Review of the pay TV wholesale must-offer obligation

Summary

There have been a number of market developments since Ofcom's 2010 Statement, in particular, the growth of OTT services, the greater prevalence of bundles and sector consolidation. These have not, however, changed what customers' value or altered the need for regulation. Sport, especially football, remains a vital driver of subscriptions and is therefore 'key content'. Our own data show that [Confidential] of our Sky Sports customers believe that it is extremely or very important to be able to watch live football. We also observe that other sports content (i.e. sport available on Sky Sports 3 and Sky Sports 4), although not as significant as Premier League and Champions League on its own, is important to be able to provide within a bundle in order to compete effectively with Sky and BT.

[Confidential]

The emergence of another well-resourced upstream bidder (or bidders) in the recent FAPL auctions has not solved (and cannot solve) the underlying competition problem when the rights are awarded exclusively. Splitting the rights between bidders simply creates two downstream monopolies because customers do not regard their offerings as substitutes. More evenly balanced rights holdings (i.e., a more equal holding of games amongst bidders) could even exacerbate the 'problem' because each party could have an incentive to sell to each other, but not to anyone else. Competition between bidders for rights does not translate into competition downstream (either at the wholesale or retail level).

Both Sky and BT have incentives to deny access to key content to Virgin Media, or provide it on unfavourable terms. Past behaviour is not necessarily indicative of future intent. Virgin Media's £3bn network expansion announcement; the increasing prevalence of bundles (including mobile) and Sky's own NOW TV service all point towards *greater* incentives to withhold content in the future. More homes passed on the part of Virgin Media means that withholding content could be used as a strategy both offensively (to tempt prospective customers to switch), and defensively (to persuade existing customers not to go).

A WMO obligation on those broadcasters that hold significant key content is proportionate. The risks for consumers of the 'wrong' decision on the part of Ofcom are asymmetrical: a Type 1 error (not requiring rights owners to wholesale channels that they would choose to withhold) is much worse for consumers than a Type 2 error (requiring rights owners to supply channels that they would have done anyway). However, the mandated wholesale supply of Premier League and Champions League content to rival pay TV retailers is by itself necessary, but not sufficient to tackle the competition problem. Ofcom must also ensure that the terms on which the rights are made available do not frustrate competition and assess the relevant scope of the remedy, i.e. is a narrow WMO remedy sufficient to incentivise rights holders to wholesale *all* of their sports channels?

It is also necessary for Ofcom to address the manner in which the rights are

sold in order to develop appropriate and effective remedies that address both upstream and downstream issues.

Question 3.1: Have we accurately represented the key developments in pay TV since 2010? Are there any other developments which you consider may be relevant to our assessment?

1. The major developments in pay TV since 2010 have been:

    a. the growth of OTT players (i.e., providers who deliver content to consumers without the involvement of a traditional broadcasting platform, typically over the internet to connected devices);
    b. the greater prevalence of consumers' acquisition of bundles of services; and
    c. BT's purchase of Premier League and Champions League sports rights.

2. In the near future, the market is likely to consolidate with the mergers of BT and Everything Everywhere ("EE") and O2 and H3G. In time, the UK could have at least five 'converged' providers—BT, Sky, Virgin, Vodafone and TalkTalk—each selling: fixed-line, broadband, pay TV and mobile services. We comment on each of these developments, and their relevance to the WMO analysis, below.

OTT

3. Estimates suggest that Netflix has around 4.1 million paid-for UK subscribers[1], and is particularly popular in pay TV homes. However, Netflix and other purely on-demand services appear to be in most cases *complementary* to, rather than substituting for, traditional TV viewing. Our customers activate Netflix on their TiVo set top box via an app, and the customer is billed directly by Netflix. **[Confidential]**. As Mike Fries (Liberty Global PLC - Vice Chairman, President, CEO) recently noted: "*I don't think we have lost a single customer to Netflix or anybody else. I think Netflix consumers are generally high-end video consumers who want everything, not just one thing. And that is fine with us*."[2]

4. At this stage, we do not regard the emergence of OTT as significantly affecting the fundamentals of the WMO analysis. The decision of many consumers to subscribe to pay TV is influenced by the availability of sports content. OTT options may subsequently be purchased, but appear to have little net impact on the consumption of other types of content. Indeed, it is hard to envisage how the availability of OTT offers showing films and high quality drama series would affect the importance of sports content in the minds of consumers, or the incentives of the broadcasters to wholesale that content to others. Moreover, as the Independent Advisory Panel considering free-to-air listed events noted: *"the long predicted market in internet sports rights has not so far materialised"*.[3]

5. However, Sky's move into OTT services *is* important for the review of the pay TV wholesale must offer obligation. The availability of NOW TV[4] *increases* the pay-off to Sky from restricting the supply of sports channels. Before NOW TV, if

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[1] See Enders Analysis: End of Netflix tightrope just in sight 26 January 2015

[2] Goldman Sachs Communacopia Conference September 1,2 2014

[3] Review of free-to-air listed events report by the Independent Advisory Panel to the Secretary of State for Culture, Media and sport November 2009, paragraph 34.

[4] In Sky's recent fourth quarter results it stated that Now TV had Sky enjoyed a quarter of record growth, driven by partnerships with Dixons Carphone, Google and Vodafone.

Virgin Media's triple-play[5] customers were to lose access to Sky's sports channels (through a refusal to supply) there were, broadly, three possible reactions: a) retain Virgin Media's broadband and fixed-line services, but purchase a Sky dish to view its sports programming; b) switch all services to Sky and c) do nothing, either because they no longer wish to view Sky Sports (or are unwilling to pay any set-up costs) or they cannot put a dish on their property.[6]

6. With Sky's NOW TV offer, some customers who would previously have stayed with Virgin Media, and stopped watching sports programmes (or found other means of accessing some of the content, such as visiting the pub) will now be able *"to access all Sky Sports channels for a one-off payment of either £6.99 for a day, or £10.99 for a week"*[7] [8]. This option was not available at the time of the Statement and, all else unchanged, it increases the pay-off to Sky from refusing to supply its sports channels in the absence of a WMO obligation because it can capture more retail revenue from Virgin Media's customers to compensate for what is lost from the wholesale arrangements. The extent to which this would be a strong driver of Sky's incentives is an empirical matter, but it can *incrementally* affect Sky's willingness to wholesale its sports channels in the absence of an obligation to do so. Unlike Netflix and Amazon, which are complementary services rather than a direct competitive threat, NOW TV's inclusion of key sports content (in particular Premier League) means that it can attract revenues away from Virgin Media.

Bundling

7. Recent data published by Ofcom in the Communications Experience Report reveals the continuing growth in the number of customers buying bundles of services. The number of consumers with bundled services rose from 60% in 2013 to 63% in 2014; triple-play fixed-line, broadband and multichannel TV bundles are up from 16% in 2011 to 23% in 2014 and, as a proportion of households, 39% in urban areas.[9] The price of bundles means that purchasing in a bundle is *"usually cheaper than purchasing the same services separately"*[10] and that bundle prices have declined over time. Ofcom reports that the lowest cost of a basket of communications services for a typical 'networked family' household has declined from £144.23 per month in 2011 to £107.99 in 2014. (figure 142 p. 146)

8. As bundled offerings become more established, the providers will use bundling strategies to make their bundles more attractive which will increase the likelihood of switching the entirety of the bundle. All things equal, this increases the pay-off from the restricted supply of sports content because the ARPU of a switcher that brings along their fixed-line, broadband and, potentially, mobile services will be significantly higher than the ARPU for a switcher of pay-TV only. As long as

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[5] Fixed-line, Broadband and Pay TV.

[6] Around **[Confidential]** of Virgin Media customers who join from Sky state "I don't want a dish / wasn't allowed a dish on my building" as one of their reasons for switching.

[7] Consultation paragraph 3.40.

[8] There is evidence of a small, but growing, number of customers who are giving up linear TV to consume programmes online.

[9] See also comments from BT's CEO Gavin Patterson: "*What we've seen across Europe and from our own primary research is that there is a growing appetite to buy bundles but also converged services across fixed broadband and mobile. Some people have talked of this as quad play but I think it's much more than that.*" www.telegraph.co.uk 9 February 2015.

[10] Ofcom Consumer Experience Report 2014 paragraph 7.36.

the 'receiving' operator has priced these services, in the round, so that the customer is more profitable (over his or her lifetime) as a bundled customer than a solus pay TV one, the benefits of withholding sports content are higher. Put simply, the purchase of bundles of services will increase over time and switching, when it occurs, is more likely to happen 'as a bundle'. Indeed, Virgin Media's customers are a particularly attractive prospect because 65.9% of our homes are triple-play customers compared with 17.6% on 'duals'[11] with an average ARPU of nearly **[Confidential]** per month compared with **[Confidential]** for a solus pay TV customer[12].

9. Ofcom's finding that switching has *declined* amongst bundle purchasers in the past year[13] does not provide a reliable indication of the likely switching that would occur in the event that key input was withdrawn from Virgin Media and other retailers that rely on wholesale supply.

10. Ofcom's recent data has been gathered in a period when Sky's sports channels are widely available (see table 7.2 in the consultation). Customers have not therefore been faced with what, for a significant proportion of customers, would be a cataclysmic event: losing the Sky Sports channels. Their current choice is between platforms, which, for the most part, carry Sky's sports channels. Should this occur, we believe that strong demand for this content combined with the increasing prevalence of bundles and the further development of bundled offers would mean that more customers than previously would switch suppliers (to one retailing Sky's sports channels[14]) and take their bundle of services with them. Indeed, the gaining provider would have an incentive to make sure that this was the case by using bundling strategies to make a bundle switch as attractive as possible.[15]

Consolidation

11. BT's has announced the purchase of EE; Sky has signed a multi-year MVNO deal with Telefónica UK to give it wholesale access to 2G, 3G and 4G services and Vodafone has declared a move into consumer broadband and pay TV services. All show that: a) the bundling of services is likely to increase in the future b) the bundling of content with mobile is likely to increase and c) the potential pay-off from the refusal to wholesale sports content may increase as consumers transfer more of their services (and spend) to the provider of sports channels. This increases the importance of a WMO obligation to maintain fair and effective competition.

12. None of the developments since 2010 undermine Ofcom's previous justification for a WMO obligation. Sector consolidation, the bundling of services and Sky's NOW TV online offer could all increase the pay-off to Sky from refusing to supply

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[11] See p.2 http://www.libertyglobal.com/pdf/press-release/Virgin-Media-Q4-2014-Investor-Release-FINAL.pdf

[12] Figure for December 2014.

[13] p.156 of the Consumer Experience report. Combining all consumers who bundle any of their services, one in ten (9%) switched provider for at least one service in the 12 months prior to the 2014 fieldwork. This is a decrease from 14% reported in the same period the year before.

[14] Obviously the more pay TV retailers that no longer have access to Sky Sports, the more likely it is that switchers will end up with Sky.

[15] We note also Ofcom's strategic preference for GPL switching processes, its likely intention to introduce these for all services and its belief that these will make the switching of bundles easier (and presumably increase the incidence of switching).

its sports channels to others. As we explain below, the purchase by BT of around a quarter of the games (or more in the future) has not resulted in the supply of sports channels that are substitutes in the eyes of consumers, or changed incentives to wholesale those channels to others.

BT's purchase of sports rights

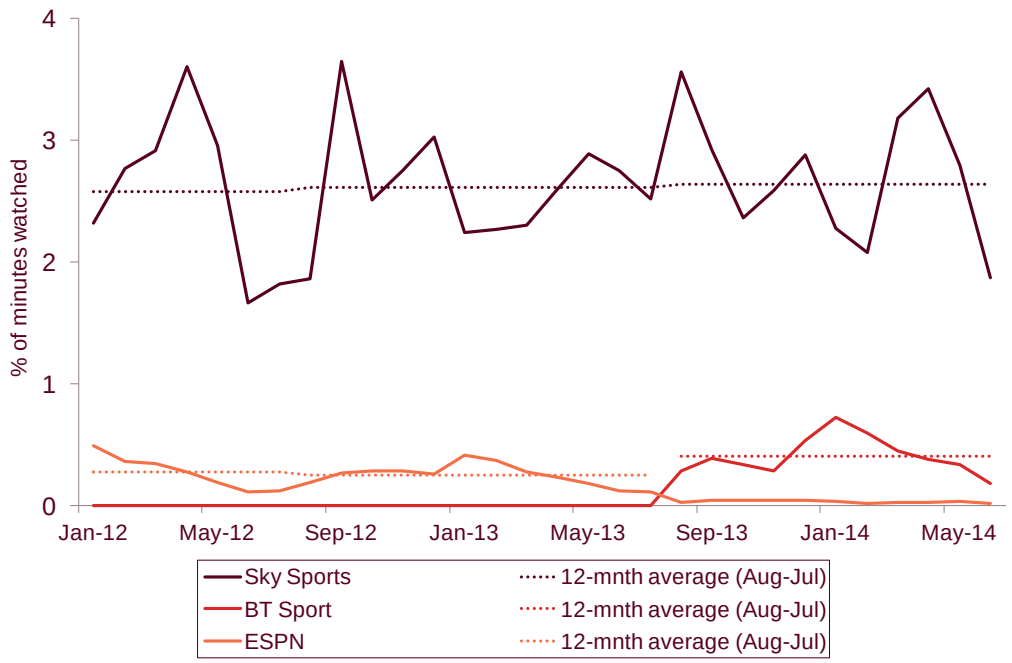
13. BT's purchase of sports rights does not mean that the competition problems associated with the limited distribution of sports content have been removed, or are likely to be removed in the future under different permutations of rights' awards.

14. The auction rules for Premier League sports rights mean that no single buyer can acquire all of the rights. The live television rights for the seasons 2013/14 to 2015/6 were won by Sky and BT, which won the right to broadcast 116 and 38 live matches per season respectively. However, BT's purchase of rights has not resulted in wholesale competition between BT and Sky to supply pay TV retailers.

15. There is, in practice, very little effective competition between different sports channel offerings in the UK. Specifically, although BT previously won two packages containing 38 matches, BT Sport is not seen as a viable substitute in the eyes of many pay TV viewers for the Sky Sports channel offering. Indeed, a considerable share of consumers are not able to trade-off one channel offering against another, and thereby exercise effective choice:

    - despite BT spending nearly £250m a year on Premier League live television rights, including a package containing top picks, and despite significant further expenditure on marketing and other content, the entry of BT Sport has had no appreciable negative impact on Sky Sports' viewership (see diagram below). This strongly suggests a lack of substitution between Sky Sports and BT Sport;

Average monthly viewership of sports channels



Note: the large variations observed in the data is driven largely by the EPL season (starts late August, ends early May), as well as other major sports events.

Source: Oxera analysis, based on BARB data.

- viewers have demonstrated that rather than BT Sport being a substitute to the Sky Sports offering, it is instead a complement. Viewers want to have access to the matches broadcast live by both Sky and BT. In particular, more than **[Confidential]** of Virgin Media's subscribers who watch BT Sport also want access to Sky Sports. Over **[Confidential]** of ex-Sky joiners to Virgin Media do so to get BT Sport *as well as* the Sky Sports channels or a 'better choice of sports channels (see the table below).

  [Confidential]

- BT is not alone in having found it difficult to acquire Premier League live rights sufficient to enable it to create a sports offering that is viewed as being an attractive alternative to the Sky Sports offering. Neither ESPN nor Setanta, the entities that prior to BT were successful in acquiring some Premier League live television rights in previous auctions, were successful in creating a sports offering that was capable of competing with Sky Sports (i.e., being seen to be substitutable).

16. The lack of substitutability is due to the fact that a Premier League match is not a homogeneous good. For many Premier League viewers, one match is not a substitute for another match and viewers are seeking access to specific types of matches, or all matches rather than access to a selected range of matches. Actual subscriptions and viewing behavior indicate that, for at least a significant share of consumers, the current offerings (i.e., BT Sport and Sky Sports) are not substitutable. Virgin Media's qualitative evidence from its Premier League

viewers is that they want to see: **[Confidential]**.[16]

17. We have recently commissioned a survey of 1,000 football fans. [17] **[Confidential]**:

    [Confidential]

18. Therefore, by the very nature of the Premier League's auction rules, the games that fans wish to watch will be broadcast on channels available from *different* providers. Indeed, in a briefing to analysts after the recent auction Sky was keen to stress that it would have the bulk of the games that football fans wish to watch: "*Sky Sports will have the best match picks and the best slots so our viewers will be able to follow the biggest matches, the key head to heads and every club at least four times*".[18] BT said it was "*pleased we will be showing Premier League football for a further three years and that we have secured the prime Saturday evening slot. These new rights will enhance our existing schedule of football, rugby and other international sport, including all the live footballing action from the UEFA Champions and Europa Leagues starting this summer*."

19. As a consequence of the fact that pay TV viewers do not consider BT Sport to be an alternative to the Sky Sports channel offering, and show a strong preference to have access to both offerings, *there is a lack of effective competition between sports channel providers at the wholesale level*. This is because, in making decisions about which sports channels to purchase from broadcasters and offer to consumers, pay TV platforms are unable to substitute between the offering of Sky Sports and the offering of BT Sport. Competition between broadcasters at this level can only be expected to develop if consumers will switch, in sufficient numbers, between offers from different broadcasters.

20. The current lack of competition means that Sky knows that it does not face the risk of retail platforms substituting away to BT Sport, which inevitably has a direct impact on the negotiating position of the retail platforms and, ultimately, the wholesale prices that can be secured by broadcasters. Broadcasters with a 'must have' offering essentially retain seller power and retailers have little or no negotiating leverage.

21. In short, the fact that the Premier League's auction mechanism has not enabled rival bidders to create differentiated substitutable sports channel offerings means that retail pay TV platforms cannot generate sufficient competitive tension between such channel providers to impose any meaningful wholesale price pressure. Similarly, the absence of competition at the retail level means that Sky, should it choose not to wholesale its content to other pay TV retailers, would expect to gain the vast majority of 'churners' from the losing network. The purchase of rights by BT has therefore neither altered the importance of live Premier League football in the minds of consumers nor *positively* altered Sky's incentives to wholesale its sports channels.

Premier League Rights for 2016/7 to 2018/2019

22. In the most recent FAPL auction (announced on 10 February) Sky has again

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[16] **[Confidential]**.
[17] This research has been submitted to Ofcom.
[18] Email from the Sky Investor Relations team on 10 February 2015.

won the majority of rights at a cost of £4.176bn, an increase of 83% on its previous spend. Sky still benefits from the 'vicious circle' identified in our previous submissions namely: "[a] firm with an established subscriber base downstream enjoys a competitive advantage when bidding for content as it can monetise its investments in content faster than firms without such content". [19][20]

23. Sky's advantages in the Premier League auction are widely recognised. The Bank of America Media Daily on 29 January notes: "*The FAPL rights are very profitable to Sky with its £750m of rights spend underpinning the customer relationship with 5m sports subs, c£3.5bn of subscription revenues and c£500m of ancillary revenues from commercial, wholesale and ad revenues*." And Ofcom comments: "*Sky has consistently won the maximum rights available to a single broadcaster in auctions for Premier League rights.* ***This indicates that Sky had a higher valuation of the rights and that it enjoyed an advantage over rival bidders***." (paragraph 6.36 our emphasis). Furthermore, *"[o]verall it is not clear whether BT's strategy of bundling it sports offering for free with broadband overcomes Sky's advantage of being the vertically integrated operator with the largest pay TV platform*". (paragraph 6.37).

24. Although unlikely, it is possible that, in the future, there will be a more even distribution of Premier League games between sports channel offerings following the next auction (in three years time).[21] However, Virgin Media would still require access to the rights of *both* broadcasters in order to be able to compete effectively. Although with more games BT would be a stronger competitor to Sky, the channels would not, for many customers, be regarded as substitutes; stronger competition at the retail and wholesale levels would not therefore materalise. Put simply, reshuffling the rights holdings between broadcasters does nothing to alter the fact that the manner in which the rights are sold—exclusive live rights with a distribution of 'top picks' between packages—means that the resultant channel offerings will not be seen as substitutes in the minds of consumers.

25. However, if there is a more even distribution of games between Sky and BT it may be that each agrees to the *mutual* wholesaling of rights between themselves, but not to others (in the absence of a WMO obligation).

26. Mark Armstrong in 'Competition in the Pay-TV market'[22] discusses the danger of two vertically integrated pay TV networks entering into collusive agreements to exchange programming. He constructs a simplified model of two symmetrically placed broadcasters who each produce a differentiated set of programs (as would be the case for Sky and BT given that the live games that each shows are not substitutes for one another), and examines wholesale interconnection, in which firms supply each other with their programmes at the wholesale level in return for an access charge.

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[19] See for example: Submission to Ofcom on the need for a market investigation into pay TV industry by BT, Setanta, TUTV and Virgin Media, 3 July 2007.
[20] BT has produced a model, which shows that "Sky will systematically be able to outbid BT for sports rights other than in exceptional circumstances". See Modelling static and dynamic competition in the retail CPSC market", Neil Dryden and Jorge Padilla, 30 April 2014, Section 5 and Appendix A.
[21] Arguably there will be a more balanced distribution of key live football rights following BT's purchase of Champions League.
[22] Journal of Japanese and International Economies December 1999.

27. He models pricing decisions in a two-stage manner: the two firms first negotiate over the wholesale access charge and then choose their retail tariffs non-cooperatively given this charge. Firms will buy each other's programmes if and only if the access charge is no greater than consumers' willingness-to-pay for the extra set of programmes. Each will choose to levy an access charge on a per-subscriber basis, since the charge then affects the marginal cost of serving subscribers—if firms just levied a lump-sum charge for the rights to screen each other's programmes then marginal costs would not be affected and collusion could not be sustained. (This corresponds to how wholesale rates are set in the UK). By charging a high (but not too high) access charge, each firm is willing to buy the rival firm's programmes, which increases its cost of supply. This sustains high prices in the retail sector at the collusive level. The collusion is sustained because the rival products are not closely substitutable.

28. The implication of these types of models can be that, with a more balanced award of packages between two buyers, the winners of rights may have an incentive to wholesale to each other at charges that dampen competition. However, they need not necessarily have an incentive to wholesale to *other* pay TV retailers. In the same way that the award of roughly 25% of the games to BT has not made the problem go away—Premier League and Champions League are 'must have' content, the absence of which will hinder fair and effective competition with incentives on the purchasers of rights to withhold content—the award of 50% of the games to each bidder will not do so either. As Harbord and Szymanski note: "*splitting the rights between pay-TV broadcasters simply creates two or more downstream monopolies in the place of one, and consumers are made no better off as a result*."[23] These monopolies may have an incentive to supply each other (at a particular structure and level of prices which dampens competition), but not necessarily to supply other retailers.

Question 4.1: Do you agree with our proposed analytical framework for identifying whether limited distribution of key content is a practice which may be prejudicial to fair and effective competition in pay TV services?

29. Ofcom should consider whether another step in the analysis is required, in particular, a consideration of Type 1 and Type 2 errors with respect to the incentives acting on the holders of sports rights, and the decision on whether to impose a WMO. Ofcom could make two types of error in respect of its decision to impose a WMO obligation:

    a. **Type 1 error**: detecting an effect that is not present i.e., Ofcom falsely concludes that the holders of sports rights are likely to withhold that content from other platforms in the absence of an obligation;

    b. **Type 2 error**: failing to detect an effect that is present i.e., concluding that holders of sports rights will have an incentive to wholesale the content, withdrawing the regulation, and discovering that they do not.

30. A key consideration for Ofcom should be an assessment of which eventuality is worse for consumers. In a Type 1 world (which presumably Sky would say that we are in at the moment) there is no evidence that competition or consumers have been harmed or that Sky has ceased to innovate (leaving aside that Ofcom

[23] David Harbord and Stefan Szymanski in Restricted View: The Rights and Wrongs of FA Premier League Broadcasting.

should not impose unnecessary regulation) as a product of the WMO requirement. Now it is in place, the costs of extending the WMO obligation are low: there are few (if any) incremental compliance costs.

31. By comparison, in a Type 2 world, the 'costs' for consumers and competition would be high (higher prices, lower quality and less innovation from ineffective downstream competition) and take years to put right.

32. Given the imbalance in costs for consumers of Type 1 versus Type 2 errors, and the inherent uncertainty about the future, Ofcom should err on the side of continuing some form of regulation unless there is compelling evidence that it is not required (which Virgin Media does not believe is the case).

Question 5.1: Do you agree with our assessment that sports content is an important driver of choice in pay TV services? If not please provide evidence to support your view.

Question 5.2: Do you agree with our assessment that live Premier League matches represent key content in competition for pay TV services? If not please provide evidence to support your view.

Question 5.3: Do you agree with our assessment that live Champions League matches also represent key content in competition for pay TV services, albeit to a lesser degree than Premier League content? If not please provide evidence to support your view.

Question 5.4: Do you agree with our assessment of the importance of other sports events? If not please provide evidence to support your view.

Sports Content

33. The importance of sports content for the choice between pay TV retailers is so widely recognised, and evidenced, as to be uncontroversial.

> *"It is widely accepted that live sport is among the most attractive programming available to either free-to-air channels or pay-TV broadcasters. The significance of some sporting events, such as the soccer World Cup, the Wimbledon tennis championship and the Olympic Games is so great that legislators have forced the rights owners to ensure that they can be viewed on free-to-air television, rather than obliging consumers to take out a subscription to watch them. In the UK, despite the fact that there are few forms of sports programming that are as attractive to consumers, Premier League soccer is not protected in this way."* David Harbord and Stefan Szymanski in Restricted View: The Rights and Wrongs of FA Premier League Broadcasting.

34. The importance of sports coverage to the 'media' is not new. Covering sports events in the printed media has helped increase circulation and advertising and boost stadium attendance for over 100 years. This has not inhibited fair and effective competition because coverage was not exclusive to a restricted number of papers or magazines.

35. Our own market research in December 2014 of 1,102 Virgin Media customers with Sky Sports in their TV package shows that **[Confidential]** of them rank as

very important or extremely important access to Sky Sports and BT Sports respectively.

36. Ofcom notes that *"[o]ur view that sports content was important was supported by a number of other pieces of evidence including the amounts paid for sports rights, statements by market players, international case studies and the number of consumers who pay for premium sports content*." (paragraph 5.2). However, data on the number of customers who pay for premium sports can *underestimate* the value to pay TV subscribers of the *option* to view premium sports.[24] Some customers will subscribe to, or stay with a platform, if it gives them the possibility of watching sports content at some point in the future. By extension, they will not move to a pay TV retailer who cannot grant them this option.[25] **[Confidential]**.

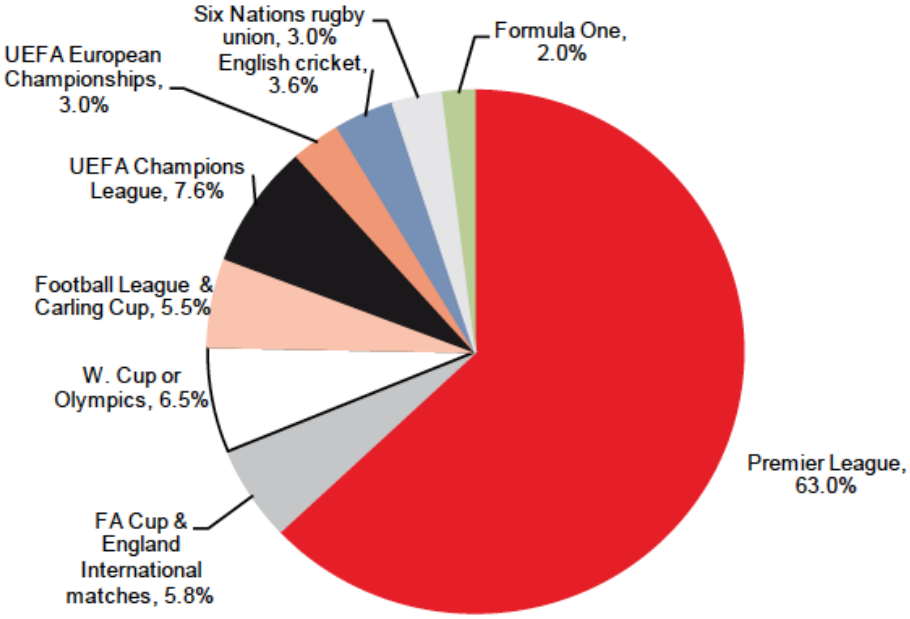
37. Ofcom recognises this point in paragraph 6.11 "*..some consumers that do not currently take Sky Sports may value the option of taking up Sky Sports at some point in the future. Those subscribers might therefore be more inclined to subscribe to a platform that offers Sky Sports even if they do not purchase it at the current time. Pay TV retailers without Sky Sports available on their platform may therefore also face certain disadvantage when competing for non-subscribers to Sky Sports*."

Premier League

38. The importance of Premier League sports content (to Sky and others) is widely recognised: "*a survey from UBS suggests that 59% of Sky customers take sports. If the English Premier League disappears, so will many of those subscribers. Sky must defend its goal*".[26] Back in 1992 Greg Dyke thought that football would be '*the biggest dish-driver of the lot*".[27] Nomura estimates and charts the top UK sports properties by value and notes: "*The premium placed on the Premier League is shown by the share of costs it absorbs compared with other sports. This should be borne in mind whenever* ***pay-TV operators start talking down the importance of the Premier League in any respective territory***." [28] (our emphasis)

[24] Although this may be reflected in the amounts paid for the rights.
[25] **[Confidential]**.
[26] Financial Times. Lex Column 4 February.
[27] Reported in 'Armchair Nation' by Joe Moran p. 297.
[28] Nomura: BT. Sky and football rights, 11 September 2014.

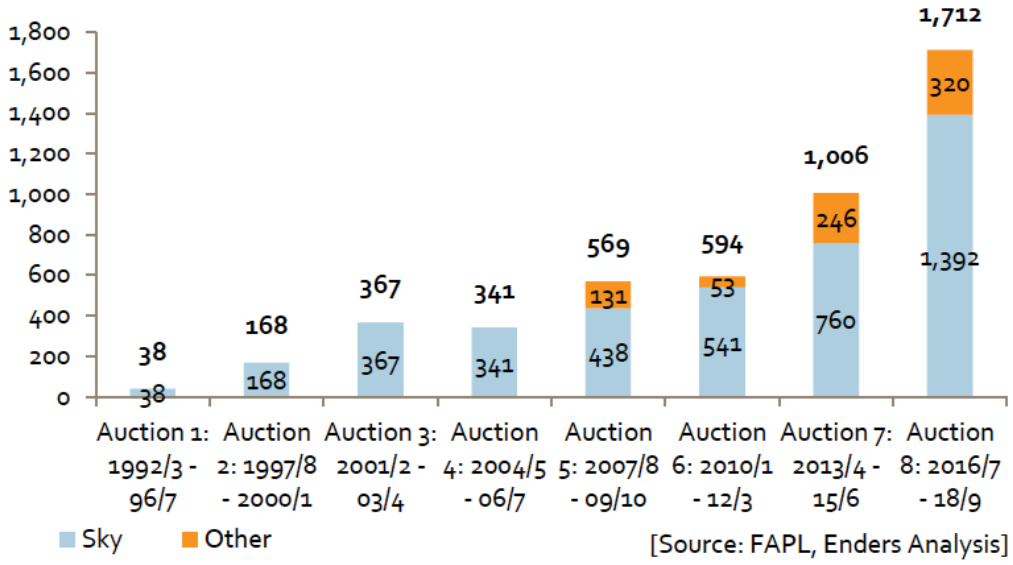
Top 10 UK sports properties by value (Nomura 2014 estimates)[29]



39. Broadcasters are prepared to continue to pay so much for Premier League (see table below) relative to other sports content because it is such an important driver of subscriptions, not just to pay TV, but also to bundles of services (with this becoming increasingly important going forward given the consolidation of the market to create entities able to offer attractive bundles). The value of the content as a subscription driver or churn reducer is far in excess of the total viewing that it generates. Nomura reports that "[t]he Premier League will likely only represent about 3% of the viewing hours on Sky Sports (not including Sky Sports news or adjacent programming). However, its importance in terms of subscriptions means it represents 53% of all Sky Sports programming cost and 28% of total Sky programming cost."[30] Jefferies notes: "[a]t last week's results, SKY again stressed the broad appeal of its content, arguing that pricing power is not dictated by football…. Actual bidding tactics don't seem consistent…. SKY appears to have admitted that a dominance in PL rights is pivotal to its UK business". [31]

[30] Nomura p.34.
[31] Jefferies February 10, 2015. PL Auction Outcome: Reassuring for BT, Sobering for SKY.

FAPL live rights (£m per season)



40. Virgin Media's own research finds that for customers with Sky Sports in their package **[Confidential]** rate football as important or extremely important to watch live on TV and **[Confidential]** always or usually watch live Premier League at home.

41. In summary, the importance of Premier League to Sky and other pay TV retailers is widely recognised. It is supported by our own data and the amounts that, in particular, Sky is prepared to pay for exclusive live rights in the auction.

Champions League

42. Ofcom suggests that: "*[i]t therefore seems unlikely that Champions League football alone could drive pay TV retailer of choice for a material group of customers…..However, given the number of consumers for whom Champions League coverage is important, it seems likely that Champions League could increase the degree to which a sports proposition which included Champions League coverage could influence consumers' pay TV retailer of choice*." Even if Champions League is not the same driver of customer behaviour (on its own) as Premier League, the key issue from a competition perspective is whether retailers who are unable to bundle these matches with Premier League (due to limited wholesale distribution) are able to compete effectively with those that can. Virgin Media considers that it would be unable to compete effectively with packages which included both Premier League and Champions League content with a package which included only Premier League content. Our own data shows that **[Confidential]** of Virgin Media's customers with access to Sky Sports always or usually watch live Champions League at home.

43. Evidence (shown below) indicates that, from its survey of non-BT customers, BT believes that there is a multiplicative effect from holding rights to Premier League and Champions League games: the combination of the two is likely to drive three times as many broadband sales as Premier League on its own.

Nomura | BT, Sky and football rights 11 September 2014

Fig. 9: Premier League and Champions League content is worth more together than individually, according to BT

BT survey showing likelihood of BT Sport driving incremental broadband sales over three years

[1]BT survey showing attitudes to BT Sport from households interested in sport [2]Excludes re-signs and benefits from churn reduction

Source: BT

Other sports

44. Virgin Media supports Ofcom's view that *"….live Premier League coverage and to a lesser extent live Champions League coverage appear capable of influencing a significant number of consumers' choices of pay TV provider. We have therefore identified them as key content in competition for pay TV services*." (paragraph 5.36). However, access to other sports content remains important. The table below shows, for the Virgin Media's customers who take Sky Sports, the percentages who rank as important and extremely important the ability to watch individual sports live on TV.

    [Confidential]

45. Virgin Media's evidence suggests that pay TV subscribers who are sports fans value a broad range of sports content. Although less important that Premier League and Champions League as a stand-alone driver of subscriptions, consumers will favour packages which include key content bundled with other sports content over those which only offer key content.

Question 6.1: Do you agree with our assessment that limited distribution of Sky Sports may be prejudicial to fair and effective competition?

46. Virgin Media agrees with Ofcom's assessment. Specifically:

    - "*….limited distribution of Sky Sports may restrict other platforms' ability to compete for a sizeable and high-value segment of pay TV subscribers*." Paragraph 6.57.

    - "*….there is a group of Sky Sports subscribers for whom Sky Sports is of such importance to their decision that they are unlikely to consider a pay TV service that cannot offer Sky Sports….Given the range of evidence available to us….we consider it is likely that between 12% and 24% (so around 20%) of pay TV subscribers are in this group*." Paragraphs 6.9 and 6.10.

    - "*..limited distribution of Sky Sports may prejudice fair and effective competition between pay TV retailers*." (Paragraph 6.65).

47. We have conducted consumer research into the degree of customer churn

resulting from the withdrawal of certain types of content including Sky Sports, Champions League and BT Sport. **[Confidential]**

Question 6.2: Do you agree with our assessment that limited distribution of BT Sport is unlikely to be prejudicial to fair and effective competition?

48. Ofcom reports that "*[t]he evidence suggests that BT Sport is very important or essential to 4%-5% of pay TV subscribers*" (paragraph 6.18) and that "*..the acquisition of live Champions League content is likely to increase the number of subscribers who are unlikely to consider a platform that cannot offer BT Sport from around 5% of pay TV subscribers to around 8% of all pay TV subscribers*" (paragraph 6.27). The results from Virgin Media's consumer research indicates that, if Virgin Media were unable to gain access to BT's Premier League and *future* Champions League matches, we would expect to lose up to **[Confidential]**.

Question 7.1: Do you agree with our assessment of Sky's incentives to limit distribution of its key content? If not please explain why.

Question 7.2: Do you agree with our assessment of BT's incentives to limit distribution of its key content? If not please explain why.

49. Broadcasters with control over exclusive content will assess the relative profitability of different distribution strategies taking into account short and longer-term considerations. There is profit to be made in supplying content to rival platforms; whilst at the same time exclusive premium content is an important draw for subscribers to its platform. This trade-off is critical. Exclusive content gives its owner an initial advantage that is amplified by dynamic effects. This benefit can outweigh the opportunity cost of forgone distribution revenues.

50. However, it is not valid to make inferences about Sky's incentives with reference to Virgin Media by looking at the existing supply arrangements. Sky's incentives are influenced by previous regulatory interventions and the existence of the WMO obligation. As Ofcom notes, "*[i]n the absence of the regulatory obligation the supply arrangements might have been different or not concluded at all*." **[Confidential]**

51. Attempting to reach a robust view on Sky's static incentives to withdraw its sports content from Virgin Media is problematic. Virgin Media is not in a position to critique Ofcom's analysis in paragraph 7.13 of the consultation because much of it is redacted. Our own simple analysis (shown below) shows that changing one assumption about Sky's success in attracting Virgin Media's switchers can alter the view about their incentives: in the 'high' scenario Sky's EBITDA uplift outweighs the loss in wholesale revenue. That said, there are many other variables that can be included to either reinforce or undermine this result: our ARPU number assumes all products switch, but some customers may not switch broadband and fixed-line; we have used Virgin Media's costs in the EBITDA calculation, **[Confidential]**; we have not considered future ARPU growth or advertising revenue; the switching percentage will underestimate the value gained by Sky from withholding, as Virgin Media would also lose new customers who would otherwise join etc. etc. In any event, we detail below the factors which give rise to Sky and BT's *dynamic* incentives to withhold the supply of sports content from Virgin Media, many of which will increase in importance going forward.

[Confidential]

52. Ofcom concludes that "*[i]n the case of Virgin Media there would appear to be a stronger possibility of a static incentive to supply…it is not clear as to whether the strategic benefits to Sky as a result of limited distribution would be sufficient to overcome this static incentive*". Although we have explained our doubts about Ofcom's views on Sky's static incentives, Virgin Media believes that there are a number of factors which already increase the benefits to Sky from withdrawing content from our platform which may be expected to increase in the future and which cannot be captured from (necessarily) simplistic modeling:

- The increased prevalence of the bundling of services will improve the retail pay-off to Sky from withholding content as more customers switch their bundles of services between suppliers;

- Sky's launch of a mobile service from 2016 will increase the value of the bundled services which could be switched to Sky following a refusal to supply;

- Sky's investment in NOW TV could increase the retail pay-off from refusal to supply;

- Virgin Media's has recently announced that it intends to invest £3bn over the next five years to pass another four million homes and that it expects to sign-up 40% of those homes (see the diagram below showing the results from our recent network build trial of 10,000 homes). Virgin Media intends to infill its existing network—we know that four million homes are up to 50 metres[32] from our network—and many of the customers that we hope to attract will already have a supplier for their broadband and pay TV needs. Sky could therefore decide to defend its existing base of customers by withdrawing the supply of its sports content. It has an incentive to prevent Virgin Media from becoming a more significant competitor and adversely affecting its prices and margins as well as becoming a viable bidder for the rights.

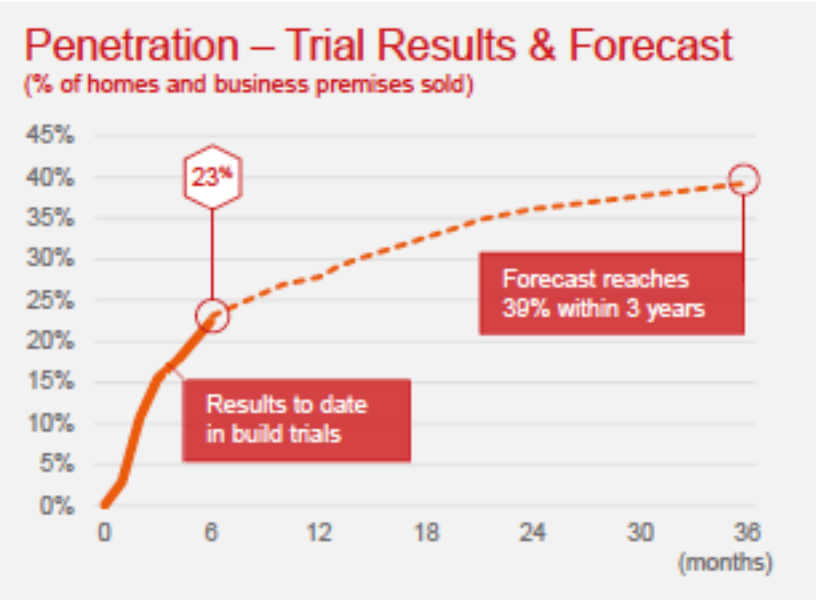
- **[Confidential]**[33] [34]

  [Confidential]

[32] Of which two-thirds are less than 20 metres. See: http://www.libertyglobal.com/pdf/presentations/Liberty-Global-2014-Investor-Call-Presentation-FINAL.pdf

[33] **[Confidential]**.

[34] **[Confidential]**.



Source: Liberty Global 2014 Investor Call presentation February 13, 2015 p.8

53. All of the above factors point in one direction: Sky is likely to have a dynamic incentive to refuse to supply its sports channels to Virgin Media. Indeed, a similar set of factors will affect BT's incentives to supply its sports channels to Virgin Media. BT will gain from the switching of bundles of services (it has large potential gains from even a small amount of bundle switching notwithstanding the dissipation of some switchers to other platforms) and may wish to 'defend its turf' (prevent its existing customers from moving to Virgin Media) by refusing to supply its sports channels. The challenge to Sky (and BT) is well put by Morgan Stanley, Goldman Sachs and new street research:

- "*…it [Virgin Media] is building a superior network with superior product offerings than the incumbents*".[35]

- "*BT may retaliate aggressively [to Virgin Media's network expansion], as we estimate a loss of over 1 mn high-margin wholesale / retail customers could weigh by up to 10% on BT's own longer-term FCF generation. However, we believe that BT will rather compete on functionality / speed / content than on price, given the risk to its overall growth from a damaging price war*."[36]

- "*VMED is targeting 40% customer penetration of an additional 4 million homes by 2020, and if this is successful most of these 1.6 million new customers would come from BT, Sky and Talk Talk. Based on national broadband market shares around 37% of these would come from BT, 29% from Sky, 23% from Talk Talk and 10% from other providers. However, based on VMED's premium product and pricing positioning, we think that Sky in video and BT in broadband (except plusnet) are more exposed than Talk Talk and other unbundlers*."[37]

54. In summary, Sky has static incentives to withhold supply: Ofcom's finding in this

[35] Morgan Stanley, February 17, 2015 Liberty Global plc Lightning Strikes in the UK.
[36] Goldman Sachs, February 17, 2015 Breaking the mould, accretively; Project Lightning extends growth.
[37] new street research February 19, 2105 UK Broadband: Lightening [sic] strike.

regard is unlikely to reflect all relevant factors (on a forward-looking basis) namely, the benefit to Sky of attracting bundled switchers (including mobile when launched by Sky), the possibility of customers unbundling to take NOW TV and the threat posed by Virgin Media's expansion which increases the proportion of customers Sky needs to defend and/or can expect to win back at the retail level by withholding supply; as well as dynamic incentives: Sky's incentive to weaken pressure from a larger Virgin Media on Sky's retail prices and margins and prevent Virgin Media from becoming a viable bidder for rights. An analogous analysis applies to BT.

Question 8.1: Do you consider it appropriate to maintain some form of regulation on Sky in order to ensure fair and effective competition in pay TV? Please provide evidence to support your view.

55. Yes. Sky holds a position of market power and still has incentives and the ability to withhold key content in order to protect its position. Without the ability to retail this content, **[Confidential]**; this would undermine our ability to compete. In the absence of a regulation it is likely that Sky would choose not to wholesale sports content to Virgin Media, or would do so on much less favourable terms.

56. **[Confidential]**[38]

Question 8.2: Do you agree with the potential options for regulation we have identified? Do you believe there are other options we should consider?

57. The options for regulation are comprehensive in so far as they relate to a WMO obligation. It is important that Ofcom has recognised that "*some form of pricing obligation may….be necessary to restrict the ability of the holder of key content to limit the ability of its rivals to compete on price*". [39] As Harbord and Szymanski[40] explain: "

> *"BSkyB acquires the exclusive rights to broadcast live Premier League matches for a lump-sum fee, and sells the programming to its own subscribers and to its competitors (via sales of its Sky Sports channels) for a per-subscriber monthly fee. Resale of the rights for per-subscriber fees allows BSkyB to prevent the dissipation of monopoly profits by increasing the marginal cost of its competitors, that is by raising rivals' costs, while simultaneously increasing the opportunity cost of serving its own customers. The resale price thus acts as an effective mechanism for both weakening downstream price competition and extracting consumer surplus from the premium product, depriving consumers of the benefits of competition."*

58. A WMO obligation therefore ensures that the content is accessible to competing retailers; it does not however rectify the consumer harm that originates upstream through the manner in which the Premier League sells the rights.[41] Nor does the

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[38] **[Confidential]**

[39] Paragraph 8.14

[40] Harbord and Szymanski: Restricted View: The Rights and Wrongs of FA Premier League Broadcasting. A report for the Consumers' Association 2003.*

[41] Collective selling of rights can lead to three types of problem: a) market power on the part of the sellers which leads to inflated prices for upstream broadcasters and down stream retailers and their customers; b) a tendency to limit the number of games available and c) strengthening

'no single buyer' rule that splits the rights between upstream bidders; this just creates two or more downstream monopolies with consumers left no better off. Moreover, the harm is exacerbated when, every three years, the protagonists pay ever-higher amounts for the rights, resulting in higher wholesale and retail prices.

59. Ofcom is investigating Virgin Media's complaint under CA98 in relation to the way that the Premier League sells live television rights. Virgin Media alleges that the collective sale of TV rights on an exclusive basis involves a breach of the Chapter 1 prohibition on anti-competitive agreements because of the restrictions on competition which result from (a) the removal of upstream competition; (b) distortion of downstream competition; (c) output restrictions (168 out of 380 matches are sold for live broadcast); and (d) reduced price competition.

60. Virgin Media notes that there are likely to be a range of remedial options that could be considered by Ofcom. However, Ofcom needs to ensure that the proposed remedy addresses all facets of the consumer harm. This could include: (a) making all Premier League matches available for live television broadcast in the UK; *and* (b) encouraging increased competition between channel broadcasters, for example by removing exclusivity in respect of live television rights made available.

61. While the removal of the Premier League's output restrictions is necessary to expand consumer access to the Premier League, it is in itself insufficient to encourage increased effective competition between broadcasters. For that, a significant proportion of consumers must find the broadcasters' offers sufficiently attractive alternatives to make the switch entirely from one to another. It is this direct competition that applies most competitive pressure on broadcasters, disciplining their prices (and in turn disciplining their upstream bidding) and encouraging improved quality and choice for consumers.

62. If the Premier League were to permit live rights for individual games to be acquired by more than one broadcaster, consumers would be given the chance to access the games they want to watch via different channel offerings. This would remove the broadcasters' uncontested positions with respect to the supply of specific matches. When consumers have the option to choose between channel offerings showing the same games, downward price pressure would be exerted on the broadcasters of Premier League content as they compete to attract subscribers. As well as disciplining prices, this competitive pressure could be expected to have further advantages for consumers. For example, broadcasters offering the same match might be incentivised to compete more fiercely on the quality characteristics of the broadcast, such as on-screen analysis, insightful commentary and companion apps.

63. In the case of competition for wholesale customers (platform operators), the broadcasters would compete to attain carriage, with platform operators selecting a preferred sports channel to provide to their end-consumers. Critically, competition between broadcasters at this level can develop only if consumers would switch between different broadcaster offers. In this case, the platform operator is able to select a Premier League broadcaster and advertise the inclusion of that content to attract subscribers. However, where consumers

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the market position of the winners of the rights (via the vicious circle). The WMO obligation only tackles the last of these problems.

regard the content as complementary, the platform operator is unlikely to be willing to alienate a proportion of potential subscribers by offering only a single Premier League broadcaster's content.

64. As things currently stand there is a need for a WMO obligation, and this may continue to be needed depending on the scope and nature of any upstream reform.

Question 8.3: Do you consider that the WMO obligation placed on Sky is no longer required to ensure fair and effective competition in pay TV? Please provide evidence to support your view.

65. Virgin Media believes that the WMO obligation placed on Sky is still required to ensure fair and effective competition in pay TV.

66. Sky retains, and is likely to continue to retain a large part of the key sports content. In the absence of the WMO, we believe that Sky is likely to have an incentive to no longer wholesale this content to Virgin Media. This incentive is likely to increase over time with: the growing prevalence of bundles, Sky's launch of its own mobile service and Virgin Media future (extensive) network build.

Question 8.4: Do you agree with our assessment that it is unlikely to be appropriate to consider the imposition of regulation on BT to ensure fair and effective competition in pay TV at the current time? Please provide evidence to support your view

67. No, not entirely. Virgin Media views BT's current and future portfolio of sports rights (the Premier League games plus the Champions League for 2016-19) as key content. We believe that a package with Premier League and Champions League games is significantly more attractive than one with just the former. **[Confidential]**.

68. **[Confidential]**.

Virgin Media
March 2015