SKY'S RESPONSE TO OFCOM'S REVIEW OF THE PAY TV WHOLESALE MUST-OFFER OBLIGATION

EXECUTIVE SUMMARY

1. There is no need to continue to impose the WMO obligation on Sky. It is a solution to a problem that does not exist. Sky spends over £**[CONFIDENTIAL]** a year to produce the Sky Sports channels, and, following the result of the recent auction of Premier League rights, that figure will rise significantly from 2016/17. This provides a powerful, indeed strengthening, incentive to distribute those channels on as wide a range of platforms, to reach as many potential subscribers, as possible.

2. And this is what actually is observed. Sky's sports channels have always been available on cable, which for many years was the only platform in the UK capable of carrying them other than satellite. As the range of platforms operating in the UK with the capacity to carry those channels has expanded, Sky has reached the commercial agreements necessary to deliver its channels via those platforms.

3. Today, Sky's sports channels are available to UK consumers in a multitude of ways, including satellite, cable, IPTV platforms, a range of 'over the top' ("OTT") IP-based services, 3G and 4G mobile networks. And they are retailed by a range of firms other than Sky – Virgin Media, BT, and TalkTalk – all of which compete strongly with Sky for customers, in particular for valuable 'triple play' customers. Sky itself retails the channels both on a traditional basis, via its satellite service, and via NOW TV, a widely available and highly marketed OTT service that offers consumers that do not want a full subscription to the channels the ability to pay to watch them on a daily or weekly basis. As well as being available via a set top box sold by Sky for a one-off £9.99, NOW TV is available via a wide and expanding range of platforms, including games consoles, tablets, LG connected TVs, Apple TV, and Google Chromecast.

4. Any conclusion that Sky restricts the distribution of its 'key sports channels', or is likely to do so in the future, flies in the face of this real-world evidence. It would similarly be erroneous to attribute the expansion in distribution of those channels over time to the introduction of the WMO. The increase in the range of platforms that have the ability to carry Sky's channels has nothing to do with the WMO, and nearly all the agreements reached with other platform operators fall outside the scope of the WMO as it has operated since 2010 – the sole current exception being Sky's agreement with BT in relation to its YouView service, which accounts for less than **[CONFIDENTIAL]**% of the overall base of Sky Sports subscribers.

5. More generally, it is important to step back from the detail of the issues raised in the Consultation when considering the necessity and appropriateness of the WMO.

6. Both the UK audiovisual sector, and indeed the wider communications sector to which it is now intrinsically linked, are highly competitive, and deliver excellent outcomes for consumers in terms of choice, quality of services and price. There are few, if any, markets in the world in which consumers have a choice of four providers of packages of TV, telephony (increasingly, both fixed and mobile services) and broadband services, as over half the UK does (*i.e.*, the half served by Virgin Media), with the other half having a choice of three providers.

7. It is also evident that this is a sector that is subject to rapid and profound ongoing change, and significant exposure to competitive forces and technological trends that emanate from outside the UK. The growth of Netflix, over a short period of time, to become a pay TV operator with over 50 million subscribers globally (and over 3 million in the UK), a well-recognised brand, integrated into content production, a significant competitor for content rights to well-established companies around the world, yet with a minimal physical presence outside its base in California, highlights the way in which the world of content production and distribution is changing.

8. Sections 1 and 2 of this response set out the broader market context and market developments relevant to the current review. Having proper regard to this context, the proposition that it is necessary for Ofcom to intervene in commercial relations among operators in the UK pay TV sector is untenable.

9. In any event, there are manifest deficiencies in Ofcom's approach in the current Consultation, such that it could not form a proper basis for a conclusion that continued regulation is required. In other words, it could not enable Ofcom to reach a well-informed, evidence-based view that it was legitimate and necessary to continue to impose the WMO on Sky.

10. In the first instance, as set out in Section 3 of this response, Ofcom's appreciation of the requirements that it must meet to establish a legal basis for regulation is flawed. The WMO was implemented under section 316 of the Communications Act, which establishes a power for Ofcom to regulate to address practices engaged in by licensed broadcasters that are prejudicial to fair and effective competition. It is not, as Ofcom appears to envisage in the Consultation a regulatory regime that enables Ofcom to seek to promote competition, far less to promote the interests of particular firms within the sector, such as BT.

11. Instead, in order legitimately to continue to impose the WMO, Ofcom must establish, on the basis of analysis and evidence capable of withstanding profound and rigorous scrutiny, that in the future Sky is likely to engage in a practice that will result in prejudice to fair and effective competition. It is plainly not sufficient, as Ofcom appears to envisage in the Consultation, simply to identify a risk that Sky may engage in such a practice.

12. Similarly, Ofcom must appreciate that the burden of making the case that it is necessary and appropriate to continue to impose the WMO on Sky rests with Ofcom. Ofcom cannot, as it appears to in the Consultation, legitimately take the view that the WMO should be retained unless Sky can demonstrate that there is no risk that absent regulation Sky would 'limit distribution' of its 'key sports channels' in some way.

13. Section 4 of this response addresses Ofcom's arguments in relation to the purported practice that forms the basis for the retention of the WMO. The best indicator of the weakness of Ofcom's analysis of this issue is the weak and tentative way in which its conclusions are framed in the Consultation: as noted above, that there *may be a risk* that Sky *has incentives* to 'limit distribution' of its key content, in particular to platforms that are small today, but which have the potential to grow significantly in the future.

14. Sky is not *likely* to 'limit distribution of its key sports channels'. They are widely distributed today, and will remain widely distributed in the future. Ofcom's discussion of this issue includes no evidence at all, let alone evidence that contradicts this view. Instead, its discussion focuses on unrealistic and essentially untestable hypotheses relating to Sky's *incentives* to 'limit distribution of its key sports channels' that have no basis in fact. Ofcom should, instead, focus on Sky's actions – what Sky is likely to do in future in the absence of the WMO – and the best evidence on that, in terms of distribution of its 'key sports channels', is what it does currently, and has done for many years.

15. Finally, as explained in Section 5 of this response, Ofcom must proceed in a manner that satisfies its duty to have regard in all cases to the principle under which regulatory activities should be consistent. A decision to continue to subject Sky to WMO regulation (which in Sky's submission would be unjustified in any event) but to show regulatory forbearance to BT would represent a serious breach of that duty.

16. Notwithstanding this, the reasons given by Ofcom for believing that, if it continues to impose the WMO on Sky, it should not regulate BT, do not withstand scrutiny. Ofcom asserts that the 'key content rights' held by BT are "*modest*". That is not the case. Measured appropriately, and taking into account both BT's acquisition of exclusive Champions League rights from the 2015/16 season and the outcome of the recent Premier League auction, BT's holdings of 'key content rights' are significant. Ofcom's belief that 'limited distribution' of BT's key sports channels – which occurs today, and may well be extended in future – has little impact on competition, is also open to question.

17. Above all, however, Ofcom's proposition that it should disregard potential anticompetitive effects of BT's decisions about distribution of its 'key sports channels' if this results in BT becoming a "*more effective competitor*" in pay TV in the longer term, is not a reasonable or credible position for Ofcom to take. BT is a large, highly profitable company – with an annual turnover of £18 billion, and profits of over £3 billion and growing. It has recently proposed spending £12.5 billion to acquire EE, a large well-established mobile telephony operator with 27 million customers. BT does not need regulatory assistance from Ofcom, and its actions should be judged no differently to Sky's.

18. Ofcom's proposition that it should forbear from regulating BT also well illustrates its illegitimate view that Section 316 is an instrument that can be used to engineer outcomes that Ofcom regards as desirable (such as a stronger BT), rather than one enabling Ofcom to intervene only where necessary to prevent harm to the competitive process.

19. Both (i) the context for Ofcom's review, and (ii) the weakness of the rationale and evidence base for intervention, point to a strong case for deregulation. On the basis of the analysis in the Consultation, there are no grounds for Ofcom to proceed to a further consultation on proposals for intervention. The appropriate course of action is to close the review and remove the WMO obligation.

SKY'S RESPONSE TO OFCOM'S REVIEW OF THE PAY TV WHOLESALE MUST-OFFER OBLIGATION

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SKY'S RESPONSE TO OFCOM'S REVIEW OF THE PAY TV WHOLESALE MUST-OFFER OBLIGATION

This submission provides Sky's comments on Ofcom's consultation reviewing the Wholesale Must Offer ("WMO") obligation imposed on Sky in 2010 ("the Consultation"). It comprises the following sections:

- **Section 1**: Relevant context
- **Section 2**: Developments in the UK Pay TV sector since 2010
- **Section 3**: The legal framework for Ofcom's review
- **Section 4**: Whether Sky is likely to 'limit distribution' of its 'key sports channels'
- **Section 5**: Ofcom's treatment of BT
- **Section 6**: Next steps

SECTION 1: RELEVANT CONTEXT

Introduction

1.1 The Consultation focuses on the supply of 'key sports channels'[1], which are premium pay TV sports channels produced by Sky and BT. It is necessary and appropriate, however, to have regard to the broader context in which those television channels are produced and supplied to subscribers. This Section 1 comments on a number of broader contextual factors that are relevant to Ofcom's review.

1.2 A proper appreciation of the broader context is important for two reasons.

1.3 First, when viewed in the context of the highly positive outcomes delivered to UK consumers, and the dynamism of the UK audiovisual sector, the proposition that this is a sector in which it is necessary and appropriate for Ofcom to intervene – particularly on the basis of concerns that cannot be more strongly advanced than there is a *risk* that certain behaviours might occur in future – is without merit. Instead, proper regard to these contextual issues strongly points to a case for deregulation.

1.4 Second, it informs a proper assessment of the likelihood of Sky acting on the basis of the hypothetical 'dynamic incentives' advanced by Ofcom. A key reason that Sky would not be able to rely on the types of 'strategic advantages' proposed by Ofcom if it 'limited distribution of its key sports channels' is that the sector is subject to rapid ongoing change, in ways that are impossible to predict. In other words, Sky could have no assurance that its desired outcome (in Ofcom's hypothesis) would eventuate.

1.5 The first sub-section, below, explains that the UK audiovisual sector is highly competitive, and delivers excellent outcomes for consumers, while the following sub-section explains the significant changes to which the sector is subject.

1 For convenience, in this submission we adopt the terminology used by Ofcom in the Consultation in relation to 'key sports channels', 'key content', and 'limited distribution'. All paragraph references in this response are to the Consultation, unless otherwise specified.

The UK market is highly competitive and delivers excellent outcomes for consumers

1.6 Economic regulation of specific sectors is normally reserved for markets in which either there is clear detriment to citizens and consumers, or a significant risk of such detriment arising. Yet UK consumers are among the best served in the world for audiovisual services, with no obvious consumer detriment.

Pay TV services are part of a broader audiovisual sector

1.7 Subscription pay television is only one of the ways in which consumers meet their demand for audiovisual entertainment and information. Other sources include free services, on-demand services (both free and pay), and pre-recorded media, such as DVDs and Blu-ray disks. Even if the view is taken that such services do not provide alternatives to premium pay TV channels at the wholesale level, they cannot be ignored as important to competition at the retail level of the sector.

1.8 In particular, the Consultation fails properly to have regard to free to air ("FTA") television services, which, cumulatively, exert a key competitive constraint on pay TV retailers. The UK has one of the strongest FTA television sectors in the world, with the licence fee funded BBC at its heart. FTA television broadcasters spend over £3 billion a year on programming, which is delivered to viewers for no additional payment over and above the compulsory licence fee, and viewing of their services continues to dominate television viewing in the UK. In addition, those broadcasters are now owners of a range of platforms that compete strongly with those operated by pay TV providers – Freeview, Freesat and YouView – as well as delivering their services via pay TV operators' platforms (Sky's and Virgin Media's) and OTT via services such as the BBC's iPlayer, ITV Player and 4OD.

1.9 In past regulatory inquiries the significant competition faced by retailers of pay TV services from FTA services has been ignored or significantly downplayed, being labelled as supplied outside the "*relevant market*"[2], normally for inappropriate and/or incorrect reasons (such as the fact that they have different characteristics, or are financed differently). In the current review, Ofcom should have regard to the objective reality of competition between the FTA and pay TV sectors in the UK, which is a key driver of the positive outcomes delivered by the UK audiovisual sector.

The pay TV sector is intensely competitive

1.10 There is an implicit proposition running through the Consultation that competition in the pay TV sector is not effective. Even if a narrow focus on the pay TV sector is adopted (which is inappropriate) this is not sustainable on the facts.

<u>The retail level</u>

1.11 Competition among retailers of pay TV services in the UK is intense. As discussed further below, entry by BT and TalkTalk as fully-fledged pay TV retailers in the past few years has meant that half of UK consumers now have a choice of four 'traditional' pay TV retailers,

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[2] The principal exception was the Competition Commission's inquiry into Sky's purchase of shares in ITV, in which pay TV and FTA TV services were found to be supplied in the same relevant market at the retail level. See paragraph 14, 'Acquisition by British Sky Broadcasting Group PLC of 17.9 per cent of the shares in ITV PLC', Competition Commission, December 2007.

with the other half having a choice of three retailers.[3] There are few if any countries in the world where that is the case.

1.12 In addition, the ability to deliver pay TV services on an OTT basis means there are low barriers to entry and expansion in the sector. New pay TV retailers are now able easily to enter using a wide range of IP-based platforms to deliver services to consumers, or supply their own cheap and readily available IP-based set top boxes, such as the set top box ("STB") recently launched by EE or the NOW TV box retailed by Sky for £9.99.[4] This is clearly demonstrated by Netflix's entry and expansion in the UK.

The wholesale level

1.13 There is also strong competition among broadcasters of pay TV channels and, increasingly, among broadcasters and providers of subscription video on demand services, such as Netflix and Amazon (operating in an upstream capacity, rather than as pay TV retailers).

1.14 The most straightforward indicator of the strength of competition at this level of the sector is rising prices for content rights. The cost of rights to most types of content has increased significantly in recent years. This is most obviously the case in relation to sports rights, where the amounts paid by broadcasters are often made public. As is now well known, strong competition between Sky and BT in the most recent auction of live rights to broadcast Premier League matches resulted in a 70% increase in the cost of those rights. Ofcom acknowledges the fact that the cost of sports rights has increased over time[5] without drawing the logical conclusion from this observation, namely that it reflects strong competition among broadcasters.

1.15 Increasing prices for content rights, however, is not limited to sports rights. Increasing competition has, for example, also driven up the cost of movie rights and rights to US television series.[6]

The UK audiovisual sector delivers excellent outcomes for consumers

A large amount of high quality programming and channels

1.16 The *raison d'être* of the audiovisual sector is to produce and deliver to consumers content which meets their diverse, highly differentiated preferences.

1.17 UK consumers have an enormous amount of content available to them, both broadcast and on demand, including content of the highest quality. Such content includes the best programming from around the world, including movies and made-for-television programmes, as well as a substantial quantity of UK-produced programmes. Many

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3 The proportion of UK consumers who have a choice of four traditional pay TV retailers could increase to around two thirds by 2020 as a result of Virgin Media's recently announced plans to increase its cable network coverage by a third. See http://about.virginmedia.com/press-release/9467/virgin-media-and-liberty-global-announce-largest-investment-in-uks-internet-infrastructure-for-more-than-a-decade.

4 There is an element of confusion in the Consultation in relation to various types of IP-based delivery of audiovisual services, and the differing types of IP-based services. For this reason, we have provided an explanation of these differences at Annex 4.

5 Heading preceding paragraph 3.33.

6 Nor is the impact of increased competition limited to the pay TV sector. For example, in 2014 the BBC's Director of Television indicated that it was struggling to compete with Netflix for content rights. See: 'BBC boss admits corporation is struggling with challenge of Netflix after streaming service 'blows them out the water' with bid for new show', Mail Online, 20 December 2014. (http://www.dailymail.co.uk/news/article-2881702/BBC-boss-admits-corporation-struggling-challenge-Netflix-streaming-service-blows-water-bid-new-show.html#ixzz3SlKJKXio.)

commentators consider that the quality of television series produced over the past 10-15 years, all of which have been available to UK viewers, merits the period being labelled as a second 'Golden Age' of television[7].

1.18 The choice of programming facing consumers at any point in time is now enormous. For, example, a household with a Sky DTH subscription which includes movies, and their set top box connected to a broadband network, has available to them via their set top box:

- around 320 broadcast television channels;
- up to 1,180 hours of programmes they can record on the hard drive of their set top box;
- 1,360 hours of Sky Movies on demand;
- 2,260 hours of movies and programmes available to rent or purchase;
- 1,740 hours of catch-up TV programmes; and
- 3,900 hours of programmes in TV box sets.

1.19 Such a household is also likely to be able to access programming delivered via services such as Netflix, Amazon Prime, and iTunes, increasing the breadth of the TV programmes and movies available to them.

1.20 UK consumers are extremely well served in terms of the services that lie at the heart of Ofcom's review, namely premium sports channels. Sky's sports channels are generally acknowledged to be of a very high quality, and have been at the cutting edge of sports broadcasting for many years. They provide consumers with an enormous range of live coverage of sports events, highlights shows, and magazine programming, catering for a wide variety of preferences in relation to watching sport on television. They are the product of many years of effort, investment and innovation.

1.21 In the current review, Ofcom should not lose sight of the basic fact that UK consumers are extremely well served in terms of the quantity and quality of audiovisual programming and television channels available to them.

A wide and increasing choice of platforms and devices

1.22 Whilst the fundamental consumer demand addressed by the audiovisual sector is being able to watch programmes that meet their tastes, consumers also have increasingly diverse preferences in relation to how and when they watch those programmes. Many customers now *expect* to be able to watch everything to which they have access on any video screen.

1.23 Again, UK consumers are extremely well served in this respect. They are able to access programming via a wide range of platforms, including terrestrial, satellite, cable, IPTV, 3G mobile, 4G mobile, and the internet (both via wireless (WiFi) and wired connections), and via a wide range of services and devices that utilise those technologies.

1.24 This plethora of choice has been described as follows:

> *"If the television story were to be splashed across the front page of tomorrow's newspapers, the headline may read: "Consumers are in control." The story beneath it may then go on to talk about how an ever-expanding array of channels, platforms,*

7 See, for example 'Barely Keeping Up in TV's Golden Age', The New York Times, 9 March 2014. (http://www.nytimes.com/2014/03/10/business/media/fenced-in-by-televisions-excess-of-excellence.html?_r=0.)

devices, experiences and choice is positioning consumers to dictate the future of television for the foreseeable future."[8]

In the pay TV sector, a wide range of packages is available at attractive prices

1.25 UK consumers have a large array of options available to them, at attractive prices, for paying to watch content in order to augment that which is available to them for free. In relation to 'traditional' pay TV packages – bundles of basic and premium channels – all the key suppliers offer consumers a menu of options, at varying price points, which are intended to appeal to a wide range of consumer preferences.

1.26 Consumers can also choose to augment FTA TV and pay TV packages with subscription on-demand services (such as Netflix and Amazon Prime), which tend to be offered at relatively low monthly fees, paid-for VOD services, and by purchasing content (*e.g.*, on DVD or Blu-ray disks, or electronic downloads).

1.27 As set out further below, the key providers of pay TV services in the UK are all now also fixed line telecommunications service providers, and therefore offer pay TV services as part of 'triple play' packages. Given that each provider tends to offer different (or differently priced and packaged) telephony and broadband services (*e.g,* in terms of broadband speed, usage caps *etc.*), this adds significantly to the menu of offers available to consumers.

1.28 Intense competition to attract and retain subscribers also leads to significant discounting of headline retail prices, either as acquisition or retention offers.

The sector is changing rapidly in ways that are difficult to predict

1.29 While many of the key trends in the sector – such as increasing delivery and consumption of content via IP - are relatively evident, the specific ways in which developments play out over time are difficult, if not impossible, to predict.

Rapid deployment and take-up of new technologies

1.30 We are now in an era in which technological development in relation to audiovisual services is rapid and pervasive. It is underpinned, in particular, by the 'start-up economy' in California, which in turn is supported by massive amounts of venture capital, with venture capital funds competing to back new firms.[9] Almost by definition, most key successful technological developments are difficult to predict.

1.31 The UK is among the most advanced countries in the world for the deployment and subsequent take-up by consumers of new technology related to audiovisual services. Indeed, the pace of change is such that, as noted in Section 4 below, analysis of this issue is often subject to significant 'hindsight bias' because novel technologies become an accepted part of the landscape so quickly that it is difficult to recall that, even a short time ago, they were in fact novel. The list of such technologies that have been introduced in the recent past is well-known, including digital TV, high definition TV, PVRs, internet-delivered linear and catch-up TV services, mobile TV services, and so on. Figure 1.1 shows clearly the

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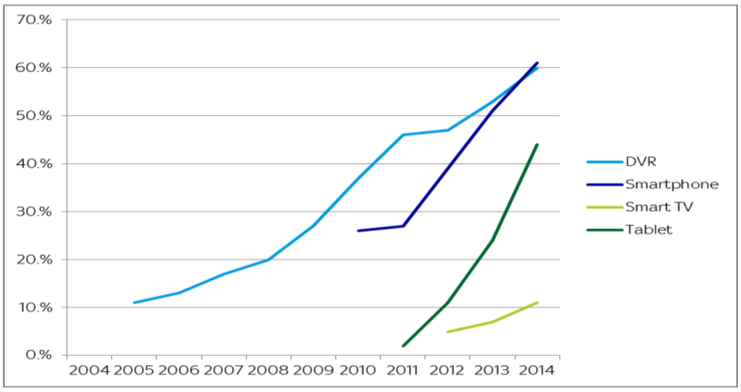
8 Page 4, 'Future of television: How M&E companies can prepare for a world where consumers are in control'. EY. (http://www.ey.com/Publication/vwLUAssets/EY_-_6_trends_that_will_change_the_TV_industry/$FILE/EY-6-trends-that-will-change-the-TV-industry.pdf.)

9 It is for this reason that Sky has opened an office in San Francisco, and has made a series of investments in technology-based small firms. For further details, see: 'Maintaining our innovative edge', Emma Lloyd, Business Development Director, Sky, October 2014. (https://corporate.sky.com/media-centre/our-blog/2014/maintaining-our-innovative-edge.)

rapidity with which new technologies related to the provision of audiovisual services are taken up in the UK.

Figure 1.1
UK household take-up of AV devices (% of individuals)



Source: Ofcom Communications Market Report, 2014, Figure 1.3

1.32 In relation to some audiovisual technologies, the UK is a world leader. For example, the UK has been a leader in the development of OTT services, such as the BBC's iPlayer and the Sky Player service. In relation to other technologies, there is generally little lag between their introduction in other countries and the UK. For example, the iPad went on sale in the US in April 2010, and at the end of May 2010 in the UK. Within four years, tablets were being used in half of UK households.[10]

US companies are expanding overseas

1.33 The rapidly increasing role of IP-distribution of content, and the fact that the some of the world's largest technology corporations (such as Google, Microsoft, Apple and Amazon) already have a significant presence in the audiovisual sector, mean the UK audiovisual sector is increasingly subject to competition from such firms. These firms operate at a scale that dwarfs UK-based operators. For example, in 2014 Apple's turnover was around £118 billion. They are able to spread their fixed costs, such as the costs of new product development, over sales at a global level, enabling them to develop, launch and market innovative new products quickly and continuously. The audiovisual services offered by these companies – from YouTube to iTunes – are now used heavily by UK consumers.

1.34 Not only are a number of these types of firms strong competitors to well-established media companies for rights to completed programmes and movies, they are increasingly integrating into original content production. Netflix, for example, has obtained significant publicity from its original productions, such as 'House of Cards' and 'Orange is the New Black'[11], Amazon is investing in both original TV series and movies[12], and YouTube is also

10 See 'Tablets swipe market share – now half of UK homes have one', Mintel, July 2014. (http://www.mintel.com/press-centre/technology-press-centre/tablets-swipe-market-share-now-half-of-uk-homes-have-one.)

11 See 'Netflix spend in the spotlight', Broadcast, 20 February 2105. This states: "*Netflix is on course to become the world's second largest buyer of content as it continues to disrupt traditional television….Worldwide its outlay would be second only to Disney-owned sports broadcaster ESPN….*" An analyst quoted in the article expects Netflix to spend £3.3 billion on content in 2016.

12 See, for example, 'Amazon Studios Confirms Deadline Scoop: Ted Hope Moving Streamer Into Original Feature Productions', Deadline Hollywood, 19 January 2015. (http://deadline.com/2015/01/amazon-studios-original-movies-ted-hop-transparent-jeff-bezos-1201353181/.)

reported to be investing in content for delivery via its platform[13]. Again, the fact that they are able to recover the predominantly fixed costs of content production over substantial international subscriber bases makes them formidable competitors.

New players have been able to grow and establish themselves quickly

1.35 It is now clear that new firms are able to establish themselves in the audiovisual sector, and grow quickly around the world, including in the UK. For example, Netflix only launched its streaming service in the US in 2007. It now has over 50 million subscribers across the world, with the majority of those being in countries outside the US. The latter includes over 3 million subscribers in the UK.[14] Netflix's physical presence in most of those countries is minimal; it is able, to a large extent, to operate its global business from its base in California. Few people in the UK had heard of Netflix four years ago.

1.36 In the Consultation Ofcom examines developments such as this through a narrow lens, seeking to determine whether such services comprise an alternative to 'traditional' pay TV services.[15] This misses the key point. Netflix's example shows the rapidity with which significant new pay TV services can be launched in the UK by large foreign firms, and grow successfully, using IP-based content delivery. This makes the future course of market developments for existing UK players extremely difficult to predict.

These changes are recognised in other contexts by Ofcom

1.37 Many of the issues described above are recognised by Ofcom in other activities that it carries out. For example, the following headings are taken from Ofcom's consultation on public service broadcasting, published around the same time as the WMO Consultation:

> "*This review takes place against the backdrop of rapid evolution of our media markets, shaped by the growth of the internet*"
>
> "*Audience needs and behaviours are changing*"
>
> "*People have access to a greater range of platforms and devices than ever before, increasingly internet-connected as standard*"
>
> "*For some people, the ability to access content whenever, wherever and on every device is increasingly an expectation rather than a desire.*"[16]

1.38 Similarly, Ofcom's discussion document on the future of free-to-view TV states:

> "*The market around FTV is changing*
>
> *Given the dynamism of the UK TV sector, free to view platforms are at an important moment in their development and a number of questions are emerging about the*

13 See, for example: 'YouTube Takes Out Checkbook Again, Pays Its Stars to Make Videos', re/code, September 18 2014. (http://recode.net/2014/09/18/youtube-takes-out-its-checkbook-again-and-starts-paying-its-stars-to-make-videos/.)

14 This figure is based on Sky estimates. Enders Analysis estimates that there were over 4 million paying Netflix subscribers in the UK at the end of 2014. See: 'End of Netflix tightrope just in sight', Enders Analysis, 26 January 2015.

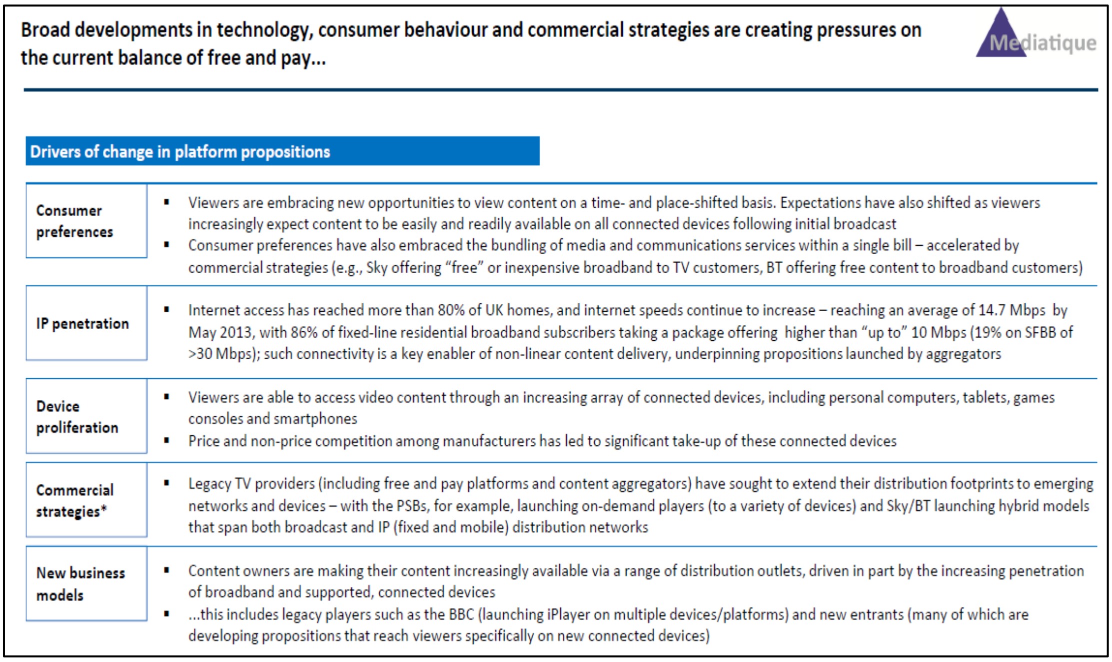
15 See in particular paragraph 6.42.

16 These are the headings preceding paragraphs 1.8, 1.13, 2.17 and 2.57 in 'Public Service Content in a Connected Society, Ofcom's third review of public service broadcasting', Ofcom, December 2014. (http://stakeholders.ofcom.org.uk/binaries/consultations/psb-review-3/summary/PSBR-3.pdf.)

evolution of the current models of delivery. In our analysis we have identified three key trends that are likely to be critical in understanding how free to view television will need to develop."[17]

1.39 The document identifies "*Greater levels of connectivity*", "*A drive for improved picture quality*" and "*Development of new services and pricing structures*" as the three key trends.

1.40 The report accompanying Ofcom's discussion document, produced by independent consultants, Mediatique[18], includes the following slide:



1.41 Mediatique concludes that the implication of these trends is that they "*are creating complexity in the platform market, enabling new routes to market and reducing barriers to entry*"[19]. Mediatique also states that "*acceleration in multi-platform and multi-device convergence*" is "*enabling convergence in content propositions and distribution options – creating a more complex environment*"[20].

1.42 Ofcom should, therefore, have greater regard to these factors in the context of its review of WMO regulation.

Summary and conclusions

1.43 A proper consideration of the relevant context for Ofcom's review shows that the UK audiovisual sector (a) is intensely competitive and delivers excellent outcomes for consumers, and (b) is changing rapidly in ways that make it even more competitive, increasingly complex and difficult to predict. These facts have two key implications for Ofcom's review of the WMO. First, they undermine a proposition that this is a sector in

17 'The future of Free To View TV, a discussion document', Ofcom, May 2014. (http://stakeholders.ofcom.org.uk/binaries/consultations/700MHz/discussion/ftv.pdf.)

18 'The development of free-to-view television in the UK by 2024', Mediatique, May 2014. (http://stakeholders.ofcom.org.uk/binaries/consultations/700MHz/discussion/Mediatique.pdf.)

19 Slide 19, *Ibid.*

20 Slide 20, *Ibid.*

which regulation by Ofcom is needed. Second, the rapidly changing nature of the sector, and the uncertainty about future events that entails, undermines Ofcom's proposition that Sky may choose to 'limit distribution' of its 'key sports channels' in order to achieve 'strategic benefits' in the future.

SECTION 2: DEVELOPMENTS IN THE UK PAY TV SECTOR SINCE 2010

Introduction

2.1 Section 3 of the Consultation sets out Ofcom's view of key developments in the UK pay TV sector since 2010.[21, 22] Although Ofcom does not explain the purpose of this analysis, Sky presumes that it is intended to comprise part of an assessment of whether there have been sufficient changes in the sector to warrant the removal of the WMO. If this is the case, Section 3 is of particular significance to the Consultation.

2.2 In general, Sky considers that Ofcom's analysis identifies the key developments in the UK pay TV sector over the past five years that are relevant to the current review.[23] In particular, Ofcom correctly identifies the following as important changes:

- BT's entry into the provision of premium pay TV sports channels;
- continued growth of broadband as a delivery mechanism for content and the launch of NOW TV; and
- bundling of pay TV with communications services.

2.3 Nevertheless, Sky also considers that Ofcom's analysis of these developments fails properly to appreciate their significance, and/or is somewhat incomplete. Accordingly, in this Section 2, we provide some additional comments on these changes.

2.4 In addition, given the focus of the Consultation on the distribution of Sky's sports channels, it is important that Ofcom has a clear appreciation of changes in the ways in which those channels are able to be delivered to consumers that have occurred over the past five years. This is particularly important in understanding whether there are any grounds for considering that Sky has 'limited' the distribution of its 'key sports channels', given the emergence of a number of new ways that they can be delivered to consumers. Accordingly, the final sub-section, below, sets out the key changes that have occurred in this respect.

2.5 Finally, Sky notes that the analysis set out in Section 3 of the Consultation comprises a rather undigested mix of (i) commentary on developments in the sector since 2010, and (ii) a number of unsystematic and partial observations on the current market, many of which are unfavourable to Sky or which fail to capture the impact of market developments on Sky. Ofcom's analysis, and the conclusions drawn from that analysis, would be clearer if (i) these two topics were considered separately, and (ii) Ofcom undertook a more systematic and balanced assessment of current market circumstances.

BT's entry into the provision of premium pay TV sports channels

2.6 BT's decision to build a premium pay TV sports channel business, and its successful execution of that strategy in a short space of time, is by a considerable margin the most

[21] Throughout Section 3 of the Consultation, Ofcom refers to "*the pay TV market*". Provided that this term is being used in its everyday sense, Sky does not object to such use. As Ofcom is aware, Sky does not accept that "*the pay TV market*" comprises a relevant market in the sense in which that term is understood in competition law.

[22] Section 3 of the Consultation seeks to identify "*key developments*" in the "*pay TV market generally between 2010 and now*". It is evident that these are in fact intended by Ofcom to be key developments in the sector that are *relevant to the issues raised by the current consultation* as there have been numerous important developments in the UK pay TV sector more broadly that are not discussed in Section 3 of the Consultation – for example, Sky's decision to begin investing heavily in original content such as television drama, and the growth of that investment over time, or Virgin Media's decision to exit as a pay TV channel broadcaster.

[23] Sky notes, however, that it would be erroneous to regard growth in pay TV revenues or subscriber numbers as a "*key development*" in the sector over this period.

important development of relevance to Ofcom's review to have occurred over the past five years.

2.7 From a position of having no involvement in the television broadcasting sector, no relevant assets, and no rights, it has taken BT less than three years to develop three highly successful premium pay TV sports channels, carrying a wide range of sports content. Since June 2012 BT has (i) acquired rights to a large amount of valuable sports content, (ii) launched two channels across DTT, IPTV, satellite, cable and the internet; (iii) acquired ESPN's UK channel business, and established a long term relationship with ESPN[24], which is the largest sports broadcaster in the world, (iv) built broadcasting studios, (v) acquired top broadcasting 'talent', and (vi) acquired around five million subscribers to its channels[25].

2.8 As Ofcom is aware, in November 2013 BT successfully outbid Sky and ITV for the exclusive rights to the UEFA Champions League and Europa League from 2015/16, the first time that UEFA has been persuaded to license its UK rights to a single broadcaster.

2.9 BT has a number of strengths that have helped it successfully expand into sports broadcasting, including:

- deep pockets: BT earns revenues of over £18 billion per annum, with profits before tax of around £3 billion annually. Free cash flow, after capital expenditure is over £2.6 billion per annum, and is growing over time. BT has stated publicly on a number of occasions that its expenditure on content rights is easy for it to afford[26];
- a strong brand: BT is a reputable, well-recognised household name; and
- an innovative model for financing rights: BT identified an opportunity to use premium content as a way of retaining customers to its highly profitable telephony and broadband services, and to win back such customers from competitors.

2.10 In the Consultation, however, this development is spread across two different sections ("*BT has expanded its operations…*" and "*BT has acquired major sports rights…*") and Ofcom appears intent on downplaying its importance – for example, by adding to the latter section title "*… but Sky continues to hold the majority of sports rights*", describing the impact of BT's acquisition of Champions League rights as "*modest*"[27], and asserting – in the face of direct evidence to the contrary – that it is "*not clear*" whether BT is able to compete effectively with Sky for sports rights[28].

2.11 This is both incorrect and entirely inappropriate. Ofcom should not dismiss or attempt to downplay the importance of BT's successful entry into premium sports broadcasting. This

24 See: 'BT Sport and ESPN extend deal', 22 January 2015. (http://sport.bt.com/sport-football/news/bt-sport-and-espn-extend-deal-S11363956012885.)

25 BT Group plc, Results for the fourth quarter and year to 31 March 2014', May 2014. (http://www.btplc.com/news/articles/showarticle.cfm?ArticleID=b37789ab-6ae4-4dbf-861d-ef6f8e07f8e0.)

26 For example, BT's CEO, Gavin Patterson, is quoted as having said: "*We have the financial muscle. This is an investment we can afford to make without betting the farm.*" 'A question of sport in the British pay television market', The Independent, 13 May 2013. (http://www.independent.co.uk/news/media/opinion/ian-burrell-a-question-of-sport-in-the-british-pay-television-market-8613220.html.) A similar article states: "*It's a big bet, don't get me wrong. A billion quid over three years is not to be sniffed at," says Patterson with a slight swagger. "But in the scale of BT's business, it's of the order of 10% of our free cash flow.*"" 'BT Retail boss set on challenging Sky for the title in sports broadcasting', The Guardian, 10 May 2013. (http://www.theguardian.com/business/2013/may/10/bt-challenging-sky-sports-broadcasting)

27 Heading above paragraph 6.27.

28 See, for example, paragraph A8.13.

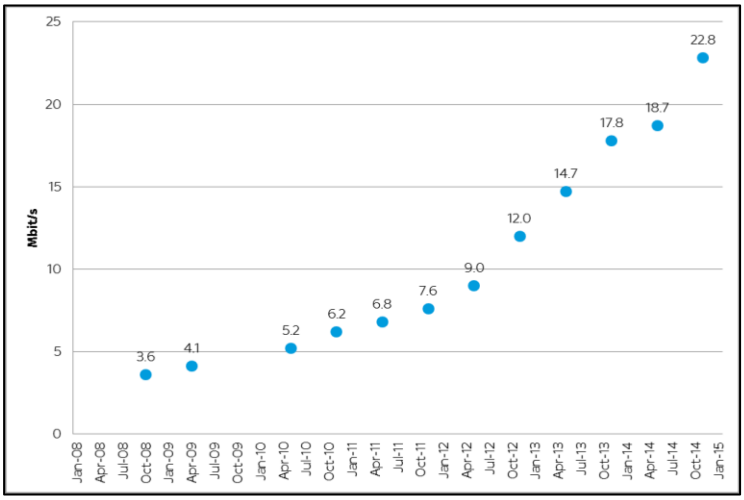
development indicates clearly that barriers to entry to this activity are not insurmountable, even for a firm that has no experience or relevant assets in that activity. [29]

Continued growth of broadband as a delivery mechanism for content and the launch of NOW TV

2.12 While delivery of audiovisual programming to end users 'over the top' ("OTT"), or via the 'open internet' in the UK was well established by the time of Ofcom's Pay TV Statement[30], it has continued to grow significantly over the past five years. This has been driven by a 'virtuous circle' which links device availability, service availability and consumer awareness of the ability to access programming via broadband on their TV sets.

2.13 This virtuous circle has been enhanced by growth in consumer take-up of broadband services, and increasing speed of broadband connections. A large majority, nearly 80%, of UK households, now have the ability to receive high quality audiovisual services via their internet connection. And over the past five years the average speed of broadband services actually delivered to consumers (as opposed to advertised headline rates) has increased over four-fold, from around 5 Mbit/s in 2010, to nearly 23 Mbit/s at the end of 2014. Figure 2.1 below is based on Ofcom data that measures the average speed of UK broadband services.

Figure 2.1
Average broadband speed received by UK households



29 We address the proposition that Sky's advantages in bidding for sports rights comprise a barrier to entry at this level of the sector further at Annex 2 of this response.

30 For example, Ofcom's 2010 Communications Market Review stated:

> "*Since the launch of early services by Sky, Five and Channel 4 in 2006, all major broadcasters now offer catch-up services, but it was the launch of BBC's iPlayer in December 2007 that seemed* (sic) *drove awareness in these services, and their popularity grew throughout 2008. The 2009 Communications Market Report highlighted that online catch-up TV services showed signs of becoming a mainstream form of audio-visual content consumption. Monthly iPlayer streams had trebled in a year, innovation was continuing, and access was widening to more platforms – with content increasingly delivered to the TV as well as the computer screen. The rapid growth in online catch-up TV continues, and is spreading to a broader range of devices.*" (Page 103.) (Sky notes that its Sky Player service referred to by Ofcom was not a "*catch-up service*".)

2.14 This change has two main implications for Ofcom's review. First, it means that barriers to entry at the retail level of the sector have fallen significantly. Firms no longer have to invest in full pay TV platforms in order to enter the sector at the retail level.

2.15 Second, it exposes players in the UK to the types of developments set out in Section 1 – competition from extremely large international operators, who are able to leverage their global scale.

NOW TV

2.16 Section 3 of the Consultation also includes a very brief discussion of NOW TV. This discussion, however, fails to appreciate its significance.

2.17 Sky has delivered its sports channels on an OTT basis for almost ten years, initially via the service that in 2010 was marketed as Sky Player. The Sky Player service was one of the first linear OTT pay TV services in the world, delivering a wide range of pay TV channels (both Sky's and third parties'). Sky Player was a standalone subscription service (*i.e.*, it was not like the current Sky Go service, which enables subscribers to Sky's DTH satellite service also to watch the channels to which they subscribe via the internet). It mirrored the packaging structure of Sky's DTH satellite service, with premium channels sold as add-ons to a basic package, although charges were £2-£3 cheaper than Sky's DTH packages. Given the relatively undeveloped nature of delivery of content via broadband for much of this period, Sky did not invest significantly in marketing the service.

2.18 NOW TV, which launched in July 2012, is based on a significantly different business model. Whilst, like Sky Player, it is a standalone subscription service delivering linear pay TV channels on an OTT basis, it is targeted at the millions of UK households who have rejected 'traditional', fully-fledged pay TV subscriptions. NOW TV has the following key features:

(i) it provides (a) a wide range of linear pay TV channels, both Sky's and third parties, and (b) a substantial volume of content on an on-demand basis, including 'box sets' of TV series;
(ii) it has no subscription contract, and in particular does not have an initial minimum 12 month subscription period;
(iii) it is offered under an entirely new brand, in order to differentiate it from Sky's DTH service;
(iv) premium channels are provided in standalone packages, rather than on the basis of a 'buy-through' from basic packages;
(v) Sky's sports channels are made available via NOW TV on the basis of a day pass, or a weekly pass[31];
(vi) customers can therefore subscribe for a month at a time, in the case of the entertainment and movie packages, or on a daily or weekly basis in the case of the Sky Sports channels;
(vii) it is available via a wide, growing range of devices which are described further below. NOW TV retails a set top box for £9.99 that can be used to receive the service, making it very cheap to try out;
(viii) the NOW TV box also provides access to the PSB 'players' (the BBC's iPlayer, ITV Player, 4oD and Demand Five); and
(ix) Sky has invested significant amounts in its marketing.

2.19 NOW TV provides an important new means by which Sky is able to expand the number of subscribers to its sports channels. It is a significant innovation in the distribution of those

[31] **[CONFIDENTIAL]**

channels, maintaining Sky's strong track record in delivering innovative new services to consumers.

Growth in the importance of triple play competition

2.20 Ofcom notes that bundling of pay TV with communications services is more prevalent than in 2010.[32] The key change that has occurred over the past few years in this respect is that both BT and TalkTalk have joined Sky and Virgin Media in supplying triple play packages that include full pay TV propositions.[33] Half of UK homes are now served by four triple play providers, and the other half by three.[34]

2.21 This has led to competition for triple play customers becoming one of the key focal points of competition among Sky, Virgin Media, TalkTalk and BT. Part of the effect of this competition can be seen in Figure 3.3 of the Consultation, where, as Ofcom notes, the percentage of UK households taking a triple play service increased from 17% in Q1 2010 to 23% in Q1 2014. In 2013/14, for example, around **[CONFIDENTIAL]** % of new Sky subscribers took a triple play package.[35]

2.22 Competition for triple play customers in the UK is intense. Competition is focused on seeking to win customers from other operators, *i.e.*, to switch supplier, and it is heavily 'offer led', with firms competing in the offers they provide to consumers. Annex 8 includes marketing by BT, Virgin Media and TalkTalk that indicates the focus on triple play propositions.

2.23 As Ofcom notes, the ability to offer consumers 'quad play' services is also developing quickly. Both Virgin Media and TalkTalk already offer their customers mobile telephony services in addition to broadband, telephony and pay TV, and Sky and BT have also announced their intentions to begin providing mobile telephony services in the future. Furthermore, Vodafone has also announced its intention to offer fixed broadband, telephony and pay TV services to its mobile customers in 2015.

Changes in the ways in which Sky's 'key sports channels' are able to be delivered to consumers

2.24 The issue of the range of platforms via which 'key sports channels' *are able in practice to be distributed* is central to any analysis of whether there is 'limited distribution' of Sky's 'key sports channels'. There is, however, no clear description of platform developments in the past five years in the Consultation.

2.25 In March 2010 it was possible to distribute Sky's sports channels via the following platforms in the UK:

(i) Sky's DTH satellite platform;
(ii) Virgin Media's cable platform, and a number of smaller cable networks in the UK;
(iii) TalkTalk's IPTV platform (purchased from Tiscali TV in May 2009);
(iv) BT's Cardinal platform, via DTT – BT's Cardinal platform at that time could not deliver linear television channels via IPTV;

32 For example, the heading preceding paragraph 3.17.

33 As set out below, BT and TalkTalk did not begin to offer full pay TV services until 2012, less than three years ago.

34 This reflects the fact that Virgin Media's cable network currently covers half of UK homes. As noted above, however, Virgin Media has announced plans to extend its network coverage to around two thirds of UK homes.

35 This includes all sales of telephony, broadband and DTH pay TV packages to *new subscribers*. If upgrades also were included (*e.g.*, a TV-only customer upgrading to take broadband and telephony from Sky) the number of sales of triple play packages would be significantly higher.

(v) TopUpTV's platform, via DTT;
(vi) 3G mobile networks; and
(vii) via the internet, to a range of end-user devices, such as Xbox 360s, PCs and laptops.

2.26 The key changes in relation to this list since 2010 are as follows:

(i) in early 2011 TalkTalk ceased taking new subscribers on the Tiscali TV platform, which suffered from significant technical limitations[36];
(ii) during 2012 BT upgraded its Cardinal platform in order to enable it to be able to deliver linear television channels via IPTV. BT began delivering linear television channels (including Sky Sports 1 & 2) via IPTV to Cardinal set top boxes if they were connected to its fibre network in early 2013;
(iii) the YouView 'platform' (comprising three different variants, namely BT's, TalkTalk's and YouView set top boxes sold in retail stores) launched in Q3 2012[37]. It had been intended that YouView set top boxes would be able to receive linear television channels delivered via multicast IPTV networks and unicast (OTT) delivery. However, to date, unicast delivery has not been enabled by YouView. Currently, linear television channels can only be delivered to BT and TalkTalk YouView boxes via their multicast networks;
(iv) 4G mobile services were launched by EE (in October 2012) followed by O2 and Vodafone (in August 2013), and 3 (in December 2013);
(v) TopUpTV ceased operating in October 2013;
(vi) in December 2014 BT announced that it is no longer adding new subscribers to its Cardinal platform, and will seek to migrate existing Cardinal subscribers to its YouView platform[38]; and
(vii) there has been ongoing expansion in the range of IP-based platforms that carry linear television channels on an OTT basis (for example, iPads[39] and other tablets, new connected TVs, new games consoles, Roku set top boxes, Apple TV, Google Chromecast, *etc.*).

Summary and conclusions

2.27 Section 3 of the Consultation sets out Ofcom's views on important changes that have taken place since 2010 that are relevant to its review of the WMO. Whilst Ofcom has identified the key changes, its appreciation of them appears somewhat incomplete. The most significant change has been BT's successful entry into broadcasting of premium sports channels. This demonstrates clearly that a belief that there are significant barriers to entry to this activity is unfounded. Ofcom appears not fully to appreciate the launch of Sky's NOW TV service, which is a major new innovation, nor the fact that the ease of delivery of audiovisual services via the internet has (i) significantly lowered barriers to entry at the retail level of the sector, and (ii) exposed the UK audiovisual sector to greater competition from overseas players. Finally, Ofcom does not appear fully to appreciate the fact that competition among BT, Sky, Virgin Media and TalkTalk has, in the recent past, become focused on competition for triple play customers. This is also a significant new development in the sector.

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36 See: 'TalkTalk Plus TV', Wikipedia. (http://en.wikipedia.org/wiki/TalkTalk_Plus_TV.)

37 TalkTalk's and BT's YouView platforms launched at slightly different dates. TalkTalk launched its YouView platform in September 2012, while BT launched its YouView platform the following month.

38 See: 'BT TV launches Sky Sports 1 and Sky Sports 2 on YouView', BT press release, 16 December 2014. (http://www.btplc.com/news/Articles/ShowArticle.cfm?ArticleID=81A969F4-BB68-44B1-98DC-820395D7085F.)

39 The iPad was launched in the UK in May 2010.

SECTION 3: THE LEGAL FRAMEWORK FOR OFCOM'S REVIEW

Introduction

3.1 In **Part A** of this Section, we set out the legal framework for Ofcom's review of the WMO. This includes the legal tests that Ofcom would need to satisfy before it could legitimately determine that it should continue to regulate Sky's supply of its sports channels pursuant to its section 316 powers.[40]

3.2 When Ofcom's approach in the Consultation is held up against the proper framework (as is done in **Part B** of this Section), it is clear that Ofcom is carrying out its review on a flawed basis. It reveals serious deficiencies in Ofcom's appreciation of the tests that must be met for continued intervention under section 316 to be justified. Contrary to Ofcom's view, the analysis and assessment in the Consultation do not provide the legal basis for Ofcom to continue to impose the WMO (or any other regulation) on Sky.

PART A: CONDITIONS FOR THE LEGITIMATE EXERCISE OF SECTION 316

Section 316 is to be used to protect competition, not to promote competition or manage markets

3.3 It is important for Ofcom to conduct its review on the basis of a proper appreciation of the purpose for which its section 316 powers may be exercised. The Consultation betrays an understanding of the objectives which may be pursued using section 316 which is wrong in law. A striking example of Ofcom having fallen into this error is its improper view that strengthening BT could be a legitimate objective of the application of section 316.

3.4 The WMO obligations were imposed on Sky in 2010 under section 316(2), which provides the legal framework for Ofcom's current assessment. It permits the imposition of conditions in connection with the provision of licensed services:

> *"that OFCOM consider appropriate for securing that the provider of the service does not -*
>
> *(a) enter into or maintain any arrangements, or*
> *(b) engage in any practice,*
>
> *which OFCOM consider, or would consider, to be prejudicial to fair and effective competition in the provision of licensed services or of connected services."*

3.5 Thus section 316 may be used by Ofcom to protect competition by preventing a provider of licensed services from engaging in a 'practice' prejudicial to fair and effective competition. For Ofcom to intervene, it must be clear that the practice identified would harm competition in the provision of the relevant services.

3.6 There is a clear difference between (i) securing (including on an *ex ante* basis) that a provider does not enter into practices which are prejudicial to fair and effective competition and (ii) seeking to promote competition by imposing requirements designed to result in structural changes which it is hoped might inject additional competition into a market. Section 316 cannot be read as giving Ofcom a power to act as it thinks best to *promote* competition; still less does it entitle Ofcom to promote the interests of a particular firm within a sector.

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40 This framework applies equally to Ofcom's consideration of whether BT's distribution of key sports content should be regulated, discussed further in Section 5 below.

Ofcom must identify a practice prejudicial to fair and effective competition

3.7 Section 316 (2) contains two requirements which must be met if Ofcom is to intervene on the grounds of ensuring fair and effective competition:

(i) the first requirement is that Ofcom must *identify a practice* which exists or will exist in the future, absent regulatory intervention; and

(ii) the second requirement is that Ofcom must establish that *the practice identified is, or would be, prejudicial to fair and effective competition* in the provision of a licensed service (or connected service).[41]

3.8 Ofcom cannot proceed to impose or maintain licence conditions under section 316 unless it has established both elements (practice and consequential prejudice to competition) to the requisite standard.

3.9 Ofcom is reviewing the WMO in line with its duty under section 318 of the Act to review conditions imposed for a competition purpose under section 316. This does not change the requirements on Ofcom. A decision by Ofcom to maintain regulation must be justified on the same basis as a decision to impose regulation *ab initio*. That is logical: in order to maintain regulation, Ofcom must be sure that there is reason to expect a practice that will harm competition. It cannot simply rely on having had that expectation in the past when the regulation was imposed.[42]

The standard and burden of proof

3.10 The standard of proof for exercising Ofcom's powers under section 316 is the civil standard of the balance of probabilities. This means that Ofcom must, as a minimum, reach a view on the evidence that the practices in question (and the consequential harm to the competitive process) are *likely* - that is, more likely than not.[43] A merely theoretical or abstract risk of a future practice prejudicial to competition does not justify regulation.

3.11 Thus, in the present case, continued regulation on the grounds of Ofcom's concern is justified only if it is more likely than not that, absent regulation, Sky will engage in a practice of withholding supply of its key content from subscribers of rival retailers and such practice will prejudice fair and effective competition.

3.12 When determining whether regulation is required (including whether it is required to be maintained) to prevent a practice prejudicial to fair and effective competition, the burden of proof rests squarely with Ofcom. Ofcom must establish the case for regulation on the basis of cogent analysis and evidence capable of withstanding rigorous scrutiny which support both Ofcom's identification of a likely practice and the proposition that the practice would be prejudicial to fair and effective competition.

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41 See paragraph 159 of the CAT's Pay TV judgment.

42 Even assuming, contrary to Sky's position, that Ofcom was correct in the first place, which, in so far as the WMO was imposed because of fears akin to the 'limited distribution' theory which underlies the current Consultation, it was not, as the Tribunal has authoritatively concluded – see below for the relevance of this.

43 Ofcom appears to recognise that this is the appropriate test at paragraph 4.17 of the Consultation, which states: *"[t]he decision as to whether or not a particular practice is likely to arise"* (emphasis added) (although, as we discuss further below, this is not in fact the standard to which Ofcom holds itself in the Consultation). Similarly, in the context of the appeals of Ofcom's Pay TV Statement, Ofcom referred to the necessity to demonstrate that "*Sky's conduct was likely to persist if not prevented*" (paragraph 260 of Ofcom's Closing Submissions, Part 1).

3.13 In assessing whether there is a case for regulation, Ofcom should also have due regard to the nature of that regulation. The WMO (compulsory licensing with charge controls) is highly intrusive and confiscatory.[44]

Ofcom's duties

3.14 Ofcom has a duty to have regard, in all cases, to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.[45] This requires it to adopt the position that regulation should not continue to be imposed unless a compelling case has been made that it is required.[46] It also requires Ofcom to demonstrate that the identified adverse effect on competition is sufficiently important to justify any intervention proposed to address it, which must be the minimum necessary to address Ofcom's competition concerns. Furthermore, Ofcom must be consistent in its exercise (and non-exercise) of its section 316 powers.

3.15 Additionally, Ofcom is under a duty to keep the carrying out of its functions under review with a view to securing that its regulation does not involve the maintenance of burdens that have become unnecessary.[47]

3.16 Ofcom's duty under section 318 to review regulation such as the WMO underlines the intrusive nature of the exercise of Ofcom's sectoral powers for competition purposes and the principle that regulation should stay in place only if, and for so long as, it is clearly justified.

Ofcom must take account of all relevant facts and evidence

3.17 Ofcom is required to take account of all relevant facts and evidence when assessing the need for regulation, as recognised by Ofcom's stated regulatory principle to strive to ensure its interventions will be evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome.[48]

3.18 When assessing the likelihood of 'limited distribution' of 'key content', and the impact of 'limited distribution' on competition, therefore, Ofcom must take proper account amongst other things of the CAT's unchallenged and authoritative findings in its judgment in the appeals against Ofcom's decision to impose the WMO obligations.[49] The CAT's findings are directly relevant to the analysis of Sky's past and current supply arrangements and how Sky could be expected to approach the distribution of its key sports content in the absence of regulation (as well as to the assessment of the potential impact of any 'limited distribution' on competition).

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44 As was recognised by the CAT: "*the regulatory action in question was undeniably commercially intrusive, depriving Sky of any choice as to the person to whom, and the prices at which, it would wholesale its premium sports channels*." (British Sky Broadcasting Limited, Virgin Media, Inc, The Football Association Premier League and British Telecommunications plc v Office of Communications, [2013] CAT 9, paragraph 57.)

45 Section 3(3)(a) of the Act.

46 As Ofcom is aware, Sky's view is that the WMO has never been needed in order to ensure fair and effective competition. But regardless of whether the WMO was imposed in 2010 on the basis of a legitimate concern, Ofcom is required to determine, when conducting the current review, whether there is a legitimate case for any continuing regulation at this point in time.

47 Section 6(1) of the Act.

48 See: http://www.ofcom.org.uk/about/what-is-ofcom/statutory-duties-and-regulatory-principles/.

49 See 'British Sky Broadcasting Limited, Virgin Media, Inc, The Football Association Premier League and British Telecommunications plc v Office of Communications', [2012] CAT 20 (the "Pay TV judgment"), in particular paragraphs 27 – 38, 496, 807-815 and 824-832.

3.19 Ofcom must also accord due weight to the evidence provided by the scope and term of Sky's current supply arrangements in respect of its key sports channels.

PART B: OFCOM HAS NOT SATISFIED THE REQUIREMENTS FOR REGULATION UNDER SECTION 316

3.20 We now consider Ofcom's approach to determining whether it is appropriate to continue to regulate the supply of Sky's key sports content. As we will show, Ofcom's approach reveals a fundamental misapprehension of the tests that must be satisfied if Ofcom is to make a case for maintaining regulation on Sky. Contrary to Ofcom's apparent view, an assessment on this basis cannot satisfy the requirements for regulation under section 316.

Ofcom has misdirected itself in relation to the purpose of section 316

3.21 It is plain from the Consultation that Ofcom's main pre-occupation is with engineering conditions which will favour the growth of BT's pay TV subscriber base, apparently in the belief that this will result in more effective competition to Sky.[50] Ofcom seeks to deliver an advantage to BT through the combination of regulated supply of Sky Sports (pursuant to a highly speculative theory of potential 'limited distribution' by Sky) and regulatory forbearance in respect of BT's non-supply to TalkTalk. Ofcom anticipates that this inequality of treatment will enable BT to achieve a stronger market position than might otherwise be possible. Ofcom states:

> *"…limited distribution of BT Sport could allow BT to grow its BT TV subscriber base and monetise sports rights more successfully than it otherwise would have. In the medium to long term, this could give BT a chance to overcome the barriers to expansion and act as a more effective competitor to Sky."*[51]

3.22 This type of objective of structural market management is not a legitimate use of section 316. It cannot properly be employed to promote BT as a competitor so as to facilitate Ofcom's vision of the way in which the market ought to operate and develop. To maintain regulation under section 316, Ofcom would need evidence demonstrating the likelihood of a practice that would damage competition. Simply identifying the potential for a better competitive outcome from Ofcom's perspective (*e.g.* a stronger BT) does not provide any legal basis for continued regulation.

Ofcom has failed to establish a practice prejudicial to fair and effective competition

Ofcom has not properly identified a practice

3.23 Ofcom claims to have identified a risk of two types of practice occurring which would be prejudicial to fair and effective competition in the provision of pay TV services both of which are described by Ofcom in the phrase 'limited distribution'. The first practice is, in essence, the non-supply of key sports content on either a wholesale or self-retail basis to

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50 Although Ofcom does not purport to assess the effectiveness (or otherwise) of competition in pay TV, there is a strong sense in the Consultation of Ofcom's dissatisfaction with the current market structure. This is focused on Sky's market position and perceived incumbency advantages, as well as what is characterised by Ofcom as BT's relatively modest position. See, for example, paragraphs 3.50, 6.45, 6.55 and 7.17.

51 Paragraph 6.69.

a rival platform. The second practice is described by Ofcom as: *"supply on terms that do not allow fair and effective competition"*[52].

3.24 In relation to the second, Ofcom has nowhere particularised its concern in relation to terms of supply, however. In Section 7, Ofcom sets out only very broad, general and brief descriptions of possible 'forms' of the practice of 'supply on terms that do not allow fair and effective competition'.[53] Ofcom does not identify anywhere in the Consultation specific terms of supply that would be problematic, other than to theorise that 'high' wholesale prices might amount to 'limited distribution'.[54] Nor has Ofcom identified any particular terms in Sky's distribution arrangements (current or past) which cause it concern. It is impossible for Sky to respond properly to such a non-specific concern.

3.25 In any event, there is no basis advanced in the Consultation for intervention in respect of any practice other than non-supply. If Ofcom intended to rely on any other form of 'limited distribution' as grounds for regulating the supply of Sky's channels, Ofcom would need to consult properly on its assessment of both the likelihood and impact on competition of a specific practice.

3.26 We show in Section 4 below that Ofcom has not established to the requisite standard that there is likely to be non-supply of Sky's key sports content in the future, absent regulation. Thus Ofcom has failed to satisfy the first limb of the substantive test for the use of its section 316 powers. That, alone, is fatal to Ofcom's proposition that it may be appropriate to regulate Sky on the basis of its assessment.

3.27 Strictly speaking, therefore, there is no need for Sky to engage with Ofcom's analysis of the impact on competition of 'limited distribution' of Sky's content. In the circumstances, we comment below only briefly on that aspect of the Consultation.

Ofcom has not established that 'limited distribution' of Sky's sports channels would be prejudicial to fair and effective competition

3.28 Even if Ofcom were to establish that Sky was otherwise likely to 'limit distribution' of its channels, Ofcom could not properly reach a view that it would be appropriate to continue to regulate Sky without also establishing that this was required in order to prevent prejudice to fair and effective competition.

3.29 The assessment in the Consultation of the impact of purported 'limited distribution' of Sky's 'key sports channels' falls well short of the standard required for it to form the basis for Ofcom's intervention. It exemplifies Ofcom's disregard for the burden on it to prove that regulation is required. For current purposes, we highlight only some key shortcomings:

(i) Ofcom has not specified the nature of the 'limited distribution' of Sky's 'key sports channels' which it considers is likely to occur, and the impact of which it should therefore assess; rather, its assessment is so broad in scope that it essentially purports to encompass the impact of 'limited distribution' (in any form) of Sky's 'key sports channels' to <u>any</u> one or more 'traditional pay TV retailers'. This is not a lawful approach, as it does not permit Ofcom to demonstrate that regulation is

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52 Paragraph 7.3. Elsewhere it is described as *"distribution of key content but on terms which would not enable rivals to compete effectively in pay TV retailing or potentially other parts of the value chain"* (paragraph 1.6), and *"distribution of key sports content* [on] *unfavourable terms to competing providers of pay TV services"* (paragraphs 8.7, 8.11 and 8.14).

53 Paragraph 7.3 and footnotes 184 and 185.

54 Footnote 184 and paragraph 8.6. We address this issue in Section 4, below.

required to safeguard fair and effective competition. Nor can such an approach enable Ofcom to satisfy its duty to ensure that its regulation is proportionate and targeted only at cases in which action is needed.

(ii) Even under its inappropriately broad approach, Ofcom has not advanced any concrete or evidenced analysis of the harm to competition that it asserts would result from 'limited distribution of Sky's key sports channels'. Ofcom states that rival platforms unable to offer Sky's 'key sports channels' *"may face difficulties in competing for a sizeable proportion of subscribers"*[55] but Ofcom's consideration of the potential impacts on static and dynamic competition (which spans fewer than ten paragraphs)[56] does not rise above the level of unsubstantiated theorising. It is certainly wholly inadequate to justify Ofcom's assertion that its analysis *"suggests that a decision by Sky to limit distribution of this content would be likely to prejudice fair and effective competition between pay TV retailers"*[57]. Ofcom has neither particularised the consequences that it fears, nor put forward the necessary evidence to support the proposition that this would amount to a material impact on the competitive process. It is no defence that assessment of the impact is *"difficult as it depends on a number of factors"*[58].

(iii) Ofcom's analysis of competition between pay TV retailers is too restricted in scope. Ofcom's position seems to be that section 316 provides a narrow prism through which competition is to be viewed only in relation to pay TV services.[59] Whilst it may be correct that Ofcom's central focus in this review should be on retail pay TV, Ofcom cannot properly disregard competition in the retailing of communications services when seeking to determine the impact of 'limited distribution of key content' on competition in the retailing of pay TV services. By adopting this 'silo' approach in relation to competition in the retailing of pay TV services, Ofcom misses the importance and impact of triple play competition which, as we explain above, is a key focus of competition between companies operating in the market. Ofcom's analysis does not properly reflect the complexity of how competition in retail pay TV operates now, nor how it is likely to operate in the future.

Ofcom has failed to satisfy the necessary standard of proof

3.30 Ofcom has set the bar too low for establishing a concern that provides a legitimate basis for its continued regulation of Sky. Ofcom has not sought to establish whether 'limited distribution of Sky's key sports channels' prejudicial to fair and effective competition would be *likely* to occur if the WMO was removed; instead, Ofcom appears to proceed on the basis that merely identifying a *risk* (of any magnitude) that Sky *may* engage in such a practice would be sufficient.

3.31 That this is Ofcom's approach is well illustrated by the *'Conclusions and next steps'* section of the Consultation:

> *"In light of our view that <u>there may be circumstances in which</u> Sky has incentives to engage in such practices... we believe it <u>may be appropriate</u> to maintain some form of*

[55] Paragraph 6.65.

[56] Paragraphs 6.57 to 6.65.

[57] Paragraph 6.70.

[58] Paragraph 6.59.

[59] See footnote 190.

regulation on Sky with the objective of ensuring fair and effective competition"[60] (emphasis added).

3.32 Ofcom's flawed approach to the legal basis for maintaining regulation on Sky is also reflected in the conclusions in the Consultation. Even at its most categorical, Ofcom's assessment of the likelihood of 'limited distribution' arising goes no further than identifying a risk: Ofcom claims, at Paragraph 8.7 to have *"identified a risk of two types of practice occurring which would be prejudicial to fair and effective competition"*; at paragraph 7.38, Ofcom states:

> *"it is difficult to state with any certainty whether the trade-off* [between factors relevant to a decision on whether to supply a rival] *is likely to result in widespread or limited distribution. However, our analysis indicates that Sky could have incentives to limit distribution to smaller platforms"* (emphasis added).

3.33 Elsewhere, Ofcom's conclusions are even more tentative and amount to no more than the identification of *a possibility of a risk* of 'limited distribution' of Sky's 'key sports channels': see, for example, Paragraph 1.22 in which Ofcom states: *"We have identified that there may be a risk that Sky has incentives to limit distribution of its key content in the absence of regulation"* (emphasis added). Indeed, Ofcom's assessment is riddled with unsatisfactorily equivocal and conditional statements, in relation to all its elements.[61]

3.34 Even on its own terms, therefore, Ofcom's assessment falls well short of establishing a sufficient likelihood of a relevant practice to form the legal basis for continued regulation of Sky's channels.

3.35 Ofcom appears to seek to rely on a broad margin of regulatory discretion to support its position that regulation is justified on the basis of such tentative conclusions; that is not the case, for the following reasons.

3.36 Ofcom's review requires it to consider the prospects for particular conduct and harm to competition. This is a particularly difficult exercise where fast-moving markets are concerned, as Ofcom's own experience demonstrates (see Annex 1, which shows the key benefits on which Ofcom relied in justifying the introduction of the WMO have not materialised).

3.37 Ofcom acknowledges that *"predicting the likelihood of future actions of content holders is an inherently uncertain exercise"*[62] and states that, consequently, *"it is very difficult to be definitive on the likelihood of limited distribution"*[63]. Ofcom then states:

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60 Paragraph 8.8.

61 Other examples include:

- "*Limited distribution of key sports content may make it more difficult for pay TV retailers to compete for subscribers … and may therefore result in barriers to expansion*" (emphasis added) (paragraph 1.7);
- "*We have identified a number of market characteristics which might cause holders of key content to limit distribution of that content*" (emphasis added) (paragraph 1.20);
- "*If Sky can retain its strong position in pay TV retailing, this may give it continued advantages when bidding for sports rights*" (emphasis added) (paragraph 6.58);
- "*We have identified a risk that Sky may engage in practices which may be prejudicial to fair and effective competition*" (emphasis added) (Section 8, first heading).

62 Paragraph 4.17.

63 *Ibid.*

"the decision as to whether or not a particular practice is likely to arise, and whether that practice is of concern, necessarily involves the exercise of regulatory judgement as to whether those factors are relevant, whether any other factors apply and the weight to be given to the[m] *in a particular case."*[64]

3.38 Whilst, as Ofcom notes in the passage quoted above, this type of assessment inevitably requires the exercise of judgement, this does not remove Ofcom's obligation to reach sound conclusions. Indeed, as a result of the uncertainty as to the future with which it must grapple, it is incumbent on Ofcom to look particularly carefully at the evidence which is available to it, including the findings of the Tribunal, Sky's current distribution arrangements and its efforts to self-retail. As we discuss in more detail in Section 4 below, Ofcom has dismissed this evidence out of hand, however, and at no point in the Consultation does Ofcom properly acknowledge, and even less give due weight to, the Tribunal's unchallenged findings on Sky's approach to distribution of its sports channels.

3.39 Ofcom's flawed approach does not require it to evaluate the magnitude of the risk that there will be 'limited distribution' of Sky's 'key sports channels' in the future. However, unless Ofcom determines the degree of risk of a future practice prejudicial to fair and effective competition, it necessarily finds itself in a vacuum in which it can neither determine whether an intervention is necessary (since this requires Ofcom to have a robust view that such a practice is likely to occur) nor (as it is also required to do) what might be a proportionate form of intervention to prevent that practice.

3.40 We demonstrate in Section 4 below that, in any case, there is no basis for concluding that, absent regulation, Sky is likely to 'limit distribution of its key sports channels'. Indeed, the evidence points to the continuation of Sky's strategy of wide distribution of those channels.

Ofcom has improperly sought to reverse the burden of proof

3.41 Not only does Ofcom fail to meet the standard of proof required to justify regulation, but it also seeks to reverse the burden of proof.

3.42 As discussed in more detail in Section 4, Ofcom's proposition that there is (or might be) a risk of a practice prejudicial to fair and effective competition in the future essentially rests on hypotheses relating to Sky's incentives to 'limit distribution of its key sports channels'. Ofcom theorises that Sky may have incentives to pursue a strategy of 'limited distribution' of its 'key sports channels' to rival pay TV retailers, upon which it may act in the future if it is no longer subject to a regulatory obligation to supply. Ofcom does not advance any evidence of Sky's current or past conduct in support of its proposition that Sky may 'limit distribution' in the future (and, indeed, dismisses evidence of current supply arrangements as being of no real value to determining how Sky might behave in the future, absent regulation).[65] This is in contrast to Ofcom's rationale for imposing the WMO in 2010, which depended on Ofcom's assessment of empirical evidence of Sky's actual behaviour in the course of the various bilateral negotiations for the supply of Sky's sports channels, which Ofcom concluded amounted to a practice of deliberately withholding supply.[66]

3.43 Ofcom's approach (that regulation should be maintained due to a risk of 'limited distribution' identified through hypothesising about Sky's incentives) places Sky in an almost impossible position: to counter Ofcom's case for continued regulation would

64 *Ibid.*

65 Paragraphs 7.28 – 7.35.

66 The Tribunal found that Ofcom had misinterpreted the evidence, which did not support the factual conclusions underpinning Ofcom's core competition concern (Pay TV judgment, paragraph 28).

require Sky to demonstrate that there is no risk of 'limited distribution' in the future. In particular, it requires Sky to demonstrate that hypothetical incentives do not exist.

3.44 It is legally and procedurally wrong for Ofcom to require Sky to prove a negative (namely that, absent regulation, there is no risk that Sky would 'limit the distribution of its key sports channels'), rather than for Ofcom itself to advance convincing evidence of the likelihood of the practice that concerns it and its prejudicial effect on competition.

Ofcom has failed to have regard to its duties

3.45 Lowering the threshold for intervention and reversing the burden of proof as Ofcom has done amounts to a bias in favour of regulation. This runs directly counter to Ofcom's statutory duty to have regard in all cases to the principle under which regulatory activities must be targeted only at cases in which action is needed and to avoid the maintenance of unnecessary regulation. It is also inconsistent with Ofcom's regulatory principle to operate with a bias against intervention.[67]

3.46 That Ofcom's approach is inappropriately biased towards regulation is underlined by the limited consideration given to the option of deregulation in the Consultation. Whilst Question 8.3 asks whether the WMO obligation should be removed, the only substantive discussion of removal of the WMO obligation is limited to three brief paragraphs in the final section of the Consultation, which give the strong impression that this is an afterthought.[68]

3.47 Furthermore, Ofcom's position that it may be appropriate to regulate Sky's distribution of its 'key sports channels' without also regulating BT is inconsistent with its duty to regulate consistently. We discuss this in detail in Section 5 below.

3.48 Ofcom's approach also fails to recognise the risk of regulatory failure. Ofcom should be particularly aware of the risk of unintended consequences of regulation of Sky's distribution of its sports channels in the light of the highly intrusive nature of this regulation. It should weigh that risk against the high degree of speculation and hypothesis involved in its assessment.

3.49 Clearly, a decision to remove the WMO now would not preclude Ofcom from using its section 316 powers (or indeed any of its other regulatory or Competition Act powers) to address prejudicial practices in the retailing of pay TV services in the future, to the extent that substantiated and material concerns arose. Ofcom should acknowledge that, in those circumstances, it is appropriate for it to wait until Ofcom can properly identify a risk that justifies intervention. It would be disproportionate for Ofcom to intervene where the extent of its concerns amount to a prediction that there 'may be a risk' of 'limited distribution' in the future.

Ofcom has failed to take account of all relevant facts and evidence

3.50 Ofcom makes no reference in the Consultation to the CAT's unchallenged findings in relation to Sky's previous conduct and terms of supply in the years preceding the Pay TV Statement. As we set out in more detail in Section 4, these undermine Ofcom's hypotheses regarding Sky's incentives to withhold supply of its channels.

[67] See: http://www.ofcom.org.uk/about/what-is-ofcom/statutory-duties-and-regulatory-principles/.

[68] Paragraphs 8.18 to 8.20.

3.51 Ofcom also dismisses the evidence of Sky's existing supply arrangements as being of limited value in determining the extent to which Sky would or would not supply its key sports channels in the absence of regulatory intervention.[69] We explain in Section 4 why Ofcom is wrong to do so; in fact, Sky's supply arrangements are strong evidence that Sky will not 'limit distribution' of its channels.

Conclusion

3.52 As set out above, Ofcom's approach to its review, as embodied in the Consultation, is wrong in law. Instead of requiring Ofcom to establish (on the basis of evidence and analysis capable of withstanding profound and rigorous scrutiny) that the 'limited distribution' of Sky's channels with which it is concerned is likely to occur, Ofcom's approach merely requires Ofcom to identify a risk that such 'limited distribution' will occur. Additionally, Ofcom's approach sidesteps Ofcom's burden of proof and requires Sky to prove that no such risk exists.

3.53 Lowering the threshold for intervention and reversing the burden of proof as Ofcom has done amounts to a bias in favour of regulation which runs directly counter to Ofcom's statutory duties and regulatory principles.

69 Paragraph 7.35.

SECTION 4: WHETHER SKY IS LIKELY TO 'LIMIT DISTRIBUTION OF ITS KEY SPORTS CHANNELS'

Introduction

4.1 This Section 4 addresses the issue of whether Sky is likely to 'limit distribution of its key sports channels'. Ofcom approaches this issue by seeking to examine Sky's *incentives* in relation to those channels, the analysis of which is set out in Section 7 of the Consultation. As explained in the second sub-section, below, this is an inapt approach. Ofcom should, as it did when it introduced the WMO in 2010, focus on Sky's *actual behaviour*, and likely future behaviour, rather than attempting to discern its incentives.

4.2 **Part A** sets out the key facts in relation to Sky's actual behaviour in relation to supply of its 'key sports channels'. This shows that Sky does not 'limit distribution' of those channels. On the contrary, they are widely distributed and Sky engages constructively in new opportunities for their distribution. **Part B** explains a number of the key flaws in Ofcom's analysis of Sky's incentives in relation to distribution of its 'key sports channels'.

Ofcom should focus on Sky's behaviour, rather than attempting to determine its incentives in a vacuum

4.3 Whether "*holders of key content have incentives to limit distribution of that content*"[70] is one of the three key issues addressed in Ofcom's framework of analysis in the Consultation, and Section 7 of the Consultation is principally devoted to this issue. The conclusion reached by Ofcom in relation to Sky is that it:

> "*could have incentives to limit distribution of Sky Sports to rival platforms, particularly where there may be strategic benefits to doing so (for example to dampen an emerging competitive threat).*"[71]

4.4 Ofcom focuses in particular on rival platforms that are small today, but which have the potential to develop into significant competitors to Sky's in the future, particularly BT's:

> "*In the case of the smaller platforms….it would take only a small short or long term benefit to render limited distribution profitable. Given this, and the evidence that BT in particular might pose a long term competitive threat to Sky's existing market position, we consider that there may be a risk that Sky has incentives to limit distribution of Sky Sports or to supply on unfavourable terms absent regulation.*"[72]

4.5 Focusing on propositions about Sky's incentives derived from speculation or hypothetical theories about Sky's motivations[73], however, is an inapt approach to the assessment of the issues raised in the Consultation. This is because, while the so-called 'static incentive' to distribute Sky's 'key sports channels' widely (associated with their high fixed cost base) is clear-cut, attempting to discern what other incentives Sky faces is extremely difficult.

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70 Paragraph 1.8, which sets out Ofcom's framework of analysis.

71 Paragraph 8.5.

72 Paragraph 7.20.

73 In the Consultation, Ofcom puts forward two candidate hypotheses about incentives that Sky might have that could potentially counteract its static incentive to supply. These are not derived from observations about Sky's actual behaviour, or any other evidential source; they are purely hypothetical. The proposition that Sky might 'limit distribution of its key sports channels' in order to reduce the competition it faces in future rights auctions, for example, was a theory invented by economic advisors to the complainants to Ofcom in 2007. No reliable evidence has ever been produced to support a proposition that Sky does in fact believe that it can reduce the competition it faces in sports rights auctions via the distribution of its 'key sports channels'.

4.6 Ofcom should, instead, focus on what Sky is likely to do *in reality* absent regulation. And the best evidence on that issue in Sky's case is what it has done in the past, and what it does now, which are discussed in the following **Part A**.

4.7 The approach adopted in the Consultation, of elevating analysis of Sky's incentives above that of its actions, is the reverse of the approach adopted by Ofcom when it proposed the introduction of the WMO in 2010. In 2010 Ofcom relied on its assessment (albeit erroneous) of substantial amounts of evidence in relation to Sky's *actual behaviour* in negotiations with third parties in relation to the supply of its 'key sports channels'. Ofcom took the view that "*Sky's <u>reasons</u> for acting as it did were not a necessary element in* [its] *reasoning*"[74] (emphasis added). Similarly, while at one point it sought to defend its analysis of Sky's incentives in the appeals of the Pay TV Statement, Ofcom ultimately stated that the incentives argument was not "*essential to* [its] *analysis, given the findings in relation to the negotiations themselves*"[75]. This position was reflected in the CAT's judgment, which stated:

> "*Ofcom's position at the hearing was that its findings relating to the strategic incentives were not essential to the existence of its core competition concern, but that the fact of Sky's acting upon these incentives would be revealed when we looked at the empirical evidence of Sky's conduct.*"[76]

4.8 A robust, evidence-based analysis of Sky's actual behaviour in relation to the distribution of its 'key sports channels' is a superior approach to the issues raised in the Consultation to focusing on an abstract analysis of Sky's incentives that is not grounded in any evidence.

PART A: SKY'S DISTRIBUTION OF ITS KEY SPORTS CHANNELS

Sky distributes its 'key sports channels' widely

4.9 Sky's premium channels have always been available on cable, in the past the main TV distribution platform with sufficient capacity to carry those channels in the UK in addition to satellite broadcasting. As other platforms have developed over time, Sky has sought to take advantage of the opportunity to expand the distribution of its channels. Sky's behaviour in this respect is no different to other broadcasters, both FTA and pay.[77]

4.10 Sky has always engaged constructively with new opportunities for the distribution of its sports channels that it judges are (a) secure, and (b) will deliver sufficient incremental subscribers to those channels to make pursuit of an opportunity worthwhile. Sky's preference in relation to such distribution remains to retail its channels directly to consumers[78], particularly where it is able now to deliver those channels via IP, where Sky is able to utilise its NOW TV service. However, Sky also remains open to new wholesale deals.

4.11 The fundamental reason for this is that Sky Sports incurs a fixed cost of over £**[CONFIDENTIAL]** every year (*i.e.*, the cost of the rights it licenses and production costs,

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74 Paragraph 118, Ofcom's Skeleton Argument in the appeals of the Pay TV Statement.

75 Paragraph 260, Ofcom's closing submissions, Part 1, in the appeals of the Pay TV Statement.

76 Paragraph 37 of the CAT's judgment. See also paragraph 829 of the CAT's judgment.

77 The only significant difference is that, as a broadcaster of premium pay TV channels, Sky is far more concerned than, for example, broadcasters of FTA or basic pay TV channels about the security of new platforms.

78 The key reason for this is that it avoids principal-agent problems that can arise when Sky is reliant on third parties to generate subscriptions to its sports channels.

which do not vary with the number of subscribers to the channels). This figure will rise to over £**[CONFIDENTIAL]** per annum from 2016/17. **[CONFIDENTIAL]** At the same time, the cost of rights has increased significantly over this period. Therefore new opportunities for expanding the number of subscribers to Sky Sports offered by distribution on new platforms are of significant value.[79]

Figure 4.1
Number of UK residential subscribers to Sky's sports channels on its DTH satellite platform

[CONFIDENTIAL]

4.12 Details of Sky's past and current distribution of Sky Sports and NOW TV are set out in Annex 3.[80] This annex provides details of distribution arrangements in both the UK and Republic of Ireland ("ROI"). Although the following discussion focuses on distribution of Sky's 'key sports channels' in the UK, it is important to recognise that (a) subscribers in ROI make a significant contribution to the recovery of Sky Sports' costs, and (b) Sky's approach to the distribution of its 'key sports channels' does not differ between the UK and ROI, despite the absence of WMO regulation in the ROI.

4.13 In the period between the launch of Sky's sports channels in 1991 and the Pay TV Statement in 2010, those channels were carried on all the platforms capable of delivering them securely to subscribers – satellite, cable, IPTV platforms (developed by Kingston Interactive Technology, and Homechoice (later purchased by Tiscali TV, which was then purchased by TalkTalk)), DTT (OnDigital/ ITV Digital), OTT (via Sky Player) and 3G mobile networks.

4.14 Discussion between Sky and three potential new platforms and/or retailers of Sky's sports channels in the period during Ofcom's Pay TV Review (2007 – 2010) were examined in detail by the CAT in its judgment on the appeals of Ofcom's Pay TV Statement[81]. The unchallenged conclusion of the Tribunal was that "*the evidence shows that Sky did, on the whole, engage constructively*"[82] in those discussions. Ofcom must have due regard to this finding of fact by the Tribunal.

79 At Annex 5 of this response, we have included a selection of documents that illustrate (i) Sky's approach and business case for distribution of its 'key sports channels' via wholesale supply and NOW TV, and (ii) the importance of the deals to Sky and the wholesale customer and the amount of work that is involved in completing such deals. **[CONFIDENTIAL]**

80 The annex also provides information on the distribution of Sky's movie channels and related services. Sky notes that, due to the historical nature of a number of the arrangements set out in Annex 3 in some cases the dates are approximate, based on immediately available records.

81 See paragraph 174 of the CAT's judgment.

82 Paragraph 29, *Ibid.*

4.15 As set out in the CAT's judgment, Sky was on the verge of agreeing commercial terms with BT for supply to its Cardinal platform at the time of the Pay TV Statement in 2010.[83] In 2010 Sky began supply of its 'key sports channels' to BT, for distribution via DTT to its Cardinal platform, and TopUpTV also for distribution via DTT.

4.16 Since 2010, the key new opportunities for expanded distribution, or different modes of distribution of Sky's 'key sports channels' in the UK have been:

(i) the upgrading of BT's Cardinal platform to be able to receive linear television channels via IPTV in 2012;
(ii) the launch of the Youview platform in Q3 2012. The YouView 'platform' comprises three different variants, namely BT's, TalkTalk's and YouView set top boxes sold in retail stores. Only BT's and TalkTalk's YouView boxes are capable of carrying linear pay TV channels and then only when they are connected to their (closed) IPTV networks; and
(iii) an ongoing increase in the range of available IP-connected platforms and services, such as connected TVs, Apple TV, Google Chromecast *etc*.

4.17 In relation to these developments:

(i) following a request from BT, Sky agreed commercial terms with BT for supply of its 'key sports channels' via IPTV to BT's Cardinal platform in December 2012;
(ii) Sky agreed commercial terms for wholesale supply to TalkTalk in relation to distribution of Sky's sports channels via its YouView box in July 2012. The agreement with TalkTalk provided Sky with an entirely new source of wholesale revenue;
(iii) Sky reached agreement with YouView to distribute NOW TV, which carries Sky's sports channels, via YouView boxes in July 2012. In conjunction with a commercial deal with TalkTalk for multicast services, this has enabled Sky to self-retail the Sky Sports channels via NOW TV on TalkTalk YouView boxes[84];
(iv) as discussed further below, Sky was unable to reach commercial agreement with BT for wholesale supply of its 'key sports channels' to BT for retail via its YouView platform. Similarly, as discussed below, Sky has been unable to deliver NOW TV via that platform. Following the decision by the CAT to extend the Interim Relief Order ("IRO") to include BT's YouView platform, Sky's 'key sports channels' have been retailed by BT on its YouView platform since December 2014; and
(v) as well as being available via TalkTalk YouView boxes and a box launched by Sky, retailed by Sky for £9.99, NOW TV has also been made available on an increasing range of third party platforms. To date, this has involved reaching commercial agreement with Microsoft, Sony, Roku, LG, Apple, Google and **[CONFIDENTIAL]**, as set out in Table 4.1 below.[85] Each of these agreements required considerable effort on Sky's part – in some cases also requiring Sky to invest significant amounts in order to be able to deliver NOW TV via these platforms.

83 See paragraph 379, *Ibid*.

84 **[CONFIDENTIAL]**

85 **[CONFIDENTIAL]**

Table 4.1
Distribution agreements for NOW TV

Operator	Platform(s)	Contract start date
Microsoft	Xbox360,	**[CONFIDENTIAL]**
Roku	Roku box	**[CONFIDENTIAL]**
YouView	YouView boxes	**[CONFIDENTIAL]**
Sony	PS3, PS4	**[CONFIDENTIAL]**
LG	Smart TVs and Smart Media Devices	**[CONFIDENTIAL]**
Microsoft	Xbox One, Windows 8.x	**[CONFIDENTIAL]**
Apple	Apple TV	**[CONFIDENTIAL]**
Google	Chromecast	**[CONFIDENTIAL]**
[CONFIDENTIAL]	**[CONFIDENTIAL]**	**[CONFIDENTIAL]**

4.18 In addition to these agreements, in 2014 Sky entered into a new long term wholesale agreement with Virgin Media, which includes Sky's sports channels. We discuss this further below.

4.19 With the sole exception of the agreement with BT in relation to its YouView platform, each of the commercial agreements set out above is outwith the WMO (as amended by the IRO).

The new wholesale agreement with Virgin Media

4.20 As set out above, in 2014 Sky entered a new commercial agreement with Virgin Media, which includes wholesale supply of Sky's 'key sports channels'. In relation to those channels, the agreement runs until 2019. Accordingly, for the foreseeable future, Sky has a contractual obligation to supply its 'key sports channels' to Virgin Media.

4.21 The agreement was the outcome of an enormous level of effort on the part of both companies. It was heavily negotiated over a period of months, and required substantial input from senior executives at both Sky and Virgin Media. The agreement involves significant mutual benefits, including for example, **[CONFIDENTIAL]**. Both companies have expressed strong satisfaction with the agreement that was reached. Virgin Media's Chief Executive Officer, Tom Mockridge, described it as "*the most extensive agreement ever signed between Virgin Media and Sky*"[86].

4.22 In these circumstances, Ofcom's proposition that it "*cannot rule out the possibility*"[87] that Sky will withdraw supply its 'key sports channels' from Virgin Media in the foreseeable future is at best purely hypothetical and in reality verging on the risible.

86 'Sky and Virgin Media strike major new channel distribution agreement', press release dated 12 May 2014. (https://corporate.sky.com/media-centre/news-page/2014/sky_and_virgin_media_strike_major_new_channel_distribution_agreement.) See, also, the memo to Sky's Board dated 29 January 2014 and the email dated 10 May 2014 from Dana Strong of Virgin Media to various at Sky entitled 're Basics Agreement - Execution Document', at Annex 5.

87 Paragraph 7.21.

Sky has made strenuous efforts to make its channels available on BT's platforms

4.23 The focus of Ofcom's analysis of Sky's supply of its 'key sports channels' is now on what it describes as supply to "*the smaller platforms*"[88], platforms where, due to low current take-up of Sky Sports, Ofcom considers that Sky does not earn significant amounts of wholesale revenue. In reality, Ofcom's concern is that, absent regulation, Sky will withhold its 'key sports channels' from BT, given that BT has emerged as a significant competitor to Sky both at the wholesale and retail levels of the sector. Although in much of Section 7 the propositions in relation to Sky's incentives are couched in general terms, Ofcom is candid in admitting that the focus of its concern is on supply to BT.[89] For this reason, we discuss Sky's dealings with BT in greater detail in this sub-section.

4.24 Ofcom is entirely correct in its belief that BT represents a substantial new competitor to Sky in pay TV services, at both the retail and wholesale levels. Evidence on these matters is copious and readily available. Yet the documentary record shows that Sky has consistently made significant efforts to deliver its 'key sports channels' via BT's platforms, both via wholesale and self-retail arrangements.

4.25 Sky responded constructively to BT's requests for supply of its 'key sports channels' via DTT to its Cardinal platform when BT first approached Sky in 2007 well before it had any means of actually carrying Sky's premium channels. As the CAT observed in relation to Sky's negotiations with BT in 2007 and 2008:

> "*Sky engaged constructively with BT in relation to the latter's request for wholesale arrangements*".[90]

4.26 The reasons that agreement in relation to such supply was not concluded until 2010 are now well documented in the judgment of the CAT, with the Tribunal attributing significant responsibility to regulatory gaming by BT. However, following BT's decision to re-engage in negotiations in 2009, Sky and BT were on the verge of concluding a commercial agreement for the supply of Sky's 'key sports channels' via DTT to BT's Cardinal platform at the time of Ofcom's Pay TV Statement in March 2010.

4.27 In mid 2012 BT indicated that it wished to move to IPTV distribution of Sky's sports channels to its Cardinal set top boxes. Again, Sky engaged constructively with BT, and Sky and BT entered into a commercial wholesale agreement for IPTV distribution of Sky Sports 1 and 2 to the Cardinal platform in December 2012.

4.28 Sky has also engaged constructively with BT in relation to supply of Sky's 'key sports channels' via IPTV to BT's YouView platform. **[CONFIDENTIAL]**.

4.29 **[CONFIDENTIAL]**.

4.30 The ability for Sky to self-retail its channels on BT's YouView platform requires either (a) the provision of multicast capacity by BT, or (b) YouView upgrading the capabilities of set top boxes, so that they can receive linear channels via unicast delivery. **[CONFIDENTIAL]**[91]

4.31 Again, these efforts have required Sky to devote considerable resources to this issue, including senior management time.

88 For example, paragraph 7.20.

89 See, for example, paragraphs 7.18 and 7.20.

90 Paragraph 339 of the CAT's judgment.

91 **[CONFIDENTIAL]**.

4.32 At Annex 6 we have provided a selection of correspondence between Sky and YouView **[CONFIDENTIAL]**.

Non-supply of Sky's 'key sports channels' to BT YouView

4.33 As demonstrated above, Sky was, and remains, willing to supply its 'key sports channels' via BT's platforms. However, since BT has become vertically integrated between retailing pay TV services and the provision of premium pay TV sports channels, following the launch of the BT Sport channels in July 2013, Sky considers that it is fair and reasonable that either (a) there is reciprocal wholesale supply of each other's 'key sports channels', or (b) each firm should be able to self-retail their channels on the other's platform. A one-way wholesale arrangement would provide BT with a significant commercial advantage over Sky, and it would not be commercially rational for Sky to enter into an agreement of this type.

4.34 During discussions with BT **[CONFIDENTIAL]** it became clear that, whilst BT was seeking wholesale supply of Sky's sports channels, it was not willing to wholesale any BT Sport channels to Sky. However, whilst BT has been able to retail its channels directly to households on Sky's DTH satellite platform, despite the alleged open nature of the YouView platform, Sky has been unable to self-retail its 'key sports channels' on BT's YouView platform.

4.35 If Ofcom considers this situation to be relevant to its analysis, it must have proper regard to the full circumstances of that situation. It is inappropriate for Ofcom, for example, to state that "*Sky and BT failed to reach a commercial agreement for the supply of SS1&2 on YouView*"[92] without also noting the facts set out above: (i) there was similar failure in relation to the supply of the BT Sport channels by BT to Sky, and (ii) despite the allegedly open nature of the YouView platform, Sky has been unable to self-retail its sports channels on BT's YouView platform in a manner similar to BT's approach to delivering its channels to subscribers on Sky's DTH satellite platform.

4.36 In the Consultation Ofcom appears to suggest that it believes that Sky's concern about reciprocity of supply is a recent development, linked to BT's emergence as a significant competitor to Sky in the past few years, and by implication that it is a pretext.[93] If that is Ofcom's view, it is demonstrably incorrect and underrates Sky's commercial sophistication. Sky has been concerned about the possibility of the very situation that has arisen in relation to BT for many years. **[CONFIDENTIAL]**.

4.37 It would also be erroneous for Ofcom to believe that the situation in relation to BT's YouView platform comprises support for a proposition that, *in general*, Sky is willing to forgo wholesale revenue from 'small platforms' associated with distribution of its sports channels due to concerns about increased competition at the retail level. The situation in relation to BT's YouView platform is the result of (a) BT having developed premium sports channels, and (b) its withholding those channels from Sky. Accordingly, a proposition that the situation in relation to BT could justify the imposition of a wholesale must-offer obligation that included a range of other parties is without merit.

Sky attaches significant value to additional, certain revenue streams

4.38 When Sky enters into a new distribution agreement with a third party retailer, or begins supplying NOW TV via a new platform, it does so in the expectation of earning additional

92 Paragraph 7.34.

93 **[CONFIDENTIAL]**.

profits, normally for many years. For example, Sky has earned over £**[CONFIDENTIAL]** in wholesale revenue from Virgin Media from supply of its premium channels over the past five years, a significant proportion of which is associated with its sports channels.[94] Such additional revenues and profits begin flowing immediately.

4.39 Ofcom's propositions posit that Sky is prepared to forgo these immediate ongoing revenues and profits in the hope of achieving benefits to its business at some point in the future. This is simply not realistic in the market environment in which Sky operates.

4.40 As set out in Section 1, the sector in which Sky operates is fast moving and constantly changing in ways that are impossible to predict. For example, less than four years ago few people in the UK had heard of Netflix; it now has over 3 million paying UK subscribers and unprompted brand awareness of around 45% among UK consumers. (Prompted brand awareness is around 95%.) Netflix's entry to the UK had significant consequences for Sky's business.[95]

4.41 The example of Netflix also illustrates a key point that the markets in which Sky, and other UK-based firms, operate are increasingly international in nature, in which very large global businesses, such as Apple, Google, Microsoft, Netflix and Liberty Global now play key roles. New competition can as easily come from firms such as these, or other international players, such as BeIN Sports (backed ultimately by Qatar's sovereign wealth fund), as UK-based players.

4.42 What this means in practice is that Sky, as a rational commercial decision-maker, highly values tangible, short to medium-term benefits, such as new deals for the distribution of its 'key sports channels'. It places little or no weight on hypothetical benefits that may only occur several years in the future. This is for the straightforward reason that Sky understands that attempting to capture such benefits would be likely to be undermined by changes in the sector that are not possible concretely to identify, but which, based on Sky's appreciation of the pace of change in the sector, are likely to occur. For these reasons, Sky's approach to the distribution of its 'key sports channels' is motivated by generating additional revenues via wholesale and self-retail deals; it is not motivated by 'strategic benefits' that have no hope of being realised.

Sky's terms of supply

4.43 Ofcom uses the term 'limited distribution' to refer to two situations (i) no supply at all, and (ii) supply on terms that do not enable a third party to compete effectively. The foregoing discussion shows that Sky distributes its 'key sports channels' widely and would do so absent regulation.

4.44 The second of these issues, *i.e.*, supply on terms that do not enable a third party to compete effectively can itself be divided into (a) price, and (b) non-price terms. Ofcom has not identified any issues in relation to either price or non-price terms that it considers to be even potentially unreasonable, so the Consultation does not provide any basis for Sky meaningfully to comment on this matter.

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94 This includes around £**[CONFIDENTIAL]**directly attributable to supply of Sky's sport channels, and £**[CONFIDENTIAL]** from supply of packages that include Sky's sports and movie channels.

95 Hindsight bias is the inclination, after an event has occurred, to see it as having been predictable, despite there having been little or no objective basis for predicting it. It is difficult to avoid a significant degree of 'hindsight bias' when evaluating change in the audiovisual sector, as important changes rapidly become 'part of the furniture' and regarded after the event as predictable, or their unpredictability, *ex ante*, downplayed. Ofcom must ensure that it does not make such errors when considering the weight that it believes Sky is able to attribute to the course of future events.

4.45 In relation to charges for wholesale supply, however, it is critical for Ofcom to note that:

(i) the issue of whether Sky's wholesale charges restricted the ability of Virgin Media to compete effectively with Sky was examined by the CAT during the appeals of Ofcom's 2010 Pay TV Statement. At that time, Virgin Media was the main retailer of Sky's 'key sports channels' other than Sky. On the basis of its analysis, the unchallenged finding of the Tribunal was:

> "*The question is … whether the rate card price has been shown to obstruct (or to contribute to the obstruction of) fair and effective competition by VM. We are clear that the answer is negative.*"[96]

(ii) **[CONFIDENTIAL]**.

PART B: FLAWS IN OFCOM'S ANALYSIS IN SECTION 7 OF THE CONSULTATION

Introduction

4.46 This Part B of Section 4 addresses the flaws in Ofcom's analysis set out in Section 7 of the Consultation. It comprises the following sub-sections:

- Ofcom's analysis of this issue is insufficient to support well-founded conclusions;
- Ofcom adduces no evidence in support of its conclusions;
- Ofcom's analysis in the Consultation only appears to relate to non-supply of Sky's 'key sports channels';
- Flaws in Ofcom's assertions about Sky's dynamic incentives:
    - Dampening future retail competition;
    - The 'vicious circle' proposition.

Ofcom's analysis of this issue is insufficient to support well-founded conclusions

4.47 The issue of whether Sky is likely to 'limit distribution' of television channels that carry live Premier League football matches[97] lies at the heart of Ofcom's case for imposing intrusive compulsory licensing regulation on Sky. As set out in Section 3, in reaching conclusions on this issue that are intended to form the basis for such regulation:

- the burden of proof lies with Ofcom. It is not for Sky to have to disprove Ofcom's propositions;
- Ofcom's conclusions must be supported by evidence capable of withstanding profound and rigorous scrutiny;
- Ofcom must establish, in the first instance, to the applicable legal standard that it is *likely* that Sky will 'limit distribution' of its 'key sports channels'; and
- Ofcom's analysis must be undertaken with great care, given that it is prospective in nature relating to a fast-moving sector.

4.48 In these circumstances, it would be expected that Ofcom's analysis of the issue at the heart of its case for continuing to impose a WMO obligation on Sky would be detailed and

96 Paragraph 810 of the CAT's judgment.

97 Ofcom identifies live Premier League and Champions League football matches as 'key content'. However, on the assumption that Ofcom's review covers the next few years, Sky will not carry any live Champions League football in that period.

substantial, supported by significant amounts of relevant evidence. Yet Section 7 is short. It comprises only eleven pages, including one page principally devoted to a table on 'current supply arrangements for Sky Sports'. The brevity of the section reflects the extremely high-level assessment Ofcom has undertaken of the relevant issues. This short, high-level assessment is insufficient to support well-founded conclusions on the issues addressed in Section 7. And, as discussed in the following sub-section, the Consultation contains no evidence on these issues.

Ofcom adduces no evidence in support of its conclusions

4.49 The question of whether Sky is likely to supply its 'key sports channels' to third party platforms, absent regulation, can only be determined by consideration of relevant evidence.

4.50 In the Consultation, however, Ofcom considers only two types of evidence on this issue, namely:

(i) the potential loss in revenues (and profits) if Sky were to withdraw supply of its 'key sports channels' from existing third party retailers[98]; and

(ii) "*whether current supply arrangements provide an indication of any risk of limited distribution*"[99].

4.51 The first of these analyses is not capable of determining whether, overall, Sky is likely to withhold supply of its 'key sports channels' (and nor is it intended to). It provides only part of the picture – the potential scale of lost revenues if Sky were to withdraw supply of its 'key sports channels' from existing third party distributors.

4.52 Ofcom's assessment of the evidence on current supply arrangements is extremely cursory, comprising around one page in relation to Sky. Ofcom effectively dismisses this evidence as being of value to its analysis. Ofcom states:

> "*existing supply arrangements may be of limited value in determining the extent to which Sky would or would not supply its key sports channels in the absence of regulatory intervention.*"[100]

4.53 As a result, Ofcom adduces no evidence in the Consultation that even begins to suggest that Sky is likely to withhold supply of its 'key sports channels' from third party platforms.

4.54 This lack of evidence appears to be reflected in the tentative (and, as explained in Section 3, above, legally inadequate) way in which Ofcom's conclusions on this issue are put – namely that Sky "*could have incentives to limit distribution*"[101] of its 'key sports channels', or that *"there may be a risk that Sky has incentives to limit distribution of Sky Sports or to supply on unfavourable terms absent regulation"*[102] (emphasis added).

4.55 Furthermore, Sky fundamentally disagrees with Ofcom's view that the evidence on new supply deals, both wholesale and self-retail, from the past five years is of "*limited value*" as evidence on the issues before it. On the contrary, it is the best evidence available to Ofcom on those issues. As set out above, virtually all those deals were outwith the scope

98 This analysis is set out at paragraphs 7.13 and 7.14 of the Consultation.

99 Heading preceding paragraph 7.28.

100 Paragraph 7.35.

101 For example, paragraph 8.5.

102 Paragraph 7.20.

of the WMO (as amended by the IRO), and it would be incorrect to believe that Sky only entered into them as a result of the WMO, or that they would have been different if the WMO had not been in place. In particular, it is fanciful to believe that (i) the time and effort required on Sky's part to secure the wholesale agreement reached with Virgin Media, (ii) the wholesale deal reached with TalkTalk for supply via its YouView platform, (iii) the efforts that Sky has put into attempting to supply its channels via BT's platforms, or (iv) the myriad of agreements that Sky has negotiated in order to be able to distribute NOW TV on other platforms, are attributable to the WMO.

4.56 Even if Ofcom decided, erroneously, to discount such evidence, however, it cannot ignore the unchallenged finding of the CAT that Sky engaged constructively with opportunities for wider distribution of its 'key sports channels' before the WMO was introduced.

4.57 In a number of places in the Consultation, Ofcom appears to imply that the failure of Sky to agree to supply BT with Sky Sports 1 and 2 for distribution on its YouView platform supports Ofcom's view that Sky generally could have an incentive to 'limit distribution of its key sports channels'. As discussed above, that would be an incorrect and partial conclusion to draw from the available evidence.

Ofcom's analysis only appears to relate to non-supply of Sky's 'key sports channels'

4.58 Ofcom uses the term 'limited distribution' to refer to two situations (i) no supply at all, and (ii) supply on terms that do not enable a third party to compete effectively.[103] Despite this, as far as Sky can discern, there is no analysis in the Consultation of the second type of 'limited distribution'; Section 7 appears to focus entirely on situations in which Sky would not supply its 'key sports channels' to third parties *at all*. Accordingly, in the discussion below we also focus on this issue.

Flaws in Ofcom's assertions about Sky's dynamic incentives

4.59 Ofcom's proposition that Sky may have incentives to withhold supply of its 'key sports channels' is, in principle, based on a standard 'vertical foreclosure' framework, which considers a vertically integrated firm's static and dynamic incentives in relation to distribution of an input to competitors. Such a theoretical framework simply provides a means of identifying relevant evidence that can be used to assess whether, *in practice*, (a) it is plausible that Sky has particular incentives and/or disincentives to distribute its 'key sports channels' and (b) the overall balance of those incentives. Theory alone cannot determine those matters. Yet, as discussed above, Ofcom currently brings no relevant evidence to bear on them.

4.60 Notwithstanding this fundamental point, Ofcom's application of the vertical foreclosure framework is subject to a number of significant flaws. These flaws deprive Ofcom's proposition that economic theory suggests that Sky may have an incentive to withhold its 'key sports channels' from third parties of any validity.

4.61 It appears to be accepted by Ofcom that Sky has a static incentive to supply its 'key sports channels' on third party platforms as a result of increased revenues, even if, in some cases, Ofcom believes that benefit to be small. Accordingly, Ofcom's belief that Sky may have an incentive to withhold those channels rests on a proposition that there are 'dynamic

103 There is a potential third category of 'limited distribution' described as supply of a lower quality service (see footnote 183). As with the second type of 'limited distribution', it is not dealt with at all in the Consultation, apart from identifying the theoretical possibility in a footnote.

incentives'[104] not to supply the channels on third party platforms which outweigh those 'static' benefits.

4.62 In a vertical foreclosure framework, the identification of a *plausible* dynamic incentive to withhold an input from third parties requires the specification of a robust, credible dynamic *mechanism* – something that explicitly links short-run effects today with long-run effects in the future. This must amount to more than a vague unsupported assertion that a firm will choose not to supply a rival today for fear of adverse consequences of one kind or another in the future.

4.63 Ofcom identifies two candidates for such dynamic mechanisms:

(i) "*dampening*" of future retail competition; and
(ii) reducing future competition for sports rights.[105]

4.64 These are discussed further in sub-sections 4B(i) and 4B(ii) respectively. Before doing so, however, we make some general observations on Ofcom's approach.

4.65 In evaluating the plausibility of the candidate dynamic mechanisms put forward by Ofcom, Sky, and other respondents to the Consultation, are significantly hindered by the paucity of detail provided by Ofcom in relation to them, and the vague way in which they are described. The following comments are provided notwithstanding this fundamental point.

These propositions were examined critically during the appeals of Ofcom's Pay TV Statement

4.66 These (or similar) hypothetical incentives were the subject of substantial economic analysis and a great deal of relevant evidence in relation to them was provided during the appeals of Ofcom's Pay TV Statement. In particular, Ofcom's economic analysis of this issue was the subject of expert reports from Professor John Van Reenen and Dr Jorge Padilla, and a significant amount of evidence on this subject was provided by Sky's then Chief Operating Officer, Mike Darcey.

4.67 Ofcom does not refer to such evidence and analysis in the Consultation. Instead, the Consultation proceeds on the basis that the propositions put forward in the 2010 Pay TV Statement in relation to Sky's incentives are valid. This approach is not tenable. Ofcom must have regard to the evidence and economic arguments put forward during the appeals of the 2010 Pay TV Statement given that they are directly relevant to the issues that it is considering. For Ofcom's convenience, Professor Van Reenen's reports and the relevant parts of Mike Darcey's witness statements on this issue are included at Annex 7. In the following sub-sections we discuss some of the key flaws in the hypothetical dynamic incentives put forward by Ofcom in the Consultation, without being exhaustive.

Ofcom ignores the unchallenged finding of the CAT on this issue

4.68 In the appeals of Ofcom's Pay TV Statement, the CAT examined in detail evidence on Sky's actual behaviour, which Ofcom believed was motivated by the dynamic incentives (or similar incentives) set out in the Consultation. The Tribunal's finding on this issue was emphatic. It stated:

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104 The term 'dynamic incentives' is commonly used by economists when referring to this issue. Although Ofcom states at paragraph 4.15 that it proposes using this terminology, in the remainder of the Consultation Ofcom refers to such incentives as "*strategic benefits*" (e.g., paragraphs 7.15, 7.21, 7.23). For simplicity and consistency, we use the term dynamic incentives throughout this response.

105 See, for example, paragraph 7.17.

"*The Tribunal has examined the evidence in considerable detail. As already mentioned this evidence includes the contemporaneous documents as well as the written and oral testimony of witnesses (some of whom were subject to extensive cross-examination) as to the relevant events and circumstances. The Tribunal has concluded that Ofcom's core competition concern is unfounded. That concern is based on the finding to which we have referred, namely that Sky has deliberately withheld from other retailers wholesale supply of its premium channels… and that in doing so Sky has been acting on strategic incentives unrelated to normal commercial considerations of revenue/profit-maximisation.*"[106] (Emphasis added.)

4.69 Similarly, the Tribunal stated:

"*However, having examined that evidence with some care we have formed a clear view that Sky was acting for ordinary profit/revenue-maximising commercial motives, and that it cannot reasonably be inferred from the material put before us that the alleged incentives were conditioning Sky's conduct.*"[107]

4.70 This critical finding is, however, not mentioned by Ofcom in the Consultation. Ofcom must have regard to this unchallenged finding of the Tribunal.

Sky's distribution of its 'key sports channels' is not conditioned by the considerations put forward by Ofcom

4.71 The simple fact is that Sky does not have regard to the hypothetical considerations put forward by Ofcom when considering opportunities for distribution of its 'key sports channels'. There is no available evidence to support a proposition that it does so, and copious evidence available to show what in fact motivates Sky when considering such opportunities, principally: (i) the possibility of earning additional revenues and expanding the number of subscribers to its sports channels, and (ii) ensuring that third party platforms are secure so that those channels cannot be pirated.

The propositions are unrealistic in the environment in which Sky operates

4.72 Sky reiterates the unrealistic nature of a proposition that it would rely on benefits of the type put forward by Ofcom as a reason for choosing not to supply its 'key sports channels' to a particular pay TV platform, or doing so only on unfavourable terms. As discussed above, this is because (i) new distribution opportunities are of considerable value to Sky, and (ii) even if Sky considered the 'strategic benefits' posited by Ofcom to be realistic (which it does not), they would arise too far in the future for Sky to rely on them given the fast moving nature of the sector in which it operates.

The recent wholesale deal with Virgin Media in particular undermines Ofcom's theories

4.73 As set out in Part A of this Section 4, the new wholesale agreement reached with Virgin Media in 2014 was a long term, wide ranging agreement. As noted above, it was described by Virgin Media's Chief Executive Officer as "*the most extensive agreement ever signed*

106 Paragraph 27 of the CAT's judgment.

107 Paragraph 37 of the CAT's judgment. See also paragraph 829 of the judgment. In relation to the economic analysis of Sky's incentives, at paragraph 829 of its judgment the Tribunal made it clear that the reason that it did not need "*to resolve the issues debated before us at some length as to the plausibility or otherwise as a matter of economic theory of the alleged strategic incentives on which Sky was said by Ofcom to be acting*" was that the evidence did not support a view that Sky was withholding its channels from third party platforms.

between Virgin Media and Sky"[108]. The agreement was negotiated outwith the WMO, and the WMO in fact played no role in either Sky's desire to reach agreement with Virgin Media, or the terms of that agreement.

4.74 Virgin Media is the second largest retailer of pay TV services in the UK, with a base of over 3 million pay TV subscribers. Among other strengths, it has a strong portfolio of products, ranging from high speed broadband services, fixed line and mobile telephony, pay TV services, TiVo set top boxes, on-demand services, and a TV everywhere service. It has recently announced its intention to spend £3 billion extending the reach of its cable network. It is a key competitor to Sky – a fact that can easily get lost in the noise generated by BT.

4.75 In 2012 the CAT concluded that Virgin Media was "*rightly regarded by Sky as a serious, well-established rival capable of constraining Sky's actions in the market*"[109]. The agreement reached between Sky and Virgin Media in 2014, which includes a broad grant of rights, plainly makes it able to become an even more effective competitor.

4.76 According to Ofcom's hypotheses about Sky's 'dynamic incentives' the agreement with Virgin Media should never have happened. Sky was under no regulatory or other obligation to engage with Virgin Media to negotiate the new agreement, or to include such an extensive range of products and rights within its scope. The facts that (i) Sky did engage, and in fact as the documentary record shows, at times drove the negotiations, and (ii) was willing to supply Virgin Media with such a broad range of products and rights, under a long term agreement, demonstrate that Ofcom's hypotheses have no basis in reality.

Other deals also undermine Ofcom's theories

4.77 As noted above, a key focus of Ofcom's theories is now on rival platforms that are small today, but which have the potential to develop into significant competitors to Sky's in the future. Ofcom's focus on BT in relation to this theory means that it fails to observe Sky's dealings with a wide range of large powerful operators with platforms that are small today (or even yet to launch), but which have the potential to grow significantly in the future. These include **[CONFIDENTIAL]**, Eircom Ireland and **[CONFIDENTIAL]**. These firms are large, well-funded operators in the **[CONFIDENTIAL]**, with millions of customer relationships and a strong desire to add TV to their proposition. According to Ofcom's theories, Sky should be doing all it can to resist delivering its 'key sports channels' via these operators' services. On the contrary, however, Sky's 'key sports channels' are available, or will be available, on all these platforms, either via a wholesale deal or via NOW TV.

4B(i) "*Dampening*" future retail competition

It is unclear how this issue differs from static disincentives to supply

4.78 As noted above, the framework of analysis adopted by Ofcom in relation to Sky's incentives to supply its 'key sports channels' to third parties is conventional. First, it considers Sky's 'static' incentives to enter into distribution arrangements with third parties, before considering 'dynamic' incentives to do so. In such a framework, analysis of static incentives involves consideration of two potentially conflicting factors: (a) supply to a third party retailer is likely to generate wholesale revenues, creating an incentive to

108 See: 'Sky and Virgin Media strike major new channel distribution agreement', 12 May 2014. (https://corporate.sky.com/media-centre/news-page/2014/sky_and_virgin_media_strike_major_new_channel_distribution_agreement.)

109 Paragraph 813 of the CAT's judgment.

supply; however, (b) it will also result in increased competition from the third party retailer for customers, potentially offsetting the positive incentive to supply.

4.79 Accordingly, the disincentive to supply an input to a third party associated with an increase in retail competition faced by the vertically integrated operator is normally captured as a cost within the assessment of (net) static incentives. Including it *in addition* as a dynamic disincentive to supply would mean that it was double-counted. Yet this is precisely what Ofcom appears to do in the Consultation, including increased retail competition resulting from supply of Sky's 'key sports channels' in both the static analysis and adducing it as a dynamic disincentive to supply.

4.80 Part of the confusion in relation to this matter may arise from the fact that the 'static' cost associated with increased retail competition has a temporal dimension; the effect is not 'one-off', but occurs over time. This is irrelevant to the categorisation of this effect as between static and dynamic incentives. The static costs and benefits of supplying Sky's sports channels to third parties both have an ongoing temporal element, and must be considered in present value terms.

The calculus in relation to 'small platforms'

4.81 Ofcom's focus in relation to the hypothetical 'dampening of competition' dynamic mechanism is on platforms that (a) are small today, but which (b) Sky perceives that, if supplied with its 'key sports channels', will grow to be significant competitors to Sky's services over time (but otherwise would remain 'small').

4.82 This proposition suffers from the following flaws:

(i) in such a case, the cost to Sky of not supplying its channels is not, as Ofcom considers, the relatively small revenues that are earned while the platform is small. Instead, Sky would be forgoing revenues and profits that are growing over time; and

(ii) notwithstanding this point, although the types of revenues and profits considered by Ofcom are *relatively* small today, they are not insignificant, especially when considered in present value terms. In order to forgo such profits, Sky would need to have a high degree of confidence that (a) the platform in question represented a significant future competitive threat to Sky's retail pay TV business, (b) not supplying its 'key sports channels' to that platform would make a significant difference to the extent of the competitive threat posed to Sky's retail pay TV business, and (c) the value of the difference to the competitive threat would outweigh the costs of non-supply in present value terms. These are demanding conditions, and it is implausible that they would be met in practice, particularly having proper regard to rapid change in the sector over time.

4B(ii) The 'vicious circle' proposition

4.83 The second hypothetical dynamic incentive advanced by Ofcom concerns bidding for sports rights. Ofcom relies on a proposition first advanced by the complainants to Ofcom in 2007 and described by them as a 'vicious circle', which was adopted by Ofcom in its 2010 Pay TV Statement.[110] This posits that the greater the size of a pay TV retailer's subscriber base, the more likely it is to win auctions of sports rights - if it is also vertically integrated

110 'Submission to Ofcom on the need for a market investigation into the pay TV industry', British Telecommunications plc, Setanta Sport Holdings Limited, Top Up TV Europe Limited and Virgin Media Limited, 3 July 2007. (http://stakeholders.ofcom.org.uk/binaries/consultations/market_invest_paytv/annexes/submission1.pdf.) For convenience, we adopt the 'vicious circle' terminology in this response.

into the production of sports channels (or is prepared to extend its activities in this way). Ofcom's theory is that this provides Sky with an incentive to withhold its 'key sports channels' in order to restrict the competition it will face in the future when bidding for sports rights.

It is the total number of subscribers or potential subscribers to a broadcaster's channels – across all platforms - that matter when bidding for sports rights

4.84 In Section 7 of the Consultation Ofcom states that its reasons for considering that having a large retail subscriber base "*may deliver advantages to* [Sky] *when bidding for sports rights*" are set out in Section 6 of the Consultation.[111] However, as far as Sky can discern, neither Section 6, nor any other part of the Consultation, provides such an explanation.[112]

4.85 There is no obvious reason why having a large *retail* base of pay TV subscribers, a large proportion of which have little or no interest in sport, or no interest in subscribing to premium sports channels, is of value to a vertically integrated pay TV operator when bidding for sports rights. As far as Sky is aware, no plausible case has been made for this proposition.

4.86 In relation to subscriber numbers, it is a pay TV *broadcaster's total number of subscribers to its channels,* across all platforms, which matters when bidding for content rights, not the total size of its *retail* base if it is vertically integrated. In Sky's case, for example, the *circa* **[CONFIDENTIAL]** subscribers to Sky Sports on Virgin Media's platform are of far greater importance to Sky when bidding for sports rights than the *circa* **[CONFIDENTIAL]** Sky retail subscribers who choose not to subscribe to those channels, despite having the ability easily to do so by upgrading their subscription and despite having had the option of subscribing to Sky's sports channels for over 20 years.

4.87 From the perspective of a potential competitor for sports rights (*i.e.*, in relation to the vicious circle theory, a platform operator that does not, today, operate sports channels, but might intend to do so in future) what matters is the number of potential subscribers to which it can deliver its channels – across all platforms – once it has acquired rights (and undertaken all the other investments needed to begin broadcasting a new premium sports channel). Such subscribers do not need to be on that operator's own platform.

4.88 Elsewhere, BT has made a great deal of the fact that there is a substantial number of pay TV subscribers with a demonstrated propensity to subscribe to premium sports channels on Sky's DTH satellite platform, and who are unlikely to choose to switch platforms. For example, BT has stated:

> "*since the highest concentration of subscribers with the highest propensity to pay for premium sports channels is present on the Sky platform, launching a successful premium sports channel in practice requires access to Sky's subscriber base. Indeed,* [redacted] *of BT's BT Sport customers access the channels via the Sky platform. Without access to these subscribers, the underlying channel economics for the BT Sport business would be materially undermined.*"[113]

111 Paragraph 7.17.

112 Paragraph 6.58 states: "*If Sky can retain its strong position in pay TV retailing, this may give it continued advantages when bidding for sports rights (see Annex 8)*". In relation to this point, however, Annex 8 of the Consultation does nothing more than assert: "*in 2010…we said that Sky was the most effective retail outlet on the largest platform and that, since third parties would be unable to access this platform as effectively, Sky would have an advantage when bidding for Premier League rights.*" (A8.7(b))

113 Paragraph 2.5 of BT's response to Ofcom's second consultation on the regulation of Sky's access control services. (http://stakeholders.ofcom.org.uk/binaries/consultations/sky-access-control/responses/BT.pdf.)

4.89 As has been demonstrated conclusively by BT, however, any potential bidder for sports rights has guaranteed access to those subscribers by virtue of the regulatory requirement for Sky to provide conditional access services and EPG listings to any broadcaster of pay TV channels in relation to its DTH satellite platform on fair, reasonable and non-discriminatory terms. Consumers do not have to switch to the platform operated by the potential entrant to premium sports channel broadcasting to gain access to its sports channels.

4.90 This fact further undermines the proposition that a firm's propensity to bid for sports rights depends to a significant extent on the size of the retail subscriber base on its own platform.

Sky's view is the exact opposite of Ofcom's proposition

4.91 Sky takes the view that withholding its sports channels is, in fact, likely to reduce Sky's chances of winning future rights auctions. This is because:

(i) the amount that Sky is willing to pay for rights is a function of the total number of subscribers to its channels, not those to whom Sky retails those channels. Accordingly, additional subscribers to Sky's sports channels are of considerable value when bidding for rights, regardless of which platform those subscribers are on, or which retailer supplies the sports channels to subscribers[114]; and

(ii) Sky takes the view that most pay TV retailers would prefer supply of its sports channels – which are high quality, well-recognised products, rather than bearing the risks and costs associated with developing their own sports channels. It is considerably more likely that a rival at the retail level would bid against Sky for sports rights if Sky refused to supply them with its 'key sports channels', or refused to supply them on reasonable terms. Bidding for content may be the only way for such a rival retailer to secure content that it regards as essential for at least some of its subscribers or potential subscribers.

4.92 Accordingly, Sky's view is the exact opposite of the hypothetical incentives posited by Ofcom.

The proposition has been fatally undermined by BT's success in acquiring sports rights

4.93 BT's success in competing successfully against Sky for content rights, despite having a relatively small retail base of pay TV subscribers, fatally undermines this purported mechanism.

4.94 BT has now successfully competed head to head with Sky for sports rights over a number of years. Its success was most evident in relation to its acquisition of rights to the UEFA Champions League and Europa League, outbidding Sky by a substantial margin. Yet, at that time BT was the second smallest pay TV retailer in the UK, having around 2 million retail pay TV subscribers (including subscribers on Sky's DTH satellite platform, BT TV and users of the BT Sport app[115]). This fact is sufficient to undermine entirely the proposition

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114 By way of example, prospective wholesale revenues were a key element in Sky's assessment when it bid to acquire rights to Formula 1 motor racing.

115 See page 4 of 'BT Group PLC, Financial results for the second quarter and half year to 30 September 2013', 31 October 2013. (http://www.btplc.com/News/ResultsPDF/q213_release.pdf) This states: "*We now have more than 2m BT Sport retail customers which include customers watching via satellite, BT TV, online or via the app.*"

that there is a positive relationship between the size of a firm's retail pay TV subscriber base and the likelihood of it (a) competing for, and (b) winning auctions for sports rights.

4.95 There is no evidence to support a view that BT's entry into pay TV broadcasting and/or its success in acquiring all the sports rights it has acquired (including Champions League rights) was in some way dependent on first building a base of retail pay TV subscribers. On the contrary, it is evident that BT bid for premium sports rights in the expectation of being able subsequently to monetise the rights it acquired in a variety of ways.

4.96 In fact, since Ofcom's Pay TV Statement it is now clear that BT has found a way to monetise 'key content' rights other than via building a base of pay TV subscribers, namely via profits derived from using those rights to drive sales of other products. In BT's model for the monetisation of 'key content' rights, direct revenues from subscribers play only a supporting role. The customer base that matters most to BT is not those customers that pay to receive the channels, but those customers who choose to continue to purchase telephony and broadband services from BT, or who switch to BT for telephony and broadband services either partly or predominantly to receive BT Sport for free.

4.97 Accordingly, it is anachronistic for Ofcom to continue to seek to rely on hypothetical incentives to limit distribution that are based on alleged concerns held by Sky that supplying its 'key sports channels' to third party retailers will assist them to build a base of paying subscribers to those channels, which in turn will assist them in competing for key sports rights in future.

Supply of Sky's 'key sports channels' to BT makes no material difference to its threat as a bidder for sports rights

4.98 BT's primary rationale for entering the production of sports channels carrying 'key content' is well known. It has been articulated publicly by BT on many occasions, and acknowledged, in part, by Ofcom[116]: it is to use those investments to reverse the loss of its line rental customers to competitors and significantly to increase its broadband market share (above the 30% for which it already accounted prior to the launch of BT Sport), by retaining existing customers and winning back customers lost to third parties, particularly Sky. The benefits of this policy are likely to be worth hundreds of millions of pounds to BT. BT has been effusive about its success to date. For example, BT's quarterly results press release for the year to 31 March 2014 stated:

> "*BT Sport has proved very popular and we are delighted the service is now in around five million homes. For BT Consumer it underpinned a record 9% growth in revenue in the fourth quarter and the lowest line losses in over five years. We achieved an excellent 79% share of broadband market net additions in the quarter.*"[117]

4.99 BT has also made it clear that its investment in premium sports channels is a long term strategy. For example:

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116 See for example, page 72 of Ofcom's decision rejecting TalkTalk's complaint of margin squeeze in relation to its bundles containing superfast broadband, where Ofcom states: "*BT's investment in sports rights was linked to BT's broadband business*". 'Complaint from TalkTalk Group against BT about alleged margin squeeze in relation to superfast broadband pricing' CW/1103/03/13, Ofcom decision, 21 October 2014. (http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01103/CW-01103-03-13.pdf.)

117 'BT Group plc, Results for the fourth quarter and year to 31 March 2014', May 2014. (http://www.btplc.com/news/articles/showarticle.cfm?ArticleID=b37789ab-6ae4-4dbf-861d-ef6f8e07f8e0.)

- BT's Chief Executive Officer, Gavin Patterson is reported as saying in relation to BT Sport:

  "*If you're going to build a business then you have to take a view over five or 10 years.*"[118]

- John Petter, CEO of BT's Consumer Division, is quoted as saying:

  "*The argument has been made that BT Sport is a marketing gimmick or a flash in the pan, and those things just aren't true….BT Sport is here to stay*".[119]

- BT TV's former CEO, Marc Watson, stated that BT intended to become "*an immovable part of the UK broadcasting landscape.*"[120]

4.100 In light of the clear evidence on the benefit to BT from its investment in BT Sport and the fact that this is a long term strategy, a proposition that Sky could somehow induce BT to abandon that strategy, or encourage it to compete less strongly for sports rights in the future, by refusing to supply its retail pay TV business with Sky's 'key sports channels' is not credible.

The set of potential competitors for sports rights is not limited to vertically integrated UK players, and most pay TV retailers have no desire to become pay TV broadcasters

4.101 Ofcom's proposition is that Sky may withhold its 'key sports channels' in order to reduce the competition that it faces in future auctions for sports rights from pay TV retailers in the UK that are either (a) vertically integrated into pay TV broadcasting, or (b) not vertically integrated today, but are prepared to extend their activities in this way as they grow. There are obvious flaws with this proposition.

4.102 First, even if Sky were able to *eliminate* the competition it faced when bidding for rights from such operators, it would still face competition from broadcasters that are not vertically integrated. For example, in the past Sky faced competition for rights from ESPN and in the most recent Premier League rights auction it was rumoured that Discovery and/or BeIN Sport would take part. BeIN Sport, which is a major international sports broadcaster, has, for example, acquired Ligue 1 and Champions League rights in France.

4.103 Second, it is evident that most pay TV retailers have little or no appetite for extending their activities into pay TV broadcasting, for a wide range of reasons. Such a move requires the deployment of significant capital, the acquisition of different skills and assets, and a major commitment of firms' time and effort. For most pay TV retailers such a move would be a distraction from their core strategies. Given the alternative of licensing Sky's (and potentially BT's) existing pay TV channels, which are well-known high quality products, for a monthly per-subscriber fee, the attraction of incurring the risks associated with becoming a premium pay TV channel broadcaster is likely to be extremely limited. This means that

[118] BT Retail boss set on challenging Sky for the title in sports broadcasting', The Guardian, 10 May 2013. (http://www.theguardian.com/business/2013/may/10/bt-challenging-sky-sports-broadcasting).

[119] 'BT Sport wins rights to Champions League and Europa League football - leaving ITV and Sky Sports with nothing from 2015', The Independent, 9 November 2013. (http://www.independent.co.uk/sport/football/news-and-comment/bt-sport-wins-rights-to-champions-league-and-europa-league-football--leaving-itv-and-sky-sports-with-nothing-from-2015-8930431.html.)

[120] See: 'Sport, The Game Changer?', RTS Cambridge Convention, 2013. (http://www.rts.org.uk/rts-cambridge-convention-2013-sport-game-changer-cc.)

there would be no point in Sky withholding supply of its 'key sports channels' to such retailers. Sky would be forgoing wholesale revenue and profits for no benefit.

Summary and conclusions

4.104 Rather than seeking to identify Sky's incentives in relation to distribution of its 'key sports channels', Ofcom should focus on how Sky is likely to behave absent regulation. Sky's track record of engaging constructively with opportunities to widen the distribution of those channels over many years provides clear and compelling evidence about how Sky would be likely to behave absent regulation, and it is inappropriate for Ofcom to ignore that evidence. A proposition that Sky would forgo certain additional wholesale revenues and profits, in the hope of influencing the competition it faces at some point in the future is wholly unrealistic in the market environment in which Sky operates. Sky's decisions about distribution of its 'key sports channels' are not motivated by the types of hypothetical incentives to 'limit distribution' put forward by Ofcom.

4.105 Ofcom adduces no evidence in the Consultation on this issue, and its theories about factors that might motivate Sky to 'limit distribution of its key sports channels' (a) have no basis in fact, and (b) are riddled with such numerous, significant flaws as to render them wholly unreliable. Section 7 of the Consultation could not constitute an adequate basis for a conclusion by Ofcom that it is necessary to continue to compel Sky to license its 'key sports channels' to third parties.

SECTION 5: OFCOM'S TREATMENT OF BT

Introduction

5.1 As set out in the preceding sections, there is no case for continuing to impose the WMO obligation on Sky. If after further analysis, however, Ofcom concludes that it is necessary to do so, the arguments set out in the Consultation for not also applying such regulation to BT's 'key sports channels' are unsustainable. Asymmetric regulation of Sky and BT would be a fundamental breach of Ofcom's statutory duty to apply regulation consistently.

5.2 The reasons provided by Ofcom for showing regulatory forbearance to BT are that (i) the 'key content' rights held by BT are "*modest*", (ii) BT is unlikely to engage in 'limited distribution' to larger platforms, and (iii) the acknowledged negative impact of BT's current non-supply to TalkTalk will be ultimately outweighed by a positive impact of BT establishing itself as a more effective pay TV competitor. These assertions do not stand up to scrutiny.

5.3 This section makes the following key points:

(i) BT's 'key content' holdings are significant;
(ii) BT already engages in 'limited distribution' of its 'key content' and this is likely to continue;
(iii) Ofcom has underestimated the potential impact of BT's 'limited distribution of key content'; and
(iv) regulating Sky but not regulating BT would be a breach of Ofcom's duty to regulate consistently.

BT's 'key content' holdings are significant

BT holds rights to a substantial volume of 'key content'

5.4 Ofcom identifies live broadcasts of Premier League and Champions League football matches as 'key content'. From 2015, BT will hold exclusive UK rights to all Champions League football matches in the UK, and shared rights to Premier League football matches.

5.5 BT's share of overall 'key content' rights in the UK is substantial. As shown in Table 5.1 below, in the forthcoming period relevant to Ofcom's review, BT will have rights to around 40% of the available Premier League and Champions League match slots for television broadcast.[121] In terms of value, BT's share of overall 'key content' rights expenditure will be 42% for the 2015/2016 season, and 31% in 2016/2017 onwards. Such figures cannot reasonably be described as "*modest*".

Table 5.1
BT's share of 'key content' rights[122]

Match slots		
	Number	**Share**
2015/16	78	40%
2016/17	82	39%

121 The term 'match slots' refers to the number of different kick-off time slots expected in the season.

122 Note that the total volume of BT's holdings is even higher than this as the number of match slots excludes the additional games to which BT has access which occur simultaneously at a given kick-off time, and which BT may broadcast simultaneously, for example via red button services. The share of rights expenditure includes BT's spend on Europa League, as this is consolidated in published figures, but this is not expected to be material.

Rights spend		
	Spend	**Share**
2015/16	£545m	42%
2016/17	£619	31%

Sources: Sky internal figures and publicly announced figures on rights expenditure; Sky internal analysis on number of match slots.

5.6 BT's rights are also of a high quality. For example, taking BT's Champions League and Premier League rights together, starting in the 2015/16 football season Sky estimates that **[CONFIDENTIAL]**% of the matches **[CONFIDENTIAL]** will be on BT Sport.[123]

BT's 'key content' is valuable

5.7 Ofcom is mistaken in its unfounded dismissal of the significance of these holdings (particularly its Champions League rights) in the Consultation as potentially "*modest*"[124].

5.8 On a like-for-like basis, as Table 5.2 below shows there is no material difference between the cost of individual Champions League and Premier League games. In fact, for the 2015/2016 season, the cost per match of Champions League rights exceeds that of Premier League rights.

Table 5.2
Cost per match of rights held by BT[125]

	Premier League matches	Champions League matches
2015/16	£6.5m	£7.5m
2016/17	£7.6m	£7.5m

Sources: Sky internal figures and publicly announced figures on rights expenditure

5.9 In terms of attractiveness for viewers, again there is no material difference between popular individual Champions League and Premier League matches. The most viewed Champions League games attract similar audiences to equivalent Premier League games. For example, Sky Sports viewing figures for the 2013/2014 season show that the most viewed Premier League game had 2.7 million viewers, whilst the most viewed Champions League game had 2.4 million viewers.[126]

5.10 It is also inappropriate for Ofcom to rely on observations based on the past in relation to the significance of Champions League football to competition. The acquisition by BT of exclusive rights to all Champions League football matches available for broadcast in the UK, by contrast to a situation in which Sky and ITV shared those rights, means that the past is an unreliable guide to the future on this issue.

5.11 Furthermore, where Sky Sports' Premier League content is widely distributed but BT Sport is subject to 'limited distribution', then BT Sport in general, and Champions League in

123 This estimate is based on the matches featuring these teams in the 2012/13 and the 2013/14 seasons, and the assumption that **[CONFIDENTIAL]**.

124 Heading preceding paragraph 6.27.

125 Again, Champions League expenditure also includes BT's spend on Europa League, as this is consolidated in published figures, but this is not expected to be material.

126 These were Liverpool v Chelsea, broadcast on Sky Sports 1 on 27 April 2014 and Chelsea v Atletico Madrid on Sky Sports 1 on 30 April 2014 respectively.

particular, will become an important differentiator for consumers interested in 'key content'. This would lend Champions League more significance than it has held previously for consumers in determining their pay TV subscription decisions.

5.12 Given the amount that BT has spent on Champions League football rights, it is to be expected that BT will seek to leverage those rights heavily in its marketing and scheduling strategy. It is not evident from the Consultation that Ofcom has obtained any information from BT as to its plans for the scheduling, bundling and distribution of its Champions League content, before drawing the conclusion that the impact of BT's Champions League rights may be modest.

Ofcom erroneously downplays the importance of BT Sport

5.13 Ofcom's analysis of the shares of supply of BT and Sky in relation to 'key sports channels' (paragraphs 6.32 to 6.35 and Table 6.1) do not provide reliable indicators of the relative positions of Sky and BT in the provision of 'key content'. Above all, by contrast to the figures set out above, this is because they involve estimates of revenues and expenditure in relation to all sports rights, not rights to 'key content'.[127]

5.14 Ofcom states that the reason that it believes that any impact on competition from limited distribution of BT Sport will be small is that "*rival platforms without access to BT Sport would find it difficult to compete for between 5% and 10% of pay TV customers*"[128]. This assertion, however, is wholly unreliable. Above all, it fails to take proper account of the change in the position of BT Sport when it begins carrying Champions League football later this year, discussed above. More generally, there are significant questions over the reliability of the survey evidence on which these figures are based – as Ofcom appears to recognise[129].

BT already engages in 'limited distribution' of its 'key content' and this is likely to continue

5.15 As acknowledged by Ofcom, BT currently chooses to limit distribution of the BT Sports channels by not supplying to TalkTalk.[130] The reason for this is straightforward. As Ofcom observes:

> "*BT's very substantial investments in developing a premium sports channel are in part aimed at supporting BT's broadband and voice business and its distribution strategy for its premium sports channels is likely to be influenced accordingly.*"[131]

5.16 There is copious evidence available to indicate that this statement underplays the role of "*supporting BT's broadband and voice business*" in the rationale for BT's investment in BT Sport, and therefore its approach to distribution of those channels. As one of many examples, BT's Chief Executive Officer, Gavin Patterson, is reported as saying:

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127 Sky notes that share of supply estimates based on revenues are also unreliable because they involve apportioning revenues from sales of bundles of sports channels and movie channels in circumstances where a wide range of reasonable methods for such an apportionment could be adopted.

128 Paragraph 6.68.

129 Ofcom describes the figures derived from this research as "*uncertain*" (paragraph 6.27). See also paragraphs A6.25 and A6.29 – A6.31.

130 Paragraph 6.72.

131 Paragraph 7.6.5. Ofcom asserts that, in relation to this issue, its Fixed Access Market Review ("FAMR") is addressed to ensuring effective competition in retail broadband and voice services (see footnote 190). However, the FAMR cannot address potential competition issues in relation to the provision of triple play packages associated with 'limited distribution' of BT Sport by BT.

"we don't look at it as a standalone investment, we judge it on whether the consumer business grows in the medium term. It is growing 9% top line and 5% bottom line, so that is a very good result."[132]

5.17 Ofcom considers that BT's 'limited distribution' of BT Sports will have a "*short term*"[133] negative impact on competition. Given the clear rationale that underpins BT's policy of not supplying BT Sport to TalkTalk, there is no reason for Ofcom to believe that that policy will change in the short term. On the contrary, it is likely to be a long term approach.

5.18 Furthermore, Ofcom cannot assume that BT's short term distribution agreement with Virgin Media will be renewed, or be renewed on terms that are acceptable to Virgin Media. Virgin Media was not certain of supply of BT Sport until the very last moment, with the deal being announced two days in advance of the Premier League season starting in 2013 and months after BT had announced the launch of BT Sport.[134]

Ofcom has underestimated the potential impact of BT's 'limited distribution of key content'

5.19 Ofcom considers that BT's 'limited distribution' of BT Sport will have a "*small*" negative impact on competition.[135] However, Ofcom takes the view that this may be offset by the benefit of making BT a stronger competitor in the provision of pay TV services in the "*medium to long term*"[136]. Both these positions are inappropriate.

Ofcom's sanguine view of the effects of BT's 'limited distribution' of BT Sport is inappropriate

5.20 In the first instance, 'limited distribution' of BT Sport has the potential to have a greater impact on the position of other platforms and retailers than Ofcom recognises. As explained above, in the period relevant for Ofcom's review BT Sport is likely to become an important differentiator for pay TV customers with a high valuation of 'key content'.

5.21 Ofcom wrongly discounts any future impact on Virgin Media (Sky's largest pay TV competitor) from 'limited distribution' of BT Sport, by assuming certainty of continued distribution to Virgin Media in the long term on acceptable terms. As noted above, this cannot be presumed, particularly once BT begins carrying Champions League matches.

5.22 Second, Ofcom appears to underestimate the potential impact of TalkTalk not being able to retail BT Sport.[137] TalkTalk is not a minor or insignificant player in the pay TV sector. It is a highly effective retailer of pay TV services, and has been the fastest growing pay TV retailer in the UK, securing one million subscribers just 18 months after launching its

132 'Taking on Sky at its own game: BT chief executive Gavin Patterson', Management Today, 29 August 2014. (http://www.managementtoday.co.uk/news/1307850/taking-sky-its-own-game-bt-chief-executive-gavin-patterson/.)

133 See, for example, paragraphs 1.17, 6.68, and 6.72.

134 See 'BT and Virgin Media sign wholesale BT Sport deal' BT press release, 15 August 2015. (http://www.btplc.com/news/Articles/ShowArticle.cfm?ArticleID=45262846-58D9-4D23-9DA8-3FB9234B29AB.)

135 See, for example, paragraphs 1.17, 6.68, 6.72, and 8.21.

136 Paragraph 6.69.

137 At paragraph 7.37 Ofcom seems to suggest that BT's non-supply to TalkTalk's YouView platform would be mitigated by the fact that "*any BT broadband customer can watch BT Sport online via the BT Sport app*". Sky notes that TalkTalk's YouView subscribers are necessarily TalkTalk broadband (not BT broadband) customers, and therefore would not have the ability to access BT Sport online, as this is only available to BT broadband customers.

YouView TV platform.[138] BT's failure to supply BT Sport to TalkTalk may, therefore, have a disproportionate impact on competition at the retail level.

5.23 Third, Ofcom disregards the impact on triple play competition. Without BT Sport, TalkTalk is weakened as a competitor for triple play customers. If Virgin Media's current arrangements for carriage of BT Sport are not renewed, Virgin Media would be in the same position.

5.24 As a result of the above, Ofcom underestimates the potential impact of TalkTalk, and possibly also Virgin Media, being weakened as competitors for pay TV subscribers and triple play customers, not only against BT, but also against Sky.

It is inappropriate for Ofcom to seek to strengthen BT's position

5.25 Ofcom is candid in its view that, in BT's case, it is prepared to trade off adverse effects on competition and consumers from 'limited distribution of its key sports channels' in order to seek to assist BT to become a stronger competitor in the provision of pay TV services. Throughout the Consultation, Ofcom states that the adverse effect on competition associated with 'limited distribution' of the BT Sport channels may be offset if it enables BT to establish itself as a "*more effective competitor*"[139].

5.26 This proposition is inappropriate.

5.27 First, and most importantly, as noted in Section 3, above, Ofcom cannot legitimately use Section 316 CA03 to promote the competitive position of BT.

5.28 Second, BT does not need regulatory assistance from Ofcom.

5.29 Ofcom asserts that permitting BT to limit distribution of BT Sport may enable it to become a more effective competitor "*in both the supply of key sports channels and at the retail level*"[140].

5.30 In relation to the supply of 'key sports channels', Ofcom's portrayal of BT as a broadcaster with a "*modest*" position in the market, and its attempts to downplay the scale and success of BT Sport, fly in the face of reality. As set out in Section 2, above, it is evident on the facts that, despite being a relatively new entrant, BT has been able to establish a strong position in pay TV channel broadcasting in a short period of time. BT's commitment to spend over £600 million per annum on sports rights from 2016/17, which BT has publicly stated it can readily afford[141], indicates that BT has an ongoing appetite and ability to maintain its holdings of 'key content' rights. BT does not need regulatory assistance from Ofcom to become a stronger competitor in the supply of 'key sports channels'.

5.31 At the retail level, it is wholly unclear why Ofcom considers it appropriate to elevate BT Retail's interests over those of other competitors in pay TV services and triple play services such as Virgin Media and TalkTalk.

5.32 BT is a large, successful and highly profitable business operating in the UK communications sector, with revenues of over £18 billion a year, profits of over £3 billion a year, which are

138 See, for example, 'TalkTalk becomes fastest-growing pay TV operator in UK', The Guardian, 15 May 2014. (http://www.theguardian.com/business/2014/may/15/talktalk-fastest-growing-pay-tv-operator-uk.)

139 See paragraphs 1.17, 6.69, 6.72 and 8.21.

140 Paragraph 6.69.

141 See Section 2, above.

growing over time, and able, for example, to pay over £12 billion to acquire EE. BT does not need Ofcom's assistance to become a more successful competitor. Indeed, it is difficult to credit the fact that Ofcom regards a proposition that it should ignore potentially anticompetitive effects of BT's actions in order to strengthen its position in the sector as a reasonable and credible position for Ofcom to take.

Regulating Sky but not regulating BT would be a breach of Ofcom's duty to regulate consistently

5.33 Under Section 3(3)(a) CA03 Ofcom must have regard to the principles under which its regulatory activities should be, amongst other things, proportionate, consistent and targeted only at cases in which actions is needed. If Ofcom considers regulation of the supply of sports channels that carry 'key content' is necessary, given the facts set out above, it would be inconsistent for Ofcom to regulate Sky but not to regulate BT.

SECTION 6: NEXT STEPS

Ofcom has not adequately established a legal basis for regulatory intervention

6.1 On the basis of the analysis in the Consultation, there are no grounds for Ofcom to proceed to a further consultation on proposals for intervention. The appropriate course of action is to close the review and remove the WMO obligation.

6.2 It is, however, important to recognise that deregulation today does not mean abandonment of concerns, or the threat of regulation in the future. It is, of course, always open to Ofcom to propose the re-introduction of regulation if there is a clear-cut case for intervention in the future that cannot adequately be addressed through use of Ofcom's Competition Act powers.

It is procedurally unfair for Ofcom to have proposed remedies at this stage

6.3 On a number of occasions, Ofcom has stated expressly that this review of the WMO obligation would be conducted as a two-stage process – the first stage being to identify whether or not there is a case for intervention under Section 316 CA03 and the second stage, if required, to consult on proposed remedies.[142]

6.4 Sky is therefore concerned by the fact that not only has Ofcom outlined proposed remedies in Section 8 of the Consultation, but has also invited respondents to (a) comment on them[143], and (b) suggest alternatives. Ofcom asserts that these remedy options are "*illustrative*"[144]. However, by inviting respondents to comment on these options, and indeed to identify further options for Ofcom to consider, Ofcom goes beyond illustration.

6.5 By outlining and consulting on proposed remedies, in advance of taking into account consultation responses on the existence of a case for intervention, Ofcom contaminates the first stage of the review. The predictable outcome of this step is that Ofcom will receive substantial submissions on this issue from respondents seeking to further their commercial interests. Given that Sky does not consider that there is a case for any remedies to be imposed, we do not intend to comment on those put forward by Ofcom in the Consultation, still less to propose alternatives. Accordingly, Sky risks suffering unfair prejudice if Ofcom begins to consider submissions on remedies, prior to reaching and setting out a properly informed conclusion on the case for intervention. Ofcom should therefore disregard any submissions it receives on remedies in response to the Consultation.

Ofcom may need to introduce an additional stage of its review process

6.6 Much of the Consultation comprises something akin to a call for inputs, rather than providing Ofcom's own analysis and consideration of relevant evidence on the issue of whether it is necessary to continue to impose the WMO on Sky. Instead, the Consultation principally comprises the presentation of a series of possibilities, on which Ofcom is inviting submissions, intended to form the basis for further analysis.

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142 Paragraph 8.17. See also Ofcom's web site which provides background to the WMO Review: http://stakeholders.ofcom.org.uk/consultations/wholesale-must-offer/about.

143 See Question 8.2 of the Consultation.

144 Paragraph 1.28.

6.7 To the extent that Ofcom intends to rely on evidence or submissions from third parties received in response to the Consultation in support of a conclusion that it is necessary to continue to impose the WMO on Sky, as a matter of procedural fairness Ofcom must give Sky the opportunity to review and comment on such evidence and have due regard to Sky's comments. (In particular, any potential concerns raised in relation to 'limited distribution' of Sky's key sports channels other than non-supply.) As a result, there may be a need for an additional stage in Ofcom's review before it moves to the consideration of remedies if, indeed, it concludes that it is appropriate to do so.

Proceeding to consider regulatory intervention is only tenable if Ofcom satisfies a number of requirements

6.8 If, notwithstanding the submissions above, Ofcom is minded to continue to consider regulatory intervention, this would only be justified on the basis of comprehensive, evidence-based analysis that established a robust case for intervention. Given the fundamental failings at the core of Ofcom's theories of harm in the Consultation, and the material discrepancies between those theories and commercial reality, Sky cannot envisage how Ofcom could successfully mount a case for intervention under Section 316 CA03.

6.9 Nevertheless, if Ofcom did purport to identify a robust case for intervention, it would not be able to proceed to impose regulatory obligations without due regard to its statutory duties and regulatory principles. In particular, Ofcom would need to ensure that any intervention was proportionate and targeted only at cases where action was needed, in line with its statutory duty under Section 3(3)(a) CA03. Ofcom would also need to ensure that any intervention conformed to its duty to apply regulation consistently as between all holders of 'key content'.

6.10 Finally, before exercising any powers under Section 316 CA03 for a competition purpose, Ofcom would need to consider if the prejudicial practice identified could more appropriately be addressed using its powers under the Competition Act 1998, as required under Section 317(2) CA03. To that end, Sky notes that the factors underpinning Ofcom's decision in 2010 not to proceed under the Competition Act 1998 are not relevant in 2015. In 2010, Ofcom stated that proceeding under Section 316 CA03 enabled it to put in place "*a comprehensive solution to a general problem affecting the relevant markets*"[145]. In the Consultation Ofcom has not identified a "*general problem*" which requires a comprehensive solution, but rather has focused on the risk of non-supply by Sky to a specific retailer for strategic anticompetitive reasons. In the unlikely event that such a situation were to arise in practice, Ofcom's concurrent Competition Act powers would be a perfectly adequate and proportionate remedy. Accordingly, given that a more appropriate way of proceeding would be under the Competition Act, Ofcom would be prevented from exercising its Broadcasting Act powers for a competition purpose, and would be required to remove the WMO.

Sky **February 2015**

145 Paragraph 9.115 of the 2010 Pay TV Statement.

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Annex 8: Examples of marketing of triple play packages

ANNEX 1

A REVIEW OF THE PAST FIVE YEARS SHOWS THAT THERE WERE SIGNIFICANT ERRORS IN OFCOM'S ANALYSIS IN 2010

A1.1 The Consultation does not include a review of the effect of the WMO since 2010 against its objectives. This means that Ofcom has not undertaken, in particular, any review of whether the arguments used to justify its introduction in 2010 have been borne out in practice, even having regard to the fact that application of the WMO was more limited than intended by Ofcom. Such a review is of paramount importance when seeking to address the question of whether the WMO remains necessary and appropriate.

A1.2 Even a cursory review indicates that a number of the key justifications relied upon by Ofcom in 2010 to argue for the introduction of the WMO have proven to be unfounded:

- there was substantial unmet demand for Sky Sports channels among DTT households;
- the WMO was needed to support the rollout of high speed broadband services; and
- introduction of the WMO would give rise to significant innovation .

We discuss each of these below.

Unmet demand for Sky Sports channels among DTT households

A1.3 One of the key justifications for the introduction of the WMO was an assertion by Ofcom that there was significant "*unmet demand*" among consumers to receive Sky's sports channels via DTT. For example, the Pay TV Statement stated:

> "*Conclusion on distortion from lack of supply on DTT*
>
> *The surveys highlight the potential unmet demand for Sky's Core Premium channels on DTT. This data (which is also discussed in our impact assessment) suggests that a significant number of households who do not subscribe to satellite or cable services would like to have access to Sky's Core Premium channels on DTT.*"[146]

A1.4 The quantified benefit from the introduction of the WMO in Ofcom's impact assessment, a £600 million increase in Sky's profits, was based on this proposition. Ofcom's central case was that after five years there would be an additional 1.8 million subscribers to Sky's sports channels on DTT (and IPTV) if they were supplied via these platforms.[147] Even at the time this was an extraordinary figure, which, had it been borne out, would have resulted in a substantial increase in the number of Sky Sports subscribers, when the total number of such subscribers had been flat for several years.

A1.5 It is now plain that Ofcom's belief was wrong. The number of subscribers to Sky's sports channels when they were available via DTT, retailed by both BT and TopUpTV, peaked at just under **[CONFIDENTIAL]** subscribers. In 2013 BT took the decision to remove Sky's sports channels from DTT, and the other provider of Sky Sports via DTT, TopUpTV ceased operations. Sky's sports channels are therefore no longer available via DTT. **[CONFIDENTIAL]**.

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146 Paragraph 8.69, Pay TV Statement.

147 Paragraph 13, second witness statement of Mark Caines provided during the appeals of Ofcom's Pay TV Statement.

A1.6 More generally, Ofcom's view in 2010 that there was substantial unmet demand for premium sports content among UK consumers, with millions of UK households waiting to access such content via alternative delivery mechanisms to DTH satellite and cable, has also be shown to be ill-founded.

The proposition that the WMO was needed to support the rollout of high speed broadband services

A1.7 A further key focus of Ofcom's rationale for introducing the WMO in 2010 was an argument that investment in NGA depended (in part) on access to Sky's sports channels. Ofcom stated:

> "*The investment necessary to deliver superfast broadband will in part depend on the ability to attract a wide range of TV subscribers including subscribers to Core Premium channels. For example in our statement on the provision of superfast broadband we observed that HDTV and IPTV services have played a role in driving demand for NGA services in Europe. On this basis we consider that access to Sky's Core Premium channels is likely to prove important, albeit as one of several potential drivers of demand. Without access to Sky's Core Premium channels development of NGA networks and services will be impeded.*"[148]

A1.8 Again, the passage of time has demonstrated that this proposition was unfounded. The rationale was only ever of potential relevance to BT; Virgin Media had already embarked on upgrading its network to fibre, and had assured supply of Sky's premium channels. Even in the case of BT it was of dubious relevance. BT had announced the upgrading of its network to fibre in March 2009[149], a year before the Ofcom Pay TV Statement, and it was evident at the time that this would have happened whether or not BT was able to retail Sky's sports channels. For example, it was important for BT to make this investment to remain competitive with Virgin Media.

A1.9 The passage of time has, however, shown how implausible a claim that rollout of high speed broadband services depended on wholesale access to Sky's sports channels was in practice. BT has largely completed the commercial roll-out of its NGA network since 2010, despite (a) only beginning to carry linear pay TV channels over that network at the end of 2012, and (b) attracting a peak of only **[CONFIDENTIAL]** subscribers to Sky's sports channels. Today, even though fibre is one of BT's key products, BT has only around **[CONFIDENTIAL]** subscribers to Sky's sports channels.

The proposition that the introduction of the WMO would give rise to significant innovation

A1.10 Another argument on which Ofcom placed emphasis in arguing for the introduction of the WMO regulation was that it would generate significant innovation on the part of pay TV retailers supplied with Sky's sports channels. In particular, Ofcom put forward a theory of firms 'innovating around' CPSCs. Ofcom stated:

148 Paragraph 8.201, Pay TV Statement.

149 See, for example: 'Green light for faster broadband', BBC News, 3 March 2009 (http://news.bbc.co.uk/1/hi/technology/7919904.stm). Ofcom provided an overview of progress in rolling out high speed broadband services in 2011 at: http://stakeholders.ofcom.org.uk/market-data-research/market-data/communications-market-reports/cmr11/telecoms-networks/5.2.

> "*The restricted supply of Core Premium channels diminishes the scope for other retailers to invest in innovative products or services to enter or expand in the market.*"[150]
>
> "*Greater availability of premium content provides firms with the opportunity to innovate around this content…. as entrants build scale, and expand the size of the customer base over which research and development costs can be recovered, their abilities to innovate will be strengthened.*"[151]

A1.11 It is telling that the current Consultation points to no significant innovations – whether technological or service-level – that have arisen as a result of the introduction of the WMO over the past five years. This is simply a reflection of the fact that the proposition that that supply of Sky's sports channels to third party retailers would generate significant new innovation was highly implausible.

[150] Paragraph 8.218, Pay TV Statement.

[151] Paragraph 11.78, Pay TV Statement.

ANNEX 2

SKY'S ALLEGED ADVANTAGES IN BIDDING FOR SPORTS RIGHTS AS A BARRIER TO ENTRY

A2.1 Throughout the Consultation there are assertions that Sky has "*advantages in bidding for key sports content*"[152] compared to other broadcasters (or potential entrants).[153] In a number of places, these are described as "*significant*"[154]. Ofcom devotes an annex to the Consultation to a discussion of the proposition that "*that Sky may have a significant advantage when bidding for rights which rivals may find difficult to overcome*"[155].

A2.2 The apparent context for these references is beliefs on Ofcom's part that:

(i) it is *more likely* that holders of 'key content' will choose to limit distribution of their sports channels if there are barriers to entry at the wholesale level of the sector; and
(ii) Sky's advantages in bidding for sports rights comprise a barrier to entry at this level of the sector.[156]

A2.3 In view of the facts that (a) as set out in Section 4, above, Sky does not limit the distribution of its 'key sports channels', and (b) Ofcom's argument relates only to the issue of whether barriers to entry upstream make it "*more likely*" that Sky would limit the distribution of those channels, we do not propose to address this argument in detail.

A2.4 At the outset, Sky notes that Ofcom's analysis of this issue is very short, comprising only two and a half pages. This is inadequate to support reliable conclusions on this issue.

A2.5 Sky does not contest the proposition that it has advantages when bidding for sports rights compared to other broadcasters, although these do not derive from the factors identified by Ofcom.[157] The relevant question in the context of an assessment of barriers to entry, however, is whether those advantages are sufficient to insulate Sky from effective competition for sports rights, and in particular, key sports rights.

Ofcom's conclusion that it is "not clear" whether BT has been able to overcome Sky's bidding advantages is perverse

A2.6 BT's success in outbidding Sky to acquire exclusive rights to the UEFA Champions League and Europa League from 2015 fatally undermines Ofcom's proposition that Sky's advantages when bidding for content rights comprise an insurmountable barrier to entry at the wholesale level:

152 Paragraph 1.25.

153 For example, paragraphs 1.25, 6.36 and 6.71 (repeated at paragraph 8.18).

154 For example, the heading preceding 6.36, A8.1 although we recognise that, once again, the latter is put as a conditional proposition ("*Sky may have a significant advantage when bidding for rights….*").

155 Paragraph A8.1.

156 This proposition is outlined at paragraph 4.16 of the Consultation, where Ofcom states: "there are a number of features of markets and of content holders, which may make it more likely that holders of key content will find it profitable overall to limit distribution…These features include the following: …barriers to entry and expansion (upstream and downstream): where there are significant barriers to entry to a part of the value chain, actions taken to reduce competition may have a higher potential payoff" (emphasis added).

157 Sky considers that its advantages stem from legitimate, pro-competitive factors such as the Sky Sports brand, its long experience in the sector, and its reputation for excellence in producing sports coverage. Sky is sanguine, however, about the value of those advantages when competing against large, determined and well-funded rivals.

- the rights in question are identified as 'key content' by Ofcom;
- BT competed head-to-head with Sky for those rights, outbidding Sky by a considerable margin;
- Sky competed strongly for the rights won by BT; and
- BT was able to achieve results from the auction that no other broadcaster has been able to achieve previously, including exclusive acquisition of all the live rights to UEFA Champions League matches, and Europa League matches.

A2.7 Ofcom addresses BT's ability successfully to compete for key content rights in four paragraphs of the Consultation, at A8.10 – A8.12. Ofcom concludes that it is "*not clear*" whether BT has been able to "*overcome…Sky's advantages*". This conclusion is perverse.

An analysis of firms' advantages in bidding for rights must be symmetric

A2.8 An analysis of whether firms are able to compete effectively with Sky for sports rights needs to evaluate the strengths and weaknesses of all potential bidders (or at least the most likely potential bidders) for those rights, in order to reach a well-informed view on whether Sky's advantages protect it from competition.

A2.9 For example, a proper analysis of BT's strengths and weakness as a bidder for sports rights would show that it also has significant advantages. Among other factors, BT has:

- a strong brand;
- very deep pockets;
- demonstrated capability in launching and successfully operating premium pay TV channels;
- substantial technical expertise – for example in operating IPTV and OTT services;
- guaranteed, low cost access to Sky's DTH satellite platform; and
- the ability to monetise content rights via profits on telecommunications services.

A2.10 These place BT in a strong position to compete for sports rights.

Sky's behaviour is inconsistent with a proposition that there are significant barriers to entry

A2.11 If Sky was, in fact, insulated from effective competition when competing for sports rights, as Ofcom believes, its behaviour when participating in rights auctions would be significantly different to that which is actually observed. In particular, there would be little reason for Sky to be concerned about other bidders when competing in rights auctions.

A2.12 Proper consideration of relevant evidence, however, would show that Sky is extremely concerned about other bidders when competing in rights auctions. For example, in the recent auction of Premier League rights, Sky devoted substantial amounts of effort to evaluating potential bids from other parties, particularly BT. Sky had no certainty that it would be able to win the rights that it acquired. Such factors undermine entirely a proposition that Sky can disregard the prospect of losing rights to other operators because it is protected from competition by barriers to entry.

The outcome of rights auctions in the UK is inconsistent with a proposition that there are significant barriers to entry

A2.13 Sky is a significant licensee of sports rights. Sky currently spends over £**[CONFIDENTIAL]** on sports rights every year, and licenses rights from more than **[CONFIDENTIAL]** rights owners. If Sky was, in fact, protected by significant barriers to entry in this activity it would be in a position to exercise significant monopsony power, and drive down the amount that it pays rights owners for licensing their rights.

A2.14 Sky cannot behave in this way. The competition it faces for sports rights means that it must compete strongly to retain and/or acquire those rights by bidding fully what it is willing to pay for those rights. It does not hold a position in which it is able to compel rights owners to license rights to Sky for less than they are worth.

A2.15 In fact, the effectiveness of competition for rights can be observed directly via prices for rights over time. In Section 3 of the Consultation, Ofcom observes that "*the cost of sports right has increased*" over the past five years, with the extent of this increase shown in the redacted Figure 3.5. This accords with Sky's experience, which is that the price it must pay to retain and/or acquire sports rights is continually increasing due to increasing competition over time. The outcome of the recent auction of Premier League rights provides all the evidence needed to undermine a proposition that Sky is able to exercise monopsony buyer power in relation to the acquisition of sports rights.

A2.16 Accordingly, the evidence from outcomes in relation to licensing of sports rights in the UK is inconsistent with a proposition that Sky is insulated from effective competition for such rights by insurmountable barriers to entry.

ANNEX 3

DISTRIBUTION OF SKY'S PREMIUM CHANNELS

ANNEX 4

INTERNET PROTOCOL ("IP") DELIVERY OF AUDIOVISUAL SERVICES

Introduction

A4.1. Ofcom's misperception of issues in relation to IP delivery of audiovisual content was a significant source of concern to Sky when the WMO was introduced in 2010, and the differences between IPTV and OTT delivery of content were the subject of considerable amounts of evidence and submission during the appeals of the Pay TV Statement. It is therefore of considerable concern to Sky that the Consultation reveals that there appears to be ongoing confusion on Ofcom's part about these issues. Accordingly, this annex explains the key concepts and illustrates where Ofcom's understanding is inaccurate.

IP-based delivery of content

A4.2. IP-based delivery of content simply refers to the ability to deliver content via packet switched networks using the Internet Protocols suite, rather than terrestrial, cable or satellite formats (for example DVB T2, or DOCSIS 3).

A4.3. There are two main methods of IP-based delivery of content: (i) over the top, and (ii) via IPTV networks. *Both methods* can be used to deliver (a) linear TV channels (both free to air and pay), and (b) on demand programmes (including, for example, movies, catch-up TV, library content and 'user generated content') to end users.

Over the top delivery

A4.4. Where audiovisual content is delivered from its source – such as a website server - into broadband networks and on to end users without the broadband network operators (or Internet Service Providers, "ISPs") undertaking any specific network management to maintain a certain level of quality for that content, it is described as being delivered over the top ("OTT"). Such services are also often described as being provided over the "*open internet*".

A4.5. There are two important features of OTT delivery:

- the content provider has little or no control over the quality of delivery; and
- the content provider does not need *ISP* agreement for its content to be delivered to the ISP's broadband subscribers.

A4.6. As a result:

- in the case of pay TV services, OTT services are often retailed by content providers directly to end users; and
- linear services delivered OTT are **unicast** to end users i.e. there is a separate stream of data over the network from the content source to each end user. (See appendix 1.)

A4.7. In principle, this means that OTT delivery currently lends itself more to services that require *relatively* lower levels of network quality than 'television quality', such as where:

- end users do not demand the highest levels of viewing quality (either in terms of delay and/or data loss or in terms of definition format); and/or where

- there are relatively lower levels of concurrent viewers (compared to viewing volumes for popular TV channels over traditional broadcast networks) – for example, as currently with NOW TV channels.

A4.8. In practice, with the availability today of (a) efficient compression technologies, and (b) high speed broadband connections, the quality of OTT services that can be delivered to consumers is very high. While improvements in (i) broadband speeds, (ii) encoding rates for audiovisual data and (iii) content delivery networks ("CDNs") over the open internet have all contributed to increases in the scale and scope of services that can be delivered OTT.

A4.9. It would be erroneous to believe that OTT services are limited to on-demand services. Today, there are many OTT services (both in the UK and elsewhere) that deliver *linear TV channels* to end users. For example, all the PSBs 'player' services provide live access to their broadcast channels, as well as catch-up and library content on an on-demand basis. This is not a new development. Sky has, for example, been delivering live access to broadcast television channels via the internet for around ten years.

A4.10. Well-known services delivered on an OTT basis in the UK currently include:

- YouTube
- Google play
- iTunes Store
- PSB 'players' (iPlayer, ITV Player, 4oD, Demand Five)
- Netflix
- Amazon Prime
- NOW TV
- Sky Go, Virgin Anywhere, BT TV Everywhere, TalkTalk TV
- The BT Sport app
- Blinkbox (now owned by TalkTalk)
- Play.com / Wuaki.tv

Of these, YouTube, the PSB players, NOW TV, Sky Go, Virgin Anywhere, the BT Sport app, BT TV Everywhere and TalkTalk TV to go all stream linear content as well as providing non-linear services.

A4.11. In places in the Consultation Ofcom appears erroneously to equate OTT services only with on-demand services. For example, at paragraph 1.9 Ofcom states:

> "*to date, OTT services have not offered the full range of services offered by more traditional pay TV retailers, being typically focused on on-demand movies and general entertainment.*"

As noted above, this is factually incorrect. Sky's 'Sky Player' service has offered on an OTT basis the range of linear channels typically offered by traditional pay TV retailers since 2006.

A4.12. Ofcom's glossary describes OTT delivery as follows:

> "*Refers to audio-visual content that can be delivered on the 'open' internet rather than requiring a managed IPTV architecture.*"

A4.13. This definition is poorly phrased. It would be better to state that OTT delivery:

> "*Refers to the delivery of audio-visual content via the 'open' internet rather than via a managed IPTV architecture.*"

A4.14. A further key difference between OTT and IPTV services relates to the end-user devices to which services are delivered. As discussed below, IPTV services, like other traditional pay TV services, are normally delivered via set top boxes provided by the IPTV network operator. By contrast, OTT services are delivered to a wide range of devices that are normally purchased in horizontal markets and which are often multi-function devices, such as computers, tablets, smart phones, games consoles, DVD players, connected TVs and connected TV devices (e.g. Apple TV, Chromecast). This means that OTT delivery enables content to be viewed on a wide range of screens *in addition to* television sets, including tablets, computers (PCs, Macs, laptops), and smart phones.

A4.15. In many of these cases, although access to the internet for delivery of content is open to all, device providers control access to users of those devices. For example, it is not possible to deliver content on an OTT basis to XBox users, or Apple TV users, without first reaching agreement with Microsoft and Apple respectively.

Internet Protocol Television ("IPTV")

A4.16. By contrast to OTT delivery, IPTV networks involve the provision of dedicated capacity and additional network management to ensure the provision of "television quality" video services to end users. Typically, they involve the provision of a set top box to subscribers (which can include PVR functionality), in keeping with 'traditional' pay TV platforms. By contrast, as discussed above, OTT services normally rely on devices purchased by consumers many of which have other uses.

A4.17. The additional network management undertaken by ISPs for the delivery of these linear services generally involves establishing a **multicast** network within the broadband network. Multicast delivery entails the transmission by the ISP of a single stream of audiovisual content to multiple, authenticated end users simultaneously. The ISP will dedicate capacity in the broadband network exclusively for this data stream to ensure that the linear content is delivered without any degradation in quality as a result of general network congestion. The ISP will also establish systems for authentication and unicasting lost or delayed packets.

A4.18. As the ISP controls the content and its quality of delivery, a content provider cannot deliver its services over the multicast network without the agreement and involvement of the ISP.

A4.19. Therefore, the ISP can combine multicast linear services with VOD services into a common pay TV platform which it retails to its broadband subscribers and which is effectively a closed platform in much the same way as a cable TV network. This is what is commonly known as IPTV.

A4.20. Ofcom defines IPTV as follows:

> "*The term used for television and/or video signals that are delivered to subscribers or viewers using Internet Protocol (IP), the technology that is also used to access the Internet. Typically used in the context of streamed linear and on-demand content, but also sometimes for downloaded video.*"[158]

A4.21. This definition fails to capture the key facets of IPTV networks, as set out above.

[158] Page 85.

A4.22. It is erroneous to exclude IPTV networks from consideration as 'traditional' TV platforms, as Ofcom does throughout the Consultation[159]. IPTV can be a considered an established means by which to deliver TV services in much the same way as DTT, DSAT and cable.

A4.23. IPTV networks have been established in the UK for many years – starting with Kingston Interactive Television ("KIT") and Homechoice from 2000. In the US, for example, Verizon and AT&T have rolled out large scale IPTV networks, and have millions of pay TV subscribers.

A4.24. In the UK, TalkTalk and BT now operate IPTV platforms.

TV Everywhere versus standalone OTT services

A4.25. The ability to offer audiovisual services via the internet has led 'traditional' pay TV operators to develop 'TV Everywhere' services. These are services that enable pay TV subscribers to access the channels and on-demand content to which their subscription entitles them on internet-connected devices, such as tablets, PCs, and mobile phones.

A4.26. In the UK, Sky Go, Virgin Media's 'TV Anywhere' service, and BT's BT Sport app are examples of this type of service.

A4.27. Such services should be distinguished from *standalone OTT pay TV services* – subscription pay TV services that are accessed via internet-connected devices, and which are not part of a pay TV service delivered via satellite, cable, DTT or IPTV. In the UK the key services of this type are NOW TV, Netflix and Amazon Prime.

A4.28. Ofcom's appreciation of these types of service appears deficient. For example, Ofcom states:

> "*The four largest pay TV providers (Sky, Virgin Media, BT, and TalkTalk) … offer OTT services which allow consumers to access their retail content services via IPTV (i.e. separately from their STB).*[160]

A4.29. However, these services are in fact delivered OTT rather than via "*IPTV*". This is readily apparent given that such services typically allow users to access their content over any broadband connection (and sometimes over mobile networks) – not just from their home.

IP-based services delivered via traditional platforms

A4.30. It is increasingly the case that set top boxes deployed by 'traditional' platform operators include the ability to receive content via IP in addition to other technologies.[161] However, it is not normally the case that their set top boxes can receive content via the 'open internet', or on an OTT basis.

A4.31. For example, Sky now provides set top boxes that can be connected to broadband

159 See, for example, paragraph 2.11, where Ofcom states: "*our primary focus has been to consider the impact of limited distribution of key content on competition between traditional pay TV retailers offering bundles of pay TV services including linear channels and on-demand services by traditional broadcast methods such as DTT, satellite and cable*." (Emphasis added.) There is no sound reason to exclude IPTV from this list. Ofcom's failure to consider IPTV to be a 'traditional' platform is surprising in view of the weight that it has placed in the past on the development of such platforms in the UK.

160 Paragraph 3.23.

161 In the case of BT's and TalkTalk's IPTV set top boxes, they are also able to receive FTA television channels delivered via DTT.

networks, either via a cable, or WiFi. This enables them to receive content on an on-demand basis delivered over a dedicated delivery system operated by Sky. (Sky's set top boxes are not able to receive IP-based linear TV channels.) They *cannot* be connected to the open internet, or receive OTT services.

A4.32. Ofcom states that providers in the UK "*often*" offer "*both OTT services and more traditional pay TV services on existing platforms (e.g. DTT, cable, DSat)*"[162]. That is certainly incorrect in Sky's case, and we believe that it is flawed as a general proposition.

A4.33. It is worth noting, however, that as described in Section 4 of this response, it was envisaged that YouView set top boxes would be able to receive linear television channels both via (i) proprietary IPTV networks operated by BT and TalkTalk, and (ii) via OTT. Whilst, today those boxes can receive on-demand content on an OTT basis, they have not been upgraded to permit them to receive linear TV channels on an OTT basis.

[162] Paragraph 3.21.

Appendix 1

Multicast and unicast delivery of content

A. Technical background

Unicast and multicast are two different ways in which live TV services can be delivered over broadband connections to end users.

With unicast delivery each device requesting access to the content is sent its own dedicated stream of data from the server in the network that hosts the content. As there are dedicated streams of data for each device in the unicast delivery of content, uniformity in content delivery is not assured. This is often referred to as "over the top" ("OTT") delivery of content.

With multicast delivery a single stream of data is sent from the relevant server to any devices that request access. Multicast delivery potentially offers a uniform viewing experience as all devices access the same stream of data, subject to the quality of individual users' access lines.
The following article provides further explanation.

> "*Information is delivered over a network by three basic methods: unicast, broadcast, and multicast.*
>
> *The differences among unicast, broadcast, and multicast can be summarized as follows:*
>
> - *Unicast: One-to-one, from one source to one destination.*
> - *Broadcast: One-to-all, from one source to all possible destinations.*
> - *Multicast: One-to-many, from one source to multiple destinations expressing an interest in receiving the traffic.*
>
> *With unicast traffic, many streams of IP packets that travel across networks flow from a single source, such as a website server, to a single destination such as a client PC. Unicast traffic is still the most common form of information transfer on networks.*
>
> *Broadcast traffic flows from a single source to all possible destinations reachable on the network, which is usually a LAN. Broadcasting is the easiest way to make sure traffic reaches its destinations.*
>
> *Television networks use broadcasting to distribute video and audio. Even if the television network is a cable television (CATV) system, the source signal reaches all possible destinations, which is the main reason that some channels' content is scrambled. Broadcasting is not feasible on the Internet because of the enormous amount of unnecessary information that would constantly arrive at each end user's device, the complexities and impact of scrambling, and related privacy issues.*
>
> *Multicast traffic lies between the extremes of unicast (one source, one destination) and broadcast (one source, all destinations). Multicast is a "one source, many destinations" method of traffic distribution, meaning only the destinations that explicitly indicate their need to receive the information from a particular source receive the traffic stream.*
>
> *On an IP network, because destinations (clients) do not often communicate directly with sources (servers), the routing devices between source and destination must be able to determine the topology of the network from the unicast or multicast perspective to avoid routing traffic haphazardly. Multicast routing devices replicate packets received on one input interface and send the copies out on multiple output interfaces.*
>
> *In IP multicast, the source and destination are almost always hosts and not routing devices.*

> *Multicast routing devices distribute the multicast traffic across the network from source to destinations. The multicast routing device must find multicast sources on the network, send out copies of packets on several interfaces, prevent routing loops, connect interested destinations with the proper source, and keep the flow of unwanted packets to a minimum. Standard multicast routing protocols provide most of these capabilities, but some router architectures cannot send multiple copies of packets and so do not support multicasting directly."*[163]

Under unicast delivery, as the number of devices requesting access to the same live content increases, more capacity is used in the broadband network. There is therefore a linear relationship between traffic on the network and number of active subscribers. This can lead to network congestion. With high volumes of concurrence of a single stream, it is usually more cost effective to deliver the live content via multicast where increased requests for access do not increase the network capacity required to deliver that content in a linear fashion, and the network capacity dedicated for multicast delivery is ring-fenced so that it is unaffected by other causes of network congestion. It should be noted that to ensure a high quality of experience, multicast networks are typically built with unicast fallback. This ensures that if a single multicast client fails to receive some part of the multicast stream, it can request unicast transmission of the missing packets until the multicast stream repairs itself.

B. Commercial implications

A key implication of the difference between unicast and multicast delivery of audiovisual content arises from the proprietary nature of multicast networks.

Unicast delivery of content enables an end user to connect directly to a content provider's service, and to view their content, on internet-connectable devices (for example, PCs, laptops, games consoles, tablets, and internet-connected TVs). OTT services such as Netflix, Amazon Prime, YouTube and BBC iPlayer (via the internet[164]) rely on unicast delivery of their content to end users.

By contrast, multicast networks are closed, proprietary networks. Accordingly, content providers are only able to deliver content to end users via such networks if they have an agreement with the multicast network operator. In this sense, they are similar to cable networks.

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163 Multicast Overview, Juniper Networks.
(http://www.juniper.net/documentation/en_US/junos13.3/topics/concept/multicast-ip-overview.html)

164 BBC iPlayer branded services are implemented differently on different platforms.

Appendix 2

Evidence given during the appeals of Ofcom's Pay TV Statement

The issue of the difference between IPTV and delivery of content via the open internet was discussed in some detail during the appeals of Ofcom's Pay TV Statement. This appendix provides excerpts from the evidence given by Sky's then Chief Operating Officer, Mike Darcey, in his third witness statement.

At the time that this witness statement was provided, Mike Darcey took the view that the term "IPTV" was used loosely in the industry to refer to a variety of different types of IP-based content delivery. Over the past four years understanding of the difference between IPTV networks and OTT delivery of content has become clearer, associated with the growth in delivery of content on an OTT basis, and the proliferation of OTT-based content services. Similarly, certain facts have changed – such as the increased use of fibre as well as DSL connections to deliver content to consumers. Nevertheless, the excerpts below include several points that remain relevant today, and important to Ofcom's understanding of these types of services:

> "*896 …I elaborate further on the various meanings of the term "IPTV" as I believe they are used in the industry:*
>
> *a. First, the term "IPTV" may refer to traditional IPTV networks, such as that operated by TalkTalk TV in the UK, and which BT is currently rolling out. Such networks use the existing copper telephone line into a subscriber's home to transmit television signals to a set top box connected to a television, typically in combination with the provision of broadband services to the customer. These networks involve a substantial amount of investment in infrastructure by the IPTV operator, including investment in video servers and local loop unbundling, and give the operator a degree of control over the end-to-end service, to ensure picture quality.*
>
> *b. The second way that the term "IPTV" is sometimes used is to refer to what is also called "internet TV", which is where consumers access online video services from a software application resident on a website, such as via the BBC's iPlayer, or Sky's Sky Player application. Consumers are able to use any equipment that can connect to the open internet (in the sense that the user is able to type in any web address (a "URL") into a browser such as Internet Explorer) to view services of this type, and to use a broadband connection supplied by any internet service provider. Although the overall quality of such services is improving, due for example to changes in compression technology and improved broadband access speeds generally, the content provider in respect of such services (such as the BBC, in respect of the iPlayer and Sky, in respect of Sky Player) has no end-to end control over the networks via which the content is conveyed, and so quality of service is not assured.*
>
> *c. The third way that the term "IPTV" is sometimes used is to apply to platforms which use the internet as a means of conveying certain video content to a specific end user device (such as Microsoft's Xbox 360 games console). These services are largely the same as internet TV services, except that the controller of the device (such as Microsoft, in the case of the Xbox 360) can restrict which internet TV services are available via the device. In the case of the Xbox 360, for example, while the device is connected to broadband, the customer is not presented with a browser (such as Internet Explorer) and is not able to enter any URL or go to any website it chooses. Instead, Microsoft offers a finite predetermined set of IP destinations where content of Microsoft's choosing is located.*
>
> *897. Internet TV services (the second category I refer to above) are sometimes said to be available over the "open internet". This refers to the fact that the content is located on servers to which any internet connected device that includes a browser may connect, via any broadband network, in contrast to "closed" services, such as the first and third of the services I describe above, where specific devices and/or broadband networks must be used and where*

only certain content is presented….

898. Although each of the technologies I refer to above use "Internet protocol" as a technological means of conveying video services from a server to a user, the term "IPTV" is, I believe, most commonly used to describe the first of the categories of technologies I outline above. This is because traditional IPTV networks of that type existed before the distribution of video over the open internet became common."

ANNEX 5

INTERNAL DOCUMENTS RELATING TO SKY'S DISTRIBUTION OF SKY SPORTS AND NOW TV

[CONFIDENTIAL]

ANNEX 6

CORRESPONDENCE WITH YOUVIEW REGARDING THE SUPPLY OF SPORTS CHANNELS

[CONFIDENTIAL]

ANNEX 7

EXPERT REPORTS BY PROFESSOR JOHN VAN REENEN AND EXTRACTS FROM WITNESS STATEMENTS BY MIKE DARCEY PROVIDED TO THE CAT DURING THE APPEALS OF OFCOM'S PAY TV STATEMENT

ANNEX 8

EXAMPLES OF MARKETING OF TRIPLE PLAY PACKAGES