

Pay TV second consultation Access to premium content

BBC response

Introduction

Although the BBC does not operate in the pay TV market,¹ it nonetheless has a legitimate interest in the outcome of Ofcom's review. The BBC has three broad objectives in respect of this investigation: ensuring universal access for (and to) licence fee payers; maintaining an open and competitive television sector (including the pay TV market) and fostering the development of open standards and gateways into the home.

The BBC welcomes this second phase of Ofcom's investigation of the pay TV market and broadly agrees with its conclusions. In particular, the BBC agrees with Ofcom's assessment that: consumers' choice of pay TV service is primarily influenced by the content that is available, rather than by platform features, and that some content is of particular importance such as live Premier League football and first-run blockbuster movies; channels containing these types of content are in their own narrow wholesale markets; and Sky has market power in those markets

The BBC agrees with the need for Ofcom to intervene to tackle the existing barriers to effective competition, and hence increase consumer choice and market innovation. The BBC also agrees with the proposed remedy, requiring Sky to wholesale certain designated channels (including any additional features such as interactive services or high definition version) on regulated terms and prices. As we have noted previously (when arguing that Ofcom should also take Sky's position on the satellite platform into account), we believe that Ofcom should introduce this remedy on all platforms where Sky otherwise risks becoming the dominant retailer through its control of premium content, including the satellite platform. Given vertical integration is a concern when there is market power, by excluding the satellite platform – the most significant of the pay TV platforms, Ofcom risks ignoring a potential source of market power in the pay-TV value chain that may affect downstream markets, restrict competition and, ultimately, reduce choice for final consumers.

In addition, in light of the analysis and proposals in their consultation around the Picnic proposal, the BBC believes that Ofcom should consider – when undertaking its review of wholesale digital television broadcasting platforms - whether to impose simulcrypt arrangements on satellite as well as on DTT. This would ensure that Sky dominant's position on satellite can effectively be challenged as it would promote intra-platform as well as inter-platform competition and would benefit all non-Sky channel providers and retailers, both basic and premium.

¹ BBC Worldwide, a wholly owned commercial subsidiary of the BBC, has a 50% stake in the UKTV suite of channels.

1. What characteristics should the pay TV sector display in order to serve consumers best?

The BBC is not best placed to respond to this question, but believes that a well functioning pay TV sector should:

- Ensure high level of **overall consumer satisfaction levels**: existing pay TV subscribers should recognise they benefit from good value for money, but, in addition, non-consumers of pay TV should not feel excluded from pay TV because of excessive prices.
- Offer a **choice of platform and content**. As set out in our previous submission, we agree with Ofcom that consumers should not only be able to choose which platform they wish to use as a means of accessing content, but also to choose which content they wish to watch on that platform, i.e. both inter- and intra-platform competition are important. We agree with Ofcom that consumer benefits are likely to be maximised if content that consumers value highly - whether offered by the free to air public service broadcasting channels or the premium content offered by some pay TV services - were available on all platforms. In addition, it would be desirable to offer a choice of providers of this content; under certain circumstances, a wholesale remedy for channels carrying “core premium”, such as that proposed by Ofcom can be appropriate and necessary.
- Foster **innovation in platform services**: We reiterate our views that a competitive market is one where there is more than one operator able to innovate.

2. Do you agree with the amendment to our criteria for assessing the pay TV market?

Yes. We agree with Ofcom’s inclusion within the “innovation” criterion of the ability to introduce new charging structures for retail packages, pricing or new bundles with innovative technical features. For instance, we believe the ability to bundle the provision of linear pay TV services with on-line applications will be a key differentiator between offers in the near future. Another important element will be the ability to provide a wide range of tariffs, adapted to individual needs and consumption patterns.

Joint response to questions 3, 4 and 5: Why do consumers pay for TV services? Do you agree with our assessment of the relative importance of platform features and content? Do you agree with our views on the importance of premium sports and premium movies content for competition in pay TV?

The BBC welcomes and agrees with Ofcom’s thorough analysis. Television viewers are primarily interested in content; whilst they enjoy the ability to benefit from additional features, such as interactive “red button” services, voting functionalities, PVRs or EPGs, and appreciate having flexible tariffs schemes and attractive bundle

offers. We agree that their main reason for choosing a pay television offer will be to receive programmes which are not available to them free-to air, e.g. live premium sports and first run blockbuster movies.

6. Are there any other international examples to which you would draw our attention?

No. We believe Ofcom's overview of the international market supports its analysis

Joint response to questions 7, 8 and 9: Do you agree with our overall approach to market definition analysis? Do you agree with our definition of the market for Core Premium Sports channels or do you believe it to be narrower or wider than we have suggested? If so, what specific evidence do you have to support your view? Do you agree with our definition of the market for Core Premium Movies channels or do you believe it to be narrower or wider than we have suggested? If so, what specific evidence do you have to support your view?

Yes. As already stated, the BBC supports Ofcom's view that premium sports and first run blockbuster movies channels play a key role in driving subscriptions for pay TV. It agrees with its statement that there is a specific market for the wholesaling of those channels which contain live FAPL matches, but wonders whether this market is not too narrowly defined and should not also include other very popular and not substitutable events such as major rugby, golf or cricket matches, when those do not fall under the listed events regulation. We also fully agree with the view that whilst some blockbuster movies are already available online, take up of such services is still in its infancy; therefore we support Ofcom's determination of a narrow market for the wholesale of channels containing first run movies from the major six Hollywood studios.

10. How would you see the future development of consumers' viewing habits for sports and movies, and of the ways movies will be delivered to them? How would this affect market definition?

The BBC believes that for the foreseeable future, viewers will continue to want to watch live premium sports, and that the most economic and easiest way of doing so will be on broadcast channels. Movies do not suffer from the same time constraints and are more likely to be consumed on demand. However, this is only just becoming a significant delivery mechanism: Consumers are upgrading to high definition and demanding better picture quality but the existing broadband networks cannot guarantee sufficient capacity to allow them watch movies with a good level of comfort, quality and at an affordable price. We also agree that DVD rentals are likely to represent relatively weak substitutes for premium movies. Therefore, we believe the market definition is likely to remain unchanged for the foreseeable future.

Joint response to questions 11, 12 and 13: Does Sky have market power in the wholesale of Core Premium pay TV channels? Do you agree with our conclusion that Sky has market power in the wholesale of Core Premium Sports channels? What specific evidence would you provide to support your view? Do you agree with our conclusion that Sky has market power in the

wholesale of Core Premium Movies channels? What specific evidence would you provide to support your view?

The BBC agrees with Ofcom's analysis, which demonstrates that Sky continues to have market power in the wholesaling of Core premium Sport and of Core Premium Movies channels.

We agree that Sky is likely to win again the majority of the live FAPL rights when they next become available, for the reasons highlighted by Ofcom:

- Sky is the only effective retail outlet on the platform with the largest number of subscribers, and third parties are unable to access that outlet as efficiently, making Sky an essential partner for premium rights holders.
- In addition, Sky benefits from its position as a vertically integrated operator.
- Sky also enjoys a branding advantage over other potential bidders which increase the likelihood it wins in auctions for rights
- Whilst Virgin Media has some countervailing buyer power, it does not seem in a position where it can outbid Sky for a significant share of the Core premium rights.

The same arguments apply for the purchase of first run Blockbuster movies rights.

14. Can retailers and / or platform operators get sufficient access to Sky's Core Premium channels?

No. Sky's premium content is only provided on a wholesale basis to Virgin Media. As set out by Ofcom, this is done on a basis which makes it unprofitable for Virgin Media to sell premium channels to existing cable subscribers. Sky does not provide its content on a wholesale basis on DTT nor on satellite.

15. Have we presented a factually correct picture of current distribution of premium sports and premium movie channels?

Yes.

Joint response to questions 16 and 17: Do you agree with the list of factors we present as being relevant when Sky considers whether to supply? Do you agree with our presentation of the longer-term factors in Sky's decisions to supply?

Yes. We agree with Ofcom that there are a number of incentives which may motivate Sky against supplying its content to competing retailers and/or competing platforms, in particular the desire to prevent the emergence or growth of potential retail or platform competitors. In addition, as set out by Ofcom, where Sky supplies Virgin Media with wholesale content, it has incentive to do so with the lower acceptable quality, and not to provide any additional features. This is because Sky has a strong incentive to ensure that consumers wishing to access Sky's premium channels get a better deal, both in quality and price terms if they do so through Sky satellite platform rather than through any other pay TV platform.

18. Do you agree with our discussion of the role of vertical integration?

Whilst we agree that vertical integration is not, in itself, always negative for final consumers, Sky's position as a vertically integrated platform operator, wholesale channel provider and pay TV retailer raises key concerns. We believe it is vital to keep this under review, particularly as Sky has already been found dominant at one stages of the pay TV value chain. In particular, Sky's control of the premier pay TV platform allows it to hinder entry of premium channel competitors, thereby reducing their ability to compete effectively for premium sports and film rights (e.g. see our answer to questions 11-13), and control/manage entry of basic channel competitors.

As we have noted previously, we believe that Ofcom should also take Sky's position on the satellite platform into account. Given Sky's position on the satellite platform, and satellite's importance as the pay TV platform of choice for both consumers and channel providers, we believe that Ofcom should introduce its wholesale must offer remedy on all platforms where Sky otherwise risks becoming the dominant retailer through its control of premium content, including the satellite platform. Given vertical integration is a concern when there is market power, by excluding the satellite platform – the most significant of the pay TV platforms - Ofcom risks ignoring a potential source of market power in the pay-TV value chain that may affect downstream markets, restrict competition and, ultimately, reduce choice for final consumers.

In addition, in the light of the regulator analysis and proposals in their consultation around the Picnic proposal, the BBC believes that Ofcom should consider – when undertaking its review of wholesale digital television broadcasting platforms - whether to impose simulcrypt arrangements on satellite as well as on DTT. This would ensure that Sky dominant's position on satellite can effectively be challenged as it would promote intra-platform as well as inter-platform competition and would benefit all non-Sky channel providers and retailers, both basic and premium and, ultimately consumers.

More generally, vertical integration also contributes to the market power of key players in the pay TV sector. It is significant that the two key pay TV players control both a platform and channel retail on that platform (as well as operating channels – premium channels in the case of BSkyB). This influence over a number of stages of the value chain allows them the opportunity to dominate and control the gateway to audiences, further reinforcing existing and future market power.

Vertical integration and convergence together offer new opportunities for strong players to leverage their market power to new markets. Strong incumbents (e.g. the owners / operators of today's proprietary gateways), can seize on technological developments (e.g. accessing television content via the PC) and extend their existing market power into other related markets such as the on-demand and mobile broadcasting environments. Control of a combination of a key gateway, key content and a strong offering of connectivity in the home provides an increasingly strong base to dominate the future Pay TV market. This might reinforce the positions of incumbents potentially to the detriment of continued innovation and value for money for the consumer.

There is already significant evidence that key Pay TV players – e.g. Virgin Media, BSkyB (and potentially BT) – are attempting to extend existing access controls (either in broadcasting or telephony) into digital media, both linear and non-linear. Consider, for instance, the introduction of triple (or quadruple) play by Virgin Media, BSkyB and BT with the aim of controlling all media consumption in the home.

A further point to consider is that even if it is the case that a vertical integrated operator has, at a given time, sufficient incentives to provide content to downstream operators, or to give access to its platforms, he might, taking a more dynamic and forward looking approach, still have a long-term interest in denying them such access, e.g. in order to weaken or eliminate future platform competition.

19. Do you agree with the figures we have presented to illustrate the playing-out of incentives to supply?

Yes.

20. Do you agree with our proposal that it is important for multiple operators to have wholesale access to Core Premium content, rather than Sky retailing on others' platforms?

Yes. Consumers will benefit from competition between retailers on prices and added functionalities, whereas in the absence of competition, Sky would be able to impose higher retail prices and lower functionality than would be delivered by a competitive market. We also agree with Ofcom's analysis that competition is particularly important when a market is moving from an expansion phase to consolidation, as is the case for pay TV. In particular, there is a risk that if the availability of attractive pay TV content is restricted on some platforms, consumers will not have the opportunity to benefit from platform enhancements that are better suited to non-satellite platforms.

21. Do you agree with our analysis of the profitability of Sky's wholesale premium business?

The BBC recognises the thoroughness of Ofcom's analysis but is not in a position to comment further on this matter.

Joint response to questions 22 and 23: What is the effect on consumers of the current situation with regard to access to premium content, now and in the future? Do you agree with our analysis of the current situation with regard to choice, innovation, pricing and consumer satisfaction?

We agree with Ofcom that restricted competition, as it occurs today, limits consumers' ability to choose between providers. Those wishing to receive premium content have only one option; they cannot make choices based on prices, or cannot access some other features they might like and which are provided by other operators.

Sky's dominant position might prevent consumers from enjoying lower prices through competition between operators; it might also prevent the development of new features, which often come from new entrants willing to differentiate their offer but who can only do so if they are also able to provide consumers with the services which really matter to them, e.g. premium content.

24. How would you see differently the future of pay TV as outlined in our "forward look"?

The BBC, in its previous consultation response, said that, whilst it agreed that the emergence of new technologies and distribution methods had the potential to bring significant benefits to consumers and to increase competition, the pace at which such new platforms would become mainstream should not be overestimated.

Joint response to questions 25 and 26: Would you agree with our analysis of the likely effects of restricted distribution of Core Premium content on consumers? What should we do, if anything, to tackle the problem we have identified relating to Core Premium content?

The BBC agrees that there is a risk that Sky, as a vertically integrated firm with market power in a key upstream market, will distribute its premium content in a manner that favours its own platform and its own retail business, and that this risk is serious enough to require some form of intervention.

Intervention to prevent Sky from acquiring or aggregating premium content could result in a negative outcome for rights holders, and ultimately for consumers; whilst this possibility should be kept as a last resort, we agree this might not be the best option at this stage. Ensuring that other retailers have able to retail Sky channels seems a more appropriate and more effective remedy – although Ofcom also needs to be conscious of the risk that its wholesale must offer remedy may reduce the incentive of others to compete against Sky for upstream sports and movie rights if they believe they can automatically receive them from Sky.²

The BBC would also suggest that beyond the wholesale must offer remedy, which we believe should also be imposed on satellite, Ofcom should consider the imposition of simulcrypt arrangements on satellite in its forthcoming review of wholesale digital television platforms (similar to those proposed for DTT in its Picnic document) - see answer to Q18 above.

27. What would you see as the key objectives of any remedy in pay TV?

As Ofcom set it out, the current situation raises significant competition concerns; in particular we believe that the vertically integrated operator Sky abuses its market

² There is a risk that pay TV retailers that would otherwise compete for sports rights may decide not to do so if they are guaranteed access to Sky's channels on a wholesale basis. They may believe that reduced competition would reduce the price paid by Sky for rights and would therefore reduce the wholesale price for third party retailers.

dominance on the content side to distort retail competition, favour its own platforms and own retail business; restrict consumer choice, and limit innovation where it risks undermining its main platform, e.g. around on demand functionalities. Any remedy should therefore address these concerns effectively.

28. Do you believe we have identified the right list of regulatory options?

Yes.

29. Have we made a suitable assessment of the option of taking no further action?

Yes. If no action is taken now by Ofcom it is likely that competition will decrease as Sky's competitors will struggle to challenge Sky. All pay TV platforms, including Sky's, will be at risk as potential new entrants might be discouraged from or prevented from introducing innovative offers combining broadcast technology with IP distribution into the UK. There is also a very high risk that should Ofcom not intervene now, negative effects on competition of Sky's dominance would not be reversible; our response to the following question develops this point.

30. Have we made a suitable assessment that it would be more appropriate to use our sectoral competition powers than to rely on ex post action under CA98?

Yes. The BBC considers that the use of sectoral competition powers under the Communications Act 2003 is both legally permitted and substantially more likely to secure a competitive outcome in this case than *ex post* action under the Competition Act 1998.

Turning first to Ofcom's legal powers, the BBC considers that section 316 of the Communications Act 2003 is clearly sufficiently widely drafted to allow Ofcom to impose conditions designed to enforce wholesaling arrangements. Section 316 allows Ofcom to impose conditions on licensed services, "that Ofcom consider appropriate for securing the provider of the licensed service does not... 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 connected services." In our view, the wording of this section clearly encompasses the present case.

In relation to appropriateness, the relevant legislation equips Ofcom with tools which allow both *ex post* action (primarily under the Competition Act) and *ex ante* action (primarily under the Communications Act). *Ex post* action is a flexible option which allows Ofcom to respond to a range of possible activities which threaten effective competition in relevant markets without stifling innovation by market participants or placing them under undue regulatory burden. However, *ex post* action can delay substantially the delivery of remedies and can lead to other market participants being harmed in a way which the available remedies cannot repair. It is also most suitable for traditional heads of "abuse" as set out in previous EC and UK case law, and less suitable for forms of prejudice which are not as readily characterised as abusive. In such cases, *ex ante* action is more often appropriate.

This seems to us to be a classic example of a case where *ex ante* use of sectoral competition powers is most appropriate. Ofcom has identified specific concerns and consulted widely. The concerns are sufficiently focussed to make *ex ante* regulation possible and proportionate, and indeed the introduction of specific conditions provides clarity for all market participants rather than regulatory burden in this case. The concerns do not necessarily fit into a classic head of “abuse” but do fit clearly within the concept of being, “prejudicial to fair and effective competition”. The potential impact is also sufficiently serious that it would not be sufficient to rely on *ex post* action.

31. Have we made a suitable assessment of the option of pursuing a process under our sectoral competition powers?

Yes. For the reasons noted in response to question 30 and in Ofcom’s paper, the BBC agrees that Ofcom’s assessment of this option is suitable.

32. Have we made a suitable assessment of the option of pursuing a reference to the Competition Commission?

Yes. The BBC does not consider it appropriate to pursue a reference to the Competition Commission at this stage where this would introduce unnecessary delay and where Ofcom has appropriate competition powers at its disposal as in this case.

33. Do you agree with our discussion of the legal framework for a wholesale must offer remedy?

Yes. For the reasons set out in response to question 30 and in Ofcom’s paper, the BBC agrees with Ofcom’s discussion of the legal framework for a wholesale must offer remedy.

34. Have we captured the potential impact on consumers and stakeholders in our preliminary impact assessment?

Yes.

Joint response to questions 35, 36 and 39 If we were to pursue a wholesale must-offer, which retailers should be able to purchase what content on what terms? 36. What is your view on which retailers should be eligible for any wholesale offer? 39. Have we picked up all the relevant issues to do with defining the wholesale product – i.e. conditions on channels, technical distribution, format, interactivity, VoD? How would you suggest proceeding on any or all of these?

The BBC broadly agrees with Ofcom’s proposal. We would support the following arrangements

- all retailers supplying residential subscribers on all non-Sky platforms should be eligible to the wholesale must-offer

- the obligation should cover all core premium sports and core premium movies channels; but this obligation should be kept under review to avoid the risk that content is move around channels to ensure some premium content is not caught;
- the obligation should cover not only the channel itself but also any interactive functionalities or services related to it; if there is an high definition version, or a version with higher sound quality or any other enhancements, it should be included in the 'must offer' solution.

The BBC recognises that the extension of eligibility to retailers operating on the satellite platform is very complex; at this stage, it is broadly in favour of such an extension but believes a decision on this point might be premature. Rather, this is one of the key issues which Ofcom should address in the forthcoming review of wholesale digital television broadcasting platforms when considering whether fostering inter-platform competition would benefit consumer, and whether requiring simulcrypt arrangements on all platforms might not be appropriate.

However, at this stage, Ofcom should at least require that Sky implements simulcrypt arrangements and allows retailers to use the Conditional Access system they choose to, subject to taking appropriate security measures. The BBC fully accepts the need to ensure appropriate protection against piracy of premium content services, but would argue that Sky should not be allowed to decide on its own what it considers as sufficient protection. Therefore, the BBC would suggest that should any dispute arise in this matter, Ofcom should be able to adjudicate on it, on the basis of any tests it would deem necessary.

37. What is your view on our decision to focus in this document on residential subscribers?

Whilst the BBC understands that intervening in that area might raise very complex issues around price determination, the commercial market is a key one for premium Sports content, as it represents a very significant revenue stream. Increasing competition in the commercial sector could not only have a positive effect on prices (which seem to have very significantly been increased over time by Sky), but also allows Sky's competitors to benefit from a stronger income base, therefore increase their ability to challenge Sky in auctions for Premium Sports content.

38. Have we identified the right content and channels to be captured by any wholesale offer?

Yes broadly. The BBC believes that, as proposed by Ofcom, it should keep under review:

- the market definition of core premium sports, and in particular the role of other important sports or major events (e.g. cricket, rugby, Champions League). The BBC agrees that at this stage, given they are broadcast on the same channels as the FAPL matches, it does not make any difference, but should their broadcast pattern change, the situation might be reviewed.

- the set of channels to which the obligation applies should be kept under review, in case Sky decided to create a new set of channels, which excluded FAPL, but which aggregated a large number of other rights in a manner that created market power.

39. Have we picked up all the relevant issues to do with defining the wholesale product – i.e. conditions on channels, technical distribution, format, interactivity, VoD? How would you suggest proceeding on any or all of these?

Yes.

40. Do you agree with our discussion of the need to set prices?

The BBC fully agrees with Ofcom that a wholesale obligation will only be effective if there are specific ex ante conditions setting out pricing rules.

41. Do you agree with our characterisation of the two main approaches to setting prices – retail-minus and cost-plus – and the practical issues with each?

Yes.

42. If we were to use a retail-minus approach, what would be the set of costs that we should take into account? Should we base the assessment on new entrant costs or on the costs of an efficient large-scale operator?

N/a

43. Have we identified the important issues related to commercial terms? How would you suggest proceeding on any or all of these?

Yes.

44. In particular, how should we tackle the issue of security?

The BBC fully accepts the need to ensure appropriate protection against piracy of premium content services, but would argue that Sky should not be allowed to decide on its own what it considers as sufficient protection. Therefore, the BBC would suggest that should any dispute arise in this matter, Ofcom should be able to adjudicate on it, on the basis of any tests it would deem necessary.

45. Is three years the right length of time before the first review of this provision? What factors should cause us to review it earlier than this?

Yes. Three years seem broadly right, as a shorter period could not give enough time for wholesale or simulcrypt arrangements to be negotiated and implemented and for Ofcom and the industry to evaluate their effectiveness. However, since the pace of change in this market is quite quick, a much longer period should not be appropriate. However, we would suggest that the review be undertaken no earlier than three

years after Ofcom's final statement, but thereafter, that it be made to coincide with the outcome of FAPL rights next auction.