

# **BBC RESPONSE TO OFCOM'S CONSULTATION ON SKY'S PROPOSED PAY DTT OFFER**

## **EXECUTIVE SUMMARY**

### **1. Introduction**

- 1.1. The application by National Grid Wireless Ltd (“NGW”) and British Sky Broadcasting Ltd (“Sky”) to remove Sky’s three free-to-air (“FTA”) channels from the digital terrestrial television (“DTT”) platform and replace them with five pay TV channels (“the Application”) could lead to one of the most substantial changes in DTT and in digital television since the launch of Freeview. The BBC welcomes the opportunity to take part in this consultation and is grateful to Ofcom for its thorough analysis of the potential impacts of the Application, which we broadly share.
- 1.2. The BBC has two major interests in this consultation and the potential effects of the Application, namely:
  - Ensuring that DTT remains a successful platform, offering high quality and diverse free-to-air content, complemented by a pay offering
  - Retaining an open and competitive market, in the interests of consumers and the industry.

### **2. A successful DTT platform**

- 2.1. DTT is now the primary digital television platform in the UK. As such, it should be able to cater for the needs of all viewers, including those who want some pay television services. We therefore welcome in principle the availability of a wider range of subscription services, delivering attractive premium content such as ‘blockbuster’ movies and the most popular sports events as a complement to a strong free-to-air offering.
- 2.2. The BBC does not believe that the extension of the number of pay services on DTT – provided it does not further constrain the number and quality of FTA services – would hamper the move to digital switchover. One might even argue that, on the contrary, consumers will benefit from an increased choice in pay services over DTT. In principle, the Application could be positive in the sense that it would allow DTT consumers to access valuable content offered by Sky channels without having to switch to another platform..
- 2.3. Freeview has marketed the DTT platform using a simple consumer proposition: more channels at no extra cost; free platform; one-off payment; no contract; with a simple ‘plug and watch’ box. Given that the concept of Freeview is now well established, we do not believe that an increase in the number of pay TV channels – and the associated marketing that would accompany their launch – would create undue

confusion for consumers. Indeed, we believe a stronger complementary pay DTT offer should, in principle, make the platform more attractive.

- 2.4. However, in the BBC's view, the Application raises a number of potential concerns with respect to the future of the DTT platform.
- 2.5. It is not certain that the move would give them more choice of content at any given time. For, unless a suitable solution ensures that consumers can receive Sky services and Top-up services on the same equipment, they will have to choose between them (the option of having two set top boxes being technically very difficult to pursue).
- 2.6. Whilst consumers will have more choice between pay services, the vast majority of DTT homes which only receive free-to-air services, would lose Sky free to air channels. The removal of Sky News would result in a further reduction in the plurality of the provision of news on DTT, with the BBC remaining the only 24 news provider.
- 2.7. The Application is likely to lead to proprietary standards being introduced to the DTT platform, which would change the nature of the DTT platform and, potentially, cause consumer confusion. This is particularly important at a time when viewers will need to upgrade their equipment, e.g. because they want high definition or PVR functionalities.
- 2.8. Also, as set out in Ofcom's consultation document,<sup>1</sup> it is relevant to consider this Proposal in the context of current plans to improve spectrum efficiency and to allow the introduction of high definition television on the platform. As mentioned by Ofcom,<sup>2</sup> the next few years will represent a significant upheaval in the development of DTT. The introduction of new technologies such as Mpeg4 and DVB-T2 should be managed in an orderly way, so as to maximise benefits for the platform and minimise inconvenience for consumers. The launch of DVB-T Mpeg4 channels could jeopardise the success of the transition to a more efficient platform.
- 2.9. There is also a concern that if Sky were to remain on the board of Freeview, they would be able to take decisions on its strategy when their interests (pay-TV) and those of Freeview (primarily free-TV) are no longer aligned. Whilst this is a matter for the board of Freeview, it remains the case that Sky could use its position to, for instance, slow down innovations on Freeview. This could, potentially, also have anti-competitive effects on inter-platform competition, which Ofcom might wish to consider as part of its review of the pay-TV sector (as Sky would benefit from an exchange of information on Freeview's plans, while its competitors such as Setanta or BT Vision would not).

### **3. Open and competitive markets**

- 3.1. The proposal also raises potential competition concerns that Ofcom, as the sector's competition regulator, must consider carefully.

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1 Ofcom proposed Sky digital terrestrial services - Consultation, 04/10/2007 paragraphs 2.51 to 2.53 p 13

2 Ofcom, op.cit. 3.14 sqq

- 3.2. The Pay TV sector in the UK is already concentrated and faces potential competition concerns (which are currently being investigated in Ofcom's pay television market investigation). In this context, it would not be prudent to allow this Application before the outcome of this review is known. Ofcom might wish to consider whether it would be good for competition to allow the dominant player on pay satellite (Sky) to extend its pay operations on DTT given the nascent state of pay DTT. The entry of Sky on pay DTT could potentially foreclose future competition in premium content (sport in particular) on all platforms.
- 3.3. Ultimately, the BBC believes that even if its concerns about DTT were to be addressed – e.g. through Sky committing irrevocably to using open standards or standards compatible with those already in use on the platform - the Application would raise serious concerns on competition grounds.
- 3.4. The BBC has also provided answers to Ofcom's specific questions in the attached submission.
- 3.5. In summary, the BBC believes that the Proposal should only be considered with the following cumulative conditions.
  - 3.5.1. BSkyB commit fully and unequivocally to facilitating and implementing open standards, either through simulcrypt or through licensing of its CA technology to all set-top box manufacturers on FRND terms.
  - 3.5.2. Ofcom makes its decision on the timing of the introduction of DVB-T2 on the platform. (prior to the Proposal proceeding).
  - 3.5.3. Should it be decided that DVB-T2 will be used from 2009/2010, as proposed in Ofcom's consultation on the future of DTT, then the Application should not proceed until DVB-T2/MPEG4 equipment is available.
  - 3.5.4. BSkyB withdraw from Free To View Ltd.
  - 3.5.5. Ensure that there is some inter-platform competition at the retail level, for instance by preventing Sky entering the pay DTT sector solely as a channel retailer and requiring it to enter the DTT platform as a wholesale channel provider too (i.e. allowing the incumbent pay DTT retailers to make the Sky channels available to consumers as well).

## **BBC SUBMISSION**

### **1. INTRODUCTION**

- 1.1. The application by National Grid Wireless Ltd (“NGW”) and British Sky Broadcasting Ltd (“Sky”) to remove Sky’s three free-to-air (“FTA”) channels from the digital terrestrial television (“DTT”) platform and replace them with five pay TV channels (“the Application”) could lead to one of the most substantial changes in DTT and in digital television since the launch of Freeview. The BBC welcomes the opportunity to take part in this consultation and is grateful to Ofcom for its thorough analysis of the potential impacts of the Application, which we broadly share.
- 1.2. The BBC has two major interests in this consultation and the potential effects of the Application, namely:
- 1.3. Ensuring that DTT remains a successful platform, offering high quality and diverse free-to-air content complemented by a strong pay offering
- 1.4. Retaining an open and competitive market, in the interests of consumers and the industry.

### **2. A SUCCESSFUL DTT PLATFORM**

- 2.1. DTT has been very successful so far for a number of reasons, primarily: its simple consumer proposition; its strong free-to-air offering; and its open standards.
- 2.2. A Simple consumer proposition
  - 2.2.1. Freeview has marketed the DTT platform using a simple consumer proposition – more channels at no extra cost; free platform; one-off payment; no contract and simple ‘plug and watch’ box. Given that the concept of Freeview is now well established, we do not believe that an increase in the number of pay TV channels (and the associated marketing that would accompany their launch) would create undue confusion for consumers. Indeed, we believe a stronger complementary pay DTT offer should, in principle, make the platform more attractive.
- 2.3. A Strong FTA offering
  - 2.3.1. The success of DTT (as Freeview) post the collapse of ITV Digital has been driven through its strong free-to-air channel offer, which offers a clear alternative for those consumers wishing to experience the benefits of digital television without having to commit to a pay television contract. While we believe that DTT will remain primarily a FTA platform in the eyes of viewers, we believe that it is now at a stage where it could accommodate the development of a complementary pay TV offer. DTT is now well established and has seen the introduction of pay TV services by Setanta and Top-Up. Moreover, it is now the primary digital television platform in the UK. As such, it must be able to cater for the needs of all viewers, including those who wish to access pay television services. Additional pay TV channels – especially if they contain additional

premium content – are therefore likely to benefit consumers by providing them with an attractive increase in pay channel choice.

2.3.2. The BBC does not believe that the extension of the number of pay services on DTT (provided that it does not further constrain the number and quality of FTA services) would hamper the move to digital switchover. One might even argue that, on the contrary, consumers will benefit from an increased choice. In principle, then, the Application could therefore be positive and allow DTT consumers to potentially access valuable content offered by Sky channels without having to switch to another platform. We therefore welcome in principle the availability of a wider range of subscription services, in particular those delivering attractive premium content, blockbuster movies and most popular sports events as a complement to a strong free-to-air offering.

2.3.3. This increase in choice for those who wish to consume pay DTT services must, however, be balanced by the fact that the vast majority of DTT homes which only receive (and only wish to receive) FTA DTT services, would lose those FTA channels provided currently by Sky.

2.3.4. As set out above, the success of DTT in the UK relies in part on the availability of a significant number of high quality free-to-air channels, which should not be jeopardised by the replacement of a number of free services by pay services, on a capacity-constrained platform. Such a move would be bad for consumers but also for the creative economy, as the ability of free to air channels to maintain a high level of investments in original productions depend on their audience share and related advertising income. This Application will, to some extent, reduce the strength of the FTA DTT offering to the detriment of the platform as a whole. We are particularly concerned about the Application on plurality grounds: the removal of Sky News will result in a very significant reduction in the plurality of news provision on free DTT.

2.3.5. In addition, whilst consumers will have more choice of pay TV services, it is not certain that the move will provide more choice of content to those wishing to consume pay DTT services unless a suitable technical solution is found that ensures the platform remains open. To ensure more choice is available, it is vital that consumers can receive both the new Sky services and the existing pay DTT (Top up TV & Setanta) services on the same equipment (see below).

2.4. An open platform: DTT has thrived because it is an open platform strengthened by horizontal competition: all set top box manufacturers operate independently of channel retailers and all set top boxes can receive all channels (both free and pay) with the pay CA software either embedded or available via a plug in module. The BBC's concern is that the Application will see the introduction of proprietary standards on the DTT platform, changing its nature.

2.4.1. This proposed change occurs at a time when the DTT platform needs to migrate to a new compression technology (MPEG4<sup>3</sup>) in order to offer High

3

MPEG4: This compression technology, which can be implemented channel by channel i.e. on the same multiplex (channels transmitted in MPEG2 and in MPEG4 can coexist), can deliver around 30% spectrum efficiency gain. However, consumers require a new set-top box – the existing integrated digital televisions or set-top boxes are not compatible with MPEG4. Therefore, today, a broadcaster willing to launch in

Definition services. This will require consumers wishing to watch new HD services to upgrade their existing equipment. There are two ways this new technology could be implemented on DTT: using either open standards, or using proprietary standards.

- 2.4.2. Using open standards, any manufacturer can produce equipment able to receive broadcasts on the DTT platform. For instance, Top-Up TV (TUTV), the current pay-tv operator on DTT, gives consumers the ability to choose whether to receive its subscription services on TUTV's own set-top box, which has an embedded conditional access technology or on a standard set top box/ digital television, readily available in the market, through a TUTV conditional access module and a TUTV viewing card inserted into the common interface module of the set-top box / digital television. Moreover, any channel can launch a service able to access all the equipment bought by consumers as Top-Up TV (TUTV) offers broadcasters the choice of whether to be part of the TUTV package, or to simply purchase TUTV Conditional Access.
- 2.4.3. Sky is proposing to replace its existing free DTT channels (currently broadcast in MPEG2) with pay DTT services broadcast using MPEG2 initially, but with the stated aim of moving to MPEG4. But Sky is not planning to use open standards on DTT. Instead it is proposing, as it did on satellite, to offer its DTT pay TV services using a proprietary standard for conditional access services and application programming interfaces (including electronic programme guides). This might remove one of DDT's major competitive advantages, its simplicity of use for consumers.
- 2.4.4. Take-up of Sky's equipment may be quite significant, given the relatively attractive content that it intends to offer. In addition, Sky will have both the opportunity and the incentive to subsidise its boxes, which in itself is a very rational and not necessarily anti-competitive behaviour. Because such boxes are likely to be available only via Sky, it has the opportunity to offer a small level subsidy - which will attract consumers and in effect link future adoption of MPEG4 technology to the use of Sky's proprietary set top boxes and access technology. Sky's incentive to drive consumers to take its offer through subsidies will be very high as it knows that the subsidies will be later reimbursed by other broadcasters through their contribution to the platform's common costs (as was the case with the satellite platform). Pay TV channel providers will have no choice other than to use the equipment designed by Sky, and will require some form of service from Sky or a company controlled by Sky (such as SSSL).
- 2.4.5. Therefore what has thrived as an essentially open platform, providing a healthy choice for consumers wishing to access digital television, could over a relatively short period of time become a closed platform making use of proprietary standards controlled by Sky. To reap the benefits of additional choice in pay DTT, it is vital that consumers can receive both the new Sky services and the existing pay DTT (Top-Up TV and Setanta) services on the same equipment. We do not believe that the option of having two set top boxes is an attractive

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MPEG4 will have no consumer base. Broadcasting one service in high definition would require nearly a whole multiplex in M<sup>PEG</sup>2, and around one third of a multiplex using M<sup>PEG</sup>4.

consumer proposition and, unless an open platform is available, consumers will have to choose which pay TV package to consume – somewhat negating the benefits of increased channel availability.

- 2.4.6. Whilst Sky claim that they will allow the conditional access technology they will use to be licensed from NDS, and that manufacturers will be free to include support for other CAS modules using a common interface, they make clear that they would expect manufacturers to ensure that any such equipment is secure in order to minimise/prevent signal theft and internet redistribution of Sky's programming, and that these arrangements will be subject to technical feasibility, allowing themselves to keep full control of whether and when such agreements are concluded. Sky's reluctance to licence its encryption technology for satellite is pertinent here.
- 2.5. An innovative platform: There is also a concern that if Sky were to remain on the board of Freeview, they would be able to take decisions on its strategy when their interests (pay TV) and those of Freeview (primarily free TV) are no longer aligned. Whilst this is a matter for the board of Freeview, it remains the case that Sky could use its position to, for instance, slow down innovations on Freeview. This could, potentially, also have anti-competitive effects on inter-platform competition, which Ofcom might wish to consider as part of its review of the pay-TV sector (as Sky would benefit from an exchange of information on Freeview's plans, while its competitors such as Setanta or BT Vision would not).
- 2.6. . Sky would benefit from an exchange of information on Freeview's plans while its competitors (such as Setanta or BT Vision) would not.
- 2.6.1. It is also worth noting that over and above the move to High Definition (and MPEG4) other factors are increasing the incentive for consumers to upgrade their equipment: the desire to acquire a Personal Video Recorder with a substantial storage capacity, or their willingness to acquire equipment with a return path and internet access for on-demand content. As set out in Ofcom's consultation document,<sup>4</sup> this Application must also be considered in the context of current plans to improve spectrum efficiency and to allow the introduction of high definition television on the platform. As mentioned by Ofcom,<sup>5</sup> the next few years will represent a significant upheaval in the development of DTT. The introduction of new technologies such as MPEG4 and DVB-T2 should be managed in an orderly way, so as to maximise benefits for the platform and minimise inconvenience for consumers. The launch of DVB-T MPEG4 channels before the possible full transition to DVB-T2 could cause consumers to repeatedly change their set top box and potentially jeopardise the success of the transition to a more efficient platform. The potential cost to consumers of having to make more than one change of set-top box in this transition was also raised by Ofcom in its MIA on the BBC's HD proposals.<sup>6</sup>

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<sup>4</sup> Ofcom proposed Sky digital terrestrial services - Consultation, 04/10/2007 paragraphs 2.51 to 2.53 p 13

<sup>5</sup> Ofcom, op.cit. 3.14 sqq

<sup>6</sup> See [http://www.ofcom.org.uk/research/tv/bbcmias/bbc\\_hdtv/bbc\\_hdtv.pdf](http://www.ofcom.org.uk/research/tv/bbcmias/bbc_hdtv/bbc_hdtv.pdf)

## 2.7. Implications for the Proposal

- 2.7.1. The BBC welcomes any Application that would strengthen the DTT platform by strengthening complementary services whilst not endangering the FTA offer. Our key concern arises in this context around the balance between the gains to pay DTT consumers and the losses (particularly of plurality of news provision) to FTA DTT customers.
- 2.7.2. Equally importantly, the BBC is concerned that the Application could – without suitable commitments and an appreciation of timetable issues – lead to the DTT platform becoming proprietary (to the detriment of the platform) and cause unnecessary expense (and possibly confusion) to consumers.
- 2.7.3. The BBC therefore believes that, in order to accept this Proposal, Ofcom should impose the following cumulative conditions:
- Ensure that Sky commits fully and unequivocally to facilitating open standards, either through simulcrypt or through licensing of its CA technology to all set-top box manufacturers on FRND terms. The presumption should be that Sky will licence the technology unless it can prove (to Ofcom) that to do so would inevitably lead to piracy. One option should be to subject Ofcom’s approval to the signature of a least one simulcrypt agreement or several contracts with manufacturers on fair and reasonable terms
  - Require that the Application does not proceed until there is a decision on the timing of the introduction of DVB-T2 on the platform and, should it be decided that DVB-T2 will be used as soon as possible on one multiplex at least, until DVB-T2/MPEG4 equipment is available
  - Require BSkyB to withdraw from Free To ViewLtd.

## **3. OPEN AND COMPETITIVE MARKETS**

3.1. The BBC has always supported mixed television ecology in the UK, containing a competitive mix of: PSB and non-PSB channels and FTA and pay channels – all available on a mix of platforms. In the BBC’s view, the Application raises potential competition concerns that Ofcom, as the sector’s competition regulator, must consider carefully.

### 3.2. The pay TV sector

- 3.2.1. The Pay TV sector in the UK is already concentrated and faces potential competition concerns (which are to be investigated in Ofcom’s market review of pay television). In this context, it would not be prudent to allow this Application before the outcome of Ofcom’s review is known. We do not believe that it would be good for competition to allow the dominant player on pay satellite - Sky - to extend its pay operations on DTT given the nascent state of pay DTT.
- 3.2.2. To-date competition between the four platforms for the subscribers of pay-TV service has not been very strong. In the UK, unlike the rest of Europe, Pay TV



has developed primarily through satellite distribution and via proprietary set top boxes. Whilst the UK has three main Pay TV distributors, one on each of the three main platforms - Virgin media on cable, Sky on satellite and Top-Up TV (“TUTV”) on DTT - and smaller operators on broadband: Tiscali and BT - their relative shares are very different, with a strong advantage for Sky (more than 70% of pay TV subscribers, and around 27% for Virgin<sup>7</sup>).

3.2.3. We would first like to stress that, at this stage, satellite is (and will remain so until the completion of switchover) the only platform offering pay television throughout the whole country (94-96%); all the competing pay platforms reach a much lower share of the population. Our broad brush assessment of their competitive constraint on pay satellite is as follows:

3.2.4. In the areas where cable is available (50% of the population), Virgin media competes actively against Sky. We did note however that Sky basic channels are not available at all and Sky does not offer its interactive, on-demand services or HD channels on Virgin Media, which tend to weaken the competitiveness of Virgin Media’s offer.

3.2.5. As far as IPTV is concerned, we fully agree with the analysis set out by the Competition Commission<sup>8</sup>: “Although services provided over the IPTV platform offer a certain level of competitive constraint with an all-TV market, it is not clear that these players will be able to acquire significant market share within the next few years.”

3.2.6. At this stage, the pay offer on DTT is too limited for it to create a real competitive challenge to satellite. DTT is mainly seen by consumers as a free-to-air platform. However DTT, which is already the most available platform today and will only continue to grow until switchover, could play a key role in fostering competition in the pay TV sector.

### 3.3. Implications for the Proposal

3.3.1. The entry of Sky on pay DTT at this stage of development risks stifling the nascent competitive challenge to satellite that pay DTT represents.

3.3.2. First, the BBC does not believe there could be sustainable retail competition on pay DTT. We fully agree with Ofcom’s analysis that there is likely to be, either immediately or after a short interim period, only one retailer of pay services on DTT. We consider that competition in the pay TV sector is much more likely to come from inter-platform competition rather than intra-platform competition.

3.3.3. We believe that in this case, two main drivers of competition in pay DTT - (1) premium content and (2) functionalities of the equipment – will both favour Sky.

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<sup>7</sup> Source: Ofcom Digital Progress Report Q1 2007 and BBC (using estimates of 0.25m subscribers for Top-Up TV).

<sup>8</sup> Competition Commission Provisional Findings in Sky/ITV investigation (at [http://www.competition-commission.org.uk/inquiries/ref2007/itv/pdf/prov\\_find\\_report.pdf](http://www.competition-commission.org.uk/inquiries/ref2007/itv/pdf/prov_find_report.pdf)) paragraph 4.70 et seq.

- 3.3.4. It is widely accepted that premium programming largely drives demand for Pay TV. Premium content consists broadly of:
- Premium sports content – primarily premium football.<sup>9</sup>
  - Premium Movie content – primarily first run Hollywood movies primarily (although it could also possibly include a few key US TV acquisitions which may drive some demand for pay-TV, e.g. Lost or 24) and
  - Ownership of rights to premium content therefore provides a degree of market power as the content is key to attracting subscribers. There is a circle by which those who own such rights can drive demand for their downstream pay television operations, and therefore increase their ability to win future auctions for such rights.
- 3.3.5. We believe that the availability of premium content could even be more important for those platforms which are capacity constrained – such as pay DTT – where there is little available capacity for basic pay channels.
- 3.3.6. Sky has only recently faced competition in its key rights market – premiership football - with Setanta successfully acquiring rights to two packages of matches. Setanta is available on all three platforms and one of its key competitive advantages of Sky was its exclusive availability on pay DTT (i.e. it was the only channel offering live Premiership football on DTT). There is a risk that Sky's entry onto DTT will undermine Setanta on DTT (because of the tendency to monopoly in channel retail highlighted above) and in the wider market (as one of Setanta's key competitive advantages is removed). Also, Setanta is Sky's only competitor for premium pay TV sports rights. A small loss of consumers on DTT would significantly impact Setanta's ability to challenge Sky in auctions for sports rights, therefore creating a vicious circle loss of subscribers -> lack of resources to acquire attractive rights -> loss of subscribers. This could cause Setanta to fail – which would reduce potential competition now and in the future (by indicating that competition to Sky is doomed to fail).
- 3.3.7. Given the relative strength of Sky's offering (in particular premium sport and film) it is likely that Sky would, in a short time, become be the sole pay DTT retailer. As rightly stressed by Ofcom, if one player were to emerge as dominant on the DTT platform, this would in itself create some competition issues. But is this player is also dominant on other platforms, these issues are exacerbated; not only would this extend Sky's dominance on the satellite platform into the DTT market, it would also, potentially, foreclose future competition for premium content (sport in particular) on all platforms.
- 3.3.8. Functionalities of the equipment are a key differentiator of the pay television offers. It is vital that channels can access their audience. As discussed above, DTT is currently an open platform but there is a risk that the Application could lead DTT to become a proprietary platform given the move to high definition, increasing consumer demand to receive content when they want it, to download and upload it on other devices such as ipods and to watch pictures and videos on

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<sup>9</sup> See for instance Commission decision Case MOMP/M.2483 – Group Canal +/RTL/GJCD/JV

their television set. The ability to provide consumers with highly complex equipment will become even more important. The specific capacity constraints on DTT could also mean that in order to differentiate themselves and make the most of the limited space available, providers of pay services should be able to use clever technologies and devices, such as for instance, push VOD, overnight downloads etc. It is therefore essential to ensure that open standards are used as far as possible, in order not to foreclose competition.

3.3.9. As noted above, Sky's ability to create such a bottleneck is particularly high both, because of the control by News Corp, Sky's parent company of NDS, and because of their very strong relationship with equipment manufacturers, and the levers that their acquisition of a million satellite set-top boxes or so a year give them on the whole supply chain. Therefore, Sky, as a strong vertically integrated operator, is in a unique situation, which makes its move to pay DTT a real threat for competition, precisely at a time where it is important to ensure that DTT continues to grow as an open and competitive platform

#### 3.4. Possible competition solutions

3.4.1. Given the above discussion, Ofcom may wish to consider the following possible solutions:

- Open standards: As noted above, the BBC believes that it is vital to maintain open standards on the DTT platform and has already suggested possible commitments that Sky could make to protect the 'openness' of the DTT platform should it enter the pay DTT market as a channel retailer.
- Wholesale channel provision only: An alternative solution would be to prevent Sky entering the pay DTT sector as a channel retailer and require it to enter the DTT platform solely as a wholesale channel provider (i.e. allowing the incumbent pay DTT retailers to make the Sky channels available to consumers). This would ensure that there is some inter-platform competition at the retail level even if it does not produce intra-platform competition. This would still require Sky to either adopt the existing encryption standard or to allow simulcasting of its channels.

#### 4. **OVERALL CONCLUSIONS**

4.1. Ultimately, the BBC believes that even if its concerns about DTT were to be addressed – e.g. through Sky committing irrevocably to using open standards or standards compatible with those already in use on the platform - the Application would raise major concerns on competition grounds.

4.2. In the context of the above discussion, the BBC has also provided answers to Ofcom's specific questions in the attached detailed response.

## DETAILED RESPONSE TO OFCOM'S CONSULTATION QUESTIONS

### **1. *Question 1 - To what extent do you consider that DTT, DSat, cable and IPTV are in competition with one another for subscribers of pay TV services – either at present or in the future?***

- 1.1. We have set out our views on competition between platforms in the section on open and competitive markets. Briefly, we believe that competition to date between the four platforms for the subscribers of pay-TV service has not been very strong, with pay satellite dominating the other platforms – both because of its rich content offering, its lack of capacity constraints and its nationwide availability.
- 1.2. In the areas where cable is available (50% of the population), Virgin Media competes actively against Sky. We did note however that Sky basic channels are not available at all and Sky does not offer its interactive, on-demand services or HD channels on Virgin Media, which tend to weaken the competitiveness of Virgin Media's offer.
- 1.3. For IPTV, we fully agree with analysis of the Competition Commission (cited above) that, despite the strong promises of hybrids solutions with IPTV attached to a satellite or DTT offer, it will be a considerable amount of time before IPTV can compete head to head with the other platforms,
- 1.4. At this stage, the pay offer on DTT is too limited for it to create a real competitive challenge to satellite. DTT is mainly seen by consumers as a free-to-air platform, with pay DTT a (nice-to-have) complement. However, DTT's continued growth and pre-eminence as a digital television platform in the UK could give it a key role in fostering competition in the pay television sector, and in allowing new entrants to grow a business without being under the constant gaze of Sky.
- 1.5. As we have set out above, we believe that the future for competition between the platforms depends crucially on this Application. Without the Application there is likely to be inter-platform competition but little prospect for intra-platform competition. However, the Application risks Sky becoming the main channel retailer on pay DTT (through control of proprietary technology and its strong premium content portfolio) to the detriment of competition in the pay TV market more widely.

### **2. *Question 2 - To what extent do you consider the Proposal is likely to deliver benefits to the consumer?***

- 2.1. As we set out above, we believe the proposal has the potential to deliver significant benefits to pay DTT subscribers by offering a richer selection of premium and non-premium pay content than they have today. This is likely to complement the FTA DTT offering and strengthen the appeal of the platform. However, this depends crucially on maintaining an open platform and on assessing the loss of Sky's FTA channels to users of FTA DTT, in particular the effect on plurality from the loss of Sky News from FTA DTT.

- 2.2. We also believe that, as the Proposal stands, these potential benefits are well outweighed by the issues highlighted in our response.
- 2.3. The BBC argues it is vital to maintain an open platform and to deliver this outcome the BBC has suggested some commitments that could be sought as part of the Application.
3. ***Question 3 - To what extent do you consider that there is scope for sustainable competition in pay TV on the DTT platform and, more broadly, across all pay TV platforms?***
- 3.1. As we note above, we do not believe there could be sustainable competition for pay TV within the DTT platform. We fully agree with Ofcom's analysis that there is likely to be, may be after a short interim period, only one retailer of pay services on DTT. This tendency, which, as Ofcom stresses, has been observed in many countries, is reinforced by existing and forthcoming capacity constraints on DTT. Whilst new technologies such as MPEG4 or the future DVB-T2 could reinforce in the mid term spectrum efficiency, the introduction of HD will create new pressures on capacity, restricting the likelihood of new entrants.
- 3.2. Also, the content which attracts consumers to subscribe to a pay service is relatively limited in quantity. Whilst there is some nice content which can attract specific categories of viewers and allow nice pay channels to flourish, for a pay offer to become a mass-market proposition, it would require access to premium content, which is expensive to purchase and which is more likely to be acquired by content distributors who have a certain scale.
- 3.3. In order to foster competition within different providers of pay services on DTT, consumers should be able to switch easily between them. In practice, this would require providers of pay services either to use the same conditional access systems, or to have simulcrypt arrangements.
- 3.4. We consider that competition in the pay TV sector is much more likely to come from competition between platforms than within platforms.
- 3.5. As rightly stressed by Ofcom, if one player were to emerge as dominant on the DTT platform, this would in itself create some competition issues. But if this player is also dominant on other platforms, these issues are exacerbated.
4. ***Question 4 - What are likely to be the key aspects of competition between providers of retail pay TV services on the DTT platform? E.g. what is the role of premium sports and movies content?***
- 4.1. As explained above, we believe the key drivers of competition on pay DTT would be (1) premium content and (2) functionalities of the equipment.
- 4.2. It is widely accepted that there are two separate markets for that content proven to drive demand for Pay TV, largely premium programming rights, i.e.:

- 4.3. Sports content, drawing a distinction between standard sports content and premium sports content – primarily premium football.
- 4.4. Movie content, drawing a distinction between standard and premium movie content – the latter revolving around first run Hollywood movies primarily (although it could also possibly include a few key US TV acquisitions which may drive some demand for pay-TV, e.g. Lost or 24) and
- 4.5. All the other programmes (despite the common segmentation of content by genre, production is interchangeable, and production facilities can relatively easily switch between the various content genres).
- 4.6. Ownership of rights to premium content provides a source of market power. This content is key to bringing subscribers to pay television offers: it is very unlikely that without a significant amount of premium content - major sports, Hollywood blockbusters, any pay television offer could thrive. There is a virtuous circle by which those who own such rights can drive demand for their downstream pay television operations, and therefore increase their ability to win future auctions for such rights. The availability of premium content could even be more important for those platforms which are capacity constrained; there is no capacity on DTT for “basic pay” or niche channels.
- 4.7. Functionalities of the equipment are a key differentiator of the pay television offers. With the move to high definition, but also with increasing consumer demand to receive content when they want it, to download and upload it on other devices such as ipods, to watch pictures and videos on their television set, the ability to provider consumers with highly complex and equipment, the control of consumer equipment will become increasingly important.
- 4.8. The specific DTT capacity constraints could also mean that in order to differentiate themselves and make the most of the limited space available, providers of pay services should be able to use clever technologies and devices, such as for instance, push VOD, overnight downloads etc. It is essential, in order not to foreclose competition at a time when the market is developing, and new technologies are incentivising consumers to upgrade their equipment, to ensure that open standards are used as far as possible. Allowing Sky - or any other provider - to create a bottleneck at this stage would have very negative impact.
- 4.9. The risk that this Application would allow Sky to create such a bottleneck is particularly high both, because of the control by News Corp, Sky’s parent company of NDS, and because of their very strong relationship with equipment manufacturers, and the levers that their acquisition of a million satellite set-top boxes or so a year give them on the whole supply chain. Therefore, Sky, as a strong vertically integrated operator, is in a unique situation, which makes its move to pay tv on DTT a real threat for competition, precisely at a time where it is important to ensure that DTT continues to grow as an open and competitive platform.

5. ***Question 5 Do you consider that if Sky were to become the only provider of pay TV on the DTT platform it would be likely to have a significant detrimental effect on competition in the long term? How might this affect the development of other platforms for the delivery of pay TV services?***

5.1. As set out above, we do believe that the most likely consequence of allowing the Application without conditions would be that Sky would become the only pay DTT channel retailer. Combined with its pre-eminent position on pay satellite, Sky would become the key pay TV channel retailer in the pay TV market, which would have a very significant impact on channel providers, other platforms and consumers.

5.2. From a channel operator's perspective :

5.2.1. Today, distribution on the two main Pay TV platforms - cable and satellite - is key to a channel's commercial success; DTT is currently a peripheral player. Satellite is vital and three factors contribute to make access to satellite an absolute requisite:

- the existing 8 million satellite subscribers;
- until switchover, satellite has the widest digital coverage (which means that its potential customer base is also higher) and
- satellite capacity is less constrained than DTT or cable capacity.

5.2.2. This makes negotiating carriage (including access to the necessary technical services) in Sky's distribution package essential for a new channel launch to be successful

5.2.3. This affects not only new channels, but also existing channel operators, who cannot credibly consider leaving either platform because it would have a material effect on their advertising and subscription revenue. This weakens their negotiating position with the incumbent channel retailer. The absence of a multicrypt solution in set top boxes and the unwillingness of Sky to licence its proprietary CA software to third party channels or third party set top boxes make it impossible for a third party to emerge as an independent packager and retailer of pay channels on the digital satellite system.

5.2.4. If Sky were to become the only provider of pay television on DTT too, its combined position on satellite and DTT will give it an insurmountable advantage in its negotiations with channel operators.

5.2.5. Also, by strengthening further Sky's position, the combination of their purchasing capacity for DTT and for satellite would make them more able to access premium content, creating a circle by which they would reinforce their dominance

### 5.3. From a platform operator point of view

5.3.1. Sky would then be in a position where it controls both DTT and satellite, the two only ubiquitous platforms. As explained above, cable is not available in all the UK and could not offer the necessary exposure to channel providers. Sky could use their dominance in order to have exclusivity deals or commercial arrangements such as to make carriage of pay services by other platforms much less attractive.

### 5.4. From a consumer point of view

5.4.1. In principle, consumers can choose freely between platforms; though each platform has various coverage restrictions, most consumers have a choice between satellite and DTT for the provision of pay services. If the same operator controls both platforms, it will be able to increase prices or reduce quality without consumers being able to switch to another platform, where cable is not available.

5.4.2. Also, Sky is a key broadband service provider and offers bundled offers. This may allow it to increase its market power through:

- increased consumer switching costs and inconvenience, reducing churn and competition in the market
- control of the gateway into the house, which allows management of intra-household media competition to defend positions in other related markets (e.g. channels, content or broadband), and
- control of connectivity within the home. While it remains the case that once a consumer has PC connectivity to TV services they can in theory access any provider of content on the web, whoever delivers the connectivity will be in a strong position to dominate the provision of content – especially for a fee – within the home.

## 6. *Question 6 To what extent, if at all, do you consider that the Proposal would be likely to lead to any of the public policy concerns outlined at Section 4?*

6.1. We have highlighted a number of policy issues in our above submission. However, we would like to emphasize a few points.

6.2. Ofcom and Public service broadcasters are working on plans to strengthen DTT and allow the platform to carry high definition channels and respond to consumers' expectations that the platform adopts new technologies. Part of the plan could lead to the adoption of DVB-T2. Consumers would be left confused if different new technologies, MPEG4 and DVB-T2 were brought to them without any coordination.

6.3. The simultaneous introduction of MPEG4 and DVB-T2 creates a unique opportunity to make the DTT platform much more efficient, and therefore to allow a better use of this scarce public resource. Take-up of these new and more efficient technologies will be much higher if they are linked together than if they are introduced at different times.



6.4. Whilst take-up of digital television is every high, there is still a significant number of consumers who need to be convinced to adopt it. They are likely to be consumers who do not like new technologies and prefer simple and clear offers. We are concerned that strong marketing by Sky of their pay services on what is usually called Freeview, as well as the use of a new technology and of Sky's proprietary conditional access could confuse them.

**7. *Question 7 Specifically, to what extent do you consider that the Proposal would be likely to lead to consumer confusion?***

7.1. As discussed above, this transaction occurs at a time when the DTT platform needs to migrate to a new compression technology, called MPEG4<sup>10</sup>, in order to develop High Definition services. This will require consumers who want to watch new HD services to upgrade their existing equipment. There is a clear risk that the Application could lead to the introduction of proprietary standards. Equally importantly, the Application comes at a time when the (technical) future of DTT is under intense debate. As noted above, it would be unfortunate if this Application at this time forced consumers to undertake multiple set top box purchases in a short space of time as the platform evolves.

**8. *Question 8 To what extent do you consider that it is beneficial for consumers to be able to obtain Sky and existing DTT pay TV content without having to purchase separate STBs?***

8.1. We have explained above how we do not envisage that consumers will have multiple set top boxes for each set in their home. If consumers can receive all pay DTT services with a single set top box, intra-platform channel competition will be enhanced - consumers will be able to receive content from both the different pay television operators, or to switch between them more easily - and the Application is more likely to create a net consumer gain.

**9. *Question 9 Do you consider that the Proposal might lead to any additional public policy concerns?***

9.1. We have set out our policy concerns in the above submission. These can be summarised as:

- General concern around Sky's predatory announcements

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<sup>10</sup> MPEG4: This compression technology, which can be implemented channel by channel i.e. on the same multiplex (channels transmitted in MPEG2 and in MPEG4 can coexist), can deliver around 30% spectrum efficiency gain. However, consumers require a new set-top box – the existing integrated digital televisions or set-top boxes are not compatible with MPEG4. Therefore, today, a broadcaster willing to launch in MPEG4 will have no consumer base. Broadcasting one service in high definition would require nearly a whole multiplex in MPEG2, and around one third of a multiplex using MPEG4.

- Removal of three free services for all DTT viewers at the time of switchover
- Complexity of the offer for consumers - potentially five types of equipment on the market:
  - standard Freeview without any CAS
  - Standard Freeview + Top-up, Setanta and BT vision compatible CAS equipment
  - DVB-T MPEG 4 equipment without any CAS
  - DVB-T Mpeg4 Sky Mpeg2/Mpeg4 equipment
  - DVB-T2 Mpeg4 equipment
- Dissociation in the upgrade to Mpeg4 and to DVBT2 will slow down a process potentially able to increase spectrum efficiency.

**10. Question 10 If Sky becoming the only provider of pay TV services on the DTT platform were likely to have a significant detrimental effect on competition, do you consider that it is possible to address this through a set of additional conditions and/or directions? If so, what form should those conditions/directions take?**

10.1. Our submission identifies a number of key commitments that would all be required, and are summarised below

**10.2. Enabling development of STBs compatible with multiple pay services through the use of open standards**

10.2.1. We understand Sky has indicated that it would not seek to prevent manufacturers from incorporating a second CA system in addition to NDS in their boxes. However, we have very strong concerns that this commitment would not be met or not in an effective way. This is because of:

- Sky's ability to impose its views on manufacturers through its orders for satellite boxes.
- higher cost and complexity of boxes with several CAS will make consumers less likely to buy them and manufacturers/retailers less likely to produce/purchase them ( fear of higher service costs)

**10.3. Ensuring access to wholesale NDS-based encryption services**

10.3.1. The BBC thus believes that Ofcom should definitely ensure that Sky commits fully and unequivocally to facilitating open standards. However, this would not be sufficient in itself.

10.3.2. BSkyB has stated that it would not prevent the licensing on NDS technology to manufacturers provided they had sufficient guarantees that it would not undermine the security of the system. We believe this commitment would have no effect as it would be easy for Sky not to do it, arguing of security and piracy issues or to wait such a long time that it becomes impossible for a new entrant to challenge Sky's position.

- 10.3.3. We would therefore argue that a requirement either to use simulcrypt or to license NDS CA technology to set-top box manufacturers on FRND terms should be set in very strict terms. The presumption should be that Sky will licence the technology unless it can prove (to Ofcom) that to do so would inevitably lead to piracy. One option should be to subject Ofcom's approval to the signature of a least one simulcrypt agreement or several contracts with manufacturers on fair and reasonable terms.
- 10.3.4. Another, potentially safer, way to ensure the effectiveness of such a commitment would be to require News Corp to divest from NDS.
- 10.3.5. Alternatively, an effective solution would be better to require Sky to use of a CAM slot or a CAS compatible with the existing pay offers (i.e. Mediaguard) - same boxes should be able to receive all pay services
- 10.4. Limiting potential for confusion resulting from inclusion of MPEG4**
- 10.4.1. Through marketing would have very small or no effect at all : a logo such as "mpeg4 ready" would not be understood by consumers unless backed by an active campaign which nobody will be incentivised to run. It seems quite unlikely that retailers would systematically warn consumers that if they were to buy such or such product, they would not get HD or TUTV with it.
- 10.4.2. The BBC therefore believes that Ofcom should require that the Application does not proceed until there is a decision on the timing of the introduction of DVB-T2 on the platform, and, should it be decided that DVB-T2 will be used as soon as possible on one multiplex at least, until DVB-T2/MPEG4 equipment is available.
- 10.5. Wholesale provision of channels**
- 10.5.1. We agree with Ofcom that this type of remedies would only be effective if it were to establish a framework for deriving appropriate wholesale prices, for instance to require the adoption of a "retail-minus" approach or "ex ante margin squeeze" rule and to ensure that content is made available in a form which supports the full range of any value-added services (e.g. interactive services), and on equivalent terms and conditions to those which might be expected in a competitive market.
- 10.5.2. We also agree that such a remedy would not work if it meant that the same channels have to be broadcast on different streams in order to make it available on STBs supporting different CA systems, and that it would lead to a very inefficient use of spectrum.
- 10.5.3. The requirement would therefore need to be accompanied by conditions on CAS.
- 10.5.4. Another option would be to prevent Sky to enter the pay DTT sector as a channel retailer, and only to allow it to act as a wholesale channel provider on the DTT platform.

10.6. **Conditions relating to TPS**

10.6.1. We agree with Ofcom that requiring the use of simulcrypt might not be effective.

10.6.2. We understand that requiring either the use of, or compatibility with, Mediaguard might have negative consequences.

10.6.3. The only other effective remedy would therefore be to restrict Sky (or any subsidiary company) from operating a CA system on DTT, which, were the Proposal accepted, should in our view be implemented.

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11. In conclusion, we believe that this Proposal raises very strong competition and broader policy concerns that should lead Ofcom either to refuse it for the time being or to impose very tight additive conditions. Should Ofcom be minded to accept the Proposal, then we believe that it should (at a minimum) require that the following conditions be met:

- Effective use is made of open standards, simulcrypt arrangements or divestment of News Corp from NDS
- The Application does not proceed until a decision on the timing of the introduction of DVB-T2 on the platform is made and, should it be decided that DVB-T2 will be used as soon as possible on at least one multiplex, then until DVB-T2/MPEG4 equipment is available
- BSkyB withdraws from Free To ViewLtd
- BSkyB is not allowed to solely retail its channels directly, and is required to let other DTT retailers retail them.