from that correspondence Sky's intention was that the GBC would equally apply to all future sports content acquired by BT (see Section 2C and Annex 3 to BT's Competition Act Complaint).

[25] [redacted]

as a retailer such as its own basic channels and movie channels in HD which it equally does not wholesale to BT.

(iii) Thirdly, the term 'reciprocity' has benign connotations. The GBC as formulated by and insisted upon by Sky is far from benign – indeed, as evidenced in detail below, it has serious and negative repercussions for Sky's rivals, the process of competition and consumers. BT has explained in detail in its outstanding Competition Act Complaint why the GBC is an anti-competitive term under any circumstances, but it is particularly problematic if imposed by Sky as a way to circumvent regulation expressly designed to introduce competition to Sky.

2.2. [redacted] However, BT notes that this is another example of Sky seeking to leverage its market power in pay TV in order to gain advantages over rivals (in this case in other aspects of triple play services).

2.3. For these reasons, BT continues to use the term GBC in lieu of 'reciprocal supply', since it more accurately reflects the nature of the terms that Sky seeks to impose.

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26 [redacted] Sky will be fully aware of these constraints and hence the fact that what it is seeking is not achievable in practice.

3. SKY'S INSISTENCE UPON THE GRANT BACK CONDITION IS A PRACTICE THAT IS PREJUDICIAL TO FAIR AND EFFECTIVE COMPETITION

3.1. Over two years ago, in May 2013, BT set out at length in its Competition Act Complaint why it considers that Sky's insistence upon the GBC is an abuse of a dominant market position. This case remains outstanding, though BT does not propose to repeat that case in detail here. Instead, in this submission, BT has focused on responding to the questions raised in Ofcom's Second Consultation, and explains why, in addition to being an abuse of a dominant market position, the GBC is also prejudicial to FEC for the purposes of s316 of the Communications Act 2003. BT notes that the evidential base to assess whether Sky's insistence upon the GBC is viewed as an abuse of a dominant market position or a practice which is prejudicial to FEC is similar. As such, it is surprising, in light of the fact that BT's Competition Act Complaint is more than two years old, and the weight of evidence that BT has submitted in support of that case, that Ofcom has not set out a clear view in its Second Consultation that Sky's insistence on the GBC is prejudicial to FEC.

3.2. In its Second Consultation Document, Ofcom has asked for parties to respond to the following two questions:

> *"Q1: To what extent may an insistence on reciprocal supply of channels containing key sports content amount to a practice that is prejudicial to fair and effective competition? Please provide evidence and reasoning to support your view."*
>
> *"Q2: Do you have evidence that Sky has engaged in a practice of requiring rival retailers to supply services or content other than key sports content in return for the supply of Sky's key sports content? If so, to what extent do you consider that this may have been prejudicial to fair and effective competition? Please provide evidence and reasoning to support your view."*

3.3. Ofcom's first question relates to the reciprocal supply of channels containing 'key sports content', and its second to Sky's leverage of its key sports content for other pay TV services that do not contain 'key sports content'. Since, for the reasons addressed in detail in BT's First Response, BT's sports channels do not contain 'key sports content',[27] the evidence in this response relates to Ofcom's second question. However, even if BT's sports channels were to contain 'key sports content' the evidence set out below would equally apply. Moreover, BT does not believe that it is necessary to separate out the issues with respect to 'key sports content' and other pay TV services in the way that Ofcom has done: Sky imposing a GBC is inherently incompatible with FEC, whether in relation to an exchange of key sports content or any other channels (whether sports channels or not).

[27] See Section 5 of BT's First Response. The evidence contained in Annex 1 to this submission further expands on some of these points.

3.4. At paragraph 2.7 of the Second Consultation, Ofcom states that:

> *"An insistence on reciprocal supply in effect forces a rival operator to choose between the following scenarios, both of which need to be considered to understand the competitive impact of this practice: a) non-supply of Sky's key content; and b) a reciprocal agreement (where both parties are supplied with each other's content)."*

3.5. BT broadly agrees with the first potential scenario, whereby refusal to accede to the GBC results in non-supply of Sky's channels, which BT has experienced first-hand. However, for the reasons discussed in detail in BT's First Response, in its assessment Ofcom must consider the products which consumers purchase in reality – channels and bundles of channels – rather than specific pieces of content in isolation if it is to properly understand and address the effects of Sky's conduct.[28]

3.6. In respect of the second scenario, the reality is that the GBC would not result in a *"reciprocal agreement (where both parties are supplied with each other's content)".* This is because (i) acceptance of Sky's GBC would not, in fact, lead to reciprocity (see section 2 above); and, (ii) it is not economically rational for BT to accede to the GBC and therefore scenario 2 is only ever hypothetical, as discussed in detail below. Moreover *were* BT to act irrationally and accept the GBC that Sky insists upon[29] the effects of such acceptance would also lead to material consumer harm and the preclusion of the emergence of FEC (again, as discussed below).

3.7. As a result, absent effective regulatory intervention, there are no palatable options available to BT in respect of Sky's insistence upon the GBC. In either event, the GBC is prejudicial to FEC.

3.8. BT explains the impact of these two scenarios in more detail below.

<u>Scenario 1: Refusal to accede to the GBC and hence no supply of Sky's channels</u>

<u>Static economic theory model – why it is irrational for BT to accept the GBC</u>

3.9. In the context of its Competition Act Complaint, BT provided to Ofcom a report by Compass Lexecon which set out static and dynamic economic theory models in respect of the GBC.[30]

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[28] See Section 3 of BT's First Response.
[29] Which BT contends would never occur in practice.
[30] Compass Lexecon report to BT *"Modelling static and dynamic competition in the retail CPSC market"* Neil Dryden and Jorge Padilla, revised 20 April 2014. (**"Compass Lexecon Theory Report"**)

These models evidence why Sky's insistence on the GBC is prejudicial to FEC both in a static sense and in a dynamic sense, and explain the consumer detriment resulting from the GBC.

3.10. The static economic theory model shows that the only logical outcome of Sky's insistence upon the GBC is BT refusing to accede to the GBC and therefore not attaining wholesale supply of Sky's sports channels. The static economic theory model also demonstrates why the GBC would result in static consumer harm; in particular, Compass Lexecon modelled the short term effects on competition of the GBC to ascertain whether consumers would be better off if BT were able to retail Sky Sports 1 and 2 on its YouView platform without being forced to grant back wholesale supply of BT Sport to Sky. The impact of the GBC on competition was measured in the model against the metrics of the retail prices paid by consumers, BT and Sky's market shares and profitability and static consumer welfare.

3.11. The model compared three alternative scenarios:

(i) The status quo, where BT does not accede to the GBC and as a result has no wholesale supply of Sky Sports 1 and 2 on its YouView platform;[31]

(ii) Sky wholesales Sky Sports 1 and 2 to BT's YouView platform without demanding a grant back of BT Sport; and,

(iii) BT accedes to the GBC and as a result Sky wholesales Sky Sports 1 and 2 to BT's YouView platform and BT 'grants back' wholesale supply of BT Sport.

3.12. The static economic theory model therefore focuses on the competitive interaction between Sky and BT [redacted] The economic model used was a standard economic model for modelling competition between two competitors with differentiated products (the Hotelling line model) and was underpinned by reasonable assumptions about the competitive conditions in pay TV by reflecting the reality of consumers' purchasing choices. In particular, the static economic theory model assumes that consumers' decisions are driven by: (i) the channels that BT or Sky can offer; (ii) the retail prices of those channels; (iii) brand preferences; (iv) switching costs; and, (v) the technical quality of the platform that the channels are supplied upon. The model also covers markets where stand-alone pay TV products, dual/triple-play products containing pay TV, or a mixture of these products are sold.

3.13. The static economic theory model shows that:

[31] BT notes that at the time the economic theory model and subsequent choice modelling exercise were produced, BT did not have access to Sky Sports 1 and 2 on YouView through the Interim Relief Order and, Sky had not yet launched Sky Sports 5. However, for the reasons set out at paragraph 3.30 of this Second Response, the economic theory and the choice modelling work stand irrespective of these changes.

(i) BT's decision not to accede to the GBC is rational in static terms. This is because, as Ofcom states at paragraph 2.9 of its Second Consultation, to accept the GBC would significantly reduce BT's profitability relative to the situation where it rejected the GBC and continued to self-retail BT Sport on Sky's digital satellite (**"DSat"**) platform (i.e. relative to the status quo). The model shows that BT acceding to the GBC would:

[redacted]

[redacted]

(ii) Given the above, accepting the GBC as formulated by Sky is not an economically rational choice for BT and will not occur in practice. [redacted] As such, Sky's demand for 'reciprocity' is merely tactical and intended to entrench the status quo. This is because Sky must know that BT could not rationally accede to the GBC without significantly reducing its profitability. BT also notes that results from its choice modelling support the fact that the 'offer' of the GBC is tactical on the part of Sky.

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[32] [redacted]

[33] Compass Lexecon Theory Report, paragraph 1.10

Evidence to support the static economic theory model's conclusions that Sky's insistence on the GBC will lead to non-supply absent regulation

Sky's own statements to BT

3.14. Sky's own statements support the findings in Compass Lexecon's static economic theory model that Sky must know that BT could not rationally accede to the GBC without significantly reducing its profitability [redacted] This supports BT's view that in reality the GBC is intended to be rejected and that the GBC is merely a smokescreen designed to appear to be a reasonable offer when in fact it is a tactic to dampen static and dynamic competition.

3.15. Sky also knows that its DSat customers will not be without access to BT Sport. [redacted] BT must access Sky's circa 11 million DSat subscribers (who as BT has previously explained have the highest willingness to pay for sports content[35]). As such, carriage on Sky's platform is essential to launch a sports proposition,[36] as evidenced by the fact that each of Setanta, ESPN and BT all sought carriage in some form on DSat from Sky for launch.[37] Therefore, while the outcome of Sky insisting on the GBC is that BT is deprived of wholesale access to Sky's sports channels, Sky is aware that its subscribers will not be deprived of access to BT Sport. Further, Sky has actively marketed the availability of BT Sport on the DSat platform to its subscribers, which have included price guarantees over the cost of subscribing to BT Sport, in conjunction with Sky's own services.[38]

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[34] [redacted]

[35] See Section 3 of BT's First Response.

[36] Indeed, the fact that access to Sky's subscribers is essential to launch a channel was recognised as far back as 2002 (when Sky's relative retail scale was considerably smaller). In its Competition Act decision into BSkyB's alleged infringement of the Chapter II prohibition from December 2002, the Director General of Fair Trading found that *"…given BSkyB's position and subscriber base, he considers that carriage on BSkyB's platform would be key to the success of any new premium channel, and that BSkyB acts as effective gatekeeper to this subscriber base."* (paragraph 309).

[37] BT is able to self-retail BT Sport on Sky's DSat platform as a result of the regulated Technical Platform Services (**"TPS"**) regime. Were that option not available to BT, [redacted]

[38] BT highlighted a number of these examples in a witness statement provided by John Petter to the CAT in support of the amendment to the IRO (these examples are reattached to this submission for convenience), and the most recent example is available at http://www.sky.com/shop/broadband-talk/bestprice/?DCMP=pac-skycom:ec_best_price.

BT's own behaviour in practice

3.16. BT's own behaviour in practice also supports the findings of the static economic theory model. Sky's sports proposition is essential to be able to build a scale retail subscriber base – without these channels half of pay TV subscribers are foreclosed to BT. Yet, it was willing to forego access to Sky Sports 1 and 2 for several years rather than accede to the GBC. Indeed, BT would not have gone to the time and expense of seeking interim relief though the courts were a rational commercial solution available to BT.

3.17. As set out above, a critical impact of BT acceding to the GBC is the fact that [redacted] One way to overcome such concerns, at least on a static basis, would be [redacted]

3.18. When further concerns, [redacted] (discussed in more detail in Section 4 below), it is clear why Sky's insistence on the GBC leads inexorably to the status quo as the only outcome as predicted by the economic theory models.

Compass Lexecon's choice modelling research and analysis

3.19. In addition to the static economic theory model discussed, BT also commissioned Compass Lexecon to conduct a choice modelling exercise to seek to test the veracity of the reasonable assumptions in the static economic theory model by using real consumer data.[40]

3.20. In particular, the economic theory model findings were based upon a number of reasonable assumptions (such as the relative value of Sky's sports offering and BT's sports offering and

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[39] BT discusses the broader dynamic implications in Section 4 below.

[40] Compass Lexecon report: *"An estimation of UK consumers' willingness to pay for Premium Sports Channels using a discrete choice analysis".* Neil Dryden, Patricia Lorenzo, Jorge Padilla and Alejandro Requejo, revised 30 April 2014. This report sets out in detail the methodology employed in the choice modelling work and BT considers that this evidence is also relevant to the issue of the GBC prejudicing FEC (as well as BT's Competition Act Complaint).

how those valuations change with the addition of Sky Sports 1 and 2 or BT Sport). The economic theory model stands on its own (as all of the assumptions utilised were reasonable). However, to supplement the economic theory model, Compass Lexecon also tested some of the key parameters to ascertain whether, empirically, the assumptions were valid in practice based on real data on consumer preferences.

3.21. The choice modelling proves that the effects predicted by the economic theory model were correct in practice – in each case, the reasonable assumptions used were valid in both theory and in practice. For the avoidance of doubt, BT's acquisition of Champions League rights has no impact upon the veracity of the findings of the economic theory model[41] even if it may impact on the magnitude of some of the parameters under the choice modelling exercise. Indeed, as previously discussed, even if Ofcom were to place **no** weight on the choice modelling findings, the findings from the economic theory model would still stand, since it is based on reasonable assumptions that are capable of standing alone.

3.22. Given all of the above, Sky's insistence on the GBC as a pre-requisite for wholesale supply of Sky Sports 1 and 2 leads to non-supply of Sky's sports channels to BT, and hence harms BT's

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[41] BT notes that at the time when Compass Lexecon undertook the choice modelling exercise, BT had not acquired UEFA Champions League rights (and as mentioned above, neither had Sky created Sky Sports 5). Notwithstanding this, it is important to note that BT's acquisition of Champions League rights does not impact on the static economic theory model at all. [redacted]

[redacted] All available evidence shows that BT's acquisition of the Champions League rights will not close the significant value gap between BTS and SS (see for example Ofcom's own research data in the First Consultation Document, pricing and take-up data for the BTS and SS proposition from BT, Sky and Virgin Media, TalkTalk's research evidence on the value of BTS versus its retail prices for SS (presented in BT's First Response) and the relative valuations from Compass Lexecon's choice modelling (Table 26)). In addition, Ofcom's own research and analysis, Sky's CEO's statements, and BARB metrics presented in BT's First Response shows [redacted].

Indeed, Ofcom's own research shows that even if BT acquired the majority FAPL rights, the impact on the value of BTS would be low. [redacted] Equally, evidence from the most recent FAPL auction demonstrates the relative value of the majority FAPL rights compared with the UCL rights (£4.2bn for the majority FAPL rights versus £903.6m for UCL and UEL rights). As such, in order for Ofcom to believe that BT's acquisition of the Champions League rights has 'closed this gap' Ofcom would need to believe that Champions League is now more 'important' than the majority FAPL rights. This is implausible.

ability to become an effective competitor. For the reasons set out in Ofcom's First Consultation and BT's First Response, this outcome is extremely problematic for BT, competition and consumers.

Impact of non-supply of Sky Sports on BT: the prejudice to FEC resulting from the GBC

3.23. Ofcom is well versed on the impact on competition and consumers of the first limb of limited distribution (non-supply by Sky of its sports channels) and the fact that such non-supply prejudices FEC, especially when it is targeted at smaller scale retail rivals and companies, such as BT, who seeks to bid for sports rights against Sky. These matters were discussed in detail in Ofcom's First Consultation, and as such, BT has provided considerable evidence already addressing these matters:

(i) The Compass Lexecon static economic theory model shows that, in a static sense, consumers are worse off under the status quo scenario than if Sky provided wholesale supply of Sky Sports 1 and 2 to BT without insisting on the GBC. In aggregate, short term consumer welfare is higher in the scenario where Sky wholesales Sky Sports 1 and 2 without the GBC than under the status quo:

(a) The average retail price paid for premium sports channels is higher under the status quo than if Sky were to wholesale Sky Sports 1 and 2 to BT without the GBC;

(b) Sky's customers pay higher retail prices under the status quo than they would if BT could offer SS1 and SS2, since the (already limited) competitive constraint imposed by BT is undermined; and

(c) BT's customers have a narrower selection of premium sports channels as a result of the GBC.

(ii) The choice modelling exercise proves that the reasonable assumptions made in the static economic theory model, and hence the predicted outcomes with respect to consumer welfare, are true using real consumer data and, as explained at footnote 41 above, BT's acquisition of Champions League rights does not change this position.

(iii) In addition to the detrimental impact on static competition, in a dynamic sense, the effect of non-supply results in the same "vicious circle" modelled and described in detail in BT's First Response.[42] The GBC also lowers BT's incentives to invest in product innovation and value-added services.

[42] See Section 5 of BT's First Response.

[redacted]

(iv) Such dynamic effects are likely to be greater than the static effects resulting from Sky's insistence upon the GBC, and can be used by Sky to ensure that it is fully protected from effective competition ever emerging at either the wholesale or retail level, notwithstanding third party investment in content. As such, even if Ofcom were to discount the findings of the Compass Lexecon static economic theory model (notwithstanding the reasonable assumptions it was built on), the supporting choice modelling analysis and the evidence of BT's own behaviour in practice, because Sky's insistence on the GBC has been shown ultimately to lead to non-supply, the dynamic effects on competition alone, which have been well rehearsed in the context of the WMO, would be sufficient to warrant regulatory intervention.

Scenario 2: 'Reciprocal' agreement will never occur in practice

Scenario 2 is only ever hypothetical and, in any event, accepting the GBC would prejudice FEC

3.24. As set out at above, it is simply not economically rational for BT to accede to the GBC as formulated by Sky to date. As such, the second scenario that Ofcom puts forward (whereby a reciprocal agreement is reached where both parties are supplied with each other's content) is unlikely to ever occur in practice given [redacted]

3.25. In the hypothetical event that either (i) BT were irrationally to accept a commercial arrangement that did not fully compensate it for the opportunity cost of acceding to the GBC or (ii) that Sky was willing to compensate BT for its static and dynamic losses from wholesaling to Sky, [redacted] then it is, of course, theoretically possible that a reciprocal deal could be agreed. However, the net result is not one where the prejudice to FEC would be resolved, and consumers would equally be left worse off as a result.

[43] Paragraph 1.14 of the Compass Lexecon Theory Report

3.26. It is clear that the GBC is structured to ensure that Sky always retains a competitive advantage over BT (or any other party who may acquire sports rights in the future).[44] Wholesale access to Sky Sports 1 and 2 is only provided by Sky if any product differentiator that a third party may be able to acquire is granted back to Sky. Sky is thereby able to appropriate the investment of a new entrant and so ensures that it can maintain a relative competitive advantage. In BT's case Sky would maintain a differentiator in sports in the form of Sky Sports 3-5 and F1, as well as its basic channels and movie channels in HD which BT also cannot offer. By dint of the GBC, BT is only permitted to improve its offering to consumers if Sky also improves its offering to consumers; as such the gap between Sky and BT subsists. As a result, regardless of its investment in its own channels, BT is precluded from ever 'catching up' with Sky and [redacted] In other words, the dynamic status quo is maintained as a consequence of the GBC, any ability on the part of BT eventually to catch-up, let alone 'leapfrog' Sky as a result of its investments is curtailed, and FEC is precluded.[45]

3.27. As a result, BT's incentives to invest and innovate will also be neutralised as any investment that BT makes would be appropriated by Sky, negating the purpose of that investment ab initio. The GBC means that there is fundamentally no merit in an entrant seeking to try to win content rights from Sky (in those exceptional circumstances where it is possible to win such rights in the first place) because if such rights are won, that entrant either has to effectively give those rights over to Sky or forego wholesale access to Sky's essential channels entirely – neither of which is an attractive proposition for a new entrant in the face of a dominant provider with essential channels. This impediment to investment incentives also means that FEC is precluded.

3.28. These points were recognised by Mr Justice Roth, who stated obiter (in the context of whether the IRO should be varied) in the Competition Appeal Tribunal's judgment:[46]

> *"[…] if the WMO remedy is eventually upheld, to deny BT access to those channels for it to supply on its YouView platform is likely to cause it commercial damage.* ***I do not think it is any answer to say that BT could obtain SS1&2 if only it were prepared to offer reciprocal supply to Sky of the BT Sport channels. BT has spent some £1.5 billion acquiring football broadcasting rights in order to improve its position*** *on the market and* ***I do not see that BT should be required, in effect, to deprive itself of the***

[44] BT understands that the GBC is a standard term that Sky imposes in all its contracts. However, as BT is currently the only vertically integrated pay TV operator [redacted]

[45] Sky would also retain its other significant incumbency advantages, including those relating to switching costs and branding, as well as its advantages resulting from superior content which BT would still be unable to access (as discussed above).

[46] Case Number: 1152/8/3/10 (IR), British Sky Broadcasting Limited v Ofcom and BT Plc et al, [2014] CAT 17.

competitive gain from that investment *in order to achieve the benefit of the WMO remedy ordered by Ofcom."* [Emphasis added]

3.29. Of course, it is theoretically possible that Sky could compensate BT for both the static and dynamic losses that BT would suffer as a result of acquiescing to the GBC. However, given Sky's insistence on imposing the GBC in the first place, it is unclear why it would then be incentivised to offer terms that would neutralise its effects. Moreover, if this were to happen, it is the consumer that would lose out as the high wholesale prices that this would necessitate would consequently lead to higher retail prices.[47] It should also be a cause for concern to the regulator that Sky would seek to 'buy off' BT from competing strenuously, which would be the consequence of such payments. BT also notes that [redacted] It would be inconsistent with Ofcom's regulatory principles that its assessment should be evidence-based[48] for it to assess Sky's conduct in insisting upon the GBC against [redacted]

The interim relief that BT has attained makes no difference to the assessment of either scenario

3.30. For the avoidance of doubt, the fact that BT was granted interim wholesale access to Sky Sports 1 and 2 on its YouView platform in December 2014 pursuant to an amendment to the IRO of the Competition Appeal Tribunal[49] makes no difference to the analysis and evidence provided above in respect of either scenario (whether to Sky or BT's incentives or otherwise):

(i) The IRO is, by its nature, interim relief. As such, if ultimately the existing WMO on Sky is removed, BT would be without wholesale access to Sky Sports 1 and 2[50];

(ii) Sky has made plain that, absent regulation requiring it to do so, it would not provide BT with wholesale supply of its sports channels other than in line with its GBC;[51]

(iii) The scope and substance of the GBC have not changed as a result of the IRO – the GBC is still not a rational 'exchange' for BT to make and the analysis set out herein is unaffected; and

(iv) The IRO goes, in any event, to the 2010 WMO and not to Ofcom's fresh WMO review of which this Second Consultation forms a part.

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[47] BT discusses these issues in more detail in Section 4 below.
[48] See, for example, paragraph 1.19 of Ofcom's Enforcement Guidelines.
[49] 1152/8/3/10 (IR) *British Sky Broadcasting Limited v Office of Communications (Interim relief)* [2014] CAT 17.
[50] Sky is entitled to terminate its agreement for the IPTV distribution of Sky Sports 1 and 2 to BT's YouView platform in the event that the existing WMO on Sky is removed.
[51] See section 4 below.

3.31. Furthermore, under any assessment, BT remains without wholesale access to the full Sky Sports proposition which is essential in order for FEC to emerge in respect of the retailing of premium sports channels.[52]

[52] See Section 3 of BT's First Response.

4. CONTRARY TO SKY'S ARGUMENTS, AN INSISTENCE UPON 'RECIPROCAL' SUPPLY IS NOT FAIR AND REASONABLE

4.1. Paragraph 2.19 of the Second Consultation Document highlights Sky's view that it "*considers that it is fair and reasonable for there to be reciprocal supply of key content between itself and its rivals."* BT finds this statement to be disingenuous, and absent any sound economic or legal basis. Sky's arguments appear to be divorced from the reality of the GBC which it insists upon, and are couched in terms (such as "*level playing field*" and a "*positive consumer experience*") to hide the fact that they are inconsistent with any sound analysis of the conditions necessary to ensure FEC. BT also notes that, unlike BT, Sky has put forward no economic, legal, research, or factual evidence in support of its arguments as to the purported positive benefits to consumers of the GBC. This is despite the fact that these issues have been the subject of investigation for more than two years.

4.2. Ofcom summarises Sky's arguments that there are benefits to competition in respect of 'reciprocity' at paragraph 2.20 of the Second Consultation Document. Ofcom states that Sky considers that 'reciprocity':

(i) *"creates a level playing field in the supply of key content, i.e. all retailers have access to the full range of key content and they are able to differentiate their service on the basis of other elements of the bundles they offer to consumers (e.g. other types of content);*

(ii) *it may create a more positive experience for consumers who will be able to access all key content from a single retailer; and*

(iii) *where a reciprocal deal provides Sky's rival with better terms of supply for its key content than would be the case under a stand-alone supply arrangement with Sky (e.g. because Sky offered higher wholesale price for the rivals' content under a reciprocal supply arrangement), the possibility of entering into such deals might be a factor that encourages the rival to invest in developing its own sports channels."*

4.3. BT comments upon each of these arguments in turn to explain why they are fundamentally flawed in respect of the GBC.

<u>The GBC does not create a level playing field in the supply of 'key content'</u>

4.4. Contrary to Sky's unsubstantiated assertions, the GBC does not lead to an outcome where all retailers will have access to "the full range of key content". For the reasons set out in Section 3 above, the GBC leads to an outcome where BT will have **no** access to **any** of Sky's key content at all, let alone access to the full Sky Sports proposition that is necessary for BT to be able to compete effectively.

4.5. Further, in the hypothetical scenario where the GBC were accepted by BT, Sky would have access to all of BT's sports channels (despite the fact that they are unnecessary in order to compete as discussed in BT's First Response) and BT would not have access to the full Sky Sports proposition which is necessary to be able to compete effectively.[53] Therefore, as discussed in detail in Section 3, the result of BT's hypothetical acquiescence to the GBC is that Sky would be able to:

(i) maintain all of its own advantages in content (including with respect to Sky Sports 3-5 and F1, as well as in movies and basics) whilst removing any point of differentiation from BT;

(ii) retain its additional significant competitive advantages in terms of incumbency advantages, including from switching costs and branding;

(iii) maintain the advantage of its large subscriber base with a high willingness to pay for sports content and further consolidate its unassailable dynamic advantages in acquiring rights, while preventing BT from using its investment in sports rights to 'close the gap' on Sky; and

(iv) neutralise BT's incentives to invest and innovate.

4.6. Under no circumstances does BT believe that this could reasonably be considered to be creating a "level playing field".

4.7. In any event, the purpose of the WMO is not to create a "level playing field" but rather to introduce appropriate regulation on those channels to which wholesale access is necessary in order to ensure FEC:[54]

(i) For the reasons explained in detail in BT's First Response, none of BT's sports channels are necessary to ensure FEC,[55] [redacted]. Neither BT's channels, nor the content on those channels are 'key' to driving competition. BT has neither the incentive nor ability to limit the distribution of BT Sport; as evidenced by its actions in

[53] Therefore, the GBC is predicated upon the wholesale supply of a non-essential product (BT Sport) in exchange for a sub-set of an essential product (Sky Sports 1 and 2). As noted at paragraph 2.1(i) above, this type of requirement is generally viewed to be anti-competitive.

[54] Specifically, s.316 requires Ofcom to consider and address those practices that are "*prejudicial to fair and effective competition*" ie it is a competition standard for intervention.

[55] As BT explained in that submission, Ofcom has conflated majority and minority FAPL issues and has significantly overplayed the importance of Champions League content. (see Section 3) Third parties have also made incorrect statements about the nature of BT Sport in their responses to Ofcom's First Consultation Document, which BT addresses at Annex 1 to this response in order to clarify the factual position and explain why these comments grossly exaggerate the importance of BT Sport.

practice. As such, there is no basis for regulating BT Sport, and no legitimate basis for Ofcom to do so.

(ii) In contrast, as evidenced in BT's First Response, access to the Sky Sports proposition is essential to ensure FEC, the Sky Sports proposition does drive consumer platform choice for significant numbers of consumers, and Sky does have both the incentive and ability to limit the wholesale distribution of its Sky Sports proposition (and has manifestly done so in practice). As a result, wholesale access to the full Sky Sports proposition does need to be regulated.

4.8. As such requiring regulated wholesale access to Sky Sports is necessary, appropriate and proportionate, requiring regulated access to BT Sport is not. The GBC is an unacceptable practice that is prejudicial to FEC because if it were permitted it would entirely undermine the purpose of the WMO by allowing Sky to require supply of BT's non-essential channels as a pre-condition for access to its essential channels with the net result that BT would be deprived of the protections afforded by the regulation. As such, prohibiting the GBC is appropriate and consistent with Ofcom's statutory obligations.

<u>The GBC will not create a more positive consumer experience</u>

4.9. As discussed above, the purpose of this review is to consider and address those practices that are prejudicial to FEC. Sky does not explain how creating "*a more positive experience for consumers*" as they "*will be able to access all key content from a single retailer*" is relevant to the question as to whether the GBC is a practice that prejudices FEC.

4.10. Moreover, contrary to Sky's assertions, the GBC will manifestly **not** create a more positive experience for consumers, nor will it result in consumers being able to access "all key content"[56] from a single retailer:

(i) Again, for the reasons set out in Section 3 above, the GBC leads to an outcome where BT will have no access to any of Sky's key content at all, let alone access to the full Sky Sports proposition that is necessary for BT to be able to compete effectively. The GBC cannot result in a more positive consumer experience if the outcome of this condition is that BT consumers are not supplied with Sky Sports at all. In contrast, as explained above, Sky's subscribers already have access to BT Sport on Sky's DSat platform without BT acceding to the GBC, and Sky has been able to market this availability to its subscribers.

[56] BT does not reiterate here again the reasons as to why none of its BT Sport channels contain 'key content' and that none of its channels are necessary to ensure FEC, nor the reasons why the full Sky Sports proposition must be regulated.

(ii) As the static economic theory model discussed in Section 3 shows, the GBC leads to higher prices for consumers and less innovation because the competitive constraint imposed by BT is weaker than where there is wholesale supply of Sky Sports to BT absent the GBC. Likewise, all subscribers are worse off as a result of the weakness in the competitive process resulting from Sky's dynamic advantages in bidding for rights remaining unchallenged over the long term.

(iii) In the hypothetical scenario where the GBC was accepted by BT, Sky's ability to offer an attractive price for BT Sport would depend upon the magnitude of the wholesale price it paid for BT Sport. Sky appears to claim (see below) that the wholesale price it would pay could be sufficiently high to make BT better off than wholesale supply absent the GBC. Whilst this would be very unlikely to occur in practice for the reasons discussed in detail below, hypothetically, under that assumption the result would be that BT Sport customers on Sky's platform would have to pay a significantly higher price than the price currently offered to those customers by BT today. As a result, the outcome would be subscribers paying more to access content that they can already receive today. The Compass Lexecon economic theory model, and choice modelling analysis also demonstrate that under this hypothetical scenario, consumers would be worse off.[57]

(iv) Finally, BT notes that when it comes to accessing BT Sport on a wholesale basis, Sky asserts that access to all content from a single retailer is beneficial. However, Sky is unwilling to provide BT with access to all of its channels (sports, movies or basics) on a wholesale basis. Therefore, it seems this self-serving argument only applies with respect to the narrow set of channels to which Sky does not have wholesale access. Moreover it is particularly incongruous given that it is the full Sky Sports proposition that is essential to ensure FEC, whereas BT Sport is not.

4.11. In sum, the GBC will not create a more positive consumer experience because its effect is to increase retail prices and stifle competition, choice and innovation.

<u>The GBC does not encourage rivals to invest in developing their own channels; indeed it has the opposite effect, dampening investment incentives</u>

4.12. Sky posits that a reciprocal deal would provide Sky's rivals with 'better' terms of supply for their content than under a stand-alone arrangement with Sky and that the mere possibility of such a deal would encourage rivals to invest in their own channels to obtain it. This unsubstantiated assertion is based on a fictional assessment of the commercial terms that Sky has been willing to offer in practice (at least to BT); in addition there is no evidence that any

[57] See Appendix C of the Compass Lexecon Theory Report.

other pay TV retailer that has agreed to such terms has consequently been 'encouraged' to make investments in content. It is no answer to the fact that the GBC precludes FEC.

4.13. Firstly, Sky's assertions presuppose that BT would be able to extract significant additional value from Sky for BT Sport if BT acceded to the GBC. There is no evidence to support this assertion, and all available evidence implies the opposite:

(i) [redacted] Wholesale access to the Sky Sports proposition is essential to be able to compete for retail pay TV subscribers whereas wholesale access to BT Sport is not. This is further exacerbated by the fact that BT Sport is already available to Sky's subscribers on Sky's platform, whereas, absent the WMO and amended IRO, BT would have no supply of any of Sky's sports channels on its YouView platform. Furthermore, as discussed above [redacted]

(ii) There is a fundamental difference between parties mutually agreeing wholesale terms, and an enforced GBC where Sky uses its market power to try to force third parties to relinquish the benefit of their investments. Thus, although Sky talks about economic outcomes where 'better' terms may be available under reciprocity, the reality to date has been that the [redacted]

(iii) Therefore, absent Sky unilaterally ceasing to insist on the GBC, unless Ofcom intervenes to mandate wholesale supply of Sky Sports and to prohibit the GBC, the only outcome that is likely to occur in reality is non-supply of Sky Sports to BT. As BT has explained in detail in Section 3 of this response, there is no fall back to accepting the GBC other than non-supply of Sky Sports. The GBC is a binary 'choice' and, in reality, no choice at all because BT cannot accept it as formulated by Sky. There is no available third option for BT to obtain Sky Sports on a stand-alone basis through commercial negotiations with Sky in the event BT does not accede to the GBC.

4.14. Secondly, BT notes that Sky does not define what it means by 'better' terms in the (hypothetical) scenario where Sky offered wholesale terms of supply both with and without the GBC requirement. Such terms would, in practice, only be 'better' for BT than wholesale

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[58] This includes, for example, the requirement that it will only provide wholesale access to Sky Sports 1 and 2, whereas BT would be required to wholesale all of its sports channels.

supply without the GBC if they were to compensate BT in both static and dynamic terms for the opportunity cost of agreeing to wholesale its channels to Sky. Simply offering a slightly higher wholesale price for BT Sport in a 'reciprocal' arrangement would not offset the static and dynamic losses of acceding to the GBC and hence would not make it rational for BT to accept the GBC, nor would it improve FEC or the outcome for consumers. More specifically:

(i) The wholesale price that Sky paid would need to compensate BT (or any third party) for the [redacted] For the reasons set out in Section 3 above, it is highly unlikely that Sky would offer wholesale revenues to BT that would be greater than [redacted]

(ii) In the unlikely event Sky was willing to compensate BT for such static losses, BT would still lose its one ability to differentiate its retail offering, and thus the value gap between BT and Sky's offerings would be far greater than if BT obtained wholesale access to Sky Sports 1 and 2 absent the imposition of the GBC. As such, contrary to Sky's assertions about creating further incentives to invest, BT's incentives to invest and innovate would be reduced even in circumstances where BT was paid a 'better' wholesale price under a reciprocal arrangement.

(iii) Alternatively [redacted] It seems highly implausible that Sky would be willing to increase the wholesale price it paid BT to such a level which itself would be contrary to Sky's own dynamic incentives (and, BT warrants, the purpose of the GBC in the first place). Further, such a deal would effectively be 'paying' to remove a competitor's incentive to compete with Sky – which clearly would not be in the best interests of consumers and, indeed, would be likely in itself to breach competition law in its own right. Moreover, the high wholesale prices that this would necessitate would consequently lead to higher retail prices for consumers, as evidenced by the Compass Lexecon economic theory model and choice modelling.[60]

4.15. Finally, even if Sky was willing to pay a 'better' wholesale price for BT Sport in the event BT was willing to accede to the GBC, Sky would still be able to control the extent to which BT was

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[59] For the reasons set out above, the economic theory model shows that this would be the case even though Sky may be able to expand the total number of subscribers taking BT Sport (as a result of its ability to bundle BT Sport with its Sky Sports channels).

[60] See Appendix C of the Compass Lexecon Theory Report.

able to impose any meaningful competitive constraint on its sports channels as a result of the fact that Sky would control the level of the wholesale price that it could set for its own sports channels. Sky would have an incentive to set the wholesale price for Sky Sports 1 and 2 at a very high level, since: (i) that would undermine BT's competitive position and ability to compete effectively with Sky; and (ii) it would relax the downstream competition that Sky faces and result in higher retail prices overall to consumers, and hence greater profitability to Sky. This is precisely the type of action that has led to the price regulation of mobile termination rates and, as such, ought to be of concern to Ofcom.

4.16. As such, it seems implausible that BT would be incentivised to increase its investment in its channels with a view to gaining ‘better’ terms under a reciprocal supply deal as Sky asserts. Clearly Sky would never be willing to offer such terms in the first place (and, indeed, has never done so to date), and in the highly unlikely event it did, the outcome would be one which would not lead to FEC nor operate in the best interests of consumers.

5. CONCLUDING REMARKS

5.1. As the evidence and analysis that BT has provided demonstrates, Sky's insistence upon the GBC is a practice which is prejudicial to fair and effective competition. It is merely a tactic employed by Sky to entrench the status quo. The GBC leaves consumers worse off and chills competition. Ofcom must address this fact as a part of the present WMO review (and indeed pursuant to BT's outstanding ex post Competition Act Complaint).

5.2. Owing to Sky's insistence on the GBC, BT had to enter into a protracted court battle to obtain any access at all to Sky Sports 1 and 2 on its YouView platform (and even then, at rates which do not ensure FEC and for a subset only of the Sky Sports proposition). This has had an impact on what BT has been able to achieve in terms of investing in its channels. If BT had access to an effective, correctly priced Sky Sports proposition under a well-functioning WMO remedy, the vicious circle described in its First Response could start to be unwound. BT would be able to begin to increase the number of subscribers with a high willingness to pay for sports channels on its own pay TV platform, and BT's ability to seek to win sports rights would be much better than it is today. This would allow vitally needed competition to begin to emerge in the retailing of premium sports channels – to the ultimate benefit of consumers.