



# Premium pay TV movies

Market investigation reference to the Competition  
Commission

This is the non-confidential version.  
Confidential information has been redacted.  
Redactions are indicated by [ X ].

Decision

Publication date:

4 August 2010



# Contents

Section		Page
1	Summary	1
2	Introduction and legal powers	4
3	Movies sector overview	8
4	Market definition	10
5	Features of the markets	15
6	Prevention, restriction and distortion of competition	29
7	Discretion to make a market reference	45

Annex		Page
1	Terms of the market investigation reference	59
2	Movies sector overview	60
3	Market definition	86
4	Features of the market	92
5	Prevention, restriction and distortion of competition	102
6	Discretion to make a market reference	111

## Section 1

# Summary

- 1.1 This document sets out our decision to refer to the Competition Commission ('CC') for market investigation under the Enterprise Act 2002 ('EA02') the following closely related markets:
- the rights to show movies from the Major Hollywood Studios<sup>1</sup> in the first pay TV subscription window in the UK; and
  - the wholesale supply of pay TV packages including Core Premium Movies channels<sup>2</sup>.
- 1.2 We published a consultation on our proposed decision to make a market investigation reference on 31 March 2010 ('the Consultation') and received 14 responses.
- 1.3 We consider that the markets we have identified are distinct economic markets and that within these markets a combination of features has an adverse effect on competition. This in turn negatively affects the consumer experience, particularly in terms of reduced choice and innovation and higher prices. The features we have identified are:
- a limited pool of premium content from the Major Hollywood Studios;
  - the way in which the rights to broadcast movies are made available over time (i.e. the release windows structure);
  - the joint licensing of premium linear channel and subscription video on demand ('SVoD') rights<sup>3</sup> by individual studios;
  - exclusivity of rights licensing agreements between individual studios and purchasers of rights;
  - other restrictions in contracts for the rights in the first pay TV subscription window, such as [ X ];
  - aggregation of substitutable premium movie content<sup>4</sup> into a single wholesale offering;
  - staggered availability of content rights and duration of contracts for premium movie rights<sup>5</sup>;

---

<sup>1</sup> By 'Major Hollywood Studios', we mean NBC Universal, Viacom, Fox Filmed Entertainment, The Walt Disney Company, Sony or Time Warner and their wholly owned or controlled subsidiaries.

<sup>2</sup> Packages including Core Premium Movies channels are packages including at least one "Sky Movies channel" (see Annex 1 for definition) and which may include other products or services, including but not limited to SVoD services.

<sup>3</sup> The term 'premium SVoD rights' is used to refer to the SVoD rights that are licensed in the first pay TV subscription window by the Major Hollywood Studios.

<sup>4</sup> Premium movie content is used to refer to movies licensed in the first pay TV subscription window by the Major Hollywood Studios.

- Sky's market power in the distribution of Core Premium Movies channels, which in turn gives Sky a high degree of negotiating power with the Major Hollywood Studios in the upstream market; and
  - vertical integration of firms over the pay TV supply chain. In particular, vertical integration in conjunction with its market power gives Sky an incentive to limit the exploitation of its SVoD rights, and restrict distribution of its wholesale channels.
- 1.4 We believe that we have reasonable grounds to suspect that the combination of these features prevents, restricts or distorts competition in these closely linked markets. In particular, the combination of the features identified creates a situation in which one player is enabled and incentivised to prevent, restrict and distort competition. We see these issues being manifested in three ways:
- limited exploitation of premium SVoD rights;
  - restricted distribution of Sky's Core Premium Movies channels; and
  - high prices for Sky's Core Premium Movies channels.
- 1.5 Pay TV is now the single largest source of revenue in the UK's TV industry. First-run Hollywood movies<sup>6</sup> on a subscription basis are particularly important to competition in the pay TV sector because they are highly attractive to a large number of consumers, and shown only on pay TV<sup>7</sup>.
- 1.6 There are three enduring characteristics of these movies that make them particularly compelling to consumers:
- they are movies of a high quality, at least in terms of box office success;
  - this is the first time they are shown on TV and consumers typically value films more the closer they are to their theatrical release date; and
  - they are available via subscription and subscription services are in greater demand than pay-per-view ('PPV') or transactional video on demand ('VoD'), given the convenience of not paying for each movie.
- 1.7 To date, subscription to packages of linear channels showing first-run movies has been the most compelling movies offer on TV. However, the importance of linear movie channels appears to be gradually declining over time. Subscription services offering recent movies on demand present an important long-term proposition. They offer consumers many of the same characteristics as linear channels, but with the added convenience of providing access to a wide range of content on demand.
- 1.8 We consider that the combination of the features has resulted in a situation in which Sky has control of premium movie rights. We are concerned that Sky will maintain and exploit its market power by restricting the distribution of its movies channels and exploitation of SVoD rights. In the longer term we are concerned that as Sky develops its SVoD services, its current market power in relation to linear channels

---

<sup>5</sup> Premium movie rights are the rights that are licensed by the Major Hollywood Studios in the first pay TV subscription window.

<sup>6</sup> We define 'first-run Hollywood movies' as movies from the six Major Hollywood Studios, shown in the first pay TV subscription window.

<sup>7</sup> Paragraphs A2.6 to A2.16 in Annex 2.

could be transferred across to these new services. Therefore, it is unlikely that, absent intervention, competition will develop and consumers will benefit in terms of choice and innovation.

- 1.9 Our preference would have been for a commercial solution to address the competition issues identified. In the Third Pay TV Consultation, we noted the evolving nature of the market and explored whether the studios' existing commercial plans were likely to result in the wider availability of premium movie services<sup>8</sup>. However, our discussions with the studios gave us a clear view that change was unlikely.
- 1.10 We conclude that it is appropriate to make a reference to the CC and in exercising our discretion to refer, we have considered in particular the four criteria set out in the Office of Fair Trading ('OFT') Guidance on market investigation references ('the OFT Guidance'), namely:
- **the suitability or otherwise of using our Competition Act 1998 ('CA98') or other sectoral powers.** Our powers under Section 316 of the Communications Act 2003 ('CA03') do not adequately extend to VoD services, whilst action under CA98 is unlikely to be effective as a means of addressing our concerns<sup>9</sup>;
  - **whether the problem could be addressed through undertakings.** We consider that adverse effects in competition arise from the complex interrelationship between several features of the market, involving the unilateral conduct of several firms. Negotiating undertakings with multiple parties poses serious potential difficulties. In any event, no undertakings in lieu were offered by any party;
  - **proportionality and whether the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response.** We believe that a market reference is a proportionate response to the persistent nature of competition concerns and the scale of the sector impacted by these concerns i.e. a significant proportion of the markets identified; and
  - **whether there is a reasonable chance that appropriate remedies will be available.** We consider that there is a reasonable prospect that the CC has appropriate remedies available to it. We consider that there are two broad approaches:
    - the CC could seek to change the way in which key premium movie rights are bought and sold. Such intervention may involve restrictions on the ability of firms to aggregate different types of rights or requirements to make the sale process more contestable; and
    - the CC could intervene to reduce Sky's ability to act on incentives to exploit market power, by requiring it to provide wholesale access to linear and SVoD premium movie content on regulated terms.

---

<sup>8</sup> Premium movie services are services based on the rights that are licensed by the Major Hollywood Studios in the first pay TV subscription window.

<sup>9</sup> We are concerned with a combination of features - some of which may not raise competition concerns if considered in isolation and some of which are unrelated to the conduct of a particular person.

## Section 2

# Introduction and legal powers

### The consultation

- 2.1 We published a consultation on a proposed market investigation reference to the CC under the EA02 on 31 March 2010.
- 2.2 We received 14 written responses and we have published the non-confidential versions of submissions on our website<sup>10</sup>.

### The pay TV market investigation

- 2.3 This statement follows from our pay TV investigation, in which we assessed whether the UK pay TV sector was delivering benefits to consumers through competition in terms of choice, innovation and price. Over the course of the investigation we published three consultations and a final statement in March 2010. In the final statement we decided to put in place a wholesale must-offer obligation requiring that Sky Sports 1 and 2 be offered to retailers on platforms other than Sky's, at prices set by Ofcom.
- 2.4 On 16 January 2007 we received a preliminary submission from BT, Setanta, Top Up TV ('TUTV') and Virgin Media, which alleged that competition in the UK pay TV sector is not working properly, and that Ofcom should refer the industry to the CC for investigation. Subsequently, in December 2007 we published a First Pay TV Consultation Document, where we set out our preliminary views on the operation of the market. This outlined some initial concerns relating to the manner in which premium content is aggregated and distributed, which we believed might restrict competition in the retail market to the detriment of consumers. The responses to this consultation focused on the distribution of premium content via Sky's linear Core Premium Movies channels.
- 2.5 Our Second Pay TV Consultation identified some particular concerns relating to access to linear premium content and consulted on the possible broad forms of remedy that Ofcom could use to address those concerns. Specifically, we were concerned that Sky, as a vertically integrated firm with market power in a key upstream market, distributes premium content in a manner that favours its own platform and retail business. We also expressed the concern that Sky may have limited incentives to exploit its SVoD rights by developing an extensive SVoD movies service<sup>11</sup>. Instead of making a reference to the CC, we proposed to tackle these concerns by putting in place a wholesale must-offer obligation using our sectoral competition powers under section 316 CA03. However, as some of the Major Hollywood Studios' rights were up for renewal in the near future, we emphasised this position was subject to change.

---

<sup>10</sup> [http://stakeholders.ofcom.org.uk/consultations/movies\\_reference/?showResponses=true](http://stakeholders.ofcom.org.uk/consultations/movies_reference/?showResponses=true). Although we could not publish seven confidential responses, we have referred to the comments contained in these responses in this statement. In most cases we have been able to include the comment without attributing it a particular respondent while in others we have had to redact the comment in its entirety. Redactions are clearly marked throughout this document.

<sup>11</sup> Second Pay TV Consultation, paragraph 9.50.

- 2.6 Responses to our Second Pay TV Consultation focused more on issues around SVoD rights. In particular, BT expressed concerns over the ‘warehousing’ of SVoD rights by Sky alongside the contractual holdbacks in Sky’s agreements with the Major Hollywood Studios<sup>12</sup>.
- 2.7 In our Third Pay TV Consultation, we argued that Sky has an incentive to restrict exploitation of its SVoD rights, in order to protect its own linear movie channels<sup>13</sup>. Consequently, we were concerned that innovation in the development of SVoD services may be stifled. This concern led us to believe that there may be a case for targeted intervention in the sale and purchase of SVoD rights. We suggested that making the SVoD rights available transparently and separately from linear rights could allow other companies to acquire SVoD rights and establish services which could appeal to consumers.
- 2.8 Responses to our Third Pay TV Consultation emphasised the importance of SVoD rights, with stakeholders such as [ X ], [ X ] and Paramount providing their first submissions on this issue.
- 2.9 In order to analyse these responses and our identified competition concerns we engaged in discussions with all the Major Hollywood Studios to establish whether likely market developments would obviate the need for regulatory intervention. What we learned from these meetings [ X ]. At this point, it was unlikely that there would be a substantial change in the way these rights were awarded in the UK in the short to medium term.
- 2.10 In a separate but related process, we also concluded on Sky and Arqiva’s proposals to launch ‘Picnic’, a proposed pay TV service on Digital Terrestrial Television (‘DTT’). We published our Picnic Statement at the same time as the Consultation on the proposed reference to the CC. We decided that Sky could launch Picnic, conditional on a wholesale must-offer on Sky Sports 1 and 2 being in place, and on any movies channels included in Picnic being offered to other digital terrestrial TV retailers.
- 2.11 Sky and Premier League have appealed against Ofcom’s decision to impose a wholesale must offer (‘WMO’) condition relating to Sky Sports 1 and Sky Sports 2. In addition, BT and Virgin Media have appealed on the basis that Ofcom’s decision does not go far enough and should, for example, include Sky Sports 3 and Sky Sports 4.
- 2.12 Sky applied to the Competition Appeals Tribunal (‘CAT’) for interim relief to suspend the application of the Sky Sports 1 and Sky Sports 2 WMO remedy pending the outcome of its appeal against our decision. The CAT made an order that the WMO remedy be implemented in relation to BT, TUTV and Virgin Media subject to certain provisions<sup>14</sup>.

## Legal powers

- 2.13 Ofcom may make market investigation references to the CC under section 131 EA02 relating to commercial activities connected with communications matters<sup>15</sup>.
- 2.14 Section 131 provides that:

<sup>12</sup> BT’s response to Second Pay TV Consultation, page 5.

<sup>13</sup> Third Pay TV Consultation, paragraphs 12.19 to 12.21.

<sup>14</sup> [http://www.catribunal.org.uk/files/1152IR\\_BSKYB\\_Order\\_29.04.10.pdf](http://www.catribunal.org.uk/files/1152IR_BSKYB_Order_29.04.10.pdf).

<sup>15</sup> Section 370 CA03.



“(1) [Ofcom] may...make a reference to the Commission if [Ofcom] has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.

(2) For the purposes of this Part any reference to a feature of a market in the United Kingdom for goods or services shall be construed as a reference to:

(a) the structure of the market concerned or any aspect of that structure;

(b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or

(c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

(3) In subsection (2) “conduct” includes any failure to act (whether or not intentional) and any other unintentional conduct.”

2.15 It is therefore clear that a “feature” of a market for the purposes of EA02 has a broad meaning. In cases where the section 131 EA02 test has been met, Ofcom has discretion on whether to make a reference. We exercise that discretion having regard to the OFT’s Guidance on market investigation references<sup>16</sup>.

2.16 The OFT’s Guidance outlines four criteria to consider before deciding to make a reference<sup>17</sup>, namely:

- the suitability or otherwise of using our CA98 or other sectoral powers;
- whether the problem could be addressed through undertakings;
- proportionality and whether the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response; and
- whether there is a reasonable chance that appropriate remedies will be available.

2.17 We have concurrent CA98 powers under section 371 CA03 in relation to activities connected with communications matters and also sectoral competition powers under section 316 CA03. However, our sectoral powers exist only in relation to licensed and connected services as defined in section 316 CA03.

## Respondents’ views

2.18 One consultation respondent disputed the extent of Ofcom’s concurrent powers<sup>18</sup>.

---

<sup>16</sup> OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006 -

[http://www.ofcom.gov.uk/shared\\_ofcom/business\\_leaflets/enterprise\\_act/oft511.pdf](http://www.ofcom.gov.uk/shared_ofcom/business_leaflets/enterprise_act/oft511.pdf).

<sup>17</sup> The OFT’s Guidance, paragraph 2.1.

2.19 Sky said that in proposing to make a reference, Ofcom had inappropriately taken into account our section 3 CA03 duty to “further the interests of consumers in relevant markets, where appropriate by promoting competition”<sup>19</sup>.

### **Ofcom’s views**

2.20 Ofcom is satisfied that the commercial activities it is considering are connected with communications matters as defined in section 369 CA03.

2.21 We consider that our approach to the proposed reference has been and remains within the framework of the EA02 and the OFT Guidelines, in which consumer (customer) detriment is a relevant factor.

### **Structure of this document**

2.22 The remaining Sections and Annexes of this document are:

- Section 3: Movies sector overview
- Section 4: Market definition
- Section 5: Features of the market
- Section 6: Prevention, restriction and distortion of competition
- Section 7: Discretion to make a reference
- Annex 1: Terms of the market investigation reference
- Annex 2: Movies sector overview
- Annex 3: Market Definition
- Annex 4: Features of the market
- Annex 5: Prevention, restriction and distortion of competition
- Annex 6: Discretion to make a reference
- Annex 7: Extracts from the Pay TV Statement

---

<sup>18</sup> [redacted].

<sup>19</sup> Sky’s response to the Consultation, paragraphs 5.15-5.19; (see also paragraphs 1.4, 4.19 and 4.33).

## Section 3

# Movies sector overview

## Introduction

- 3.1 This Section provides a short summary of the movies sector. The detail of our movies sector overview is contained in Annex 2. We have updated our overview in the light of recent data, market developments and responses to the Consultation.
- 3.2 We reflect on the impact of particular developments or specific comments from respondents further in Sections 6 and 7 of this document.

## Summary of movies sector overview

- 3.3 Films can be viewed in a number of different formats, including traditional theatrical release in the cinema, DVDs, linear TV channels and on-demand viewings. To access a wide range of films without having to pay each time they view a film consumers may use subscription services, for example through TV packages or through online DVD rental. Some may use PPV and Over The Counter ('OTC') rental.
- 3.4 From the time of their initial release, movies are sold in a series of different formats in distinct or overlapping time periods known as "windows". Typically a movie has a cinema release, then a DVD retail/rental window, then it will be shown on PPV, then premium pay TV, before finally being shown on free-to-air ('FTA') services. In general terms, the commercial value of a movie declines over time following its release date. For example, newer DVDs and movies on PPV services command higher prices than older releases, and movies typically appear on premium TV channels before they are shown on basic or FTA channels.
- 3.5 Premium content is particularly important to the UK pay TV market. Movies and sports are highlighted as being of particular importance to consumers, and have helped drive pay TV subscriptions. In particular, first-run Hollywood movies are seen as effective in driving pay TV subscriptions as they have a significant appeal to a broad audience, and a high degree of exclusivity to pay TV<sup>20</sup>.
- 3.6 There are three enduring characteristics of first-run Hollywood movies that make them particularly compelling to consumers<sup>21</sup>:
- they are movies of a high quality, at least in terms of box office success;
  - this is the first time they are shown on TV (and consumers typically value films more the closer they are to their box office release date); and
  - they are available via subscription and subscription services are in greater demand than PPV or transactional VoD, given the convenience of not paying for each movie.
- 3.7 Sky currently holds exclusive rights to show films in the first pay TV subscription window from the six Major Hollywood Studios<sup>22</sup>. Sky has had exclusive agreements

<sup>20</sup> Paragraphs A2.6 to A2.16 in Annex 2.

<sup>21</sup> Paragraphs 6.55 to 6.69 of our Pay TV Statement contained in Annex 7.

with the six Major Hollywood Studios for a very long period [ X ]<sup>23</sup>. The movies licensed to Sky represent the vast majority of the Major Hollywood Studios' output per year.

- 3.8 The main supplier of wholesale premium movies channels is Sky, though Disney also supplies one channel (Disney Cinemagic). Core Premium Movies channels are retailed by Sky and the cable companies, primarily Virgin Media.
- 3.9 Our overview suggests that there is considerable potential for change in the way movies are distributed, particularly facilitated by Internet Protocol Television ('IPTV') and greater broadband speeds and penetration<sup>24</sup>. IPTV and cable can offer not only linear channel capability but also new ways of delivering content such as VoD. We expect movies content to be important in driving demand for VoD services over IPTV, especially given that movies are suited to VoD whereas sports content is generally more suited to be shown on linear channels, given the particular importance consumers attach to watching sports events live.
- 3.10 Another development is that the release windows prior to the first pay TV subscription window appear to be shortening. Both the Major Hollywood Studios and pay TV operators are experimenting with release timings more generally, in particular via the introduction of concurrent release across the DVD and PPV/VoD windows<sup>25</sup>.

---

<sup>22</sup> For definition see footnote 1 and also <http://www.mpa.org/AboutUsMembers.asp>. Contracts as at 31 March 2010.

<sup>23</sup> The year depends on the studio. Source: Sky response to information request of 20 December 2007. Note however that Disney premieres its animated films on its Disney Cinemagic channel, before they are shown on Sky Movies (see for example [http://media247.co.uk/skydigital/newsarchive/2006/02/sky\\_launch\\_conf.php](http://media247.co.uk/skydigital/newsarchive/2006/02/sky_launch_conf.php)).

<sup>24</sup> Paragraphs A2.61 to A2.84 in Annex 2.

<sup>25</sup> Paragraphs A2.85 to A2.90 in Annex 2.

## Section 4

# Market definition

### Introduction

4.1 In this Section, we assess the views of respondents on the economic markets identified in the Consultation and present our conclusions on market definitions.

4.2 Additional detail of our market definition analysis is set out in Annex 3.

### Consultation on a market reference

#### Identified markets

4.3 In the Consultation, we presented our preliminary view that there are distinct economic markets for:

- the upstream supply of movie rights from Major Hollywood Studios in the first pay TV subscription window in the UK. The purchaser of these rights is able to show movies on subscription linear channels as well as via SVoD services; and
- the wholesale supply of packages including Core Premium Movies channels. This market would include SVoD services, but few such services currently exist.

#### Assessment of competitive constraints at the retail and wholesale levels

4.4 Section 4 of the Consultation summarised the findings of our Pay TV Statement as regards the wholesale and retail markets and referred to Section 6 of the Statement for further detail and evidence<sup>26</sup>.

4.5 Beginning with the retail market, in the Pay TV Statement we analysed in detail the competitive constraints in the market for retail packages including Core Premium Movies channels<sup>27</sup>. We assessed each potential substitute and considered a wide range of evidence, including (but not limited to) product characteristics and the preferences of viewers with regard to these characteristics. On that basis, we identified:

- a close substitute (SVoD services during the first Pay TV window) which we included in the market;
- moderate substitutes (PPV, FTA/basic movies channels, movies on other FTA channels, retail DVDs sold during the first Pay TV window, online DVD rentals), which we determined were outside the relevant market but exerted a degree of competitive constraint; and
- distant substitutes (non movies programming on TV, cinema, over the counter DVD rental and retail DVDs outside the first Pay TV window), which do not exert any appreciable constraint.

---

<sup>26</sup> Relevant extracts of the Pay TV Statement are contained in Annex 7.

<sup>27</sup> Paragraphs 6.104-6.254 contained in Annex 7.

- 4.6 We concluded that there were narrow markets for the retail of packages including Core Premium Movies channels to UK residential customers. Packages containing Core Premium Movies channels are those which allow subscribers to see a wide range of relatively recent movies from the Major Hollywood Studios on TV for a monthly fee.
- 4.7 With regard to the wholesale market, in the Pay TV Statement, we considered that there were limited direct constraints on the wholesale supply of packages including Core Premium Movies channels. We concluded that the boundaries of the wholesale market were no wider than the retail market and hence there is a narrow economic market for the wholesale supply of packages including Core Premium Movies channels.

### **Assessment of competitive constraints in the market for the sale of movie rights**

- 4.8 The Consultation analysed constraints in the upstream market for premium movie rights separately, because they were not considered directly in the Pay TV Statement<sup>28</sup>. Our preliminary view was that a wholesale channel provider would be unlikely to switch to other content in the event of a price increase, and indirect constraints were likely to be very limited.
- 4.9 In both cases, we relied on our finding in the Pay TV Statement that there were no close substitutes for channels including premium movie content in the first pay TV window available to a consumer or retailer. We referred to the substantial body of evidence in the Pay TV Statement underlying our view. In essence, consumers have a strong preference for recent popular movies. This underpins Sky's market power at the wholesale level. It also means that other content is not seen as a close substitute either by Sky, which currently buys the rights, or by the other broadcasters which do not. As such, a hypothetical monopoly owner of the rights to these movies would not face a significant constraint from other content available at either the rights level or at lower levels of the supply chain.

### **Respondents' views on market definition**

#### **Support for our approach**

- 4.10 A number of respondents broadly agreed with our overall approach to market definition. BT, Virgin Media and the BBC explicitly supported our preliminary view that both markets constitute distinct economic markets<sup>29</sup>. Orange provided views on the relevant upstream market only, agreeing with our delineation of that market<sup>30</sup>.
- 4.11 As regards the upstream market, BT and Orange considered that there were no substantial constraints on the pricing of movie rights from the Major Hollywood Studios in the first pay TV window in the UK. Both firms said that direct constraints were limited because a wholesale channel provider was unlikely to respond to an

<sup>28</sup> Paragraphs 4.15-4.26 and 4.34-4.35 of the Consultation.

<sup>29</sup> See the following responses to the Consultation: BT's response, paragraphs 3.2, 3.10 and 3.15; Virgin Media's response, paragraph 3.1; BBC's response, page 2.

<sup>30</sup> Orange's response to the Consultation, page 5.

increase in the price of those rights by replacing them with non-movies content or less popular movies from other studios<sup>31</sup>.

- 4.12 BT also supported Ofcom’s conclusion that the wholesale market was a distinct market which was no broader than the retail market and did not include potential substitutes such as theatrical releases, DVD rentals, FTA movies, movies from other studios or alternative, non-movie content. BT inferred that the scope for indirect constraints on the upstream prices of premium movie rights was likely to be very limited. In any event, BT added, given that the effects on competition were sufficiently clear it was unnecessary to draw firm conclusions on the exact boundaries of the relevant markets<sup>32</sup>.
- 4.13 BT, [ X ] and [ X ] supported our inclusion of SVoD rights along with linear rights in the relevant market, mainly on the basis that linear TV and SVoD services are closely substitutable and have similar characteristics<sup>33</sup>.

### Areas of disagreement with our approach

- 4.14 Sky did not accept the market definitions or our preliminary finding that it had market power in the wholesale market. It commented on our findings at the wholesale level and argued that Ofcom ignored competitive constraints exercised on Core Premium Movies channels by PPV movies (including both linear and VoD), SVoD, DVD sales and rentals, FTA movies and pay TV channels in library windows and non-movie programming<sup>34</sup>.
- 4.15 Similarly, with regard to the upstream market, two Major Hollywood Studios ([ X ] and Warner Bros. Entertainment UK (“Warner”)) said that Ofcom failed to acknowledge constraints faced by sellers of movies rights from sellers of non-movies entertainment content, other producers/ distributors of movies (including both non-Major Hollywood Studios and Studios located in Europe) and movie rights in other windows<sup>35</sup>.
- 4.16 In support of their position, both studios said that Ofcom’s analysis of the upstream market lacked evidence<sup>36</sup>. [ X ] argued that Ofcom did not assess in any depth demand and supply-side reactions of licensees in the event of a price increase by a hypothetical single supplier of premium movie content, or whether Sky would switch to other content on which its margin would not be narrowed after such an increase.
- 4.17 [ X ] added that the correct economic test was whether a sufficient proportion of demand would switch to make a price rise unprofitable. It said Ofcom took no view on whether, faced with an attempt to raise prices, a purchaser of rights (Sky or any other purchaser) could switch some proportion of its demand to alternative content. By focusing instead on whether all demand for premium movies would switch, Ofcom misapplied the test<sup>37</sup>. [ X ] argued that Ofcom also focused on a specific release

---

<sup>31</sup> Orange’s response to the Consultation, page 5. BT’s response to the Consultation, paragraphs 3.9-3.10.

<sup>32</sup> BT’s response to the Consultation, paragraphs 3.14-3.16.

<sup>33</sup> See the following responses to the Consultation: BT’s response, paragraph 3.8, [ X ]; [ X ]. [ X ] argued in this context that, being closely substitutable and part of the same market, competition between linear TV and SVoD services would be very intense if both sets of rights were separately available, which would greatly reduce the value of the movie rights.

<sup>34</sup> Sky’s response to the Consultation, paragraph 3.2.

<sup>35</sup> Warner’s response to the Consultation, paragraph, 3.8; [ X ].

<sup>36</sup> Warner’s response to the Consultation, paragraph, 3.8; [ X ].

<sup>37</sup> [ X ].

window and ignored the fluid interaction between various windows and potential overlaps<sup>38</sup>.

- 4.18 Warner argued that our market definition exercise was conducted in light of our specific competition concerns, rather than as a prior step in determining whether such concerns arise, and hence circularity arises<sup>39</sup>. As a result, it argued that Ofcom settled on a narrow view of the market, defining it in terms of the supply side structure – namely Major Hollywood Studios– when the analysis should have been primarily concerned with demand side substitutability.
- 4.19 While agreeing with our preliminary conclusions on market definition, [X] did not support our description of the nature of competition between the studios. In particular, it did not agree with our statement that the upstream prices of movie rights were likely to be relatively close to competitive levels. In [X]'s view, Ofcom did not carry out any material analysis to support that position<sup>40</sup>.

### Ofcom's views

- 4.20 Ofcom has considered the degree of competitive constraints exercised by the range of potential substitutes identified by Sky, Warner and [X], both at the wholesale and upstream levels. This is set out in detail in Annex 3 to this document<sup>41</sup> and Section 6 of the Pay TV Statement (which is reproduced at Annex 7)<sup>42</sup>.
- 4.21 We agree with [X] that the correct economic test is whether a sufficient proportion of demand would switch in response to a price rise. We explained in our Pay TV Statement the importance of focusing the analysis on marginal consumers<sup>43</sup>. However, since the Major Hollywood Studios currently sell pay TV rights to all or almost all their movies as a package, there is no realistic scenario in which a hypothetical monopolist of these rights would be constrained by marginal switching by the broadcaster – it could simply offer the rights on an all-or-nothing basis. The fundamental question is whether there is scope for substitution to other content. In our view, based on the reasoning referred to in paragraph 4.20 above, is that neither Sky nor other broadcasters could respond to above competitive prices by switching to other content, as this would lead to a substantially less attractive retail and wholesale offer.
- 4.22 [X]'s point related to “direct constraints” – i.e. to the possibility that the purchaser of the rights (the broadcaster) responds to an increase in the price of rights by switching to other content, leading to a loss of revenue to the seller of rights, and potentially making the price increase unprofitable. An alternative possibility is that of indirect constraints – in which any increase in the price of rights is passed on in higher retail prices, leading to switching by subscribers and, again, a loss of revenue to the seller of the rights. Our Pay TV Statement concluded (paragraph 6.254<sup>44</sup>) that retail bundles including Sky Movies comprised a distinct market, and that alternative content was not sufficiently substitutable to constrain prices to the competitive level. As such, even if a 5-10% rise in rights prices led to retail prices which were 5-10% above competitive levels, we would not expect so many subscribers to switch that the price rise would be unprofitable to the rights seller.

<sup>38</sup> [X].

<sup>39</sup> Warner's response to the Consultation, paragraph, 3.7. See also [X].

<sup>40</sup> [X].

<sup>41</sup> Paragraphs A3.18 to A3.21 and A3.26 to A3.28.

<sup>42</sup> In particular paragraphs 6.76 to paragraph 6.251, 6.262 to 6.270 and Annex 5 Appendix 2.

<sup>43</sup> Paragraphs 5.42-5.45 and 6.27 of the Pay TV Statement contained in Annex 7.

<sup>44</sup> Contained in Annex 7.



- 4.23 We recognise that, as argued by [ X ], the size of different release windows changes over time and that there is an overlap in time between the first pay TV window and other rights licences<sup>45</sup>. However, our Pay TV Statement concluded that movies in other release windows were only moderate substitutes for movies shown in the first pay TV window<sup>46</sup>.
- 4.24 As noted, Warner argued that conducting market definition in the light of specific competition concerns was “circular”. However, the starting point for our market definition analysis is the focal product, which is the “product under investigation”<sup>47</sup> – i.e. that which has given rise to a competition concern<sup>48</sup>. As such, Ofcom has followed the standard approach in defining the market. Warner did not explain how the alleged circularity leads to a false conclusion.
- 4.25 Next we consider Warner’s argument that Ofcom defined the market in terms of an element of supply side structure, rather than on the basis of demand-side substitution. The methodology we have used to define the market is indeed based on demand side substitution. Defining a market necessarily entails identifying the firms that participate in it (in this case, the Major Hollywood Studios) in order to assess the competitive constraints they face and/or calculate their respective market shares if necessary. If we discovered that some of the output of these studios was not part of the market, or that content from another source was a demand-side substitute, we would amend our definition accordingly.
- 4.26 Finally, in relation to [ X ]’s claim that Ofcom had no evidence for its view that upstream prices of movie rights are likely to be relatively close to competitive levels, we have not assessed the degree of competition between the studios and agree that this is an open question.

## Conclusion

- 4.27 Having given careful consideration to the responses to the Consultation and based on our analysis set out in Annex 3, we remain of the view that there are distinct economic markets for:
- the rights to show movies from the Major Hollywood Studios in the first pay TV subscription window in the UK; and
  - the wholesale supply of pay TV packages including Core Premium Movies channels.

---

<sup>45</sup> See, for instance, paragraphs A2.29-A2.33 and A2.85-A2.90 of Annex 2.

<sup>46</sup> Paragraph 6.251 contained in Annex 7.

<sup>47</sup> OFT Market Definition Guidelines, December 2004, paragraph 2.9.

<sup>48</sup> In some cases the choice of focal product may influence the final market definition – for example a mass-market product may constrain the price of a niche product, but the niche product may not constrain the mass-market product (because too few of the mass-market product’s consumers would see it as a substitute).

## Section 5

# Features of the markets

## Introduction

- 5.1 In this Section we assess the views of respondents on the features of the markets that we identified in the Consultation and conclude on the combination of features that we suspect prevents, restricts or distorts competition in connection with the supply and acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels.
- 5.2 Additional detail of our analysis of each of the features of the markets is contained in Annex 4.
- 5.3 For the purposes of a market investigation reference, a ‘feature’ of a market may be either structural or conduct-related, although in practice there may not be a clear divide between these<sup>49</sup>.

## Consultation on a market reference

- 5.4 In the Consultation<sup>50</sup>, we identified a combination of features of the market which we suspected adversely affected competition:
- **limited pool of premium content.** A single studio releases a limited number of movies per annum, on average around 30;
  - **the release windows structure.** The release windows structure drives the timing of when movies over different formats become available for viewing and how consumers pay to view them;
  - **the joint sale of linear and SVoD rights.** At present, the Major Hollywood Studios sell the subscription rights to show movies in the first pay TV window, which includes both linear and SVoD rights. These rights are acquired on an exclusive basis by Sky;
  - **exclusivity.** Rights to the first pay TV subscription windows are secured under exclusive contracts with individual studios. In the UK, Sky has exclusive agreements with all six Major Hollywood Studios;
  - **other restrictions in contracts** for the rights in the first pay TV subscription window, such as the condition that [ X ];
  - **staggered availability of content rights and duration of contracts.** Typically, the rights are agreed for varying durations and contracts do not run in parallel. Rights become available on a staggered basis rather than all at once;
  - **aggregation of substitutable content by one buyer.** Sky currently purchases the rights to movies in the first pay TV subscription window from all six Major Hollywood Studios and aggregates them into a single wholesale offering;

<sup>49</sup> OFT’s Guidance, paragraph 4.4.

<sup>50</sup> Paragraph 5.1.

- **Sky's market power in the distribution of Core Premium Movies channels**, which in turn gives Sky a high degree of negotiating power with the Major Hollywood Studios in the upstream market; and
- **vertical integration** of firms over the pay TV supply chain. In particular, vertical integration in conjunction with its market power gives Sky an incentive to limit the exploitation of its SVoD rights, and restrict distribution of its wholesale Core Premium Movies channels.

5.5 We set out in the Consultation, that the combination of these features has an adverse effect on competition in the supply and acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels.

5.6 In this Section, we begin with the responses relating to our overall approach to identifying features of the market, and then consider the responses relating to each of the individual features in turn.

## Our general approach to identifying features of the market

### Respondents' views

5.7 BT, [ X ] and Orange largely agreed with our analysis of the features of the markets identified<sup>51</sup>. BT and [ X ] said that they did not find any additional features of the identified markets that might be relevant to this assessment of competition<sup>52</sup>.

5.8 Other respondents broadly agreed with the features we identified but suggested a number of extensions – namely with regard to (a) the terms on which Sky supplies its premium movie channels, (b) holdbacks, (c) output deals, (d) Sky's use of bundled services to leverage its market power into the residential broadband market and (e) the retail market:

- Virgin Media argued that Ofcom did not place sufficient weight on the prevention, restriction and distortion of competition arising from the terms on which Sky supplies its Core Premium Movies channels to Virgin Media<sup>53</sup>. It argued that linear broadcasting continues to be the primary medium for movies content and disagreed with Ofcom's statement that there is limited demand for Core Premium Movies channels from pay TV retailers.
- [ X ] considered that Sky's holdbacks over movie rights are potentially stifling competition and their competitive impact is in need of review, alongside the bundling of SVoD and linear rights<sup>54</sup>.
- The BBC was of the view that Ofcom should include a consideration of the potential effect of output deals as it understood that each of the six Major Hollywood Studios had such a deal with Sky. It said that these deals could

---

<sup>51</sup> [ X ]; Orange's response to the Consultation, response to Q.2; BT's response to the Consultation, section 4.

<sup>52</sup> BT's response to the Consultation, page 24; [ X ].

<sup>53</sup> Virgin Media's response to the Consultation, paragraphs 5.3 – 5.16.

<sup>54</sup> [ X ].

provide studios with a level of guaranteed income as they sold rights to a movie irrespective of box office performance in return for exclusivity<sup>55</sup>.

- Orange said a missing feature was that Sky is using bundled services to leverage its market power into the residential retail broadband market, by “giving away” broadband to Pay TV subscribers, thereby weakening the position of competitors<sup>56</sup>.
- Similarly, [ X ] considered that the scope of the reference should be broadened to address any adverse effects from Sky’s position being leveraged into the adjacent telecommunications markets for retail fixed broadband access<sup>57</sup>. [ X ] said that in the absence of wholesale provision of content from Sky, the intensity of competition for customers wishing to purchase a bundle including TV was therefore lower than for other customers<sup>58</sup>.
- Virgin Media and TUTV argued that the scope of the proposed reference to the CC should extend to retail markets. In Virgin Media’s view, the absence of a reference to the retail market would undermine the CC’s ability to remedy the problems identified by Ofcom, particularly in light of the mutually reinforcing effect of market power at the wholesale and retail levels<sup>59</sup>.

5.9 Several Major Hollywood Studios criticised our approach to identifying market features. Warner argued that we failed to describe the features of the market adequately<sup>60</sup>. [ X ] argued that some of the features identified are factual characteristics of the market which are prevalent in other markets around the world, while other features (such as the limited pool of premium content) are conclusions drawn by Ofcom based on its own judgement rather than factual statements<sup>61</sup>.

5.10 [ X ] said that Ofcom did not engage with the movie studios on the features which were now forming the basis of the reference<sup>62</sup>.

5.11 Both Warner and [ X ] argued that media markets are dynamic. In Warner’s view, our analysis assumed that the features are likely to persist, despite evidence of evolution in the features themselves and in their market context – particularly the ongoing development of VoD services. If, as Ofcom believes, demand for linear movie channels is likely to decline, rights holders would evaluate their options<sup>63</sup>.

5.12 Similarly, [ X ] noted that media markets are undergoing a period of change in which creators of content are considering how to benefit from new technologies and means of distribution. In its view, studios will seek to adapt to these changes and continue to sell content rights in a way that furthers their economic interests. [ X ] argued that studios are likely to take different approaches. In its view, [ X ]<sup>64</sup>.

5.13 Sky declined to comment on the individual features identified, arguing that they were addressed in its previous submissions to the pay TV review. However, it said that

<sup>55</sup> BBC’s response to the Consultation, page 2.

<sup>56</sup> Orange’s response to the Consultation, page 7.

<sup>57</sup> [ X ].

<sup>58</sup> [ X ].

<sup>59</sup> Virgin Media’s response to the Consultation, paragraph 4.2.

<sup>60</sup> Warner’s response to the Consultation, paragraph, 3.10.

<sup>61</sup> [ X ].

<sup>62</sup> [ X ].

<sup>63</sup> Warner’s response to the Consultation, paragraphs, 3.11-3.12 and 4.4-4.9.

<sup>64</sup> [ X ].

Ofcom's discussion of the features was cursory and that Ofcom's only concern was the "supposed" limited availability of SVoD movies in the first pay TV window<sup>65</sup>.

## Ofcom's views

5.14 As summarised above, respondents identified five possible extensions to the range of features identified:

- The terms on which Sky supplies its Core Premium Movies channels, both to Virgin and others, are identified as a manifestation of the adverse effect on competition of the identified features<sup>66</sup>. In our view, Sky's conduct in regard to supply to Virgin Media is not best characterised as a separate feature, but as the adverse effect of Sky's incentives as a vertically integrated firm which competes with Virgin Media downstream and which has aggregated all closely substitutable premium movie content). However, this characterisation would not prevent the CC from taking a different view. As regards demand for Sky's linear channels, we cited the Pay TV Statement (paragraphs 9.9 and 9.10) as noting an apparent lack of demand for Sky Movies channels in responses to our Third Pay TV consultation. However, the discussion addressed the question of whether the channels should be included in a wholesale must offer remedy. As such, it related to the potential demand for Sky Core Premium Movies channels among broadcasters who did not already have wholesale access to them and in relation to the immediate prospects for take-up and launch of new services by those broadcasters had we imposed the proposed remedy. We recognise that Virgin Media currently has a base of subscribers to linear movies channels, and a strong demand for wholesale supply of these channels; and that other broadcasters wish to build premium movies offerings<sup>67</sup>. Our market definition includes linear Core Premium Movies channels, and we are not ruling out the possibility that the CC may decide that any remedy should apply to Core Premium Movies channels.
- [ X ] did not provide any further detail in relation to its view that holdbacks were potentially stifling competition. We recognise that these are potentially important – indeed in our view they are fundamental to the release windows structure. We consider that the CC would if necessary have scope to address any specific problems relating to holdback conditions.
- As far as output deals are concerned, we discuss these as an aspect of the limited pool of premium content<sup>68</sup>. They are also related to exclusivity, the staggered availability of rights, and long contract durations (since it is because of output deals that rights do not become available as often as movies do); and the aggregation of substitutable content by one buyer. We consider that output deals could arguably be described as a separate feature, but that doing so would not have any substantive effect on our analysis.
- We have not identified Sky's ability to leverage its market power into the residential retail broadband market as a relevant feature. As with the terms on which Sky supplies its channels to Virgin Media, we have, however, identified adverse effects on competition in relation to packages including Core Premium Movies channels.

---

<sup>65</sup> Sky's response to the Consultation, paragraph 3.3.

<sup>66</sup> Paragraph A.5.18 in Annex 5.

<sup>67</sup> [ X ].

<sup>68</sup> Paragraph A4.4-A4.10 of Annex 4.

- As regards retail markets, it is our view, that the combination of features we have identified as adversely affecting competition is associated with the movie rights market and the wholesale pay TV market. Many of them could equally be characterised as features of the retail market, but no consultation respondent suggested that they should be and in our view they are best understood from upstream. However, as discussed in the next section, we consider that competition for retailed goods and services is adversely affected by the combination of the identified features and we consider that the scope of our reference to the CC is sufficient to ensure that it will be able to consider adverse effects on competition for these goods and services.
- 5.15 Next we consider the more general comments on our approach to setting out the features, from Sky, [ X ] and Warner. As regards Sky’s claim that the features were addressed in its previous submissions, we considered all the arguments Sky set out in its responses to consultations in Pay TV in the course of preparing the Consultation. However, having had regard to Sky’s arguments on these points, we remain of the view that the combination of the features we have identified prevents, restricts or distorts competition.
- 5.16 We do not accept Sky’s and Warner’s argument that our description of the features was cursory or inadequate for a reference to the CC. The features and their combined effect on competition were clearly described in Sections 5 and 6 of the Consultation and our position is now set out in this document in Sections 5 and 6 and Annexes 4 and 5. It would be for the CC to conduct a further detailed assessment of these features and their interaction.
- 5.17 With regard to [ X ]’s comment that some of the features identified are matters of judgement, this does not render the features in question invalid. For example, the identification of market power necessarily entails a degree of judgement, but market power is commonly identified as a feature of markets by the CC<sup>69</sup>. We have reasonable grounds to suspect that all of the features we have identified are present in the market.
- 5.18 In response to Warner’s and [ X ]’s point on the dynamic nature of media markets, we recognise that the market is continually evolving. However, we consider that the evidence points to the features in question persisting as the market continues to develop. In particular, we consider that Sky’s market power derives from its aggregation of closely substitutable premium movie content. We have explained the reasons why we consider that Sky is likely to continue to win the majority of premium movie rights – in particular, the staggered availability of rights and Sky’s efficiency advantages from being vertically integrated and having a significant premium movie subscriber base<sup>70</sup>.
- 5.19 We continue to believe that, absent intervention, it is unlikely that the ongoing development of VoD services, a potential shift in consumer demand from linear channels to SVoD services or the existence of new technologies and means of distribution will have an impact on Sky’s market power. Indeed, we are still concerned that Sky could be the only player to take advantage of these market

<sup>69</sup> For example, in its 2008 report on the supply of groceries in the UK, the CC found that the exercise of buyer power by certain grocery retailers was a feature of the market which prevented, restricted or distorted competition. (Paragraph 41, [http://www.competition-commission.gov.uk/rep\\_pub/reports/2008/fulltext/538.pdf](http://www.competition-commission.gov.uk/rep_pub/reports/2008/fulltext/538.pdf))

<sup>70</sup> Paragraphs A.4.39-A4.42 of Annex 4; A5.5-A5.11 of Annex 5 and paragraphs 6.309-6.316 of our Pay TV Statement contained in Annex 7.

developments<sup>71</sup>. We recognise that, as [ X ] argued, the availability of a new means of delivery may cause studios to change their strategy. However, we do not consider that we can rely on this happening, or that any change in strategy by the studios would necessarily lead to an outcome that would address our competition concerns. Indeed, several studios argued that separating linear and SVoD rights would not be in their economic interest because it would greatly diminish their value<sup>72</sup>.

- 5.20 In relation to [ X ]'s comments, the purpose of the Consultation was to engage with the Major Hollywood Studios and other stakeholders on issues including the features of the market which we had provisionally identified. In the Consultation we specifically asked if stakeholders agreed with our analysis of the features of the markets identified<sup>73</sup>. We also invited stakeholders, including [ X ], to meet with us and discuss their views. We therefore consider that we have provided stakeholders with the opportunity to respond to the arguments raised in the Consultation. [ X ], did not set out any evidence on this point. Nor did it accept our invitation to meet with us in order to discuss the issue.
- 5.21 Sky's claim that our only concern is the limited exploitation of SVoD rights is incorrect. We identify this outcome as a key concern based on our belief that SVoD is key to the future development of the pay TV sector. However, we also set this concern alongside the other anticompetitive outcomes – namely restricted distribution of, and high prices for, Core Premium Movies channels<sup>74</sup>.

## A limited pool of premium content

### Respondents' views

- 5.22 Virgin Media and Orange agreed with our preliminary view that a wholesaler wishing to launch a new service will typically need to acquire the movie output from more than one studio to construct an appealing movies package<sup>75</sup>. Virgin Media said that a key barrier to entry is the need to acquire a sufficient mass of premium content. In its view, deals with no fewer than three Major Hollywood Studios would be required to support a viable competitive offering. It cited our Consultation (paragraph 5.11) as showing that the studios themselves confirmed that content from multiple studios would be required to launch an effective competing service to that of Sky<sup>76</sup>.
- 5.23 In Virgin Media's view, any potential competitor could take a number of years to acquire a viable portfolio of premium content and launch an attractive service. Problems with building up the customer base and uncertainty about future revenues would undermine the retailers' ability to negotiate attractive terms with additional studios. Similarly, Orange agreed that entry was constrained by the limited pool of content produced by the Major Hollywood Studios (in addition to the staggered availability of rights to that content)<sup>77</sup>. BT explained the consequences of its lack of

---

<sup>71</sup> Paragraphs A6.26-A6.30 of Annex 6.

<sup>72</sup> Paragraph A4.28 of Annex 4.

<sup>73</sup> Question 2 in Annex 5 of the Consultation.

<sup>74</sup> Paragraph A5.20-A5.24 of Annex 5.

<sup>75</sup> Virgin Media's response to the Consultation, paragraph 2.3 and 2.4; Orange's response to the consultation, page 6.

<sup>76</sup> Virgin Media's response to the Consultation, paragraphs 2.3 , 2.4, 3.6 and 3.8.

<sup>77</sup> Orange's response to the Consultation, page 6.

access to premium content. [ X ]<sup>78</sup>. It highlighted the importance of content from the first pay TV subscription window in driving sustainable pay TV services<sup>79</sup>.

- 5.24 Several respondents criticised our analysis of this feature. [ X ] said it was never asked about why the industry achieves the level of output it does. It also said that Ofcom did not allege or investigate whether [ X ] or its competitors had market power, and asked why the level of output was considered limited absent such allegations<sup>80</sup>.
- 5.25 Warner argued that we did not offer any metric by which one could judge whether there is any restriction on content output, that we made no justification for our narrow focus on the output of the six Major Hollywood Studios, and that we failed to consider movie output of non-Major studios and other TV content. It also said that there are other movie subscription services available to consumers and that Ofcom recognised that it is possible to enter the market with only a small amount of movies content<sup>81</sup>.
- 5.26 According to [ X ], Ofcom reached a conclusion on the limited pool of available content based on our own definition of what counted as premium content and our own judgement that such content is not substitutable with other content or about what should be viewed as “limited”<sup>82</sup>.

### Ofcom’s views

- 5.27 As regards the question of limited supply, raised by [ X ] and Warner, for the avoidance of doubt, Ofcom has not made a finding that the studios have market power, nor is it suggesting that any studio is deliberately restricting output in order to raise the price of movie rights<sup>83</sup>.
- 5.28 However, we do not consider the assertion that premium content from the Major Hollywood Studios is in limited supply to be controversial. Clearly the cost of producing and marketing new movies is high. We do not expect that an individual studio which signed a deal with a UK broadcaster other than Sky would be able or willing in the short to medium term to double or triple its output of movies such that the broadcaster in question would have sufficient new movie content to be able to compete with Sky, let alone to do so with no decrease in the quality or popularity of the movies.
- 5.29 In relation to [ X ]’s response, this feature is based on our market definition analysis, that premium movie content constitutes a distinct market at the rights level. As set out in Section 4 above, this is the justification of our focus on the output of the Major Hollywood Studios. Again, the feature does not depend on a view that any of the Major Hollywood Studios has market power.
- 5.30 As to Warner’s submissions, we have given reasons for our focus on the Major Hollywood Studios and for our reasoning on subscription movies services outside the first pay TV window in our market definition analysis. We accept that Disney Cinemagic is an example of viable entry with a small amount of movie rights. However, our view is that while small-scale entry was viable in this case, from a studio whose movies are largely aimed one narrow audience (children), any other

<sup>78</sup> BT’s response to the Consultation, paragraph 2.11.

<sup>79</sup> BT’s response to the Consultation, paragraph 2.7.

<sup>80</sup> [ X ].

<sup>81</sup> Warner’s response to the Consultation, paragraph, 3.12.1.

<sup>82</sup> [ X ].

<sup>83</sup> Annex 3 and paragraphs A4.4-A4.10 of Annex 4.



pay TV package based on movie rights from a single Major Hollywood Studio is unlikely to be an attractive proposition from the perspective of audiences, prospective broadcasters, or the studio in question.

- 5.31 As regards [X]'s response, it is correct that our view is based on our own definition of premium movie content. Our view of what counts as premium movie content, and the extent to which other content is substitutable, is based on our detailed market definition analysis in Section 6 of the Pay TV Statement<sup>84</sup>.

## The release windows structure

### Respondents' views

- 5.32 Three respondents (the BBC, Warner and Sky) said that the current release window structure was not a problem in itself<sup>85</sup>:
- 5.33 The BBC argued that the windows system allows film studios to maximise their returns on investment through price discrimination. In addition, the system maximises content availability for final consumers by separating different classes of channel with different willingness to pay (i.e. PSBs and pay TV operators) and facilitating broadcast on a variety of platforms<sup>86</sup>.
- 5.34 Warner argued that we did not explain how the “entirely legitimate” release windows structure contributes to competitive distortion and said that this structure enables content rights holders to seek to recoup their upfront investments and provides consumers with a wide choice of formats, timing, price and payment models<sup>87</sup>.
- 5.35 Similarly, Sky said that the release windows structure is a rational way for studios to exploit their rights with a view to maximising revenues and avoiding over-exposing their titles<sup>88</sup>.
- 5.36 [X] suggested that the release windows structure could, in combination with staggered rights negotiations, limit competition between studios<sup>89</sup>. It did not, however, set out its views on how the release windows structure could have such an effect.

### Ofcom's views

- 5.37 We recognise that the release windows structure may well have a legitimate rationale and considered in isolation may have some benefit to final consumers. It may also be the case that, as noted by [X], the combination of a sub-set of features could have adverse effects on competition. However, as set out below, our view is that in combination with the other features, this feature of the market prevents, restricts or distorts competition. This is discussed in more detail in the next Section and Annex 5.

---

<sup>84</sup> Contained in Annex 7.

<sup>85</sup> Warner's response to the Consultation, paragraph 3.12.2; Sky's response to the Consultation, paragraph 3.4; BBC's response to the Consultation, page 2.

<sup>86</sup> BBC's response to the Consultation, page 2.

<sup>87</sup> Warner's response to the Consultation, paragraph, 3.12.2.

<sup>88</sup> Sky's response to the Consultation, paragraph 3.4.

<sup>89</sup> [X].

## The joint licensing of linear channel and SVoD rights by individual studios

### Respondents' views

- 5.38 Several respondents agreed with our concern regarding the joint sale of linear and SVoD rights within the first pay TV subscription window<sup>90</sup>. According to BT, joint licensing of both sets of rights (alongside other contractual restrictions) limits the possibility that the supply of SVoD services will constrain linear channel services and vice versa<sup>91</sup>.
- 5.39 Similarly, Orange argued that Sky's ability to purchase both sets of linear and SVoD rights exclusively prevents other platforms from bundling content into attractive SVoD packages<sup>92</sup>.
- 5.40 Virgin Media argued that the joint licensing of rights prevents, restricts or distorts competition in relation to SVoD. Virgin Media considered itself to be uniquely well placed to offer SVoD, as it could provide high quality 'true VoD' services, including HD. It said that customers show a clear preference for SVoD over PPV services, based on its own experience, on the experiences of ntl and Telewest, and on market research. However, its services would continue to be of limited appeal due to lack of access to premium movie content<sup>93</sup>.
- 5.41 Both Sky and [ X ] considered that Ofcom is not correct in suggesting that there are two sets of rights currently sold as a bundle. In their view, the Major Hollywood Studios simply licence exclusive rights to show movies on TV for a limited period (namely, the first pay TV subscription window)<sup>94</sup>. To date, [ X ] said [ X ]<sup>95</sup>.
- 5.42 In Warner's view, rights holders would evaluate their options as changes in demand emerge for linear broadcasting and that therefore joint licensing could not be regarded as a static feature restricting competition<sup>96</sup>. [ X ] said that all content owners would continue to sell the content rights in the way that furthered their economic interests<sup>97</sup>. [ X ]<sup>98</sup>.

### Ofcom's views

- 5.43 We recognise that the market is still evolving. However, we have seen no evidence to date suggesting that there will be any change in the way the linear and SVoD rights are sold. On the contrary, we have set out details of [ X ] on this point, from which we infer, [ X ], that there will be no change in the near to medium future<sup>99</sup>.
- 5.44 We do not consider Sky's (and [ X ]'s) view, that linear movie rights and SVoD rights are one set of rights to show movies on TV within the first pay TV window, is in any

<sup>90</sup> BBC's response to the Consultation, page 3; Orange's response to the Consultation, page 6. BT's response to the Consultation, paragraph 4.10; Virgin Media's response to the Consultation, paragraphs 5.17-5.24.

<sup>91</sup> BT's response to the Consultation, paragraph 4.10.

<sup>92</sup> Orange's response to the Consultation, page 6.

<sup>93</sup> Virgin Media's response to the Consultation, paragraphs 5.17 – 5.24.

<sup>94</sup> Sky's response to the Consultation, paragraph 3.4; [ X ].

<sup>95</sup> [ X ].

<sup>96</sup> Warner's response to the Consultation, paragraph, 3.12.3. and 3.12.4.

<sup>97</sup> [ X ].

<sup>98</sup> [ X ].

<sup>99</sup> Paragraph A4.28 of Annex 4.

way inconsistent with our position that it is a feature of the movie rights market that linear movie rights and SVoD rights are jointly licensed.

## Exclusivity of rights licensing agreements between the studios and purchasers

### Respondents' views

- 5.45 [X] said it agreed with our analysis of features, and in particular it noted Ofcom's recognition of exclusivity provisions in agreements between the Major Hollywood Studios and Sky<sup>100</sup>.
- 5.46 BT said that the exclusive licensing of rights only prevents, restricts or distorts competition in the context of Sky's market power. It said that exclusive licensing can bring substantial consumer benefit in the absence of market power. In its view, product differentiation due to exclusivity allows platforms to drive take-up, which in turn generates a wider base against which fixed costs can be recovered<sup>101</sup>.
- 5.47 Similarly, [X] said that exclusivity is an entirely legitimate commercial practice and does not represent a distortion of competition. [X] argued that exclusivity ensures that studios obtain an adequate payment for content which is expensive to produce and the success of which is uncertain. It is a prevalent feature of vertical distribution which is widely recognised to be efficient for both licensors and licensees, and one which promotes and protects incentives to invest in content production and distribution<sup>102</sup>.
- 5.48 Both Warner and Sky said that Ofcom did not adequately explain or provide cogent evidence in support of its view that exclusivity *per se* prevents, restricts or distorts competition, particularly when it is inherent in the commercialisation of copyrighted material. Warner said [X] but that this should not be wrongly characterised as a market feature giving rise to competitive distortion<sup>103</sup>.

### Ofcom's views

- 5.49 As regards BT's, Warner's and Sky's arguments in relation to exclusivity, we have explained that we are concerned with the way the features work in combination and have not sought to assess their effect on an individual basis. This is discussed in more detail in the next Section and Annex 5.
- 5.50 We recognise that exclusive rights can potentially have positive effects (in particular, by allowing the creator of the rights to earn an appropriate return on its investment). However, we are concerned that exclusivity, in combination with the other features we have identified, is preventing, restricting or distorting competition in ways that are not justified by its positive effects, in particular by having a broader impact on competition in downstream markets.
- 5.51 Notwithstanding [X]'s comment that [X], there is still no evidence that a broadcaster other than Sky would have a realistic chance of securing these key content rights. As a result, no other pay TV providers are able to supply these services to consumers.

---

<sup>100</sup> [X].

<sup>101</sup> BT's response to the Consultation, paragraph 4.3.

<sup>102</sup> [X].

<sup>103</sup> Warner's response to the Consultation, paragraph, 3.12.4.

## Other restrictions in contracts

### Respondents' views

- 5.52 Because of the redactions in the Consultation, Warner said that Ofcom did not give details of the contractual restrictions we identified or to what extent the provisions were present in one or more contracts. Nor did we explain what weight we attached to it. It was therefore inappropriate to rely on this in making any reference<sup>104</sup>.
- 5.53 As noted above, [ X ] considered that Sky's holdbacks over movie rights (agreeing with rights holders that rights will not be sold to rivals) are potentially stifling competition<sup>105</sup>.

### Ofcom's views

- 5.54 We accept that the Consultation gave limited information on the contractual restrictions to which we referred. We remain of the view that it would be inappropriate for us to have given more information, since to do so would have made the studios aware of one another's privately negotiated and highly confidential commercial agreements.
- 5.55 However, we recognise the difficulties this presented for stakeholders to comment. In light of this, we have also considered the extent to which the combination of all the features, absent this feature, has an adverse effect on competition. We believe that there are sufficient competition concerns relating to the combination of the remaining features that our overall conclusions on the making of the reference are not affected<sup>106</sup>.
- 5.56 Therefore, whilst we continue to identify 'other restrictions in contracts' as a feature of these markets, we consider that this feature is not necessary for the purpose of deciding whether or not we may make a reference.
- 5.57 We consider the holdback point in paragraph 5.14 above.

## Aggregation of substitutable premium movies into a single wholesale offering

### Respondents' views

- 5.58 Virgin Media said that Sky's aggregation of a high proportion of available premium movie rights from Major Hollywood Studios into its movie channels has the effect of restricting competition. In its view, since much of that content is substitutable in the eyes of consumers, Sky's ability to prevent other potential competitors from accessing that content enables it to render the services of (potential) competitors unattractive to consumers<sup>107</sup>.

### Ofcom's views

- 5.59 Our view remains that aggregation of substitutable content by one buyer is a relevant feature.

<sup>104</sup> Warner's response to the Consultation, paragraph 3.12.5.

<sup>105</sup> [ X ].

<sup>106</sup> Paragraph 6.16 below.

<sup>107</sup> Virgin Media's response to the Consultation, paragraph, 3.5.

## Staggered availability of content rights and duration of contracts

### Respondents' views

- 5.60 Several broadcasters agreed with our preliminary view that the staggered availability of content rights for the subscription pay TV window and long contract durations (amongst other things) gave Sky a considerable advantage in winning key premium movie rights and prevented other wholesalers from acquiring a critical mass of premium movie content.
- 5.61 [ X ] said that by securing a critical mass of output deals with the Major Hollywood Studios it becomes easier for Sky to agree the pay window for a further studio as its film offering has achieved a level of commercial stability. This advantage is supported by the staggered nature of the contracts with key studios, the renewals of which rarely coincide. It stressed that as a result it is difficult for competing parties to enter this market and provide effective competition<sup>108</sup>.
- 5.62 Similarly, Virgin Media identified the staggered availability of rights and long contract durations amongst other factors (including vertical integration and Sky's strength vis-a-vis the studios) as having raised barriers to entry in the wholesale market. It noted that those factors increase the risks and timescales associated with new entry and, amongst other things, explain why "Sky has monopolised the acquisition of premium linear and SVoD rights for almost 20 years"<sup>109</sup>.
- 5.63 Orange argued that the limited pool of premium content together with the staggered availability of contents rights and duration of contracts amounted to a barrier to entry for competitors because it prevents a wholesaler wishing to launch a new service from simultaneously acquiring rights from more than one studio<sup>110</sup>.

### Ofcom's views

- 5.64 Our view remains that staggered availability of content rights and duration of contracts is a relevant feature.

## Sky's market power

### Respondents' views

- 5.65 Several respondents agreed with our preliminary views on market power. [ X ] agreed with Ofcom's analysis of Sky's market power both in premium movie rights alone and in combination with sports rights. It was of the view that the market advantage that Sky holds in respect of movie content is attributable to its ability to secure output deals with the Major Hollywood Studios. It said that SVoD and linear premium movie services from alternative providers could provide necessary competition to Sky's linear offering, and promote competition between platforms. However, it added that if Sky's pull VoD services gains significant traction, it is likely to simply lead to an extension of Sky's market power from linear to VoD, and would fail to deliver any competition benefits in terms of platform or service competition<sup>111</sup>.

---

<sup>108</sup> [ X ].

<sup>109</sup> Virgin Media's response to the Consultation, paragraphs 2.5 -2.6.

<sup>110</sup> Orange's response to the Consultation, page 6.

<sup>111</sup> [ X ].

- 5.66 Virgin Media agreed that Sky has material market power in the wholesale market due to its position as the sole entity with access to sufficient premium movies content<sup>112</sup>. In its view, Sky's market power is evidenced by (a) very high and sustained market share in the wholesale market, (b) the existence of barriers to entry, and (c) a lack of countervailing buyer power by Virgin Media and other potential purchasers of Core Premium Movies channels. However, it said that Ofcom's approach understates the market power enjoyed by Sky by giving undue weight to what Virgin Media considers "very distant" substitutes such as DVDs and library films<sup>113</sup>.
- 5.67 Similarly, in Orange's view market power stems from Sky's ability to purchase linear and SVoD premium rights exclusively and jointly. This, according to Orange, makes it difficult for another platform to launch a competing movie service with a premium linear channel or SVoD bundle. Only on PPV, video-on-demand and new media markets, it added, is premium movie content sold non-exclusively. Even then, Sky has secured contracts for exclusive direct-to-home rights and is seeking to secure arrangements that reduce the appeal of movie titles available on other platforms in the same window<sup>114</sup>.

### Ofcom's views

- 5.68 As regards Virgin Media's view that we placed undue weight on distant substitutes, our rationale for deciding whether other services are close, moderate or distant substitutes for Core Premium Movies channels is set out in Section 6 of the Pay TV Statement<sup>115</sup>. This includes analysis of movies on retail DVDs<sup>116</sup> and movies on free-to-air and basic channels<sup>117</sup>, which Virgin Media considers "very distant substitutes" and we categorised as "moderate substitutes" instead.
- 5.69 We concluded that the relevant market was "pay TV packages including Core Premium Movies channels" and that Sky had 100% of the wholesale market. We said that even on the strongest plausible assumptions (i.e. with all moderate substitutes included in the market), Sky would still have a wholesale market share of around [X] [30-50]%, and that these figures overstated the strength of the constraint exerted by these other products, since they treated moderate substitutes as if they were close substitutes.
- 5.70 Hence, we agree with Virgin Media's point that our "best case" scenario gave undue weight to moderate substitutes, and we explicitly said that. We do not, however, agree with its characterisation of those as "very distant substitutes", for the reasons set out in our Pay TV Statement.

### Vertical integration

#### Respondents' views

- 5.71 Virgin Media said that Sky's vertical integration, together with its wholesale market power, gave it the ability and incentive to restrict wholesale supply of packages including Core Premium Movies channels. In Virgin Media's view, Sky's market power at all levels of the supply chain provides it with incentives to engage in

<sup>112</sup> Virgin Media's response to the Consultation, paragraph, 3.8.

<sup>113</sup> Virgin Media's response to the Consultation, paragraph, 3.10.

<sup>114</sup> Orange's response to the Consultation, page 6.

<sup>115</sup> Contained in Annex 7.

<sup>116</sup> Paragraphs 6.145 to 6.169 of our Pay TV Statement contained in Annex 7.

<sup>117</sup> Paragraphs 6.170 to 6.194 of our Pay TV Statement contained in Annex 7.

behaviour that forecloses, or at the very least marginalises, competitors. In addition, Virgin Media agreed with our view in the Pay TV Statement that Sky's non-supply of various enhanced or alternative versions of its premium channels, in particular HD, will remain a significant prejudice to fair and effective competition<sup>118</sup>.

5.72 Orange said that, as a vertically integrated operator with market power in a key upstream market, Sky has distributed its Core Premium Movies channels in a way that favours its own platform. It highlighted that Sky makes it very difficult for competitors to secure its Core Premium Movies channels. In Orange's view, Sky has either refused to supply rivals or offered terms which left little room for competing platforms to attract customers and earn an acceptable margin. This, according to Orange, has contributed to a poor subscription rate in non-satellite homes<sup>119</sup>.

5.73 BT said that vertical integration only prevents, restricts or distorts competition in the context of Sky's market power rather than in and of itself. It noted that, absent market power, vertical integration can allow firms to deliver products that are more closely targeted to consumer demand<sup>120</sup>.

### Ofcom's views

5.74 Our view remains that vertical integration is a relevant feature.

### Conclusions

5.75 Having given careful consideration to the responses to the Consultation and based on our analysis set out in Annex 4, we conclude that the combination of the following features of the market may adversely affect competition:

- a limited pool of premium content from the Major Hollywood Studios;
- the way in which the rights to broadcast movies are made available over time (i.e. the release windows structure);
- the joint licensing of premium linear channel and SVoD rights by individual studios;
- exclusivity of rights licensing agreements between individual studios and purchasers of rights;
- other restrictions in contracts for the rights in the first pay TV subscription window, such as [ X ];
- aggregation of substitutable premium movie content into a single wholesale offering;
- staggered availability of content rights and duration of contracts for premium movie rights;
- Sky's market power in the distribution of Core Premium Movies channels; and
- vertical integration of firms over the pay TV supply chain.

---

<sup>118</sup> Virgin Media's response to the Consultation, paragraphs, 3.14-3.15.

<sup>119</sup> Orange's response to the Consultation, pages 6-7.

<sup>120</sup> BT's response to the Consultation, paragraph 4.3.

## Section 6

# Prevention, restriction and distortion of competition

## Introduction

- 6.1 In this Section, we assess the views of respondents on the prevention, restriction and distortion of competition and conclude on whether there are reasonable grounds to suspect that the combination of features prevents, distorts or restricts competition in connection with the supply and acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels.
- 6.2 Additional detail of the analysis is contained in Annex 5.
- 6.3 We interpret the phrase “prevent, restrict or distort” competition broadly, to encompass any reduction or dampening of actual or potential competition<sup>121</sup>, noting that markets will operate effectively when firms engaged in the market are subject to competitive constraints from other firms already in the market and/or from firms that could readily enter it, and from their customers<sup>122</sup>.

## Consultation on a market reference

- 6.4 In the Consultation we expressed our view that the features set out in Section 5 were inter-related and that evaluating the effect of each on an individual basis would be an artificial exercise. We were concerned with the way the features work in combination. By purchasing linear and SVoD rights from all six Major Hollywood Studios jointly and exclusively during the first pay TV subscription window in the UK, Sky aggregates the limited pool of closely substitutable premium movie content available during that window.
- 6.5 We suspected that this combination of features (alongside the staggered availability of movie rights and other contract restrictions) underpins Sky’s market power and, in conjunction with vertical integration, has created a situation in which Sky is enabled and incentivised to prevent, restrict and distort competition in connection with the supply or acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels<sup>123</sup>.
- 6.6 Our Consultation set out the three ways in which the competition concerns we identified are manifested:
- **limited exploitation of premium SVoD rights:** Sky has exclusive access to the SVoD rights in the first pay TV subscription window as part of its contracts with the six Major Hollywood Studios, because they are sold exclusively together with the linear channel rights. However Sky currently only exploits these rights via Sky Player (on the PC or Xbox)<sup>124</sup> because its satellite platform is not able to offer

<sup>121</sup> OFT’s Guidance, paragraph 4.2.

<sup>122</sup> OFT’s Guidance, paragraph 4.1.

<sup>123</sup> Paragraphs 1.6-1.7 and 6.8-6.15 of the Consultation.

<sup>124</sup> The distribution of these services, however, is fairly limited. For example in October 2009 there were only [ X ] Sky Player subscribers.



true VoD<sup>125</sup>. We note that Sky is planning to introduce a pull VoD service to the TV via broadband, but it appears that at least initially this will only be available to a minority of its installed base of set-top boxes. In contrast, operators of cable or IPTV platforms have been capable of delivering true VoD services for several years but have been unsuccessful in gaining access to premium SVoD rights. We believe that limited exploitation of premium movie SVoD rights means that consumers will increasingly lose out in terms of both choice and innovation;

- **restricted distribution of Sky's Core Premium Movies channels:** Sky exploits its market power by restricting wholesale distribution of its Core Premium Movies channels. The current importance of these channels to competition in the pay TV sector means that consumers lose out in terms of choice and innovation; selection of pay TV platform appears to be distorted by the limited choice of retailers of Core Premium Movies channels, and new innovative platforms are less able to develop without access to Core Premium Movies channels needed to establish premium movie services; and
- **high prices for Sky's Core Premium Movies channels:** The combination of identified features, in particular, the joint licensing of the linear and SVoD rights that allows Sky to aggregate this content, and Sky's market power in the wholesale supply of packages including Core Premium Movies channels, means that Sky is able to charge high wholesale prices for Core Premium Movies channels, which are reflected in high retail prices to consumers.

6.7 We therefore believed that the section 131 EA02 test for a market reference to the CC was satisfied. We set out below respondents' views on our general approach to competition issues before summarising their replies in respect of each competition issue identified in the Consultation.

## Ofcom's general approach to competition issues

### Respondents' views

6.8 BT and Virgin Media agreed with Ofcom's view of the three competition issues identified<sup>126</sup>. In their view, certain individual features are sufficient in themselves to affect competition adversely or justify a reference to the CC. Both firms argued that the combination of multiple features merely exacerbates the adverse effects arising from any one individual feature<sup>127</sup>.

6.9 However, Virgin Media was concerned that Ofcom did not place sufficient weight on the adverse effects on competition arising from the terms on which Sky supplies its Core Premium Movies channels to Virgin Media<sup>128</sup>.

6.10 Other respondents criticised our analysis of competition issues. Warner said that most of the features identified could equally be described as legitimate commercial

---

<sup>125</sup> True or 'Pull' VoD means that consumers can get instant access to the film of their choice. In contrast Sky's satellite platform offers a 'Push' VoD service, where content is downloaded to the hard drive of the set-top box and made available to view on demand, thus creating the effect of VoD. Push VoD services are limited by the capacity available to store programming on the set-top box, so generally offer much less on-demand programming than Pull VoD.

<sup>126</sup> BT's response to the Consultation, paragraph 4.14. Virgin Media's response to the Consultation, paragraph 5.1.

<sup>127</sup> BT's response to the Consultation, paragraphs Q.3 and 4.6-4.8. Virgin Media's response to the Consultation, paragraphs 2.2 and 3.2.

<sup>128</sup> Virgin Media's response to the Consultation, paragraph 5.2.

behaviour underpinned by applicable copyright laws<sup>129</sup>. As noted in Section 5, several respondents made the same point in relation to individual features such as exclusivity, the window structure or vertical integration.

- 6.11 Warner criticised Ofcom for not explaining convincingly how each of the features identified contribute to the perceived overall competitive distortion. In its view, this is particularly troubling and contradictory since Ofcom has recognised that many features may be anodyne in isolation. Warner argued that the approach lacks sufficient rigour, particularly given that Ofcom suggested remedies that would relate to individual features<sup>130</sup>.
- 6.12 Similarly, Sky said that Ofcom’s analysis of the features having an adverse effect on competition was insufficient and inadequate to justify a market reference. In Sky’s view, our “key concern” of the wider availability of SVoD movies would be too narrow an issue to justify a reference and the “alleged wider features” used to bolster our case are of no substance<sup>131</sup>.

### **Ofcom’s view**

- 6.13 In response to Warner’s point that we did not explain convincingly how each of the features identified contributed to the overall competitive distortion, we consider that this was clearly explained in the Consultation and is also set out in paragraphs A5.5 to A5.12 of Annex 5.
- 6.14 In relation to BT’s and Virgin Media’s point that some individual features are sufficient on their own to affect competition adversely, and Warner’s contrary point that most of the individual features can be described as legitimate commercial behaviour, we consider that the features are inter-related and we do not seek to evaluate their effect on an individual basis.
- 6.15 Our view does not depend on whether each feature, separately considered, has an effect on competition or is a legitimate commercial practice. It may be that that individual features, or a subset of the features we have identified, may in themselves have an adverse effect on competition which does not depend on the remaining features. Conversely, we acknowledge that some individual features may not raise competition concerns in isolation. The CC may consider it appropriate to assess these features individually, particularly if considering which of the features to address in any market intervention.
- 6.16 We remain of the view that the combination of features identified has an adverse effect on competition in the way described. However, we have assessed the extent to which we need to rely on the feature “other contract restrictions”, details of which were redacted from the Consultation. Contract requirements [ X ], further increase the difficulty of developing a competing pay TV service based on the SVoD rights of a single studio, or a subset of the studios. However, even in the absence of these conditions, we consider that competitors face high barriers to developing such a service, because of the limited pool of premium content, the staggered availability of content rights, aggregation of movies, exclusivity of rights licensing agreements, and the joint licensing of linear and SVoD rights. We therefore do not consider this feature to be necessary for the purpose of deciding whether or not to make a reference.

<sup>129</sup> Warner’s response to the Consultation, paragraph, 3.10.

<sup>130</sup> Warner’s response to the Consultation, paragraph, 3.10.

<sup>131</sup> Sky’s response to the Consultation, paragraph 3.4 – 3.5.

- 6.17 As regards Sky's criticism, we have explained that our concerns are not limited to the exploitation of premium SVoD services, but include the restricted distribution of Sky's Core Premium Movies channels and high wholesale prices for those channels.

### Limited exploitation of premium SVoD rights

#### Support for our approach

- 6.18 Several respondents supported our analysis set out in the Consultation. [ X ] agreed that there are potential competition concerns in relation to the exploitation of premium movie rights in the first pay TV window<sup>132</sup>.
- 6.19 BT and Orange said that an innovative premium SVoD movie service could have been introduced in the UK several years ago. BT said that historically Sky warehoused SVoD rights and therefore SVoD services incorporating the first pay TV subscription window rights have not been available on a standalone basis in the UK, in contrast with other European countries<sup>133</sup>.
- 6.20 Both BT and Virgin Media highlighted the advantages of a subscription service over PPV and linear channels and explained that their customers have a clear preference for SVoD services over PPV<sup>134</sup>. According to BT, SVoD services free consumers from relying on linear movie channels or from a micro-payment mechanism required under PPV services<sup>135</sup>. [ X ], BT and Orange argued that SVoD services could provide necessary competition to Sky's linear channels and promote competition between platforms to the benefit of consumers<sup>136</sup>. [ X ], BT and Orange also highlighted the importance of SVoD for the development of IPTV services<sup>137</sup>.
- 6.21 Some respondents noted the difficulties faced by potential rivals lacking access to premium movie content. Virgin Media and BT said that they have had technology in place for years and are well-placed to offer an SVoD service. Virgin Media said that although it sought to innovate in VoD services (via Picture Box and Virgin Media online movies), its services will continue to be of limited appeal due to a lack of access to premium movie content in the first pay TV subscription window<sup>138</sup>. Virgin Media said that, due to the existing arrangements for the exclusive sale of premium SVoD rights to Sky, cable customers cannot access this content, leading directly to consumer detriment. Similarly, [ X ] and BT argued that premium movie content in that window is central to the development of sustainable competing platforms<sup>139</sup>.
- 6.22 Virgin Media believed that the new Sky pull VoD service<sup>140</sup> would not address the distortions of competition arising from the limited exploitation of SVoD rights<sup>141</sup>. Both Virgin Media and Orange were of the view, that this service would only extend Sky's

---

<sup>132</sup> [ X ].

<sup>133</sup> BT's response to the Consultation, paragraph 4.15.

<sup>134</sup> BT's response to the Consultation, paragraphs 2.9-2.11. Virgin Media response to the Consultation, paragraph 5.21.

<sup>135</sup> BT's response to the Consultation, paragraph 2.9.

<sup>136</sup> [ X ]; Orange's response to the Consultation, page 8. BT's response to the Consultation, paragraph 3.10.

<sup>137</sup> [ X ]; Orange's response to the Consultation, page 7. BT's response to the Consultation, paragraph 4.15.

<sup>138</sup> Virgin Media's response to the Consultation, paragraph 5.23.

<sup>139</sup> [ X ]; BT's response to the Consultation, paragraph 2.7.

<sup>140</sup> Sky is planning to launch a "pull" VoD service [ X ] as set out in Sky's confidential response to the Consultation, paragraph 4.23.

<sup>141</sup> Virgin Media's response to the Consultation, paragraph, 5.24.

dominance in relation to premium movie content<sup>142</sup>. Virgin Media added that the service would be subject to streaming and capacity issues, and would only be available to a minority of Sky's subscriber base<sup>143</sup>.

### Areas of disagreement with our approach

- 6.23 Sky and the Major Hollywood Studios that responded to our consultation, disagreed with our view on the limited exploitation of premium movie content. Sky argued that the exploitation of SVoD rights is not as limited as Ofcom alleged. Sky said it was innovating and exploiting movies on an SVoD basis, via the following platforms<sup>144</sup>:
- Sky Anytime, a VoD service which “pushes” programming to the set top box, which is then ready for selection at the convenience of the viewer. Sky Anytime is available to over 6 million homes in the UK that have a Sky+ or Sky+ HD box, and where technological developments in the last 3 years have meant that storage capacity of Sky's PVRs has increase significantly.
  - Sky Anytime+, a “pull” VoD service which is currently in its final test phase and will be launching later in 2010. This service involves programming being progressively downloaded to the set top box in response to the viewer's individual selection. Sky Anytime+ will [ X ], and will include more than 500 movies across different windows.
  - Sky Player, which allows Sky subscribers to access Sky Movies on-demand over their PC, and making Sky content available to non-DSat customers via a large number of third party devices, on both a linear and on-demand basis. Sky has reached agreement with a number of operators to make Sky Player available via games consoles (e.g. Microsoft's X-box 360), Computers (including PC and Apple Mac), IP enabled DTT set top boxes and connected TVs. [ X ].
- 6.24 Sky also said that it had recently concluded agreements for the supply by Virgin Media of a range of on-demand content from its premium and basic channels, for the latter to distribute to its subscribers as part of its retail offering<sup>145</sup>. Sky further noted that there are significant developments taking place in relation to VoD services without regulatory intervention. Examples included Picturebox, the BT Vision Film Club, Lovefilm Player and Apple iTunes<sup>146</sup>.
- 6.25 Moreover, Sky took the view that our concern was insufficiently substantiated, because:
- Ofcom has misunderstood the nature of Sky's rights and the extent to which Sky has exploited them and sought to innovate in relation to their distribution; and
  - Ofcom has failed to appreciate the dynamic, fast moving nature of the sector and the fact that developments are at a relatively early stage. In Sky's view, it is

<sup>142</sup> Virgin Media's response to the Consultation, paragraph, 5.24; Orange's response to the Consultation, page 7.

<sup>143</sup> Virgin Media's response to the Consultation, paragraph, 5.24.

<sup>144</sup> Sky's response to the Consultation, paragraph 4.17 – 4.29.

<sup>145</sup> Virgin Media told us that [ X ]. [ X ].

<sup>146</sup> Sky's response to the Consultation, paragraphs 4.30-4.33.

incumbent on Ofcom to ensure that its concerns are appropriately founded and are not outdated or would become so without regulatory intervention<sup>147</sup>.

- 6.26 In Sky's view, our concern essentially relates to the exclusivity granted to Sky over premium SVoD movie rights for the first pay TV window. It argued that Ofcom could not rely on the "high strategic importance" of SVoD movies because it had not carried out any detailed exploration of whether premium movie content is important for the growth of SVoD. In its view, Ofcom has relied on submissions by BT and Virgin Media but has disregarded evidence by Paramount to the effect that SVoD premium movie rights are not essential to the development of IPTV platforms. Sky also noted the difficulty in commenting on submissions from the Major Hollywood Studios relating to the importance of SVoD due to the redactions and lack of other detail<sup>148</sup>.
- 6.27 In addition, Sky argued that Ofcom's view that investment in IPTV and superfast broadband is being hampered by lack of access to SVoD content is not consistent with its statements in its reviews of wholesale local access and superfast broadband, where Ofcom admitted that it was not yet clear on what types of service will be demanded by consumers over next generation broadband. It said that BT's recent announcement of an expansion in its superfast broadband network did not appear to be contingent on the availability of SVoD movies, and also noted Virgin Media's recent and planned roll-out<sup>149</sup>.
- 6.28 Warner said that it was aiming to build on existing business models and to experiment with new models. It said that [ X ], and cited WarnerFilms, an SVoD service on BT Vision showing movies after they have been licensed to Sky, [ X ], and similar deals between BT Vision and other studios<sup>150</sup>. It believed that a reference would undermine these new developments<sup>151</sup>.
- 6.29 [ X ] said that it was difficult to understand Ofcom's continued focus on the sale of SVoD rights given the widespread availability of its movies online through VoD/PPV, as well as through cinema and retail outlets<sup>152</sup>. Finally, [ X ] said that Ofcom's concerns in relation to SVoD services suggested that Ofcom had decided that it would like a certain category of content to be delivered using particular technology with a standalone pricing structure. The fact that such a service had not yet been offered, it added, did not amount to a restriction or distortion of competition<sup>153</sup>.

## Ofcom's views

- 6.30 In relation to Sky's point that the exploitation of SVoD rights was not as limited as we alleged, we recognise that Sky Anytime offers considerable benefits to Sky's subscriber base, but it offers a relatively limited range of movies compared to what would be possible over a "true" SVoD service. Sky Anytime+ has the potential to offer a much wider range. However, the service is still in development, and [ X ]. As such, in future the supply of SVoD services will continue to be restricted by the rate at which Sky can develop its own service, and by Sky's incentive not to cannibalise its linear channels. Sky will only exploit SVoD rights in terms of its own ability to retail SVoD services and therefore other operators will not be able to innovate in this area.

---

<sup>147</sup> Sky's response to the Consultation, paragraph 4.1 – 4.3.

<sup>148</sup> Sky's response to the Consultation, paragraph 4.6-4.9 and 4.12.

<sup>149</sup> Sky's response to the Consultation, paragraph 4.10 – 4.11.

<sup>150</sup> Warner's response to the Consultation, paragraph, 4.10.1-2.

<sup>151</sup> Warner's response to the Consultation, paragraph, 4.10.3.

<sup>152</sup> [ X ].

<sup>153</sup> [ X ].

Operators of cable and IPTV platforms have had the capability to offer true VoD services for several years. The fact that they are unable to take advantage of this capability, by supplying content which is highly valued by consumers, leads to a restriction in consumer choice.

- 6.31 We also recognise that [ X ]<sup>154</sup>.
- 6.32 As set out in Annex 5, we have a number of reasons for believing that the importance of SVoD to competition will increase in the future. Several stakeholders expressed the opinion that SVoD is likely to take over from linear channels as the main way of delivering movies. SVoD services would provide a very similar experience to subscribing to a linear channel, but with the added convenience of allowing consumers to view a wide range of content when they want to. This view is also confirmed by the fact that the consumption of VoD services has significantly increased<sup>155</sup>, suggesting that consumers want to have more control over watching programmes.
- 6.33 For the reasons given in Section 6 of our Pay TV Statement, we consider that an SVoD premium movies service would be a competitive constraint on linear Core Premium Movies channels. We expect that there would be scope for customers to switch between those services given their common characteristics and the views of industry players including pay TV broadcasters, a potential pay TV entrant, and the Major Hollywood Studios<sup>156</sup>. We recognise that, as explained in our Third Pay TV Consultation, as a premium movie SVoD service does not yet exist we have no direct empirical evidence on the point – therefore our views are based on the other evidence we have set out.
- 6.34 We consider that the examples Sky and Warner provided of other operators investing in on-demand services movies provide further evidence that the industry expects strong demand for such services. However, without access to the rights to show premium movies on subscription, broadcasters are restricted in their ability to meet such demand, and are limited to delivering content which is less highly valued by subscribers and potential subscribers.
- 6.35 As Sky pointed out, some of the respondents including some Major Hollywood Studios requested that their comments be redacted for confidentiality reasons. However, the fact that the redacted information related to particular stakeholders' views on the future of SVoD was made clear. The redactions did not prevent consultation respondents from commenting on the future of SVoD, (we have considered these comments in reaching our view as to the importance of SVoD movies); nor did they hide the basis upon which our view of the importance of SVoD was reached.
- 6.36 As regards Sky's final point, we recognise that the extent and nature of demand for superfast broadband remains unclear. However, we expect that demand for superfast broadband will depend on the applications and content it can deliver to consumers. The demand for IPTV will depend on the attractiveness of content available over it and, as we have set out at length in Section 6 of our Pay TV

---

<sup>154</sup> [ X ].

<sup>155</sup> Paragraph A2.62 of Annex 2.

<sup>156</sup> Paragraphs 6.211 to 6.221 of the Pay TV Statement contained in Annex 7; paragraph A5.15 of Annex 5.

Statement<sup>157</sup> premium movies are a highly distinctive form of content which is particularly suited to SVoD.

- 6.37 As such we remain of the view that there is substantial scope for premium movie content over SVoD to be a key driver of demand for superfast broadband. This is not to say that the restricted availability of this content is an absolute barrier to takeup and investment in superfast broadband. However, there is a danger that it will lead to a slower rate of investment than would otherwise be the case.
- 6.38 As regards [ X ]'s argument, we have defined relevant markets in relation to pay TV (paragraph 4.27 above), and in this context we consider delivery of SVoD services to be an important development. As we argued in our Pay TV Statement<sup>158</sup>, the low total revenue from PPV movies compared to linear pay TV suggests that consumers have a strong preference for a subscription service.
- 6.39 Our concerns are not, as [ X ] suggests, based on a specific view of how content should be delivered or priced. We are concerned that the combination of the features we have identified creates a situation in which Sky is enabled and incentivised to restrict, prevent and distort competition in the wholesale supply of premium subscription movie services<sup>159</sup>. Whilst at present most of this supply takes the form of linear channels, broadcasters argued that SVoD services will become an increasingly important way of delivering this content in future. This view is evidenced by the intrinsic advantages of SVoD over linear channels, and the fact that a number of broadcasters are currently developing SVoD services. We are concerned that, if the features of the market persist, competition in the supply of this content over linear and SVoD services will continue to be restricted.
- 6.40 In conclusion, we expect that premium movie content over an SVoD service would be a compelling offer for a large number of UK households. However Sky, which has exclusive access to the necessary rights, currently has a very limited ability to exploit them. While it plans to launch a “pull” VoD service on DSat, this will only be [ X ]. In contrast, other platforms are already well placed to offer SVoD services, but are unable to access the necessary premium movie rights.

## Restricted availability of Sky's Core Premium Movies channels

### Respondents' views

- 6.41 Some stakeholders agreed with our concern relating to restricted availability of Core Premium Movies channels. Orange said that Sky favours its own retail business and platform by refusing to supply premium content on fair and reasonable terms, or by supplying it at prices that rivals could not afford<sup>160</sup>.
- 6.42 Similarly, BT noted that Sky's wholesale pricing of Core Premium Movies channels creates an incentive for cable to use the channels solely as a retention tool, rather than as a source of added value for customers. In addition, according to BT, Sky's policy of restricting wholesale supply of its Core Premium Movies channels:
- significantly distorts consumer choice in downstream markets;

---

<sup>157</sup> Paragraphs 6.50 to 6.73 and 6.170 to 6.210 of the Pay TV Statement contained in Annex 7.

<sup>158</sup> Paragraph 6.5 of the Pay TV Statement contained in Annex 7.

<sup>159</sup> Paragraph 1.7 of the Consultation; paragraph A5.5-A5.12 of Annex 5.

<sup>160</sup> Orange's response to the Consultation, page 7.

- has limited the range and variety of packages and price points that consumers can access; and
- limits choice in triple-play bundles, as consumers increasingly buy their telephone, internet and Pay TV services as a single standalone bundle<sup>161</sup>.

6.43 As noted above, Virgin Media was concerned that Ofcom did not place sufficient weight on the adverse effects on competition arising from the terms on which Sky supplies its Core Premium Movie channels to it<sup>162</sup>. In its view, there will continue to be significant demand for linear movie channels, which is why Sky has an incentive to eliminate Virgin Media as a competitor in relation to the supply of linear Core Premium Movies channels (and not just in relation to SVoD). In particular, according to Virgin Media:

- Sky supplies SD premium channels to Virgin Media only on uneconomic terms; and
- Sky has not [ X ] supplied HD versions of its premium movies channels to Virgin Media, despite the latter's technical ability and commercial desire to provide that content to its customers.

6.44 This, Virgin Media said, means that its pay TV services compare very unfavourably with those of Sky and has led to substantially lower penetration of Sky's Core Premium Movies channels on cable compared to Sky's satellite platform. In Virgin Media's view, because Sky heavily promotes HD services on the SD versions it supplies to Virgin Media, [ X ]<sup>163</sup>.

6.45 Sky said that where an opportunity arose, it was keen to explore options and to engage in dialogue with operators around the possibility of making its content available (on a linear and on-demand basis) via their platforms.

### Ofcom's view

6.46 We consider that Sky:

- has restricted wholesale supply of its Core Premium Movies channels to other retailers on the DTH, DTT or IPTV platforms<sup>164</sup>;
- has restricted wholesale supply of its HD Core Premium Movies channels to Virgin Media<sup>165</sup>; and
- supplies its Core Premium Movies channels to Virgin Media at prices which do not allow Virgin Media to compete effectively with Sky at the retail level<sup>166</sup>.

6.47 In relation to Virgin Media's comments, while our primary concern is in relation to the absence of supply to other retailers, the terms on which Sky supplies its channels to Virgin Media nonetheless create a situation in which consumer choice is likely to be

<sup>161</sup> BT's response to the Consultation, paragraph 4.15.

<sup>162</sup> Virgin Media's response to the Consultation, paragraphs 5.1-5.16.

<sup>163</sup> Virgin Media's response to the Consultation, paragraphs 5.13.

<sup>164</sup> Paragraphs 7.59 to 7.171; 7.190 to 7.201; 7.210 and 7.219 to 7.233 of our Pay TV Statement contained in Annex 7.

<sup>165</sup> Paragraphs 7.291 to 7.312 of our Pay TV Statement contained in Annex 7.

<sup>166</sup> Paragraphs 7.235 to 7.238; 7.246 to 7.259; 7.262 to 7.290 of our pay TV Statement contained in Annex 7.



distorted. We consider that the CC will have the scope to consider this issue in the context of its own investigation, if necessary.

- 6.48 More generally, it is still our view that a number of companies have tried and failed, over an extended period of time, to negotiate terms with Sky which would allow them to retail Core Premium channels to their customers. We believe this is because Sky is acting on two strategic incentives – to protect its retail business on its own satellite platform, and to reduce the risk of stronger competition for content rights.

## High Wholesale Prices for Sky's Core Premium Movies channels

### Respondents' views

- 6.49 BT and Virgin Media agreed with our view that the combination of features in Section 5 has resulted in high wholesale prices of packages including Sky's Core Premium Movies channels<sup>167</sup>.

### Ofcom's views

- 6.50 We set out our views on how the combination of features has resulted in high wholesale prices of packages including Core Premium Movies channels in Annex 5 paragraphs A5.20 to A5.22.

## Effects on consumers: choice

### Respondents' views

- 6.51 A number of respondents agreed with Ofcom's analysis on consumer choice<sup>168</sup>. [ X ] believed that the restriction of choice, innovation and pricing is likely to be a long term issue considering the current critical stage of growth and development of the market<sup>169</sup>. Orange said that Sky's control over premium movie content means that consumers have less choice in terms of platform over which they can receive pay TV services<sup>170</sup>.
- 6.52 Virgin Media considered that there is a wealth of evidence suggesting that consumer needs in terms of choice are not being met in relation to premium movies content. It cited as examples:
- Sky's refusal to supply Core Premium Movie channels to pay TV retailers on the DTT platform, so that consumers on those platforms are denied the ability to subscribe to those channels;
  - Sky's refusal [ X ] to supply HD services to Virgin Media, meaning that cable customers are faced with restricted choice at a time when HD channels are becoming an increasingly important factor in consumer choice;
  - Sky's stranglehold on premium movie content prevents third parties from creating attractive movie channels in competition with Sky's; and

---

<sup>167</sup> BT's response to the Consultation, paragraph 4.14. Virgin Media's response to the Consultation, paragraph 5.1.

<sup>168</sup> [ X ]; BT's response to the Consultation, paragraph 4.15; Orange's response to the Consultation, page 7.

<sup>169</sup> [ X ].

<sup>170</sup> Orange's response to the Consultation, page 7.

- Sky’s acquisition of premium movie SVoD rights on an exclusive basis in the first pay TV window forecloses Virgin Media and others from providing effective competition to Core Premium Movies channels<sup>171</sup>.
- 6.53 BT agreed with our view that Sky’s policy of restricting wholesale supply of its Core Premium Movies channels significantly distorts consumer choice in retail markets. It said that Sky only wholesales to cable and provides SD channels only<sup>172</sup>.
- 6.54 The BBC said that the increasing importance of IP-delivered functionality to complement and compete with traditional broadcast television meant that greater SVoD availability would be beneficial to consumers. However, it said that this consumer benefit, and SVoD revenues, must be weighed against the risk that SVoD availability across the release windows could reduce the value of broadcast rights. A net loss of revenue from movies could affect investment and innovation<sup>173</sup>.
- 6.55 In contrast, Sky said Ofcom had ample evidence that the UK audiovisual sector was delivering good outcomes for consumers. In particular, in Sky’s view:
- there is high consumer satisfaction with pay TV services;
  - the penetration of digital pay TV is amongst the highest in Europe; and
  - consumers are very well served in terms of content choice (both range of TV channels and quality of content on those channels) – consumers have a choice of over 500 linear channels, and movie content (including movies) is provided on a VoD basis (including on a SVoD basis) by a significant number of providers including Virgin Media, BT Vision, Talk Talk TV, Top Up TV, Sky, 4oD, Apple TV, iTunes, Microsoft Xbox Live Marketplace and Lovefilm. Some of the Major Hollywood Studios also offer their own standalone VoD services (such as Universal’s Picturebox or Sony’s and Disney’s Filmflex). Sky said that Virgin Media, BT Vision, iTunes and Microsoft Xbox Live Marketplace all offer recent movie titles before (and after) they are available on Sky’s linear movie channels. Other recent developments include Universal, Warner and Fox all introducing ‘day and date’ on demand content in the UK, bringing forward the opportunity for viewers to access movies closer to the date of DVD release<sup>174</sup>.
- 6.56 In Sky’s view, the fact that some movies may not be available as part of an SVoD service on some or all TV platforms during the pay TV window does not amount to consumer detriment, especially since the same movies continue to be available on DVD throughout the period and will become available again in a later window. Sky also referred to two PricewaterhouseCoopers (‘PwC’) reports it submitted in the context of the pay TV review, which, in its view, shows that UK consumers are among the best served in Europe in terms of choice<sup>175</sup>.
- 6.57 [ X ] said that Ofcom gave insufficient consideration to the various options which consumers have and instead narrowly focused on Sky’s offering and SVoD services<sup>176</sup>.

<sup>171</sup> Virgin Media response to the Consultation, paragraphs 6.1-6.2.

<sup>172</sup> BT response to the Consultation, paragraph 4.15.

<sup>173</sup> BBC’s response to the Consultation, paragraph 3.

<sup>174</sup> Sky’s response to the Consultation, paragraphs 2.1-2.6.

<sup>175</sup> Sky’s response to the Consultation, paragraph 2.5 -2.6.

<sup>176</sup> [ X ].

## Ofcom's views

- 6.58 Sky's (and [X]'s) arguments appear to assume that other TV/movies content is an effective substitute for Core Premium Movies content. Our Pay TV Statement concluded that non-movies content and SVoD movie services after the first pay TV subscription window were at most distant substitutes for Core Premium Movies channels<sup>177</sup>. It also concluded that other films (on FTA and basic channels), DVD sales in the first pay TV window and PPV services lay outside the relevant market, although we recognised that there was likely to be a moderate degree of substitutability of this content for Core Premium Movies channels<sup>178</sup>.
- 6.59 Our concern remains that consumers have limited options for accessing the movies content for which they have the highest demand. The availability of services offering movies which are not closely substitutes for Core Premium Movies channels – whether because they are less popular films, or in a different release window – does not address this concern. Further detail of our reasoning is set out in Annex 5 paragraphs A5.23 to A5.32.

## Effects on consumers: innovation

### Respondents' views

- 6.60 Several respondents agreed with Ofcom's analysis on innovation. Some of them highlighted the negative impact on innovation caused by lack of access to premium movie content. As noted above, BT and Orange said that an innovative SVoD service could have been introduced in the UK several years ago. According to BT, lack of access to that content has restricted the development of IPTV, as evidenced by the fact that IPTV penetration is substantially higher elsewhere in Europe<sup>179</sup>.
- 6.61 In BT's view, warehousing of movie rights and rights holdbacks has prevented third parties from developing new, innovative SVoD services which could compete directly with Sky's linear movies channels, despite them having the technology and latent demand for them in place<sup>180</sup>. Virgin Media agreed with this view<sup>181</sup>.
- 6.62 The BBC noted that the bundling of premium SVoD and broadcast rights has the potential, especially when combined with Sky's restricted utilisation of these rights, to prevent the future development of online movie distribution in competition with traditional broadcasting before, during (and possibly beyond) the first pay window. However, the BBC also expressed a concern that, if the increase in SVoD revenues were lower than the loss of revenues from linear broadcast, the result could be a reduction in investment and innovation in movies, to the detriment of consumers<sup>182</sup>.
- 6.63 Similarly, [X] said that the limited exploitation of SVoD services would increasingly be an issue as digital services and consumer demand continue to evolve. It said that lack of access to key premium content restricts the development of new and innovative services and players across the full range of platforms, including cable, DTT and non-Sky digital satellite. In its view, the growth of SVoD services from existing IPTV players has been limited by lack of access to premium content

---

<sup>177</sup> Paragraph 6.210 of our Pay TV Statement contained Annex 7.

<sup>178</sup> Paragraph 6.194 of our Pay TV Statement contained in Annex 7.

<sup>179</sup> BT's response to the Consultation, paragraphs 2.17.

<sup>180</sup> BT's response to the Consultation, paragraph 4.15.

<sup>181</sup> Virgin Media's response to the Consultation, paragraph 5.18.

<sup>182</sup> BBC's response to the Consultation, page 3.

including the first pay TV SVoD window. Absent intervention, it added, it is likely that the future emergence of new services will be restricted<sup>183</sup>.

- 6.64 Both BT and Virgin Media highlighted the importance of pay TV subscriptions and high-value video content on demand for investment in superfast broadband<sup>184</sup>. BT said that pay TV is the primary source of additional revenue per user necessary to pay for such infrastructure investments. Without access to the right content to allow such investment to be recouped, in BT's view the investment case in superfast broadband would be substantially undermined. Moreover, Virgin Media [ X ].
- 6.65 In contrast, Sky argued that Ofcom had ample evidence that the UK audiovisual sector is delivering considerable innovation. It said that the UK is one of the leading European countries in terms of the development and penetration of innovative products and services, including a large number of VoD services<sup>185</sup>. It highlighted strong innovation on pricing and packaging of pay TV services as a positive outcome for UK consumers<sup>186</sup>.
- 6.66 Sky also argued that the difficulty of predicting future innovation should engender much more caution on Ofcom's part, particularly since it recognised that "the record of innovation in the UK was strong and Sky had played a central role in developing innovative services<sup>187</sup>.
- 6.67 Sky argued that Ofcom's view about the need for regulatory intervention was being clouded by its unduly narrow views about the importance of SVoD movies in the first pay TV window. As a result, Ofcom was disregarding its own counsel that regulatory intervention itself could stifle innovation<sup>188</sup>.
- 6.68 Finally, [ X ] argued that if the SVoD rights are so important for investment in superfast broadband networks, then the value of these rights on that platform should exceed their value on any other platform. A broadband operator might then be expected to win the rights even if bundled with linear movie rights, especially as SVoD services are to increase in importance relative to linear channels in the future<sup>189</sup>.

### Ofcom's views

- 6.69 We recognise the BBC's concern that a loss of revenues from linear broadcasting, if not outweighed by new SVoD revenues, could have an impact on incentives to invest and innovate in relation to upstream content. The possible impact of any remedy on the prices of movie rights and studios' incentives will be a point which the CC may wish to consider.
- 6.70 As regards Sky's points, we are concerned that Sky's exploitation of its market power is holding back innovation by other companies<sup>190</sup>. We agree with Sky that this does not mean innovation on other platforms is unlikely to happen in an absolute sense. However, we consider that the lack of access to premium movie content, which is a

<sup>183</sup> [ X ].

<sup>184</sup> BT's response to the Consultation, paragraphs 2.14-2.17. Virgin Media's response to the Consultation, paragraph 5.27.

<sup>185</sup> Sky's response to the Consultation, paragraph 2.1.

<sup>186</sup> Sky's response to the Consultation, paragraph 2.1.

<sup>187</sup> Sky's response to the Consultation, paragraph 4.16.

<sup>188</sup> Sky's response to the Consultation, paragraph 4.18.

<sup>189</sup> [ X ].

<sup>190</sup> Paragraph 1.6 of the Pay TV Statement contained in Annex 7.

key driver of demand for pay TV services, is a material restriction on the scope for innovation by other providers.

- 6.71 We recognise the risk that regulatory intervention may reduce investment and innovation. However, we consider it likely that the potential benefits outweigh the risks. We are concerned that in the absence of intervention, the restricted supply of Core Premium Movies content will continue to prevent, restrict and distort innovation indefinitely. The basis of our view of the importance of SVoD delivery of premium movies is discussed in Annex 5.
- 6.72 As regards [ X ]'s argument, we consider it quite possible that the value of the SVoD rights to a broadband operator could be high (because of their importance for investment in infrastructure), but not as high as the value of exclusivity to Sky (reflected in the exclusivity premium it pays the studios, and its own rents from this exclusivity). If this is so, then the bidding outcome is inefficient – the rights go to a bidder whose valuation is based on monopoly rents, rather than one whose valuation relates to investment opportunities.
- 6.73 We have seen the current business models persist for some time. We therefore have no evidence to suggest that the current position will change.
- 6.74 Further detail of our reasoning is set out in Annex 5 paragraphs A5.33 to A5.40.

### Effect on consumers: prices

#### Respondents' views

- 6.75 Virgin Media agreed that Sky has achieved persistent and significant profits in excess of its cost of capital, and endorsed Ofcom's conclusion from this evidence that the prices of packages including Sky's Core Premium Movies channels are above the competitive level<sup>191</sup>.
- 6.76 Orange agreed with Ofcom's view that Sky's control over premium movie content makes it difficult for rivals to offer attractive alternatives, with the result that consumers face higher retail prices for packages including premium content<sup>192</sup>.
- 6.77 Sky said that retail prices for pay TV services are not out of line with prices of pay TV providers in other European countries, on a like-for-like basis, and that pay TV services including Sky's movies channels have been increasing in quality while not significantly increasing in price in real terms<sup>193</sup>.

#### Ofcom's views

- 6.78 In our view, the price comparisons between the UK and other countries which Sky cites do not provide a reliable basis for concluding that UK prices are competitive. This is due in particular to (a) considerable differences in the content and services offered between countries, meaning that any "like-for-like comparison" entails a degree of subjective judgement, (b) differences in costs of provision (even for similar content/services) between countries, and (c) uncertainty as to whether other markets are sufficiently competitive to provide a benchmark against which competition in the UK can be measured.

---

<sup>191</sup> Virgin Media response to the Consultation, paragraph, 5.25.

<sup>192</sup> Orange's response to the Consultation, page 7.

<sup>193</sup> Sky's response to the Consultation, paragraph 2.1.

- 6.79 Sky’s argument that pay TV prices have not been increasing does not rule out the possibility that they have persistently been above competitive levels. We would expect a supplier with market power to set a profit-maximising price, and then keep it constant or adjust it in response to changing cost or demand conditions, rather than to increase it continuously. As such, we do not accept that a lack of real price increases is evidence that prices are not above competitive levels.
- 6.80 Further detail of our reasoning is set out in Annex 5 paragraphs A5.41 to A5.43. We conclude that Sky is able to charge high wholesale prices for premium movies channels, which are reflected in high retail prices to consumers. If other operators could access SVoD or linear movies rights, we would expect them to compete down the price of premium movies.

### **S131 EA02 test**

- 6.81 The Consultation asked whether the threshold for making a market investigation reference to the CC was met.

### **Respondents’ views**

- 6.82 A number of respondents considered that Ofcom has sufficient grounds to refer the identified markets to the CC<sup>194</sup>. BT added that the “reasonable grounds” threshold is recognised as being a low hurdle, reflecting Ofcom’s role as the first phase investigator in this process<sup>195</sup>.
- 6.83 [ X ] argued that Ofcom did not engage with the Major Hollywood Studios sufficiently to establish a reasonable suspicion of adverse effects on competition. As a result Ofcom did not meet the “reasonable grounds” threshold. [ X ] said that our investigation of the upstream market did not establish that there is a competition problem.
- 6.84 Warner said that Ofcom did not reach the threshold for a reference to the CC. It said that the key drivers behind Ofcom’s proposals, that is, its findings on the appropriate markets for reference, and identification of market features, were flawed and not supported empirically. Accordingly, it said the consultation document failed to disclose the requisite reasonable grounds for suspecting competitive distortion<sup>196</sup>.
- 6.85 [ X ] said that the consultation paper did not disclose reasonable grounds for suspecting that there was a relevant market for upstream sale of movie rights as defined by Ofcom, or that any features of that market prevented, restricted or distorted competition.

### **Ofcom’s views**

- 6.86 [ X ] provided little by way of evidence or reasoning. Although we invited it to make fuller submissions, it declined to do so.
- 6.87 The purpose of this consultation was to engage with stakeholders including the Major Hollywood Studios. We have communicated with all of these studios over the course

<sup>194</sup> TUTV’s response to the Consultation; BT response to the Consultation, paragraph, 5.2; Virgin Media response to the Consultation, paragraph 9; [ X ]; Orange response to the Consultation, page 8.

<sup>195</sup> BTs’ response to the Consultation, see also Orange response to the Consultation, page 8.

<sup>196</sup> Warner’s response to the Consultation, paragraph, 3.5.

of the Consultation, and most of them have submitted their views on the features of the market, effects on competition, and other issues which we raised in the consultation. We also note that Ofcom contacted stakeholders in advance of the Consultation being published, and also that many of the issues raised in the Consultation had previously been raised, and discussed with relevant stakeholders, in the course of our Pay TV investigation.

- 6.88 We therefore do not accept that we have not engaged with the Major Hollywood studios on the features of the market.
- 6.89 We disagree with [ X ] and Warner on the adequacy of the grounds we set out in our Consultation for our reasonable suspicion that the combination of the features of these two closely related markets prevents, restricts or distorts competition. We consider that our analysis sets out sufficiently our reasoning as to why we consider that the threshold is met.

## Conclusion

- 6.90 As discussed in Section 2, in order to make a market investigation reference to the CC under s131 EA02, Ofcom must have reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.
- 6.91 In the course of our analysis set out in in this section and Annex 5, we have assessed a wide range of evidence and considered the impact of the combination of the features identified. Having given careful consideration to the responses to the Consultation, we conclude that there are reasonable grounds for suspecting that the combination of the features of the markets we identify prevents, restricts or distorts competition in connection with the supply and acquisition of movie rights from the Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels. We suspect that the combination of features has created a situation in which Sky is enabled and incentivised to prevent, restrict and distort competition in connection with the supply or acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels.
- 6.92 The restrictions in contracts which we mentioned as a separate feature contribute to our competition concerns. However, even if these terms were absent from the contracts, this in itself would not adequately address our competition concerns, because the exploitation of movies rights in the first pay TV window, and competition in the wholesale market, would continue to be restricted by the combination of the other features we have identified.
- 6.93 We therefore consider that the section 131 (EA02) test is met.

## Section 7

# Discretion to make a market reference

## Introduction

- 7.1 In the previous Sections we conclude that there are reasonable grounds to suspect that the combination of the features identified prevents, restricts or distorts competition. In cases where the section 131 EA02 test has been met, we have discretion to decide whether to make a market investigation reference to the CC.
- 7.2 In this Section, we assess the views of respondents on whether we should exercise our discretion before setting out our decision to refer the two closely related markets to the CC on the terms set out in Annex 1.
- 7.3 Additional detail of our analysis on exercising our discretion to make a reference is contained in Annex 6.

## Consultation on market reference

- 7.4 In the Consultation, we set out the OFT's Guidance that outlines four criteria to consider when making a reference<sup>197</sup>, namely:
- the suitability or otherwise of using our CA98 or other sectoral powers;
  - whether the problem could be addressed through undertakings;
  - proportionality and whether the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response; and
  - whether there is a reasonable chance that appropriate remedies will be available.

## Application of CA98 or Article 101/102 and alternative powers

- 7.5 In the Consultation, we considered whether the competition issues we identified may involve an infringement of CA98 and recognised that it may be possible to define some aspects of these concerns as potential infringements of CA98. However, we did not consider that one or more CA98 investigations would be appropriate to address our concerns.
- 7.6 We also explained why we do not believe that it is appropriate for us to use sectoral powers. We did not think it appropriate to include Core Premium Movies channels in a wholesale must-offer remedy, given that the importance of linear movies channels appears to be gradually declining over time and our powers under section 316 CA03 do not adequately extend to SVoD services.
- 7.7 Overall, we considered that it would not be more appropriate to address the concerns under either our CA98 or our sectoral powers.

---

<sup>197</sup> The OFT's Guidance, paragraph 2.1.



## **Undertakings in lieu of a market reference**

7.8 Ofcom has the power under section 154 EA02 to accept undertakings instead of making a reference to the CC. We considered that due to the complex interrelationship between several features of the markets identified and the practical difficulties of negotiating with several different parties, we were not in a position to assess whether particular undertakings would effectively address the problems identified. Nonetheless, we said that we would consider any proposals for undertakings that were offered by parties in response to the Consultation.

## **Proportionality**

7.9 In line with the OFT's Guidance, we considered whether the suspected adverse effects of the combination of the features identified are likely to have a significant detrimental effect on customers through higher prices, lower quality, less choice or less innovation. In line with the OFT Guidance we considered three factors which were relevant to determine whether a market reference was proportionate:

- the size of the market. We set out why we considered this a substantial market both in terms of the sums paid for content rights and in terms of the revenues from pay TV premium services;
- the proportion of the market affected by the feature giving rise to adverse effects on competition. We considered that a significant proportion of the markets we identified is affected by the combination of the features that we believe prevents, restricts or distorts competition. In particular a lack of SVoD content and wholesale access to Core Premium Movies channels inhibits the range and variety of packages on offer to consumers; and
- the persistence of the feature giving rise to adverse effects on competition. We considered that the nine features of the market we identified were likely to persist.

7.10 We considered that a market reference was a proportionate response given the persistence of the features identified, the scale of the sector affected and the detrimental effects of the adverse competition conditions.

## **Availability of remedies**

7.11 In accordance with the OFT's Guidance, we recognised that Ofcom should take into account the likely availability of appropriate remedies in the event that the suspected adverse effects on competition were found by the CC to exist. We briefly outlined, at a high level, the availability of appropriate remedies. We did not set out a detailed analysis of the remedies, since that would be for the CC to assess once it had concluded its view of the competition concerns. We set out two broad approaches:

- the CC could seek to change the way in which key premium movie rights are bought and sold. Such intervention may involve restrictions on the ability of firms to aggregate different types of rights or requirements to make the sale process more contestable; and
- the CC could intervene to reduce Sky's ability to act on incentives to exploit market power, by requiring it to provide wholesale access to linear and SVoD premium movie content on regulated terms.

- 7.12 We considered that there was a reasonable prospect that the CC would have appropriate remedies open to it to address competition concerns in these markets.

## Conclusion

- 7.13 We consulted on the view that we should exercise our discretion to refer two markets to the CC under section 131 EA02 for investigation. We considered that the scale of the problems and their adverse effects on competition more than justified a reference and we considered that the CC would have appropriate remedies available to it.

## The appropriateness of a reference

### Support for our approach

- 7.14 BT, TUTV and Virgin Media argued that a reference should be made without delay<sup>198</sup>. Virgin Media said there could be no suggestion, by Sky or any other party, that any reference to the CC should be delayed until the outcome of any appeal of the Pay TV Statement<sup>199</sup>. It said that (a) a reference to CC would be made pursuant to different powers and on the basis of different tests; (b) proceeding with a reference at this stage would not deprive Sky of its rights of defence, and (c) further delay would cause the consumer detriment identified by Ofcom to persist.
- 7.15 TUTV and BT pointed out that it has been more than three years since Ofcom began its pay TV investigation. BT added that it may take up to two years for the CC to reach its conclusions<sup>200</sup>.
- 7.16 TUTV and Virgin Media said that our pay TV investigation revealed ample evidence of continuing consumer detriment. They feared that any further delay could perpetuate the features of the market which were preventing, restricting or distorting competition<sup>201</sup>.
- 7.17 Orange also supported a market investigation reference to the CC without delay, in view of i) the complexity of the failings in the pay TV sector in the UK, ii) the long history of problems surrounding Sky's dominance; and iii) the complexity of determining the appropriate charging methodology<sup>202</sup>.

### Areas of disagreement with our approach

- 7.18 In contrast, Sky and Warner argued that Ofcom should not propose a reference to the CC when Sky and other parties have appealed against Ofcom's Pay TV decision in respect of Sky's sports channels<sup>203</sup>. In particular, in Sky's view:
- Ofcom's findings in the Consultation rely heavily on the evidence and findings set out in the Pay TV Statement, and there is an overlap between the three competition issues identified by Ofcom and matters under appeal; and

<sup>198</sup> BT's response to the Consultation, paragraph 1.4; TUTV's response to the Consultation, page 2; Virgin Media's response to the Consultation, paragraph 1.4.

<sup>199</sup> Virgin Media's response to the Consultation, paragraph 9.4 to 9.5.

<sup>200</sup> BT's response to the Consultation, paragraph 5.8.

<sup>201</sup> TUTV's response to the Consultation, page 2; Virgin Media response to the Consultation, paragraph 1.4.

<sup>202</sup> Orange's response to the Consultation, page 3.

<sup>203</sup> Sky's response to the Consultation, paragraphs 5.1. – 5.5. Warner's response to the Consultation, paragraphs 4.14-4.16.

- the CAT’s judgement on the Appeal will contain reasoning which will be of relevance to the movies sector. For example, the CAT’s findings in relation to Virgin Media’s view that Ofcom failed to impose any price control on wholesale prices for Sky Sports 1 and/or 2 when bundled with the Sky Movies channels is likely to involve consideration of evidence relating to Sky’s Movies channels.
- 7.19 Sky and Warner were concerned that separate consideration by the CAT and the CC of the same issues would lead to potentially inconsistent decisions, and be a waste of private and public resources. Sky added that Ofcom should exercise its discretion not to refer and it could always reconsider the appropriateness of the reference after the appeals are determined<sup>204</sup>. Sky noted that it would be unfair for Ofcom to base any decision on findings which are already under challenge before the Tribunal, as the outcome of the Appeal could be such that the CC is left with a wholly inappropriate reference<sup>205</sup>.
- 7.20 Sky was also concerned that the OFT’s Guidance states that the OFT “will not attempt to make more than a preliminary analysis...it will be for the CC to produce a definitive analysis if a reference is made”. Sky said this was “presumably for fear of the referring regulator’s developed views inadvertently or unduly influencing the direction of the CC’s subsequent investigation”. Sky said that after a three years investigation, most of the views expressed in the Consultation are based on a definitive view in our Pay TV Statement rather than preliminary analysis<sup>206</sup>.
- 7.21 Sky said that gaming had occurred in negotiations between itself and other pay TV platforms over the last few years. It said that if a reference is made to the CC, there is a risk of regulatory gaming by other platforms in their negotiations with Sky over the supply of movie rights because of the climate of regulatory uncertainty. To eliminate this risk, a fairer and more efficient outcome in Sky’s view would be to consider a reference only after final determination of the Appeal. In Sky’s view, any inconveniences caused by a delay would be outweighed by the inefficiencies, the unfairness of having a reference and Appeal running concurrently and the distinct possibility that the outcome of the Appeal would intensify the inappropriateness of any reference<sup>207</sup>.
- 7.22 Finally, Sky, Warner and [ X ] criticised our approach as emanating from our desire to dictate market outcomes:
- Sky criticised paragraphs 7.45 and 7.49 in the Consultation for assuming that Ofcom is able to use a CC reference as a means of shaping the development of the market in the way Ofcom would like. In Sky’s view, section 3(1)(b) of the Communications Act does not give Ofcom powers to seek to shape markets in pursuit of what it considers to be desirable policy objectives, and it is inappropriate for Ofcom to influence the direction of the CC’s investigation<sup>208</sup>.
  - Similarly, in Warner’s view it would be clearly inappropriate for the market investigation process to be used to further the policy objective of broadband take-up, for instance, by requiring content producers to license SVoD rights to

---

<sup>204</sup> Sky’s response to the Consultation, paragraph 5.7.

<sup>205</sup> Sky’s response to the Consultation, paragraph 5.8-5.9.

<sup>206</sup> Sky’s response to the Consultation, paragraph 5.10.

<sup>207</sup> Sky’s response to the Consultation, paragraphs 5.11-5.12.

<sup>208</sup> Sky’s response to the Consultation, paragraphs 5.15-5.19.

broadband providers. Warner said that it would be troubled if this wider policy agenda were to influence Ofcom's decision in any way<sup>209</sup>.

- [ X ] criticised Ofcom's approach for being entirely distorted by our desire to dictate market outcomes. In [ X ]'s view, Ofcom appears to believe that consumers are being harmed simply because Sky is offering services which are different from those that Ofcom would like to see, because a licensee other than Sky would be more likely to invest in super high speed broadband networks and because Ofcom would prefer there to be a wholesale competitor to Sky<sup>210</sup>.

## Ofcom's views

- 7.23 The Pay TV Statement appeals relate to Ofcom's decision in relation to Sky Sports 1 and 2 and do not directly relate to premium movies. Delay now will perpetuate consumer detriment for the duration of the appeals and may have longer-term consequences in circumstances where Sky is the only player able to take advantage of a window of opportunity in relation to SVoD. We therefore do not consider that the appeals mean that a reference to the CC is an inappropriate exercise of our discretion. Nor do we accept that there is any unfairness in the processes running simultaneously. While we are aware of the resource costs of a CC investigation, we consider that there is likely to be a significant detrimental effect on consumers from the combination of the features we have identified, such that a reference is appropriate.
- 7.24 Sky did not offer any basis for its presumption that the quoted phrase from the OFT Guidance was intended to prevent the regulator's developed views influencing the CC's investigation. A more obvious reason for the OFT to limit itself to a preliminary analysis is to prevent duplication of effort between OFT and the CC. We do not consider that the inclusion of our analysis in the Pay TV Statement will prevent the CC from forming its own view, or unduly influence that view.
- 7.25 Based on our review of documents relating to negotiations for Core Premium Channels, our Pay TV Statement concluded that the lack of wholesale supply of Core Premium channels in recent years could not be attributed to regulatory gaming by third parties<sup>211</sup>. We recognise that any investigation by a regulatory authority could potentially create a risk of gaming, and that where more than one level of the supply chain is investigated the opportunities for such gaming may be increased. However, Sky's proposed approach of delaying consideration of a reference appears as likely to prolong as to shorten the period of industry uncertainty. In any event, we see no basis for a view that the risk of regulatory gaming is so great, or that such gaming would be so damaging to the industry, that a reference should not be made.
- 7.26 Our concerns are not, as Sky, Warner and [ X ] suggests, based on a specific view of how content should be delivered or priced. We are concerned that the combination of the features we have identified creates a situation in which Sky is enabled and incentivised to prevent, restrict and distort competition in the wholesale supply of premium subscription movie services<sup>212</sup>. Whilst at present most of this supply takes the form of linear channels, broadcasters have argued that SVoD services will become an increasingly important way of delivering this content in the future. This

<sup>209</sup> Warner's response to the Consultation, paragraph 4.13.

<sup>210</sup> [ X ].

<sup>211</sup> Paragraph 7.147 contained in Annex 7.

<sup>212</sup> Paragraph 1.7 of the Consultation.

view is evidenced by the intrinsic advantages of SVoD over linear channels, and the fact that a number of broadcasters are currently developing SVoD services.

- 7.27 As set out in Section 6, we are of the view that there is scope for premium movie content over SVoD to be a key driver of demand for superfast broadband. However, our main concern in making this reference is that if the features of the markets we have identified persist, competition in the supply of this content over linear and SVoD services will continue to be restricted, not the development of broadband.

## Application of CA98 or Article 101/102 and alternative powers

### Respondents' views

- 7.28 BT, [X] and [X] agreed with Ofcom's position that it would not be more appropriate to address concerns using CA98 or sectoral powers<sup>213</sup>. [X] went on to say that it was the CC alone who has the powers to enable meaningful competition<sup>214</sup>. The BBC was of the view that Ofcom's sectoral powers are insufficient to address all the issues identified<sup>215</sup>. BT said that the prohibitions contained in the CA98 do not provide appropriate tools to deal with a situation where there are inter-related competition concerns at multiple different levels of the supply chain<sup>216</sup>.
- 7.29 Warner considered that Ofcom's concerns were focused on single firm conduct at the downstream distribution level and that powers under CA98 would be more appropriate to investigate these concerns. In its view, Ofcom dismissed the possibility of a CA98 investigation in an unconvincing manner, and that CA98 powers would be less invasive in terms of impact on the sector and targeted at actual infringing behaviour if established to the requisite standard<sup>217</sup>.

### Ofcom's views

- 7.30 Ofcom's concerns are not focused on single firm conduct at the downstream distribution level. We recognise that it may be possible to define some aspects of the concerns we have identified as potential infringements of CA98. However, we consider it doubtful that one or more CA98 investigations would be appropriate to address these as:
- a CA98 investigation is concerned with behaviour that has occurred in the past and would not address the specific competition concerns that we have identified as likely to develop in the future;
  - we are concerned about the consequences of a combination of features, some of which may not raise competition concerns if considered in isolation and some of which are unrelated to the conduct of a particular person, but which are likely to have a significant detrimental impact on competition when considered together. A CA98 investigation which targeted one issue might therefore not be able to address an underlying cause of the competition concern; and

---

<sup>213</sup> BT's response to the Consultation, paragraph, 5.4-5.9; [X]; [X].

<sup>214</sup> [X].

<sup>215</sup> BBC's response to the Consultation, page 3.

<sup>216</sup> BT's response to the Consultation, paragraph, 5.5.

<sup>217</sup> Warner's response to the Consultation, paragraph, 4.17-4.19.

- we have also identified a variety of effects on competition. A CA98 investigation is geared to address specific conduct or issues and any remedies aimed at addressing the infringement identified would be likely, in our view, to be inadequate to deal with the set of industry-wide competition issues we have identified.

## Undertakings in lieu

### Respondents' views

- 7.31 We received no proposals for undertakings by any party; nor did any party seek to discuss the possibility.
- 7.32 Warner said that due to redactions, in particular in terms of the description of the “Other restrictions” feature, it was “very difficult for interested parties to consider whether it might be appropriate to offer undertakings in lieu of a reference, notwithstanding that Ofcom purports to be open to such proposals”<sup>218</sup>.

### Ofcom's views

- 7.33 In response to Warner's comment, the information was redacted because it would inform the studios of each other's negotiating position in relation to particular aspects of the sale of movie rights and we remain of the view that it would be inappropriate to disclose it. As set out in Section 5 and Section 6, we believe that the other features we have identified are sufficient to justify a reference. It follows that undertakings in lieu relating to this feature would be insufficient to remove our concerns.

## Proportionality of the reference

### Ofcom's general approach to proportionality - respondents' views

- 7.34 [X], Orange, BT, [X], TUTV, BBC and [X] expressed their support for Ofcom's proposal to make a reference to the CC. TUTV was of the view that the longer the current market features and Sky's conduct are allowed to persist, the greater the detriment suffered by consumers<sup>219</sup>. The BBC said that Ofcom's market analysis as set out in its various consultation documents during its pay TV investigation demonstrated the size of the markets identified and the potential benefits of increased competition<sup>220</sup>. Orange said that only the CC had sufficient resources and the power to fully investigate the problems in the UK TV market and design a suitable wholesale remedy by May 2011<sup>221</sup>.
- 7.35 Warner argued that Ofcom should not exercise its discretion to make a reference because the prolonged period of uncertainty and disruption it would cause would itself affect competition. A reference would be premature and disproportionate, and would run a high risk of dampening competition and impacting incentives to invest and innovate throughout the supply chain<sup>222</sup>.
- 7.36 [X] did not believe that Ofcom presented a reasonable case supporting its proposal to refer and therefore should not make the reference. [X] doubted that

<sup>218</sup> Warner's response to the Consultation, paragraph, 3.12.5.

<sup>219</sup> TUTV's response to the Consultation, page 2.

<sup>220</sup> BBC's response to the Consultation, page 3.

<sup>221</sup> Orange's response to The Consultation, pages 3-4.

<sup>222</sup> Warner's response to the Consultation, paragraphs 4.1- 4.6.

there was any public interest in an expensive, drawn out market investigation following on from three years of scrutiny and was concerned with the cost to the taxpayer of a reference, which could be at least £5 million<sup>223</sup>.

- 7.37 [X] argued that the reference would impose on [X] a significant burden in terms of both time and cost [X] also said that it was a disproportionate exercise of Ofcom's discretion pursuant to section 131(1) of the Enterprise Act 2002 to make a separate reference to the CC of the upstream rights market, distinct from the referral of the wholesale market that is the subject-matter of Ofcom's concerns<sup>224</sup>.
- 7.38 Sky argued that the magnitude of the harm that Ofcom is targeting is insufficient to justify the intrusive and burdensome intervention<sup>225</sup>. Sky noted that a market investigation is a material burden to industry and public resources.

### **Ofcom's general approach to proportionality - Ofcom's views**

- 7.39 In relation to Warner's comments, we recognise that during the CC investigation there could be a period of uncertainty which may have an impact on the development of SVoD services by Sky and the studios. However, we consider that the overall benefits to consumers arising from appropriate remedies that ensure that Sky is not the only player to develop these services will outweigh any risks associated with the process.
- 7.40 With regard to [X], [X] and Sky's views, a CC investigation clearly incurs significant costs, both for the taxpayer and for companies concerned. However, the markets affected by this reference are highly significant in revenue terms, as set out in more detail in Annex 6. Features of the market which adversely affect competition are likely to have a correspondingly large negative impact on consumer welfare. In particular, given the popularity of pay TV and of movies content, any remedies which deliver more innovative pay TV services to consumers, or make premium movie content more widely available, or available at more competitive prices, are likely to have a considerable positive impact on consumer welfare. Therefore we consider that the potential benefits arising from remedying the competition issues identified considerably outweigh the costs of an investigation.
- 7.41 In relation to [X]'s final comment, we consider that the combination of the features we have identified may be seen equally as features of the movie rights market and of the wholesale market for packages containing Core Premium Movies channels, while the adverse effects on competition are felt throughout the supply chain. It is important that the CC have the opportunity to consider the supply chain as a whole.

### **The size of the sector and the proportion of the market affected – respondents' views**

- 7.42 Sky believed that Ofcom's assessment of proportionality was flawed. It said that Ofcom judged the size of the market by reference to the pay TV market, the amount paid by Sky for premium movies content and Sky's retail and wholesale revenues from its Core Premium Movies channels. This, in Sky's view, is inconsistent with our

---

<sup>223</sup> [X].

<sup>224</sup> [X].

<sup>225</sup> Sky's response to the Consultation, paragraph 2.7.

statement that our “key concern” is around SVoD movies in the first pay TV window, which is much narrower<sup>226</sup>.

### **The size of the sector and the proportion of the market affected - Ofcom’s views**

7.43 Ofcom has identified markets relating to movie rights from Major Hollywood Studios in the first pay TV subscription window and wholesale supply of wholesale packages containing Core Premium Movies channels. These markets are clearly not limited to SVoD movies. Sky’s challenges to our position on the size of the market and how much of it is affected omit any consideration of the issues we have identified in relation to the wholesale and retail premium movies pay TV markets generally (which currently principally comprise the linear channels) or the movie rights market. We consider that we have taken into account the broader market structure as set out in Annex 2. However, it will be for the CC to give further consideration to this taking into account all relevant evidence.

### **The persistence of features giving rise to adverse competition effects - respondents’ views**

7.44 Warner referred to the OFT Guidance on “the “*persistence*” of the feature(s) giving rise to adverse effects on competition as a key factor to be taken into account when considering whether it is appropriate to make a market investigation reference”. It argued that it would be inappropriate for Ofcom to refer a clearly dynamic sector where it has failed to provide strong and convincing evidence of ongoing problematic features that are likely to persist. In particular, it said that due to the dynamic nature of the sector it would be disproportionate to make a reference in order to address distortions that (if they exist at all) are likely to self-correct without the need for regulatory intervention<sup>227</sup>.

7.45 Similarly, Sky believed the reference was disproportionate. It argued that Ofcom’s assessment on proportionality was flawed because the sector is still developing and therefore assumptions of persistence cannot be made. Sky considered that our assessment that the alleged problems are persistent is incorrect as it ignores the fast-moving nature of the market<sup>228</sup>.

### **The persistence of features giving rise to adverse competition effects - Ofcom’s views**

7.46 Whilst SVoD is a relatively new concept, the combination of the features that we have identified relate more generally to the first pay TV subscription window. Almost all of the features which we have identified, including the release windows structure, staggered availability of content rights, aggregation of rights, Sky’s market power, and vertical integration, have already persisted for many years and we have no expectation that these will change in the absence of intervention.

7.47 In relation to certain features that relate specifically to SVoD, particularly the joint licensing of premium linear channels and SVoD rights by individual studios, we note that no studio has chosen to separate these rights to date. Indeed, as noted in Annex 6 and below in relation to remedies, [ X ]. Therefore, we have no basis for expecting that studios will separate linear and SVoD rights in the foreseeable future.

<sup>226</sup> Sky’s response to the Consultation, paragraph 5.13.

<sup>227</sup> Warner’s response to the Consultation, paragraphs 4.3, 4.7 and 4.9.

<sup>228</sup> Sky’s response to the Consultation, paragraph 5.13.



## Detrimental effects on consumers – respondents’ views

7.48 Sky believed that Ofcom had drawn the wrong conclusions in relation to consumer detriment. It said that we had underestimated the benefits to consumers and overstated any detriment, relying on erroneous conclusions and unsubstantiated arguments<sup>229</sup>.

## Detrimental effects on consumers - Ofcom’s views

7.49 Our analysis on consumer detriment is set out in paragraphs A5.23-A5.43 of Annex 5 and A6.31-A6.32 of Annex 6. We recognise that the pay TV sector has delivered substantial benefits to consumers, both through investment in high-quality content and through innovative services, many of which have been introduced by Sky. However, we remain concerned that the current restricted distribution of key content and services has a detrimental effect on consumers, in terms of innovation, choice and pricing and believe that it is competition that will deliver these consumer benefits.

## Remedies

### Support for our approach - respondents’ views

7.50 A number of respondents agreed with Ofcom's analysis on remedies:

- Virgin Media agreed that the CC would have appropriate remedies open to it to address the competition concerns identified by Ofcom<sup>230</sup>.
- [ X ] believed that a suitable remedy would be to require Sky to wholesale its movie channels and SVoD rights on a regulated basis<sup>231</sup>.
- [ X ] believed that making SVoD rights available separately from linear subscription rights would be valuable in driving innovation and uptake of new digital services. It agreed that this could in turn act as a constraint on wholesale movie prices<sup>232</sup>.
- [ X ] said it would like to be able to compete for the purchase of premium movie SVoD rights within the Pay TV window<sup>233</sup>.

7.51 BT accepted Ofcom’s view that a linear channel WMO remedy would not by itself be an effective solution to all of the various competition concerns identified, as it would not address the development of competing SVoD services<sup>234</sup>. In BT’s view, it is likely that the CC may need to impose remedies targeted at both the upstream and downstream markets, at least in the short to medium term<sup>235</sup>. It also noted that remedies such as operational or structural separation should not be ruled out at this point, emphasising that it would be inappropriate unilaterally to rule out any potential remedies<sup>236</sup>.

---

<sup>229</sup> Sky’s response to the Consultation, paragraph 5.13.

<sup>230</sup> Virgin Media’s response to the Consultation, paragraph 9.4.

<sup>231</sup> [ X ].

<sup>232</sup> [ X ].

<sup>233</sup> [ X ].

<sup>234</sup> BT’s response to the Consultation, paragraph, 5.8.

<sup>235</sup> BT’s response to the Consultation, paragraph, 5.19.

<sup>236</sup> BT’s response to the Consultation, paragraph, 5.22.

7.52 Orange argued in favour of a WMO remedy allowing access to Sky’s linear and SVoD premium content on regulated terms. The WMO remedy should be available across all platforms (including DTT, IPTV and satellite) in order to enable other operators to develop pay TV offers that can genuinely compete with Sky<sup>237</sup>. As regards the way in which movie rights are sold, in Orange’s view a requirement to make premium movie SVoD rights available separately from linear rights may be sensible, as there would be price competition between linear and SVoD<sup>238</sup>.

### Areas of disagreement- respondents’ views

7.53 BT argued that limiting exclusivity and rights aggregation could adversely affect other pay TV operators, as absent market power, these features can give significant consumer benefits<sup>239</sup>.

7.54 The BBC pointed out that there is a trade-off for studios between increased SVoD revenue and the value the studios receive from the sale of broadcasting rights. It said the value of movie rights to a broadcaster depends largely on the degree of exclusivity available to it; the more exclusivity in its window the higher a VoD retailers’ willingness to pay (other things being equal). Therefore, increased SVoD availability may reduce the value of broadcast rights, which in turn could reduce investment and innovation in movies to the detriment of consumers<sup>240</sup>.

7.55 [ X ] expressed its surprise by the intrusive nature of the remedies proposed by Ofcom in circumstances where there is no suggestion that (a) a movie studio enjoys market power so as to be subject to the special responsibility on dominant firms under Chapter II of the CA98, or that (b) a movie studio has contravened the Chapter I prohibition by agreeing to an exclusive license of its content rights<sup>241</sup>.

7.56 [ X ] said that regulatory intervention had the potential to create unanticipated distortions in markets and have negative consequences for innovation and investment in the UK. In its view, any compulsory split of SVoD and linear rights would [ X ]. [ X ] criticised the Consultation for not acknowledging this or grappling with the issues that it raises<sup>242</sup>.

7.57 [ X ] noted that it has serious doubts about the availability of appropriate remedies. In its view, the remedies outlined at paragraph 7.52 of the Consultation would interfere with the global pattern of sales (because rights to content are typically licensed in each territory on an exclusive basis), would mandate a specific structure of rights sales in the UK and not in other territories and would prevent a movie studio from disposing of its own intellectual property rights freely and in furtherance of its own economic interests. In particular<sup>243</sup>,

- a behavioural rule which requires (a) any one Major Hollywood Studio to sell its output in the first pay subscription TV window to more than one provider, or which (b) prevents any one Major Hollywood Studio from selling its SVoD rights in the first pay TV window on an exclusive basis, or which (c) prevents any one Major Hollywood Studio from joint selling linear and SVoD rights; would effectively

<sup>237</sup> Orange’s response to the Consultation, pages 4 and 8.

<sup>238</sup> Orange’s response to the Consultation, page 8.

<sup>239</sup> BT’s response to the Consultation, paragraph, 5.20.

<sup>240</sup> BBC’s response to the Consultation, page 3.

<sup>241</sup> [ X ].

<sup>242</sup> [ X ].

<sup>243</sup> [ X ].

outlaw the exclusive licensing of movie rights during the first pay TV window in the UK; and

- a behavioural rule which prevents any one wholesale provider from purchasing rights from more than two or three Major Hollywood Studios would create an artificial limit on the number of purchasers, as once one broadcaster has agreements with three studios it would not be able to bid for other output. Moreover, in [X]’s view this would be detrimental to consumers who would be denied the benefits of content aggregation, and could well disadvantage pay TV as compared with other means of content delivery and would be against principles of technological neutrality.

7.58 [X] warned that such interventions are more likely to have negative than positive consequences for innovation and market development. [X] also felt that Ofcom’s suggested remedies that interfere with property rights are not a proportionate response to a perceived downstream competition issue<sup>244</sup>.

7.59 Warner argued that the suggested possible remedies are over-interventionist. It further added that they represent an unwarranted interference with the commercial freedom and legitimate rights of content producers to exploit their intellectual property. Warner highlighted possible unintended consequences from imposing regulatory constraints:

- restricted content availability, as some providers might choose not to licence their content at all, potentially harming all parties concerned, including consumers;
- adverse effect on incentives to invest, given that the production of a movie cannot reasonably commence until the necessary financial backing has been secured and arrangements to distribute films are in place; and
- undermining the development of initiatives in relation to SVoD services, where Warner [X]. Recently, Warner Films has launched on BT Vision, which will include content to be screened after it has been licensed to Sky)<sup>245</sup>.

7.60 [X] was disappointed with the limited emphasis placed by Ofcom on the well-established role and value of the exclusivity in the film rights windowing process, and the significant drop in revenue that would occur if SVoD rights are sold separately<sup>246</sup>. It also argued that Ofcom failed to understand that these rights are only a part of a value chain that comprised multiple windows through which rights are exploited<sup>247</sup>.

7.61 [X] said that the competition concerns that Ofcom identified relate to the operation of the wholesale rights market, from which [X] is absent<sup>248</sup>. The Consultation did not suggest that the upstream rights market operated otherwise than competitively. The only apparent purpose of the proposed upstream reference is to make available to the CC the extended range of remedy options. [X] said that this purpose would not be achieved by the proposed upstream referral.

7.62 [X] and [X] doubted whether the CC would have the power to impose the types of remedies suggested by Ofcom due to Article 3.2 of Regulation 1/2003 (the

---

<sup>244</sup> [X].

<sup>245</sup> Warner’s response to the Consultation, paragraphs 4.10- 4.12.

<sup>246</sup> [X].

<sup>247</sup> [X].

<sup>248</sup> [X].

“Modernisation Regulation). This EC Regulation prevents the UK authorities from prohibiting agreements between undertakings that do not breach Article 101 of the EC Treaty (agreements between undertakings that prevent restrict or distort competition)<sup>249</sup>. [ X ] further argued that it would be a waste of public and private resources for Ofcom to make a reference only to find out that the matter must be remitted back to Ofcom for investigation under Article 101.

## Ofcom’s views

- 7.63 Ofcom has the role of a first stage investigator and as such needs to be satisfied that there is a reasonable chance that appropriate remedies will be available to the CC. Our Consultation did not set out a detailed analysis of the remedies, since that would be for the CC to assess once it has concluded its view of the competition concerns.
- 7.64 In relation to a number of comments on exclusivity, as noted above, we recognise that exclusivity can have positive effects, and as a result there is a potential cost to any remedy which removes exclusivity. We would only expect the CC to consider such a remedy if it was proportionate to the consumer harm identified, and if less interventionist remedies were not feasible.
- 7.65 As regards [ X ]’s view that there is no suggestion that it has contravened the CA98 and [ X ]’s view that we proposed to refer the upstream market in order to make available an extended range of remedy options, our view is that if the combination of the features which give rise to adverse competition effects principally concerns the upstream market, it is appropriate to refer that market even if many of the competition effects occur in a downstream market.
- 7.66 As to whether the CC would have the power to impose all the remedies suggested, the Modernisation Regulation does not restrict the CC’s powers to take action in relation to unilateral behaviour, nor to take action in relation to agreements which does not amount to a prohibition of those agreements (including through the acceptance of undertakings). We consider the detail of any remedy design to be a matter for the CC. We note by way of example that a remedy such as a WMO requirement may be sufficient to address the competition concerns and the availability of such a remedy is alone, in our view, sufficient for us to make the proposed reference.
- 7.67 The CC (unlike the OFT and Ofcom) does not have the power to prohibit agreements infringing Article 101. It may be that the CC might conclude that the situation cannot be addressed without determining whether any agreements infringe Article 101 and might recommend that the OFT or Ofcom open a CA98 investigation. We have set out above our reasons as to why we do not consider that a CA98 investigation would be appropriate to address the competition issues identified.

## The Terms of reference

### Respondent’s views

- 7.68 [ X ] considered that the terms of reference as currently drafted were unduly prescriptive<sup>250</sup> in terms of limiting the markets to the outputs of the Major Hollywood Studios in the first pay TV window and excluding movies over other media.

---

<sup>249</sup> [ X ].  
<sup>250</sup> [ X ].

- 7.69 Both Virgin Media and TUTV suggested including specific references to the retail market in the terms of reference.
- 7.70 While Sky did not consider that any reference should be made, it stated that should a reference be made it should not include specific references to the retail market, since the CC would be able to examine the state of competition at the retail level in order to assess competition upstream<sup>251</sup>.

### **Ofcom's views**

- 7.71 Ofcom has set out its market definition analysis in detail in Section 6 of the Pay TV Statement (contained in Annex 7) and section 4 and Annex 3 of this decision. We identified close, moderate and distant substitutes and concluded that in some cases movies over other media were moderate substitutes and could exert a degree of competitive constraint and that movies outside the first Pay TV window were distant substitutes and did not exert any appreciable constraint. Our terms of reference reflect our analysis of the relevant markets. However, the CC will need to conclude on its own market definitions to enable assessment of its competition concerns.
- 7.72 We have set out our views in relation to the need to explicitly refer to retail markets in Section 5. Our view is that the combination of the features we have identified is associated with the movie rights market and the wholesale pay TV market and is best understood from upstream. However, we consider that competition for retail goods and services is adversely affected by the identified features and that the scope of our reference to the CC is sufficient to ensure that it will be able to consider adverse effects on competition for these retail goods and services.

### **Conclusions**

- 7.73 As set out in Section 2, where the section 131 EA02 threshold has been met, Ofcom has discretion on whether to make a reference, having regard to the OFT's Guidance on market investigation references.
- 7.74 In Section 6, we set out our conclusion that the section 131 EA02 test has been met.
- 7.75 Having given careful consideration to the responses to the Consultation in respect of exercising our discretion and based on our analysis set out in Annex 6, we remain of the view that it is appropriate to exercise our discretion to refer two closely-related markets to the CC under section 131 EA02 for investigation on terms set out in Annex 1.

---

<sup>251</sup> Letter from Sky to Ofcom dated 22 July 2010.

## Annex 1

# Terms of the market investigation reference

Ofcom, in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act) hereby makes a reference to the Competition Commission for an investigation into the supply and acquisition of **Subscription Pay TV Movie Rights** and into the wholesale supply and acquisition of **packages including Core Premium Movies channels**.

Ofcom has reasonable grounds for suspecting that a combination of features of the market or markets in the UK in which the **Subscription Pay TV Movie Rights** and **packages including Core Premium Movies channels** are supplied and acquired prevents, restricts or distorts competition in connection with the supply of these rights and the supply of packages including Core Premium Movies channels in the UK.

4 August 2010

### Definitions

For the purposes of this reference:

**“Core Premium Movies channels”** means Sky Movies channels

**“Major Hollywood Studios”** means the members of the Motion Picture Association of America and their wholly owned or controlled subsidiaries.

**“Subscription Pay TV Movie Rights”** means the intellectual property rights licensed by the Major Hollywood Studios, which:

- i) permit the exhibition of movies on broadcast channels and/or Subscription Video on Demand Services in the UK; and
- ii) relate to the first period during which movies are licensed for exhibition on subscription broadcast channels or Subscription Video on Demand Services.

**“Subscription Video on Demand Services”** means video on demand services for which a subscription fee is levied.

**“Ofcom”** means The Office of Communications.

**“Packages including Core Premium Movies channels”** are packages including at least one “Core Premium Movies channel” and which may include other products or services, including but not limited to subscription video on demand services.

**“Sky Movies channels”** means those television broadcast channels offered by Sky for wholesale and retail, which wholly or mainly comprise movies, and for which a subscription fee is levied that is not associated with the provision of channels wholly or mainly comprising non-movies content.

## Annex 2

# Movies sector overview

### Structure of this Annex

- A2.1 In this Annex we illustrate the importance of movies content to consumers, in particular its role as a driver of pay TV subscriptions. We also describe how the movies sector operates in the UK, from the sale and acquisition of content rights to the available services which utilise these rights. Finally, we consider the current trends, in both the movies sector and the broader pay TV market, which we believe will drive growth in the future.
- A2.2 In this Annex, we set out our movies sector overview. Since publishing the Consultation on 31 March 2010, we have reviewed the most recent data available to us and have taken into account the submissions received. The overview is based on that contained in Section 3 of the Consultation and includes updates where relevant of any developments and new services launched, incorporating responses to the Consultation where appropriate.
- A2.3 In summary, this Annex will outline:
- An overview of the UK pay TV market
  - Movie sector overview
  - Summary of available movie services
  - Premium movie content
  - The market players
  - Future developments
  - Current trends within the pay TV market and the movies sector

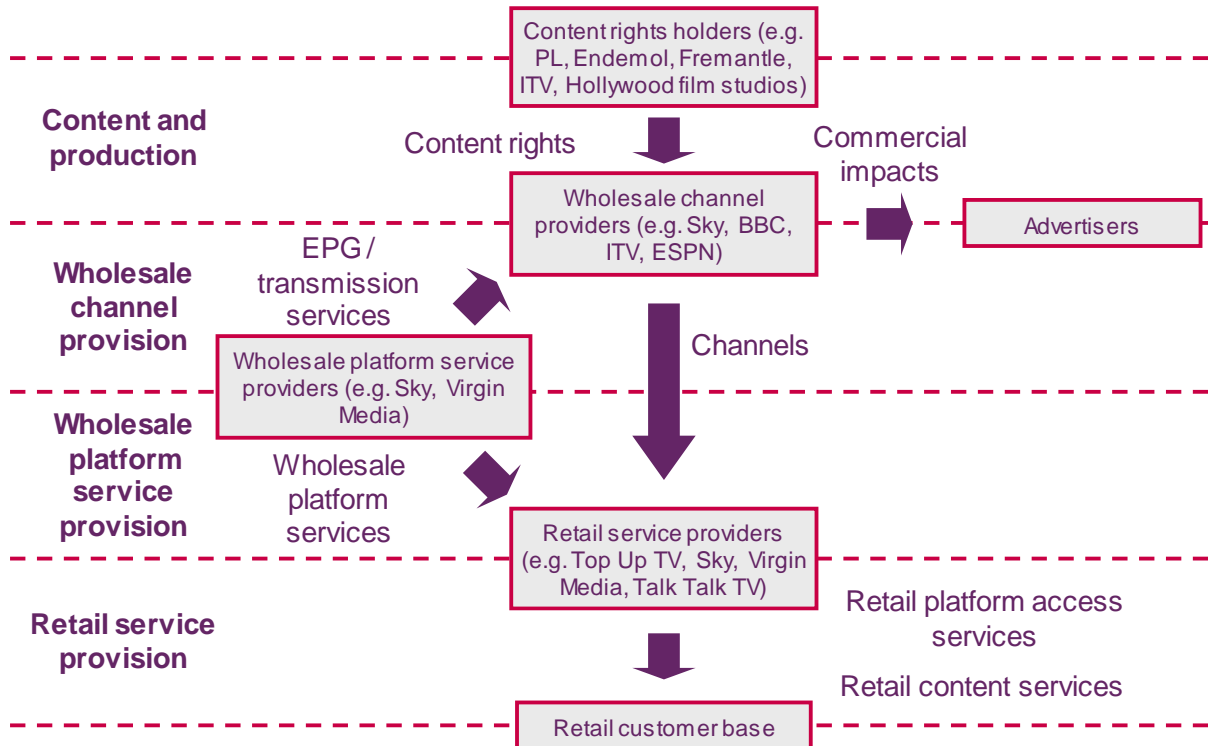
### Overview of the UK pay TV market

#### Value chain

- A2.4 We consider that the supply chain for the UK broadcasting industry consists of four layers, illustrated in Figure 1 below:
- content production, for example creating and recording content which can be broadcast;
  - wholesale channel provision, which is the aggregation of content to bundle into channels. This could include acquiring rights to broadcast content or licensing content from other providers;
  - wholesale platform service provision, which is the provision of services to enable retailers to restrict the supply of content to consumers, or providing Electronic Programme Guide ('EPG') services to broadcasters;

- retail service provision, which includes the bundling of channels into packages to retail to consumers.

**Figure 1 Pay TV value chain**



Source: Ofcom

### Vertical integration

A2.5 It is very common for companies involved in pay TV to be vertically integrated. This is illustrated in Figure 2 below, which shows the major companies active at different levels of the value chain.



**Figure 2 Table showing operators’ participation at different levels of the value chain**

	Content generation	Wholesale channel	Wholesale platform services	Retail services
<b>BT Vision</b>			✓	✓
<b>Discovery</b>	✓	✓		
<b>Disney</b>	✓	✓		
<b>MUTV</b>	✓	✓		
<b>Sky</b>	✓	✓	✓	✓
<b>Top Up TV</b>			✓	✓
<b>Virgin</b>	✓	✓	✓	✓

Source: Ofcom

### Premium content as a driver of pay TV subscriptions

A2.6 The content which is likely to be most effective in driving pay TV subscriptions must have two characteristics:

- a significant appeal to a broad audience; and
- limited availability via FTA TV channels.

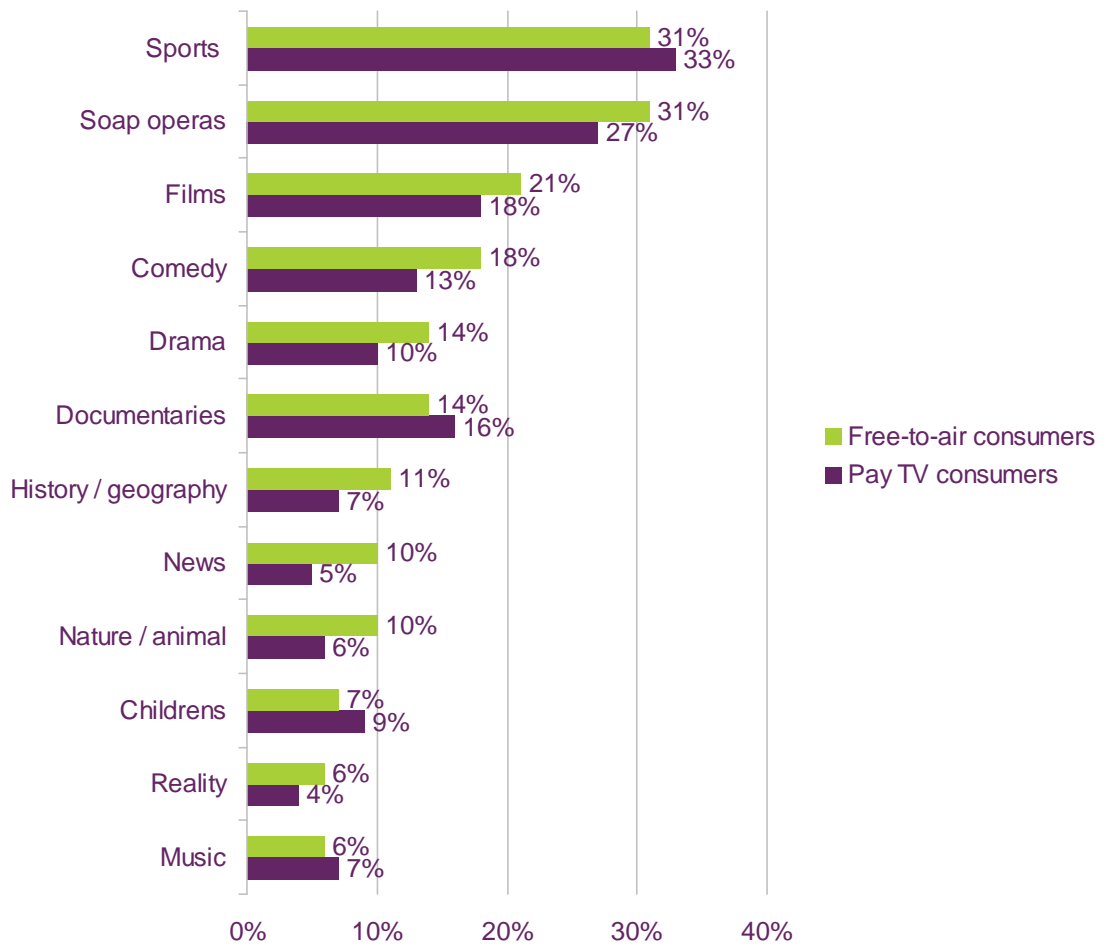
A2.7 Content which has a broad appeal, but which is widely available free-to-air, such as some of the UK-originated content available via the public service broadcasters, is unlikely to drive pay TV subscriptions, since consumers are unlikely to pay a significant premium to watch programmes similar to those which they can watch for free.

A2.8 The characteristics which viewers look for when deciding what programme to watch are highly subjective – the level of interest in a particular genre or a particular storyline, the attractiveness of particular actors or actresses, the degree of support for a particular sporting event or for a particular team, and so on. In addition, consumers have very varied preferences for different types of content. This was illustrated by the consumer research we set out in our previous consultation documents<sup>252</sup>.

A2.9 Figure 3 shows the genres of content that are most attractive to consumers.

<sup>252</sup> See in particular the charts set out in section 4 of Annex 14 to our First Pay TV Consultation – [http://www.ofcom.org.uk/consult/condocs/market\\_invest\\_paytv/annex14.pdf](http://www.ofcom.org.uk/consult/condocs/market_invest_paytv/annex14.pdf).

**Figure 3 Chart showing varied preferences (consumer research)**



*Base: All multi-channel TV household decision-makers for whom content is 'must have' (FTA 045, pay TV 947) Source: Ofcom pay TV research phase one (June / July 2006). Notes: Spontaneous mentions of programme genre among those for whom content is 'must have'.*

- A2.10 The three genres that are most valued by consumers are sports, soap operas and movies. Of these, soap operas are widely available on FTA television, and so are unlikely to be a primary driver of pay TV subscriptions. The same is true of other genres which are valued by consumers, such as comedy, drama and documentaries. Sports and movies stand out as being among the most valued genres by consumers, and also having a high degree of exclusivity to pay TV. On this basis alone we would expect them to be key drivers of pay TV subscriptions.
- A2.11 The comment is frequently made in broadcasting that 'content is king'. A number of consultation respondents agreed with the observation in our Second Pay TV Consultation that no amount of high-tech platform features could make up for an absence of attractive content, or "turn unattractive content into attractive content". The ability to time-shift a programme, for example, is of value precisely because consumers want to watch a specific and valued piece of content in the first place.
- A2.12 This is not to say that platform features are unimportant – far from it. A movie buff, given the choice between a movies channel in SD and HD, may well value the enhanced definition afforded by HD sufficiently to pay extra for it; however, given the choice between that movies channel in SD and another channel which is in HD

but does not contain interesting content, they are much more likely to follow the underlying content rather than the higher definition.

A2.13 We set out below our analysis of the importance of movies content, looking specifically at:

- sums paid by channel providers for content rights; and
- statements made by market players.

#### *Sums paid for content rights*

A2.14 The importance of first-run Hollywood movies in particular is revealed by evidence including the observed behaviour of firms which are active in the market. Movies programming represented 16% of Sky's programming costs in 2008/09, and 6% of Sky's entire operating expenses. This is significantly lower than Sky's expenditure on sports programming, but is similar in magnitude to Sky's total expenditure on all third party channels (18% of programming costs) and higher than its total expenditure on its own news and entertainment channels (12% of programming costs). The cost of movie programming decreased by 1% year on year to £278m<sup>253</sup>.

#### *Statements made by market players*

A2.15 The importance of premium movie content to Sky's platform is evident from internal documents that we have obtained:

- [X]<sup>254</sup>.

A2.16 It is also confirmed by many internal documents which we have obtained following various information requests to other pay TV providers:

- [X]. [X]<sup>255256</sup>. [X]<sup>257</sup>. [X]<sup>258</sup>.
- [X]<sup>259</sup>. [X]; and
- [X]<sup>260</sup>.

## **Movies sector overview**

### **Viewing formats**

A2.17 Films can be viewed in a number of different formats, including traditional theatrical release in the cinema, DVDs, linear TV channels and on-demand viewings. To access a wide range of films without having to pay each time they view a film consumers may use subscription services, for example through TV packages or

---

<sup>253</sup> Page 38,

<http://www.sec.gov/Archives/edgar/data/932789/000095012309028302/u06991e20vf.htm>.

<sup>254</sup> [X].

<sup>255</sup> [X].

<sup>256</sup> [X] Ibid.

<sup>257</sup> [X] Ibid.

<sup>258</sup> [X] Ibid.

<sup>259</sup> [X] Ibid.

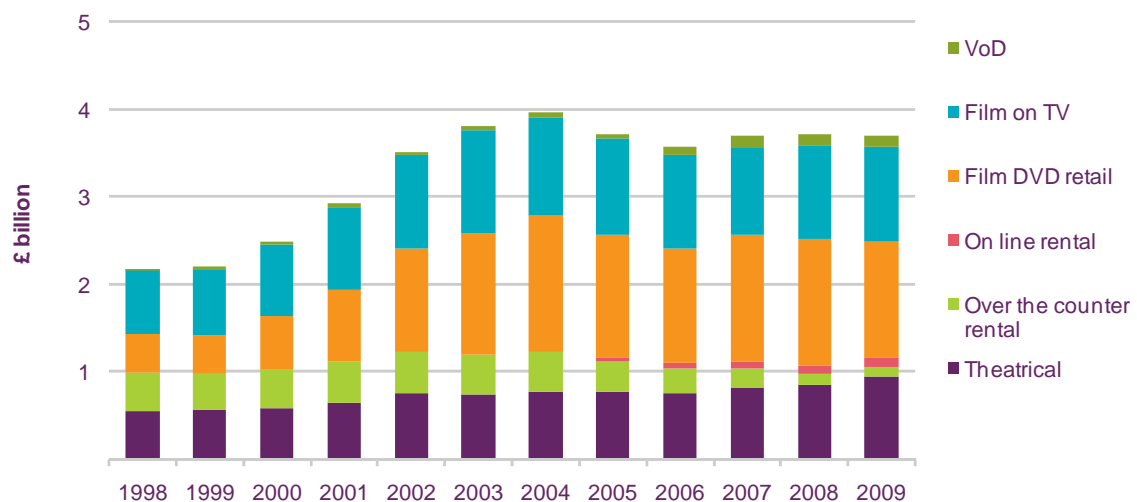
<sup>260</sup> [X] Ibid.

through online DVD rental. Some may use PPV and Over The Counter ('OTC') rental.

A2.18 As shown by Figure 4, the most important means of watching movies (measured by revenue) are DVD retail, television (including FTA and pay TV channels) and in cinemas. In comparison, services such as VoD and rental (both OTC and online) are markedly smaller. It also summarises trends in revenues associated with different film formats and windows. Revenues have declined overall since 2004, though trends vary between the different formats:

- after a small increase in revenues associated with films on TV, the value of televised films rose in 2009 to reach £1.1 billion. According to Screen Digest the value of the FTA window appears to be broadly flat over the period<sup>261</sup>;
- SVoD services have been relatively unimportant to date. However, as we have discussed in this document our view is that there is considerable scope for these services to grow in popularity if they are able to provide sufficiently attractive content;
- revenues from OTC DVD rentals are falling sharply, but this is partly offset by increases in VoD and online DVD rentals.

**Figure 4 Value of films from different formats, nominal figures**



Sources: *Theatrical, retail film, film on TV and VoD: UK Film Council Statistical Yearbook 2009 (forthcoming); over the counter and online rentals: British Video Association Yearbook 2009*

Notes: 'Film on TV' covers terrestrial, subscription and free multi-channel. Pay-per-view is included within the VoD total. 'VoD' includes Near Video on Demand (nVoD) and true video on demand. 2009 UK Film Council data unavailable at date of publishing.

A2.19 **Cinematic release:** films are first released at the cinema often accompanied by very substantial and costly marketing and promotional campaigns. Average ticket prices were £5.44 in 2009<sup>262</sup>. Screen Digest reported that the cinema release "is regarded as a marketing platform and most distributors will not make profit at this

<sup>261</sup> See figure 10 of Annex 11 to First Pay TV Consultation.

<sup>262</sup> See for example: <http://www.cinemauk.org.uk/ukcinemasector/ukcinema-industryeconomics/averageukticketprices/>.

stage”<sup>263</sup>. However, cinema release is important to consumers: research conducted by Sky reported that “films were most special at the cinema, closely followed by owning films on DVD”<sup>264</sup>.

- A2.20 **DVD retail:** consumers purchase DVDs in order to obtain permanent access to a number of specific favourite films within a film library of their own. Sky’s consumer research<sup>265</sup> showed that DVD retail was perceived as offering very good value as it provides the benefits of permanent ownership of an extremely popular delivery mechanism. The average price of a DVD reached £8.62 in 2009<sup>266</sup>, although the range of prices is wide – particularly as prices typically fall by more than half after the initial release period<sup>267</sup>.
- A2.21 **DVD rental:** consumers can rent DVDs to access recently released films on a temporary basis. Sky’s research found that “renting films is still reasonably popular (even amongst Sky Subscribers) with renters welcoming variety, the mid week deals and improved window<sup>268</sup>. Consumers can choose to rent from traditional over the counter stores or – increasingly – from online subscription services. The majority of rentals (by value) are still over the counter rentals but the quantity and value of online subscription rentals is growing rapidly. The average rental price for OTC DVDs in 2009 was around £3.10<sup>269</sup>.
- A2.22 **PPV:** a number of TV retailers including Virgin Media, Sky, TalkTalk TV and BT Vision offer PPV movies, allowing consumers a convenient way to access new movies. PPV services based on ‘Pull VoD’, or ‘True’ VoD<sup>270</sup>, are possible on Virgin Media’s cable network and the IP networks of TalkTalk and BT Vision. Sky’s satellite service provides both ‘Push VoD’<sup>271</sup> and ‘Near’ VoD PPV services<sup>272</sup>. These services differ in terms of both pricing and the number of films available:
- In 2009, Sky offered a total of around 400 films (including HD) priced at £3.99 per film on its PPV nVOD service<sup>273</sup>. Only a small fraction of these films were available at any one time.
  - In 2009, Virgin Media offered a catalogue of around 500 films on the FilmFlex PPV VOD service. New releases were priced between £2.50 and £3.50 and library titles were priced between 50p and £2<sup>274</sup>. FilmFlex offers more films at any one time than Sky’s PPV nVOD service.
- A2.23 We estimate that Sky’s revenue from PPV nVOD services was [ X ] in 2008 and Virgin Media’s revenue from PPV VOD services was [ X ] in 2008<sup>275</sup>. Taking into

<sup>263</sup> First Pay TV Consultation, Annex 11, page 21.

<sup>264</sup> Sky’s third response to Ofcom information request of 29 May 2008.

<sup>265</sup> Ibid.

<sup>266</sup> British Video Association Yearbook 2010, p.30.

<sup>267</sup> The Official UK Charts Company, top DVDs released in August to November 2007 (ranked by retail DVD revenue in 1<sup>st</sup> year of DVD release)

<sup>268</sup> Sky’s third response to Ofcom information request of 29 May 2008.

<sup>269</sup> British Video Association Yearbook 2010 page 81.

<sup>270</sup> ‘Pull’ or ‘True’ VoD means consumers can get instant access to the film of their choice.

<sup>271</sup> ‘Push’ VoD refers to services where content is downloaded to the hard drive of the set-top box and made available to view on demand.

<sup>272</sup> ‘Near’ VoD (nVoD) refers to a multiple linear channels that broadcast the same content at staggered start times.

<sup>273</sup> UK Film Council Statistical Yearbook 2010, page 102.

<sup>274</sup> Ibid, page 106.

<sup>275</sup> Responses to Ofcom Information requests. [ X ].

account the fact that there are markedly more subscribers to Sky's satellite platform than to Virgin Media's cable platform<sup>276</sup>, these revenue figures suggest that cable subscribers are more likely to purchase PPV VOD services than satellite subscribers are likely to purchase PPV nVOD services.

- A2.24 **Internet Download:** Downloading content to watch from the internet offers consumers a wide range of content that can be accessed relatively easily and viewed at their convenience. Content can be downloaded legally from the internet either to watch on a one-off basis (also known as download to rent or rental VOD) or to retain permanently (also known as download to own). Suppliers include Apple (via its iTunes store) and Blinkbox. Movies can also be downloaded illegally using file sharing applications such as Bit Torrent.
- A2.25 **Pay TV Subscription Services:** Sky Movies and Disney Cinemagic show films in the first pay TV subscription window from the six Major Hollywood Studios. Sky also has contracts with several independent distributors and other movie studios (see paragraph 4.276 in the Third Pay TV Consultation). Consequently, Sky's premium movie channels provide the first opportunity for viewers to watch the vast majority of the most popular films on a linear TV channel.
- A2.26 SVoD services are also available. As set out in Section 6 and described below, Sky provides SVoD services that show movies during the first pay TV subscription window. Sky has a "pull" SVoD service, its Sky Player service that can be accessed via a subscriber's PC, or games console and it intends to launch a service available via television sets to subscribers with suitable set top boxes later in 2010.
- A2.27 Secondly, there are various other SVoD services not owned by Sky that show films after the first pay TV subscription window. For example Picturebox offers a rolling catalogue of second pay TV and library titles over a number of UK platforms. The available titles from the non-exclusive second pay TV window are older than those featured in the exclusive first pay TV subscription window. They typically run from 27 to 36 months after cinematic release<sup>277</sup>.
- A2.28 **FTA Channels:** FTA channels and other basic tier subscription channels show a wide variety of older films. In 2009 there were 2,218 film transmissions on the main terrestrial channels, 20,271 film transmissions on FTA multi-channels and 45,012 transmissions on subscription movie channels<sup>278</sup>.

## Windowing structure

- A2.29 From the time of their initial release, movies are sold in a series of different formats in distinct or overlapping time periods known as "windows". Typically a movie has a cinema release, then a DVD retail/rental window, then it will be shown on PPV, then premium pay TV, before finally being shown on free-to-air services. In general terms, the commercial value of a movie declines over time following its release date. For example, newer DVDs and movies on pay-per-view services command higher prices than older releases, and movies typically appear on premium TV channels before they are shown on basic or FTA channels.

<sup>276</sup> In 2008, Virgin Media had approximately 3.6m subscribers and Sky had 8.8m satellite subscribers. Statistical Yearbook 2009, UK Film Council, page 106.

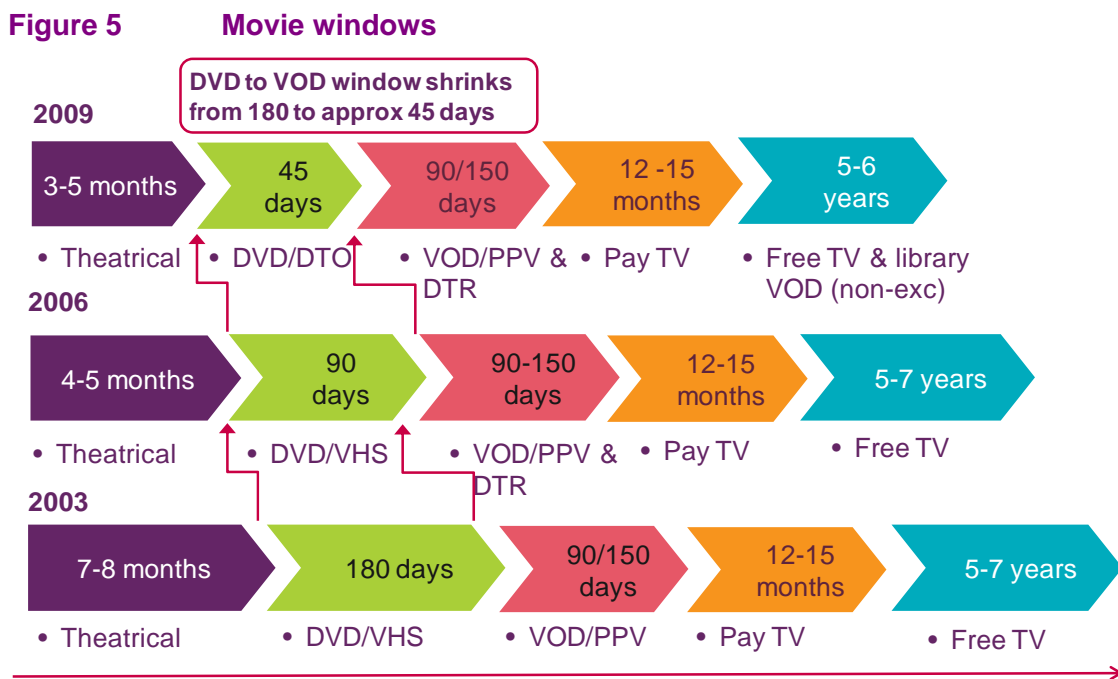
<sup>277</sup> Virgin Media's supplementary submission dated 15 August 2008, page 15 - <http://www.ofcom.org.uk/tv/paytv/virginmedia.pdf>

<sup>278</sup> UK Film Council Statistical Yearbook 2010, p.91 and 97.

A2.30 As such, the lifecycle of movie content differs from that of sports content, which has relatively limited value after the initial live broadcast of an event. This has a number of implications:

- While viewing of sports is largely limited to attendance at events, and live broadcast on linear channels and pay-per-view services, movies are available over a wider range of formats such as DVD retail and rental, and, increasingly, VoD.
- Linear movie channels regularly repeat movies, and in some cases multiple channels are used to show the same movie starting at different times.
- While premium sports channels primarily comprise bundles of different live sports content, premium movies channels bundle newer movies with older movies.

A2.31 Movie studios manage the timing of film release across different formats, as we explained in further detail in Annex 11 of our First Pay TV Consultation. The timed availability of films across different formats is a form of price discrimination. It enables studios to exploit consumers’ different willingness to pay for content in order to maximise the value of their movies and recover the fixed costs of production and marketing. The timing of the different windows and formats is set out in Figure 5 below, which also shows the way in which the windows have changed over the past few years.



Source: Ofcom, Industry sources, Screen Digest (windows are indicative and change on a title-by-title basis)

Note: There are potential future changes in the movie windows. For example, some studios are releasing movies on PPV at the same time as DVDs.<sup>279</sup>

A2.32 As the figure shows, in recent years, some of the movie windows have been getting narrower. For example, since 2003 the DVD window has shifted from 7-8 months to

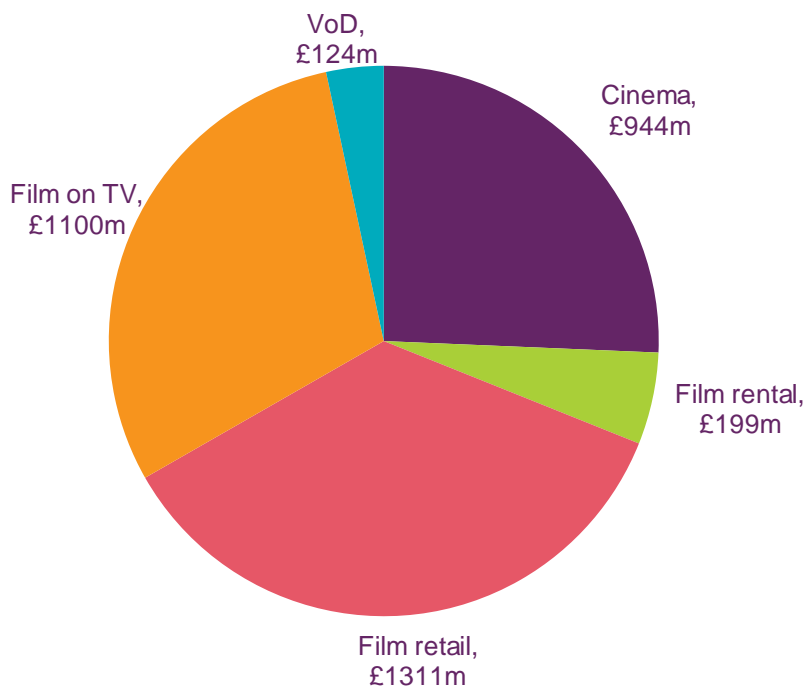
<sup>279</sup> See Matthew Garrahan (23 December 2009) “Warner launches on-demand push into Europe” at FT.com

3-5 months after cinematic release<sup>280</sup>. The delay between cinematic release and the first pay TV subscription window has also reduced.<sup>281</sup>

- Sky told us that “Over the last few years, Sky has renegotiated its movie contracts so that it can show titles at an earlier date post cinematic release. In 2001 the pay TV subscription window ran from 18 to 33 months after cinematic release; by 2007 it had moved forward by six months, typically running from 12 to 27 months after cinematic release. Therefore any film can be shown six months earlier than would have been possible in 2001, meaning that it is closer to the cinematic release and the accompanying publicity”<sup>282</sup>.
- In addition, [ X ]<sup>283</sup>.

A2.33 The studios determine the order and length of the windows over which their movies are shown, to maximise profits. This structure enables studios to earn significant revenues from movies well after initial release, as shown in Figure 6.

**Figure 6 UK revenue for different film windows in 2009, nominal figures**



Source: Film Council 2010 Statistical Yearbook, based on data supplied by Nielsen, EDI, MRIB, BVA, Official Charts Company, DGA, Screen Digest and RSU Analysis.

<sup>280</sup> The Odeon cinema group threatened not to show the film “Alice in Wonderland” in protest against Disney’s plan to shorten the theatrical run by bringing forward the DVD release date: see “Odeon ends Alice in Wonderland boycott”, guardian.co.uk, 25 February 2009.

<sup>281</sup> Third Pay TV Consultation, paragraphs 4.295 to 4.296.

<sup>282</sup> Sky’s response of 9 July 2008 to Ofcom’s information request of 29 May 2008 question 6 “Changes in the quantity and quality of services delivered to subscribers to Sky’s packages that include Sky’s sports channels, 2001/02 – 2006/07” section 4, paragraph 12.

<sup>283</sup> [ X ].



## Summary of available movie services

### Wholesale premium movies channels

- A2.34 The main supplier of wholesale premium movies channels is Sky, though Disney also supplies one channel (Disney Cinemagic). Premium movies channels are retailed by Sky and the cable companies, primarily Virgin Media.
- A2.35 Sky's agreements with the Major Hollywood Studios cover movies from the first pay TV subscription window and older library titles, which are bundled together in wholesale premium movie channels. As noted above, the first pay TV subscription window provides the first opportunity for viewers to watch the vast majority of the most popular films on a linear TV channel.
- A2.36 Subscriptions to these channels are driven by the titles which have been successful at the box office and are capable of generating strong audiences<sup>284 285</sup>. For example, Sky describes Sky Premiere as "home of the biggest new movies"<sup>286</sup>. This has by far the most views per film of any Sky Movies channel, which suggests the importance of big box office films.
- A2.37 [ X ].

### Figure 7

[ X ]

### Sky Movies

- A2.38 Sky offers 12 premium movies channels. Eight are, broadly speaking, genre-specific, while two (Sky Movies Screen 1 and Sky Movies Screen 2) put "the best of Sky Movies in one place", and two (Sky Movies Premiere and Sky Movies Premiere+1) show a small number of major new releases (five per week). These channels, taken together, show all of the films from the six Major Hollywood Studios, among others, in the first pay TV subscription window.
- A2.39 All these channels are available in SD or HD except for Sky Movies Classics and Sky Premiere +1, which is only available in SD. They are aggregated into three packages<sup>287</sup>:
- Sky Movies 1: Sky Movies Comedy, Sky Movies Family, Sky Movies Classics, Sky Movies Modern Greats.
  - Sky Movies 2: Sky Movies Action and Thriller, Sky Movies Sci-Fi and Horror, Sky Movies Indie, Sky Movies Drama.

<sup>284</sup> First Pay TV Consultation, Annex 11, Screen Digest report 'Movie markets in the UK', page 93.

<sup>285</sup> In our Second Pay TV Consultation we also noted that Sky has exclusive agreements with the six Major Hollywood Studios to exploit their films in the pay TV window and that these films accounted for 80% of UK box office revenues (paragraph 5.155).

<sup>286</sup> <http://www.sky.com/shop/tv/movies/> (as viewed on 30 June 2010).

<sup>287</sup> See <http://packages.sky.com/see/MoviesMix.aspx> (as viewed on 11 January 2010).

- Sky Movies Pack (Sky Dual Movies / Sky Movies Mix): Sky Movies 1 and Sky Movies 2, Sky Premiere and Sky Premiere +1, Sky Movies Showcase and Disney Cinemagic<sup>288</sup>.

A2.40 Sky Movies channels are retailed by Sky and by cable companies, primarily Virgin Media. Sky retails directly on its satellite platform and TalkTalk TV's IPTV platform. Virgin Media retails Sky Sports on its cable platform. Sky has a direct relationship with its retail subscribers. Subscribers pay Sky a monthly fee in exchange for access to packages of channels. In order to receive these channels satellite subscribers must install equipment to receive and decode a satellite signal, including a satellite dish and set-top box.

A2.41 As shown in Figure 8 Sky retails Sky Movies 1, Sky Movies 2 and Sky Dual Movies in bundles with other basic packages (mixes) and Sky Sports packages. [ X ]<sup>289</sup>.

### Figure 8 Sky premium movies subscribers

[ X ]

A2.42 Virgin Media retails Sky Movies 1, Sky Movies 2, Sky Dual Movies, on its cable platform with other basic TV packages ("M", "M+", "L", and "XL") and Sky Sports channels<sup>290</sup>. Virgin Media retails Sky Movies 1 or standalone Sky Movies 2 at between £13.50 per month (if they are taken with the 'M+', 'L' or 'XL' package) and £28 a month (if taken with the 'M' package)<sup>291</sup>.

### Disney Cinemagic

A2.43 Disney Cinemagic is the only other channel that shows films from the "first pay TV window" from a Hollywood Major Studio, as it shows a limited number of Disney's animated films alongside a range of children's and family-based programming.

A2.44 It is included within the Sky Dual Movies bundle on Sky's satellite platform or is available as a standalone channel on Virgin Media or Sky for £5 per month<sup>292</sup>. Disney Cinemagic shows very few first run movies, with the majority of its content being library programming and older films.

### Other movie services in the UK

A2.45 Alongside the main pay TV operators, a broad range of services are based on movies in different release formats, including:

- Lovefilm – Lovefilm is a DVD rental and digital download service with over 1 million active DVD rental subscribers in the UK. It offers a range of subscription DVD rental packages, alongside its on-demand streaming service launched in May 2009. Lovefilm offers SVoD movies as part of its "Unlimited" online DVD rental plans. These plans cost from £9.99 per month (1 disc at a time) to £15.99 per month (3 discs at a time). In 2010, it had 1,024 films/features in its

<sup>288</sup> Sky retails its 12 Sky Movies channels in this pack with Disney Cinemagic. But Disney Cinemagic is not included within its wholesale products.

<sup>289</sup> [ X ].

<sup>290</sup> Virgin Media also offers an "M+" basic package.

<sup>291</sup> See <http://allyours.virginmedia.com/html/tv/sky-movies-channels.html> (as viewed on 30 June 2010).

<sup>292</sup> Correct as of 30 June 2010.

catalogue<sup>293</sup>. These films are streamed over the internet through a web browser. In March 2010 Lovefilm announced an agreement with Sony and Samsung to make their internet film library available via the manufacturer's internet-connected TVs<sup>294</sup>. The service is limited to subscribers to Lovefilm's premium 'unlimited' package and appears to showcase mainly films from the FTA / library VoD window<sup>295</sup>. [ X ]<sup>296</sup>.

- Sky Player – Sky currently only exploits its SVoD rights through its PC-based Sky Player application transmitted over the internet. This is available on a standalone basis, enabling customers to subscribe to watch a package of channels from Sky on a PC, Mac or Xbox 360 without the need to install a set-top box. Sky Player is also available to consumers via IP enabled DTT set top boxes and connected TVs: Cello iViewer<sup>297</sup>. Sky offers SVoD films for free as part of a Sky Dual Movies subscription on Sky's satellite platform. In 2008, Sky's SVoD service had 400 films in its catalogue from all the Major Hollywood Studios<sup>298</sup>.
- Sky Anytime – Sky offers a "push" VoD service offering up to 200 hours of content on demand to around 6.5 million Sky+ and Sky+ HD customers. In terms of the genre split, 46% of content viewed via Sky Anytime are movies, followed by entertainment (18%), documentaries (23%) and sports / news (13%). For 2010, the average monthly reach of Sky Anytime was 45.9% (according to data published in May 2010)<sup>299</sup>.
- PictureBox – NBC Universal's branded SVoD service, which offers a rolling catalogue of second pay TV and library titles over a number of UK platforms. This gives subscribers the ability to watch movies over several sittings, freeing viewers from the constraints of rental. The available titles from the non-exclusive second pay TV window are older than those featured in the exclusive first pay TV subscription window. Subscription is monthly and can be purchased on a standalone basis or tied into a TV bundle. Subscribers are then able to choose from a rolling selection of 28 titles (or more depending on platform) available every month. PictureBox offers movies via 'pull' and 'push' VoD, depending on the capabilities of the platform on which the service is offered. PictureBox is available on the platforms of Virgin Media, BT Vision, TalkTalk TV and Top Up TV.
- BT Vision Film Club – In May 2010, BT Vision consolidated its SVoD film offering to include over 60 films every month, with 14 new titles added each week. This brings together the existing PictureBox and Warner Films services alongside additional on-demand titles from Sony and Film4. BT Vision customers can subscribe to the 'Film Club' pack for £6.99 per month, or to PictureBox or Warner Films individually for £4.99 per month.
- FilmFlex – a VoD service offering PPV movies on Virgin Media TV. This was launched in January 2005, replacing 'Front Row', the previous nVoD service. FilmFlex is a joint venture between Walt Disney and Sony Pictures (following the

<sup>293</sup> Source: <http://www.lovefilm.com> (as viewed on 22 January 2010).

<sup>294</sup> <http://www.ft.com/cms/s/0/b6565eaa-32ea-11df-bf5f-00144feabdc0.html>.

<sup>295</sup> <http://www.lovefilm.com/on-your-tv/>.

<sup>296</sup> This service is now available see [http://www.screendigest.com/news/warner-agrees-new-distribution-terms-with-lovefilm/view.html?start\\_ser=bi](http://www.screendigest.com/news/warner-agrees-new-distribution-terms-with-lovefilm/view.html?start_ser=bi).

<sup>297</sup> Sky's response to the Consultation, paragraph 4.27.

<sup>298</sup> Source: Film Council 2010 Statistical Yearbook, page 102.

<sup>299</sup> See <http://www.skymedia.co.uk/Audience-Insight/dashboard.aspx>.

exit from the venture of On Demand Group). In 2008 it had around 500 available films. New releases are priced between £3.50 and £4.50 and library titles are priced between 50p and £2. It has films from all major studios except Fox and is available to 3.7 million cable TV subscribers.

- Virgin Media 'Movies' – Virgin Media has also recently launched an online streaming service powered by FilmFlex, where consumers can purchase films to watch on their PC<sup>300</sup>. After purchase, titles are made available to watch via online streaming for a specified rental period, although movies are not currently available on a download-to-own basis. A beta version of the service is currently operating, with new release movies available from £3.75 - £3.99, alongside a catalogue of library films available for £2.50.
- Fetch TV – the company IP Vision offers a set-top box that combines DTT channels and broadband to offer on-demand content, including PPV movies, under the Fetch TV brand. Fetch TV customers can also subscribe to Sky Player.
- Apple TV – Apple TV offers a range of movies and TV content that can be viewed on a TV using the Apple TV digital media adaptor (which first launched in the UK in December 2007)<sup>301</sup>. Apple TV can access content from Apple's iTunes download service.
- Blinkbox – Blinkbox is an online VoD service featuring movies to stream, download to rent and download to buy. Movie rentals are available from 99p and download-to-own movies from £3.99<sup>302</sup>. The service launched in April 2008.
- Games consoles (various) - These includes Sony's PlayStation 3, which offers movies and TV programmes, and Microsoft's Xbox Live service, which offers movies, Sky Player live and on-demand content.

A2.46 There are services offering movies on demand that are due to launch in the future. These include:

- Sky Anytime + - Sky is due to launch its 'pull' VoD service 'Sky Anytime +' later in 2010, offering over 500 movies (and TV programmes) on-demand via the Sky EPG. The service, delivered by broadband internet, will utilise the Ethernet port of existing Sky+ HD boxes and will use progressive download technology<sup>303</sup>. Sky Anytime + will be available to Sky customers [ X ]<sup>304</sup>.
- Project Canvas<sup>305</sup> - the joint venture between the BBC, ITV, Channel 4, Five, BT, Talk Talk and Arqiva, is expected to launch in 2011. The VoD service will rely on broadband to deliver on-demand content to viewers' television sets. It is expected to offer both free and paid for content. Reports have suggested that Lovefilm could offer movies via the Canvas service<sup>306</sup>.

<sup>300</sup> <http://onlinemovies.virginmedia.com/>.

<sup>301</sup> <http://www.apple.com/uk/appletv/>.

<sup>302</sup> <http://www.blinkbox.com/>.

<sup>303</sup> <http://www.trustedreviews.com/home-cinema/news/2010/06/02/Sky-Unveils-On-Demand-Download-Service/p1>.

<sup>304</sup> [ X ].

<sup>305</sup> [http://www.bbc.co.uk/bbctrust/assets/files/pdf/our\\_work/canvas/canvas\\_conclusions.pdf](http://www.bbc.co.uk/bbctrust/assets/files/pdf/our_work/canvas/canvas_conclusions.pdf).

<sup>306</sup> <http://paidcontent.co.uk/article/419-bbc-viewers-dont-want-canvas-lovefilm-does-sony-not-invited/>.

- Additionally, Sky [ X ]<sup>307</sup>.

## International examples

A2.47 There are also various international examples of SVoD services:

- Netflix is the leading DVD rental service in the US<sup>308</sup>. Netflix offers an on-demand subscription service bundled with their traditional DVD rental service. [ X ]<sup>309</sup>. [ X ]<sup>310</sup>.
- In Italy there are various examples of SVoD services available over the internet and IPTV<sup>311</sup>. For instance, Telecom Italia's 'Alice Home TV' service, which offers SVoD films on IPTV through a partnership with Sky Italia. The 'Sky SVoD film pack' offers a choice of 140 films for a monthly subscription fee of €16.00 alongside a 'SVoD sport' pack which costs €15.00 per month<sup>312</sup>.
- In December 2003, in France Orange TV launched the '24/24 video' service to its subscribers, an IPTV based VoD portal that combines instant and subscription payment methods<sup>313</sup>. The SVoD service currently offers a set of genre based 'series packs', which cover music and children's programming at a fixed price of €4.99 per month, with plans to launch another series pack in the coming months<sup>314</sup>.

## Premium movie content

A2.48 In Section 6 of our Pay TV Statement<sup>315</sup>, we set out our view of the nature of demand for Core Premium Movies channels. Here, we summarise the main issues in respect of two characteristics of the channels, quality and timing, and subscribers' preferences for these characteristics.

## Quality of films

A2.49 In our Third Pay TV Consultation we said that Sky's Core Premium Movies channels also show a large quantity of films that are of particularly high quality (at least in terms of box office success). We also noted that Sky has exclusive agreements with the six Major Hollywood Studios to exploit their films in the pay TV subscription window and that these films accounted for 80% of UK box office revenues<sup>316</sup>.

A2.50 Sky argued in response to our Third Pay TV Consultation that we gave insufficient weight to the quality of films as distinct from timing<sup>317</sup>. As we said, we agree that quality is important. Many of the films viewed on Sky Movies are those that had large box office revenues. Sky describes Sky Premiere as "home of the biggest new

---

<sup>307</sup> [ X ].

<sup>308</sup> <http://www.netflix.com/>.

<sup>309</sup> [ X ].

<sup>310</sup> [ X ].

<sup>311</sup> NPA Conseil, 'Video on demand in Europe', page 261 to 262.

<sup>312</sup> Ibid, page 261.

<sup>313</sup> <http://2424video.orange.fr/>.

<sup>314</sup> NPA Conseil, 'Video on demand in Europe', page 209.

<sup>315</sup> Contained in Annex 7.

<sup>316</sup> Third Pay TV Consultation, paragraphs 4.274 to 4.275.

<sup>317</sup> October 2009 Sky's Submission, paragraph 95.

movies<sup>318</sup>. This channel has by far the most views per film than any other Sky Movies channel, which suggests the importance of big box office films<sup>319</sup>. Using box office revenues as an indicator of quality, these facts suggest the importance of the quality of films to Sky Movies subscribers.

- A2.51 In contrast, Sky Indie has the fewest views per film. The differences in the viewing figures for the different Sky Movies channels emphasise the importance of films distributed by the Major Hollywood Studios. This is evidence that consumers regard the films distributed by these studios as relatively attractive (i.e. in some sense higher 'quality' from the perspective of the majority of consumers).

### *Timing*

- A2.52 Consumers typically value a given film more the closer it is to its release date. Sky accepted this<sup>320</sup>, but also stated that an older movie may be valued more highly than another (different) film that is more recent for example because viewers consider the older film to be higher 'quality'. Sky gave a number of examples in support of this proposition, including viewer data showing that a repeat on Channel 4 attracted a greater number of viewers (among households with Sky Movies) than the first showing of a more recent film on Sky Movies<sup>321</sup>.
- A2.53 While some older films may be more attractive than some newer films, most films are more attractive when they are closer to their release date. All other things being equal, more recent movies are more attractive. This is in part because significant marketing occurs around the time of the initial cinema release which increases the awareness of a film<sup>322</sup>. The value of this marketing will diminish over time. Furthermore, once a consumer views a film in an earlier window its value to that consumer in later windows is likely to be diminished.
- A2.54 The attractiveness of recent movies is supported by a number of pieces of evidence:
- Internal research supplied to us by Sky<sup>323</sup>, [ X ].
  - A survey carried out for Virgin Media asked consumers for which genre of content they would consider paying more than their current subscription. This Virgin Media survey found that "new" movies was the most popular movie genre for both Virgin Media and Sky subscribers (cited by [ X ]% and [ X ]% of subscribers on each platform). This was significantly above "classic movies", cited by only [ X ]% of subscribers on both cable and Sky<sup>324</sup>.

<sup>318</sup> <http://movies.sky.com/sky-movies-home> (as viewed on 15 February 2010).

<sup>319</sup> Pay TV Statement, Figure 77 in section 6 of the Pay TV Statement, contained in Annex 7.

<sup>320</sup> October 2009 Sky Submission, footnote 67 to paragraph 95.

<sup>321</sup> Sky's data related to the evening of 26 September 2009. The Lord of the Rings: The Two Towers was released in the cinema in 2002 and attracted an average audience amongst households that subscribe to Sky Movies of 162,000. Tropic Thunder was released in the cinema in 2008 and was broadcast on Sky Movies for the first time. It attracted an average audience of 100,000. 6 October 2009 Sky Submission, Table 3 and paragraph 95.

<sup>322</sup> Sky has referred to the pay TV window moving closer to the cinematic window "and the accompanying publicity". Sky response of 9 July 2008 to Ofcom's information request of 29 May 2008 question 6 "Changes in the quantity and quality of services delivered to subscribers to Sky's packages that include Sky's sports channels, 2001/02 – 2006/07" section 4 paragraph 12.

<sup>323</sup> Sky's third response to Ofcom's questions of 29 May 2008, [ X ].

<sup>324</sup> Virgin Media response to information request of 15 May 2007, [ X ].

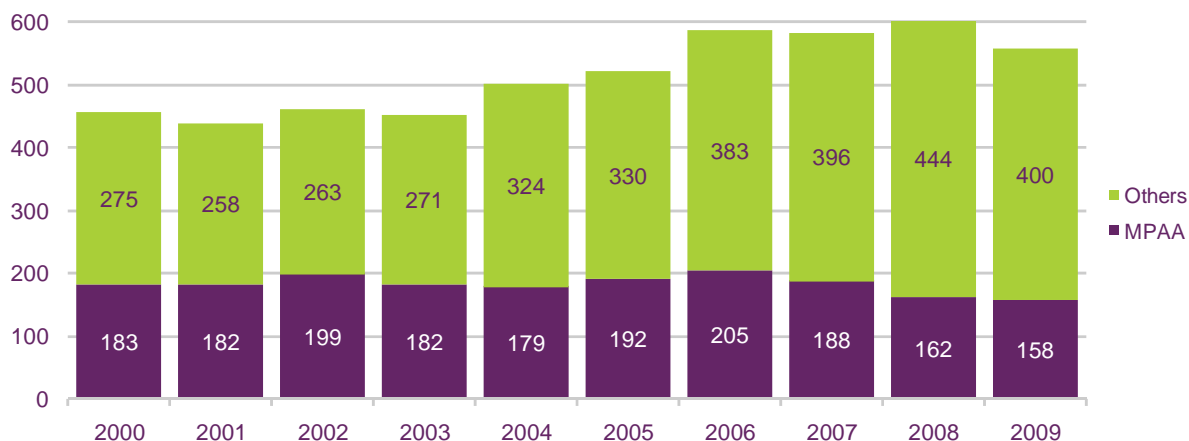
- [redacted]<sup>325</sup>. [redacted]. This provides further evidence on the importance of newer films.
- In addition, in our survey 22% of price sensitive consumers responded that access to new films is a “must have” and 46% say it is “nice to have”<sup>326</sup>.
- For consumers that are less price sensitive, the corresponding figures are 35% and 40% respectively.

## Market players

### Major Hollywood Studios

- A2.55 Sky currently holds exclusive rights to show films in the first pay TV subscription window from the six Major Hollywood Studios<sup>327</sup>. This allows Sky’s Core Premium Movies channels to show a large quantity of films that are of particularly high quality (at least in terms of box office success).
- A2.56 Sky has exclusive contracts with all six Major Hollywood Studios alongside a number of independent distributors to show films from the pay TV window<sup>328</sup>, [redacted] and Pathé. Sky has had exclusive agreements with the current six Major Hollywood Studios since [redacted]<sup>329</sup>.
- A2.57 Figure 9 shows the overall output of studios, including Major Hollywood Studios. The movies licensed to Sky represent the vast majority of the Major Hollywood Studios’ output per year.
- A2.58 Screen Digest estimates that the films produced by the six Major Hollywood Studios typically account for around 35% of films released at UK cinemas but for 80% of UK box office revenues.

**Figure 9** Number of film releases from the studios



Source: Motion Picture Association of America (chart excludes reissued films)

<sup>325</sup> [redacted].

<sup>326</sup> Ofcom pay TV research phase 2.

<sup>327</sup> For definition see footnote 1 and also <http://www.mpa.org/AboutUsMembers.asp>.

<sup>328</sup> [redacted].

<sup>329</sup> The year depends on the studio. Source: Sky response to information request of 20 December 2007. Note however that Disney premieres its animated films on its Disney Cinemagic channel, before they are shown on Sky Movies (see for example [http://media247.co.uk/skydigital/newsarchive/2006/02/sky\\_launch\\_conf.php](http://media247.co.uk/skydigital/newsarchive/2006/02/sky_launch_conf.php)).

## Pay TV operators

A2.59 Today, the main operators of satellite and cable services are:

- British Sky Broadcasting (Sky), which was created by the merger of Sky and BSB in 1990. It launched digital TV in 1998 and had 9.8 million subscribers by Q1 2010<sup>330</sup>. Its Sky Digital service offers a range of free-to-air, basic and premium channels; and
- Virgin Media, created by a consolidation over 13 years of the cable franchise areas created in 1984, culminating in the merger of NTL and Telewest in 2006, and the subsequent re-branding in 2007 to Virgin Media. After Q1 2010, Virgin Media had 3.7 million TV customers<sup>331</sup>.

A2.60 Other providers of residential pay TV services include:

- BT Vision, which offers paid-for content such as TV shows and movies on-demand via IPTV. It also offers the linear TV channels from Freeview and the ESPN subscription channel via DTT. BT Vision launched in December 2006 and its customer base had grown to 467,000 by the end of March 2010<sup>332</sup>.
- TUTV, the pay DTT service, offers a selection of on-demand content, such as TV shows and films. Programmes are downloaded to the hard drives of its TUTV Freeview+ digital video recorders (DVR), so-called 'push' VoD. Top Up TV also offers the linear TV channels from Freeview, via DTT, and the ESPN subscription channel, also via DTT. TUTV launched in 2004.
- TalkTalk TV<sup>333</sup> is the UK's only pay TV service to offer linear TV channels via IPTV (or television over DSL). Recent set-top boxes also include a DTT tuner. It also offers a wide range of on-demand content. TalkTalk TV was formerly HomeChoice, which launched in 1999 offering just VoD content. It launched linear TV channels in 2004. Internet service provider Tiscali announced plans to acquire HomeChoice in August 2006 and rebranded the service to Tiscali TV in March 2007, before it was acquired by Carphone Warehouse in 2009. TalkTalk TV has since de-merged from Carphone Warehouse and has around 50,000 subscribers<sup>334</sup>.

## Future Developments

A2.61 The likely future development of the pay TV market is relevant to our analysis as it indicates whether certain types of content are likely to continue to be as important for pay TV in the longer term as we believe them to be now:

- In terms of movie programming, blockbuster movies are likely to retain their appeal, but the ways in which consumers access movies are likely to evolve. The simultaneous broadcast of a small number of movies to a large number of

<sup>330</sup> [http://corporate.sky.com/documents/pdf/latest\\_results/Q3\\_Press\\_Release\\_0910](http://corporate.sky.com/documents/pdf/latest_results/Q3_Press_Release_0910).

<sup>331</sup> <http://pressoffice.virginmedia.com/phoenix.zhtml?c=205406&p=irol-newsArticle&ID=1418909&highlight=>.

<sup>332</sup> <http://www.btplc.com/News/Articles/Showarticle.cfm?ArticleID=4C5AFFB0-EB60-4171-B43F-FFBA68646870>.

<sup>333</sup> TalkTalk TV was previously called Tiscali TV but was rebranded in January 2010 by its owner Carphone Warehouse.

<sup>334</sup> <http://www.ft.com/cms/s/0/a76f1918-70ad-11de-9717-00144feabdc0.s01=1.html>.



viewers may not be the most effective means of distribution in the longer term. Increasing availability and adoption of on-demand technologies and services are likely to mean that distribution techniques change as consumers take greater control over how they watch movies.

- It is not difficult to imagine scenarios under which movies are generally accessed more directly by consumers, for example via various forms of internet download. Movie download services are already available, though they have yet to be taken up by large numbers of consumers.

## Current trends

A2.62 We now set out some current observations of the UK audiovisual sector that provide the background to our assessment of the future of the movies sector in the UK. While it is difficult to assess how a sector will develop over a longer time horizon, current trends can offer useful indicators to future behaviour and developments:

- There remains a strong appetite for watching TV and viewing levels on the whole are increasing<sup>335</sup>.
- Consumers are demonstrating an appetite for enhanced viewing experiences. At the end of 2009, more than 3 million homes had the reception equipment – set-top boxes and integrated digital televisions – capable of accessing HDTV channels and on-demand content<sup>336</sup>.
- Content consumption habits are changing as on-demand services become more widespread. Such services enable consumers to take increasing control of their viewing through applications like DVRs or VoD (more than half of Virgin Media digital TV customers - 58% - regularly used VoD, including catch-up TV, at Q4 2009, up from 47% at Q4 2008<sup>337</sup>).
- New technologies are becoming more capable. For example, increased broadband speeds and availability, coupled with more advanced delivery techniques, are enabling consumers to watch high-quality video over the internet: 23% of adults with home internet watched online catch-up TV in 2009, up from 17% a year earlier (Ofcom Communications Market Report 2009<sup>338</sup>).
- Portability and transferability are likely to become more important to consumers as they watch and listen to content on a greater range of devices. This is already being seen, in part helped by the take-up of devices such as Apple's iPod and iPhone.
- More consumers are buying pay TV services as part of bundles of communications services. In Q1 2009, 34% of UK adults that claimed to buy a bundle of services bought a three-product combination of TV, broadband and fixed-line telephone, up from 12% in 2005<sup>339</sup>.

---

<sup>335</sup> <http://www.ipa.co.uk/content/IPA-publishes-Q4-2009-Trends-in-TV-Report>.

<sup>336</sup> UK homes with linear HDTV channels, figures from Sky, Virgin Media, Freesat.

<sup>337</sup> <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzMxMjI8Q2hpbGRJRD0tMXxUeXBIPtM=&t=1>.

<sup>338</sup> <http://www.ofcom.org.uk/research/cm/cmr09/>.

<sup>339</sup> <http://www.ofcom.org.uk/research/tce/ce09/research09.pdf>.

- ‘Hybrid’ models are becoming more common, whereby different technologies are combined to create more advanced products and services. For example, combining broadcast and broadband distribution technologies in one device to offer both linear and non-linear programming (BT Vision and TalkTalk TV offer such services).

A2.63 Section 4 of our Pay TV Statement looked in greater detail at the changes in the pay TV and related audiovisual sectors that were already happening and those that were likely to take place given announcements by industry<sup>340</sup>. This is relevant to our analysis, as we turn to the particular importance of movies content for driving the development of VoD, and investment in new superfast broadband networks and IPTV in the UK.

## Video on demand

- A2.64 Pay TV has historically provided a means of accessing a greater range of TV channels for a monthly subscription than is available on a free-to-air platform. 49% of UK homes subscribed to a pay TV service at the end of 2008<sup>341</sup>. Within the last decade, pay TV operators have also introduced a range of additional TV products, some of which have been enabled by developments in technology. An example of this has been the increasing prominence of VoD as a new method for consumers to access programming.
- A2.65 Superfast broadband, IPTV, and VoD are a set of closely linked technological innovations which have the potential to deliver significant benefits to consumers. VoD services provide convenient access to a wide range of content on-demand and can be delivered over either a closed IPTV platform or the ‘open’ internet. Both of these types of network are ideally suited to Next Generation Access (‘NGA’), as they require a high bandwidth access network to enable the reliable and robust delivery of video services to consumers.
- A2.66 In the UK, VoD has become increasingly popular amongst consumers. BBC’s iPlayer catch-up TV service received 61.5 million requests to stream/download radio and TV programmes across all platforms in January 2009. This figure had nearly doubled to 114.8 million in December 2009<sup>342</sup>. At Q1 2009, 23% of UK adults (15 years and above) with internet access at home (or 16% of all adults) said that they watch online catch-up TV<sup>343</sup>.
- A2.67 Figure 10 below provides a summary of selected VoD offers from key UK providers, covering the earliest VoD offerings to the latest services available today. In the UK, VoD providers such as Virgin Media, BT Vision and TalkTalk TV, which employ pull VoD, are now offering thousands of hours of on-demand programming.

<sup>340</sup> Pay TV Statement, paragraphs 4.157 to 4.182, contained in Annex 7.

<sup>341</sup> Ofcom International Communications Market Report 2009.

<sup>342</sup> [http://www.bbc.co.uk/pressoffice/pressreleases/stories/2010/01\\_january/14/iplayer.shtml](http://www.bbc.co.uk/pressoffice/pressreleases/stories/2010/01_january/14/iplayer.shtml).

<sup>343</sup> Ofcom Communications Market Report 2009, page 267.

**Figure 10 Selected VoD offers from key providers**

Provider	Distribution technology	VoD launch date	VoD content available	Number of VoD homes
Talk Talk TV	IPTV (pull VoD)	1999 (as HomeChoice)	Thousands of hours of VoD content. Free catch-up, SVoD films (Movies Now, Picture Box, Film4 On Demand), PPV VoD and SVoD TV packages.	60,000
Virgin Media	Cable (pull VoD)	December 2005 (as Telewest's TV Drive)	Thousands of hours of VoD content. Free catch-up, SVoD films (Picture Box), PPV VoD and SVoD TV packages.	3.7 million
Top Up TV Anytime	DTT (push VoD)	November 2006	Over 700 shows a month available and SVoD films (Picture Box).	585,000 (Ofcom DTV Update, Q4 2009)
BT Vision	IPTV (pull VoD)	December 2005	Thousands of hours of VoD content. Free catch-up, SVoD films (BT Film Club pack), PPV VoD and SVoD TV packages.	467,000
Sky	Satellite (push & pull VoD)	push VoD November 2007, pull VoD late 2010	Sky Anytime TV service offers up to 85 hours of different content. Sky Anytime+ pull VoD service to launch in 2010 to Sky HD+ and Sky broadband subscribers	6.5 million for push VoD*
BBC iPlayer	Online (pull VoD)	December 2007	Offers most programming from the previous seven days of the BBC schedule on demand (for streaming or download).	All homes with hardware and suitable internet connection
Sky Player	Online (pull VoD)	December 2008	Pay TV channels on demand. Premium option for Sky Sports and Movies. On demand movies also available.	All homes with hardware and suitable internet connection

Source: Operators, using latest available data.

Note: \*Sky Anytime TV data found at <http://www.skymedia.co.uk/Audience-Insight/dashboard.aspx>

A2.68 As the table above illustrates, there is a variety of business models for VoD:

- Transactional VoD allows customers to purchase content, usually on an individual PPV basis, such as films or music videos.
- Customers can buy standalone SVoD packages, providing unlimited access to on-demand programming for a monthly fee. One example of this is PictureBox.
- In some cases VoD is bundled in with a linear television channel subscription, such as Virgin Media's TV Choice service or Sky's Sky Player service.
- Some operators also offer free access to on-demand programming, such as 'TV catch-up', where viewers can access programmes recently broadcast on TV. Such VoD services are increasingly being made available via the internet as well,

offering TV-like experiences on personal computers, such as the BBC's iPlayer, 4OD and Sky Player.

- Sky Player is also available on a standalone basis as a subscription service.

A2.69 Similar services include ITV Player, Demand Five and Blinkbox. The online TV market is likely to further develop as new providers enter the market, resulting in a greater range of programming available online to consumers. SeeSaw, owned by transmission company Arqiva, launched a catch-up TV service in February 2010 and Hulu, the US service backed by NBC Universal, News Corporation and Disney, has previously stated its ambitions to launch in the UK<sup>344</sup>. However, Hulu has since abandoned its plans to launch a UK version of its content aggregation service after struggling to agree content deals with British broadcasters<sup>345</sup>.

A2.70 In the USA, a number of Hollywood studios are expected to announce an agreement shortly with Time Warner Cable, that would allow viewers to pay between \$20 and \$30 (£14 to 21) to watch a newly-released film at home 30 days after the cinema release (which is far earlier than the usual four months<sup>346</sup>) on a PPV service. The service could launch by the end of the year or early 2011<sup>347</sup>. The service would be most likely to affect cinema owners the most as it would be launched in the traditional cinema window where films are usually only available to view at a theatre. Although this service is currently only planned in the USA, the technology is available via satellite and cable in Britain for the Time Warner idea to be adopted in the UK.

### Subscription video on demand

A2.71 The UK pay TV operators have emphasised the potential for SVoD services, which exploit rights to movies in the first pay TV subscription window, to offer instant access to a wide range of recent movies that would be highly valued by consumers. For instance, in response to our Second Pay Consultation, Virgin Media stated:

“In particular, there is a strong demand for SVoD as customers in the UK show a clear preference for subscription services over PPV services. An SVoD movie service would be an extremely compelling proposition by enabling customers to watch a movie of their choice at their convenience and without paying an additional specific fee per movie<sup>348</sup>.”

A2.72 BT expressed similar views on the strategic importance of SVoD movies services in response to our Third Pay TV Consultation:

“BT has emphasised, in particular the importance of SVoD movie services, and would highlight the success of SVoD services in other markets (particularly the US) where competitive distortions in accessing SVoD rights - such as those that exist in the UK market –

<sup>344</sup> <http://paidcontent.co.uk/article/419-hulu-talking-with-possible-partners-for-uk-launch/>.

<sup>345</sup> <http://www.telegraph.co.uk/technology/news/7639763/Hulu-abandons-UK-plans-after-broadcaster-talks-collapse.html>.

<sup>346</sup> <http://www.telegraph.co.uk/news/worldnews/northamerica/usa/7756931/From-Hollywood-to-home-blockbusters-to-hit-TV-screens-after-a-month.html>.

<sup>347</sup> [http://online.wsj.com/article/SB10001424052748704167704575258761968531140.html?mod=WSJ\\_latestheadlines](http://online.wsj.com/article/SB10001424052748704167704575258761968531140.html?mod=WSJ_latestheadlines).

<sup>348</sup> Virgin Media response to Second Pay TV Consultation, paragraph 7.12.

are not present. Accordingly, BT supports fully Ofcom’s analysis of the “high strategic importance” of VoD, including SVoD<sup>349</sup>.”

A2.73 [X] believed a broader change was occurring in the way consumers view movies, [X].

“For movies, consumers’ habits are already changing. [X] predicts that they will continue to change further.... [X]<sup>350</sup>.”

A2.74 The Major Hollywood Studios have also provided us their respective views on the future relevance of SVoD, for example:

- Sony [X]<sup>351</sup>.
- [X]<sup>352</sup>. A content provider stated that, in its view, as on-demand services continue to proliferate and grow their customer bases, the pay TV window will eventually be predominantly SVoD-based. However, given some viewers’ preference for watching programming from a linear schedule it also expected that the pay TV window will continue to include a linear component for the foreseeable future<sup>353</sup>.
- [X]<sup>354</sup>.

A2.75 Virgin Media expected strong demand for linear services to continue for some time to come, reflecting the familiarity amongst consumers for this type of viewing experience<sup>355</sup>.

A2.76 In its response to the Consultation, the BBC agreed with Ofcom in that first-run movies play an important (but declining) role in creating demand for traditional pay-TV services and are likely to play an important and growing role online as televisions become increasingly IP connected<sup>356</sup>.

## **IPTV**

A2.77 In previous Pay TV documents, we have drawn on international examples to understand how different pay TV markets operate<sup>357</sup>. Looking beyond the UK market can also help in defining a forward-looking assessment of pay TV. Our analysis in Section 4 of the Pay TV Statement<sup>358</sup> showed that the most successful IPTV launches around the world tended to share the common characteristic of having access to important premium content.

A2.78 Despite significant differences in many cases, some international markets can offer indications of how particular technologies and sectors can develop. One of the more

---

<sup>349</sup> BT response to Third Pay TV Consultation, paragraph 6.1.

<sup>350</sup> [X] response to Second Pay TV Consultation, page 6.

<sup>351</sup> [X].

<sup>352</sup> [X].

<sup>353</sup> [X].

<sup>354</sup> [X].

<sup>355</sup> Virgin Media’s non-confidential response to movies investigation reference consultation, paragraph 5.3.

<sup>356</sup> BBC response to the Consultation Executive Summary.

<sup>357</sup> First Pay TV Consultation, Annexes 9 and 16; Second Pay TV Consultation, paragraphs 3.62 to 3.86.

<sup>358</sup> Pay TV Statement, paragraph 4.166 to 4.176, contained in Annex 7.

recent technologies to see notable take-up in some markets is IPTV, which enables the delivery of television channels and on-demand programming over a broadband network rather than traditional infrastructures such as terrestrial, satellite or cable.

- A2.79 We believe VoD services are also set to become particularly important in the context of IPTV. Within this trend, premium content (in particular premium movies) could be important in driving take-up of such services. This is different to premium sports content, which loses a significant proportion of its appeal once it ceases to be live and is likely to be less important.
- A2.80 In the UK, IPTV has seen limited take-up even though it was among the first countries in which such platforms were launched. There are currently around 50,000 subscribers to the TalkTalk TV<sup>359</sup> service, while 467,000 customers had BT Vision at the end of 2009, which offers VoD over the broadband network and live television channels through the DTT service Freeview.
- A2.81 While there appears to be a move towards two-way networks facilitated by the move towards IPTV and 'next generation access' technologies, broadcast networks are likely to continue to be utilised to deliver a volume of linear television. The combination of broadcast and unicast technologies is likely to offer attractive consumer propositions.
- A2.82 IPTV appears to have seen reasonable take-up in markets where it has had access to a wide range of content. While much of the growth of IPTV in France has been attributed to 'free' TV offered with a broadband subscription, Orange TV had attracted 663,000 subscribers to its premium sports and movie channels by Q4 2009<sup>360</sup>. Other IPTV providers offer the premium sports and movie channels of Canal Plus.
- A2.83 IPTV and fibre-based broadband TV services have also seen reasonable take-up in other regions. In the US, there were 5.5 million at the end of Q1 2009<sup>361</sup>. Here some operators have adopted fibre technology (often referred to as FTTH, which stands for 'fibre to the home') to deliver a wide range of television services. Verizon's Fios TV, for example, offers up to 125 HDTV channels, multiroom<sup>362</sup> DVR functions and premium channels<sup>363</sup>. In June 2009, Verizon had 3.1 million FTTH subscribers, of which 80% had a TV subscription. At the same time, AT&T had 1.6 million subscribers on its fibre network, of which 99.5% were customers to its U-verse<sup>364</sup>. AT&T had an initial target of 30 million homes passed by the end of 2010 (but this has now been pushed back a year)<sup>365</sup>.
- A2.84 In its response to the Consultation, BT was supportive of Ofcom's view that a lack of access to SVoD content could affect IPTV's future prospects in the UK, and it argued that this lack of access had already restricted the development of IPTV to

<sup>359</sup> <http://www.ft.com/cms/s/0/a76f1918-70ad-11de-9717-00144feabdc0,s01=1.html>.

<sup>360</sup> [http://www.orange.com/en\\_EN/finance/invest-analysts/cons-results/att00014504/FranceTelecom\\_FY09Results.pdf](http://www.orange.com/en_EN/finance/invest-analysts/cons-results/att00014504/FranceTelecom_FY09Results.pdf).

<sup>361</sup> <http://www.screendigest.com/reports/10tvmarketmonitorq32009/pdf/RJAY-7ZPGPM/SD-2010-01-TVMarketMonitorIPTVQ32009.pdf>.

<sup>362</sup> Multiroom enables customers to have multiple subscriptions in the home by installing additional set-top boxes.

<sup>363</sup> <http://www22.verizon.com/Residential/FiOSTV/Details/Details.htm>.

<sup>364</sup> U-Verse uses fibre optic technology to bring to provide high speed internet, digital TV and a digital home phone service through the same connection.

<sup>365</sup> IDATE FTTx Watch Service 2009.

date<sup>366</sup>. BT also noted that IPTV penetration is substantially higher elsewhere in Europe, where market operators have had access to the necessary content to recoup investment in new delivery mechanisms.

## Changes to the window structure

- A2.85 As noted previously in this Annex, a feature of the various release windows set by the studios is that they are not fixed structures; their position and boundaries change over time. In recent years the Major Hollywood Studios have shortened windows to maximise returns from the most profitable windows<sup>367</sup>:
- In 2002 the exclusive DVD rental window was dropped, with titles being released on DVD for retail and rental simultaneously.
  - The theatrical release window has narrowed significantly, from 31 weeks to 19.5 weeks on average between 2002 and 2005.
  - Some distributors are attempting to bring the DVD window forward even further.
  - Some of the Major Hollywood Studios have publicly supported the simultaneous release of titles across cinema, DVD and VoD platforms.
- A2.86 As Figure 4 illustrates, in recent years, some of the movie windows have been moving closer together. For example, since 2003 the DVD window has shifted from being 7-8 months after the theatrical release to being 3-5 months. It has been suggested that the Major Hollywood Studios have actively shortened these windows because of the piracy that emerges in the 'dead space' between cinema and DVD releases<sup>368</sup>.
- A2.87 In February 2010, the Odeon cinema group threatened not to show the film 'Alice in Wonderland' in protest against Disney's plan to shorten the gap between the theatrical release and DVD release dates<sup>369</sup>. By reducing the standard theatrical release period from 17 weeks to 12 weeks, Disney would have been able to bring forward the film's release the end of May. This is indicative of a broader attempt by the studios to cut down the theatrical window, which reflects both the lucrative nature of the DVD market, and the studios belief that getting their films on to DVD quicker will help beat piracy. Conversely, Odeon feared that Disney's plans would lead to a standard 12 week theatrical release window for most films in the UK, reducing the period during which cinemas can generate revenue.
- A2.88 As outlined above, a non-exclusive second pay TV window has developed (the 27-36 month release window) to offer titles available immediately after the exclusive 15 month first pay TV window has finished. Currently in the UK, the only service in the second pay TV window is NBC Universal's PictureBox, which only shows the movies from one studio. However, our discussions with the Major Hollywood Studios [X]<sup>370</sup>.
- A2.89 Alongside the trend towards shorter windows, it is also important to note that studios continue to experiment with the timing of movies release. One example is

---

<sup>366</sup> BT response to The Consultation, paragraph, 2.17.

<sup>367</sup> First Pay TV Consultation, Annex 11, Screen Digest report 'Movie markets in the UK', page 9.

<sup>368</sup> <http://www.guardian.co.uk/film/2010/feb/23/alice-wonderland-odeon-disney-row>.

<sup>369</sup> <http://www.guardian.co.uk/film/2010/feb/25/odeon-alice-in-wonderland-boycott>.

<sup>370</sup> [X].

'day and date' strategies, which involve concurrent PPV and DVD movie releases. One of the pioneers of this strategy internationally has been Warner Bros, who carried out early trials by allowing digital distribution before a DVD launch<sup>371</sup>. In April 2008, Warner Bros UK brought the PPV/VoD release date to within 15 days of the DVD release of a number of films, such as *Beowulf* and *The Assassination of Jesse James by the Coward Robert Ford*<sup>372</sup>.

A2.90 Pay TV operators in the UK have also experimented with release timings<sup>373</sup>. Sky has tested the "day and date" release strategy with theatrical release and its PPV VoD, or nVoD, service Sky Box Office. It has conducted experiments with independent studios to make available the films *Edge of Heaven* and *Mum and Dad* on a PPV basis on the same day as their theatrical release<sup>374</sup>.

---

<sup>371</sup> <http://paidcontent.org/article/419-warner-bros.-tests-vod-release-of-some-new-movies-before-dvd/>.

<sup>372</sup> <http://metue.com/05-01-2008/itunes-warner-brothers-studios-dvd-day-and-date-releases/>.

<sup>373</sup> <http://www.independent.co.uk/news/media/sky-movies-ian-lewis-we-have-to-get-films-to-fans-before-they-get-to-them-illegally-816403.html>.

<sup>374</sup> Sky response to Second Pay TV Consultation, Annex 3, paragraph 2.6.



## Annex 3

# Market definition

## Summary

A3.1 In this Annex we present the additional detail of our analysis in relation to market definition. Respondents' views on the market definition analysis set out in the Consultation, and our final views on market definition in light of those responses, are presented in Section 4 of this document.

## Introduction

A3.2 In making a reference to the CC, the OFT's Guidance says that it is necessary to give 'some consideration to the definition of the relevant market', although noting that 'the effects on competition of some features may be clear enough that firm conclusions on the definition of the relevant market ... are unnecessary'<sup>375</sup>.

A3.3 The purpose of market definition in the context of a market reference is to help us assess competition concerns. We have concerns that a combination of features of the market for the sale of movie rights from Major Hollywood Studios in the first pay TV subscription window in the UK and the wholesale of packages including Core Premium Movies channels prevents, restricts and distorts competition, resulting in adverse impacts on consumers. We consider the relevant markets in order to consider the extent of this problem and to help scope possible remedies.

A3.4 The test for making market investigation references to the CC under s131 EA02 requires the consideration of reference markets for the goods or services involved. Market definition is an important means of identifying the competitive constraints that individual firms face and is an exercise which assists regulators and competition authorities in the assessment of the relative competitive positions of firms. In this case, we believe it is necessary for us not only to consider the definition of the upstream market for the relevant content rights, but also the related downstream wholesale market within which those rights are packaged into products suitable for distribution by pay TV retailers. We therefore look at the sale of movie rights in the first pay TV subscription window in the UK and also the supply of wholesale packages including Core Premium Movies channels for which these rights are an input.

A3.5 We start by describing our approach to market definition before going on to consider the relevant upstream focal product. We then briefly set out the downstream markets which we have defined as part of the Pay TV Statement<sup>376</sup> and how these relate to the upstream market.

## Our approach to market definition

A3.6 Our approach to market definition is to consider whether any other products are close substitutes for the focal product, and may therefore be expected to exert a competitive constraint. The standard test for identifying close substitutes is the 'hypothetical monopolist' test ('HMT'). The test seeks to establish the smallest

---

<sup>375</sup> OFT's Guidance, paragraph 4.8.

<sup>376</sup> Contained in Annex 7.

product group such that a hypothetical monopoly provider of the products in that group could sustain prices above the competitive level.

- A3.7 Market definition in a sector which is characterised by highly differentiated products may be difficult. In this situation, the market boundary may not be well defined. In addition, having a differentiated product (i.e. one with unique characteristics which are important to consumers) generally allows providers to charge a higher price. The more differentiated a product is from its closest substitutes, the more scope its provider will have to set prices above competitive levels. With a limited degree of differentiation, prices may be close to their competitive levels. However, at the other end of the spectrum, the provider of a highly-differentiated product may be able to act as a monopolist<sup>377</sup>.
- A3.8 Assessing the impact of an increase in prices under an incorrect assumption that current prices are at competitive levels is known as the Cellophane Fallacy. We believe that the cellophane effect compromises the application of the HMT in the case of movies market definition. As a result there is limited value in using empirical studies to assess switching responses to a price increase in order to define market boundaries. This is considered further in our Pay TV Statement<sup>378</sup>.

### The relevant focal product

- A3.9 As market definition is essentially a tool for assessing competition concerns, it should be conducted in light of the specific competition concerns that we have identified. Our concern is that Sky, as a vertically integrated firm, with market power in a key upstream market, distributes its Core Premium Movies channels in a manner that favours its own platform and its own retail business by denying these channels to other retailers / platforms, or by making them available on unfavourable terms.
- A3.10 Our concern about upstream rights is that the way in which these rights are sold may create a barrier to entry in the wholesale of packages including Core Premium Movies channels. As noted in Section 3 and Annex 2 of this document, movies are an important content genre for consumers and availability of premium movies is a key driver of pay TV subscriptions. In particular, and as argued in our Pay TV Statement<sup>379</sup>, consumers value access to (a) high-quality movies, (b) recent releases, (c) a large number of movies for a monthly subscription and (d) movies on TV. While movies are delivered in a number of different formats, Core Premium Movies channels are distinct in allowing subscribers to see a large number of recent high quality movies on TV for a monthly subscription, although an SVoD service with first-run Hollywood movies would also have these features. Sky is uniquely able to offer pay TV packages with this combination of features because it has exclusive rights to show movies from Major Hollywood Studios in the first pay TV subscription window, both on linear channels and SVoD.
- A3.11 As noted in Section 6 and Annex 5, there is currently limited exploitation of SVoD rights; Sky has access to the rights as part of its exclusive contracts with Major Hollywood Studios but does not fully exploit these rights over its platform and does not supply SVoD to other wholesalers. However, since the SVoD rights are sold as part of the exclusive package of first window pay TV rights and the rights underpin

<sup>377</sup> This is distinct from cases where there are multiple providers of an undifferentiated product, and in which the current price can be taken to be competitive (e.g. in some merger cases).

<sup>378</sup> Pay TV Statement, paragraphs 5.47 to 5.59, contained in Annex 7.

<sup>379</sup> Section 6, contained in Annex 7.

services with very similar characteristics to linear movie channels, e.g. in terms of films available and payment methods, we include these rights in the focal products.

- A3.12 As a result, we believe the relevant focal product for us to consider in the upstream market is the sale of movie rights in the first pay TV subscription window in the UK from the Major Hollywood Studios. The next step is to consider whether this focal product forms a distinct economic market. We then consider downstream wholesale and retail market boundaries which have been reviewed as part of the pay TV investigation, in order to assess whether downstream switching in the event of a price increase by a hypothetical monopolist supplier would impose indirect constraints on the upstream supply of movie rights from Major Hollywood Studios.
- A3.13 Premium SVoD services could provide a very similar experience to subscribing to a linear channel, but with added convenience, and are likely to be a close substitute, particularly given that the rights are supplied in the same window as linear channels<sup>380</sup>.

### Upstream market definition

- A3.14 We start with the hypothesis that there is a distinct market for the sale of Movie Rights in the UK. The relevant question is then whether the market should be expanded to include other content rights (non-movies or movies from other studios) and/or movies rights in other windows.
- A3.15 In order to assess this, we have regard to both the direct and indirect constraints if a hypothetical monopolist provider of Movie Rights (including linear and SVoD rights) raised the price of the rights.
- A3.16 Switching in response to a price rise may be affected by the cellophane effect<sup>381</sup>. We note in the context of upstream rights that there are six Major Hollywood Studios. Given that we have not assessed the degree of competition (and product differentiation) between these studios, we are unable to assess whether their prices are above competitive levels. However, the fact that Sky has retained the rights for all six Major Hollywood Studios for almost 20 years, means that we have not observed any switching in response to price rises, so the cellophane effect does not arise as an empirical concern in our analysis.
- A3.17 **Direct constraints** on rights sellers would arise from pay TV wholesalers responding to an increase in upstream rights by choosing to purchase other rights (demand-side substitution), or by an alternative supplier (e.g. a movie studio other than one of the Major Hollywood Studios) responding to a price increase by entering the market and supplying equivalently attractive rights as the hypothetical monopolist (supply-side substitution). This is in contrast to **indirect constraints** which could arise if (a) upstream prices were passed on to wholesalers and in turn passed on in retail prices and (b) subscribers were to respond to these retail price increases by switching to other services. We first consider direct constraints and move on to examining downstream market definition in order to draw conclusions about the likely extent of indirect constraints.
- A3.18 In terms of direct constraints, in response to an increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window a wholesale channel provider has two options:

---

<sup>380</sup> Pay TV Statement, paragraphs 6.211 to 6.221, contained in Annex 7

<sup>381</sup> Pay TV Statement, paragraphs 5.47 to 5.59, contained in Annex 7

- replace movie rights from Major Hollywood Studios in the first pay TV subscription window with non-movies content or movies content from other studios; and/or
- replace movie rights from Major Hollywood Studios in the first pay TV subscription window with movie rights from other windows

A3.19 Consumers have strong preferences for a wide range of up-to-date quality movies on television, as discussed in Annex 2. Based on the evidence set out in section 6 of our Pay TV Statement, (annexed to this document) we consider that there are likely to be few close substitutes for the content on Core Premium Movies channels for consumers. As a result it seems unlikely that a broadcaster could profitably switch from using movie rights from Major Hollywood Studios in the first pay TV subscription window to using rights to alternative, non-movies, content or less attractive movies which would hold similar appeal to consumers.

A3.20 It is possible that the Movie Rights market should be broadened to include the supply of movie rights in other release windows. For example, movie rights in the second pay TV window or rights to DVD rentals could constrain the pricing of movies in the first pay TV window. However, we note that the structure of the release windows system is designed to exploit different consumer preferences and is consistent with distinct narrow markets.<sup>382</sup> As a result, we think it unlikely that a wholesale provider of Core Premium Movies channels would be able to switch away from the first pay TV subscription window and provide a service which satisfies consumer preferences for premium movies on television.

A3.21 In addition, we note that it is possible that Sky could continue to purchase premium movie rights in the event that a hypothetical monopolist tried to increase their price. As noted in the Pay TV Statement<sup>383</sup>, we believe that prices for retail and wholesale packages including Core Premium Movies channels are above the competitive level. Therefore, Sky could, in principle, absorb an increase in the price of premium movie rights from competitive levels, and this may be more profitable than switching to rights to content which is perceived as being a poor substitute.

A3.22 We do not consider, therefore, that there are likely to be strong direct constraints to a small but significant increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window.

A3.23 We now consider whether it would be possible for supply-side substitution to undermine a price increase by a hypothetical monopolist. This would require another studio entering the sector, or an existing smaller player growing and being able to offer rights of equivalent appeal as recent releases from Major Hollywood Studios. This in turn would be dependent on another studio being able to make films of a comparable quality and quantity each year as the six Major Hollywood Studios, which is likely to be associated with substantial upfront costs and specialist knowledge of the sector. It would also require a new entrant to be able to supply a significant number of movies in order to make its product a viable alternative to the products available from existing studios and to encourage switching away from those products. This scale is only likely to be achievable over the long term and is likely to be associated with a high degree of risk. As a result we do not believe supply-side substitutability causes us to extend market boundaries beyond the focal product identified.

<sup>382</sup> Pay TV Statement, e.g. paragraph 6.30, contained in Annex 7.

<sup>383</sup> Pay TV Statement, paragraph 6.329 to 6.337, contained in Annex 7.

A3.24 Hence, we do not believe there are substantial direct constraints on pricing in the upstream Movie Rights market.

### Downstream markets

A3.25 In assessing downstream markets, we consider the conclusions of the market definition analysis set out in the Pay TV Statement<sup>384</sup> section 6 (annexed to this document). In this, as part of the retail market definition exercise, we considered whether our candidate market – the supply of packages including Core Premium Movies channels - should be expanded to include Major Hollywood Studio movies delivered in different windows. We also consider whether the relevant market should also include, for example, theatrical releases, DVD rentals, FTA movies or alternative types of content (non-movies).

A3.26 We concluded that there are narrow markets for the retail of packages including Core Premium Movies channels to UK residential customers. In coming to this view, we considered a range of evidence, including product characteristics, profitability analysis, consumer preferences and data on alternative means of watching movies, which suggests that demand-side substitution is unlikely in the event of a price rise<sup>385</sup>.

A3.27 This partly reflects our analysis that basic pay TV and FTA movies are inferior substitutes in terms of the number of hours of movie programming and the age of the movies. Similarly, characteristics of other movie formats are not sufficiently close to the first pay TV window movies to provide an adequate substitute such that switching to these products would constrain the pricing of a hypothetical monopolist supplier of packages including Core Premium Movies channels (even when we consider the aggregate constraint imposed by all potential substitutes).

A3.28 In addition, we believe that entry by new suppliers is unlikely in the short term, because of the lack of availability of alternative relevant wholesale channels which would be of equivalent appeal to viewers.

A3.29 In the Pay TV Statement, we also concluded that the scope of the relevant wholesale market is no wider than the relevant retail market and hence there is a narrow economic market for the wholesale supply of packages including Core Premium Movies channels.

A3.30 In coming to this conclusion, we took the view that there are limited direct constraints associated with retailers switching away from purchasing Sky Movies in the event of a price rise. In addition, the narrow wholesale market definition derives from the limited indirect constraints imposed by consumer switching in the event of a price rise. As with retail market definition, this is based on a range of evidence, including product characteristics, consumer preferences, data on alternative means of watching movies, internal documents and pricing and profitability evidence<sup>386</sup>.

A3.31 For more details on downstream markets, please refer to Section 6 of the Pay TV Statement contained at Annex 7.

---

<sup>384</sup> Pay TV Statement, Section 6, contained in Annex 7

<sup>385</sup> Pay TV Statement, Section 6, contained in Annex 7

<sup>386</sup> Pay TV Statement, paragraphs 6.102 to 6.103, contained in Annex 7

### **Indirect constraints on the prices of upstream rights**

- A3.32 As noted above, we need to assess the likely indirect constraints on pricing which might arise if the increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window was passed on to wholesalers of packages including Core Premium Movies channels and ultimately subscribers. If consumers respond to the price increase by switching to alternative content or alternative means of watching recent releases from Major Hollywood Studios, this could impose an indirect constraint on upstream rights.
- A3.33 Since we have identified narrow wholesale and retail movies markets as part of our market definition in the Pay TV Statement, we can infer that the indirect constraints on upstream prices are likely to be very limited. We have noted that there are no close substitutes for channels including films in the first pay TV subscription window from the Major Hollywood Studios that a consumer or retailer would switch to in the event of a price rise.

## Annex 4

# Features of the market

## Introduction

- A4.1 In this Annex we present the additional detail of our updated analysis from the Consultation in relation to market features. Respondents' views on the analysis, and our final views on market features in light of those responses, are presented in Section 5 of this document.
- A4.2 We suspect that the combination of the features we identify in this section adversely affects competition – we explain how in Section 6 and Annex 5.
- A4.3 For the purposes of a market investigation reference, a 'feature' of a market may be either structural or conduct-related, although in practice there may not be a clear divide between these<sup>387</sup>. Features of a market may include conduct, either in the market referred or a related market, by persons active in the market concerned<sup>388</sup>. They may also include conduct relating to the market concerned, by customers of any person who supplies or acquires goods or services<sup>389</sup>. Each of the features we identify can be regarded as relating to each of the two interdependent but related markets: the upstream market for the sale of movie rights in the first pay TV subscription window in the UK and the wholesale market for the supply of packages including Core Premium Movies channels in the UK. In the context of these particular markets we do not consider it possible to conclude that these features are exclusive to only one of the markets.

## A limited pool of premium content

- A4.4 In Annex 2, we have noted the importance of premium movies for driving platform choice and hence entry into the market for the supply of packages including Core Premium Movies channels. As set out in Section 4 and Annex 3, we believe that there are distinct markets for Movie Rights and the wholesale supply of packages including Core Premium Movies channels.
- A4.5 In the first pay TV subscription window, movies are typically licensed exclusively. Depending on its size, a single studio releases a limited number of movies per annum ('studios' output) – on average around 30. The average cost for making and marketing a single Hollywood film is about \$100m<sup>390</sup>.
- A4.6 Currently, Sky has ongoing individual agreements with all six Major Hollywood Studios<sup>391</sup>, which generally require Sky to purchase a maximum number of around [ X ] releases from each studio per year<sup>392</sup>. This means that the total number of first

---

<sup>387</sup> OFT's Guidance, paragraph 4.4.

<sup>388</sup> S131(2)(b) Enterprise Act.

<sup>389</sup> S131(2)(c) Enterprise Act.

<sup>390</sup> The MPAA's Theatrical Market Statistics 2007 - <http://www.mpa.org/2007-US-Theatrical-Market-Statistics-Report.pdf>, page 7.

<sup>391</sup> As at 31 March 2010. Sky's response dated August 2007 to information request dated 18 July 2007 and Sky's response dated 8 May 2009 to information request dated 20 March 2009 question.

<sup>392</sup> Output deals are common in the Hollywood film industry where the studios typically agree to license to broadcasters their entire anticipated film production (subject to a maximum) for a given period of years. For details see Sky's output deals with the Major Hollywood Studios.

releases from the Major Hollywood Studios licensed to Sky is around [ X ] less than 200 per year.

- A4.7 A potential entrant at the wholesale level would have to acquire a broad enough selection of the premium movie rights to assemble an appealing package for consumers. The ability to do so is constrained by this limited pool of rights for broadcasting movies produced by the Major Hollywood Studios which presumably results from the high costs of producing such content.
- A4.8 Paragraphs 4.7 to 4.8 of Annex 5 of our Pay TV Statement discussed the minimum volume of rights needed to viably launch a Core Premium Movies channel<sup>393</sup>.
- A4.9 In its response to the Second Pay TV Consultation, Virgin Media argued that the rights of at least three Major Hollywood Studios would be required in order to assemble an appealing package which could then be marketed as a mid-priced alternative to Sky Movies<sup>394</sup>.
- A4.10 The importance of being able to acquire movies from a number of Major Hollywood Studios was also confirmed by the studios. For example, [ X ] said that aggregation drives people to services and that it only produces [ X ] movies a year which is not enough, even with library content, to make a service<sup>395</sup>. Similarly, [ X ] was of the view that it is quite hard to launch a service with the content from one studio. [ X ] believed that in the UK a platform would probably need content from around three Major Hollywood Studios<sup>396</sup>.

### The release windows structure

- A4.11 As explained in Annex 2, in the UK films are released through a series of windows set by the Major Hollywood Studios. Different time windows mean that the movies can be watched in various ways, including on traditional linear TV channels such as Sky Movies channels and other basic or FTA channels. Alternatively, they can be downloaded via the open internet, bought or rented on DVD, or watched on an on-demand service.
- A4.12 Essentially, the release windows structure drives the timing of when movies over different formats become available for viewing and how consumers pay to view them (e.g. whether they pay on a one-off or a subscription basis). Potential substitutes to Core Premium Movies channels at the wholesale and retail levels are strongly differentiated in terms of format, timing, quality, quantity and price.
- A4.13 The release windows structure enables movie studios to price discriminate, i.e. set different prices for different windows, and studios determine the order and length of the windows in order to maximise their profits. As a result, the studios can earn significant revenues well after their initial release.
- A4.14 The traditional sequential windowing structure has persisted for a number of years, although durations of windows have changed. It is possible that the sequencing or

<sup>393</sup> Contained in Annex 7. See also paragraphs 2.263 to 2.266 of Annex 8 to Third Pay TV Consultation for our discussion on synergies that arise from having a large volume of movies.

<sup>394</sup> See Virgin Media's response to Second Pay TV Consultation, paragraph 4.7.

<sup>395</sup> [ X ].

<sup>396</sup> [ X ].



structure of windows will change in the future. However, studios have not informed us of any firm plans in relation to [X]<sup>397</sup>, although [X].

A4.15 In its response to the Consultation, Warner said that the UK launch of WarnerFilms on BT Vision was announced on 4 May 2010<sup>398</sup>. This is an SVoD service that provides access to 28 movies each month, with 7 new titles added every week. Warner added that “It will include content to be screened after it has been licensed to Sky”. [X]<sup>399</sup>.

A4.16 Given the duration of current contracts and the nature of many of the studios’ comments, we do not expect significant changes in the way rights are sold in the first pay TV subscription window in the short to medium term. We note, however, that the studios may experiment with new methods of distribution that could initiate some significant changes to the release schedule in other windows.

### The joint licensing of linear channel and SVoD rights by individual studios

A4.17 At present, the Major Hollywood Studios bundle SVoD rights with the rights to show movies on subscription linear channels, and these bundled rights are acquired on an exclusive basis by Sky. As a result, Sky holds the SVoD rights across multiple distribution technologies for all six studios. As noted above, the studios [X].

A4.18 However, the joint sale of linear and SVoD rights creates a risk that only one set of rights is exploited effectively, because the purchaser does not have the platform capability to exploit the other set of rights. The result is that the other rights effectively become warehoused.

A4.19 Sky in particular faces a technological restriction in the supply of SVoD services on its satellite platform<sup>400</sup>. In contrast, other operators have had the capability to deliver SVoD services for several years, and have unsuccessfully tried to obtain access to SVoD rights.

A4.20 We have analysed information on the negotiations between UK operators and the Major Hollywood Studios in relation to the acquisition of UK pay TV premium movie rights. [X].

A4.21 In particular, on a number of occasions Virgin Media and [X] have discussed purchasing premium movie rights with the Major Hollywood Studios. However on each occasion Virgin Media decided that it was [X]. Virgin Media told us that “it has been unsuccessful due to the difficulties of countering Sky’s dominant position. [X]<sup>401</sup>.”

---

<sup>397</sup> The responses from the six Major Hollywood Studios to Ofcom’s May 2009 Information Requests [X].

<sup>398</sup> Paragraph 4.10.2.

<sup>399</sup> [X].

<sup>400</sup> Broadcast satellite is a one-to-many technology and is unable to offer true SVoD. It is important to note that DVR services such as Sky+ offer a somewhat similar experience to SVoD, but with a lower choice due to storage capacity, and also with the need to plan ahead. The same is true of push VoD. Push VoD services (such as Sky Anytime) are limited by the capacity available to store programming on the set-top box, as well as by the need to predict what consumers will wish to watch, so typically offer a significantly reduced choice of programming as compared to pull VOD.

<sup>401</sup> [X].

- A4.22 Some of the studios, like [ X ], have explored alternative means of exploiting their rights, including unbundling the SVoD rights, [ X ]<sup>402</sup>. [ X ]<sup>403</sup>.
- For example during negotiations in [ X ]<sup>404</sup>. [ X ]<sup>405</sup>.
  - This is consistent with [ X ]'s discussions with [ X ] for premium SVoD rights. It appears that Sky's offer, [ X ]<sup>406</sup>.
  - Virgin Media also told us that it had [ X ] explored the potential to secure a deal for a non-exclusive SVoD movie package from [ X ]. However, such a move could have had repercussions on the price that [ X ] received from Sky for the package of linear rights. [ X ]<sup>407</sup>. [ X ]<sup>408</sup>.

### Exclusivity of rights licensing agreements between studios and purchasers

- A4.23 Rights to the first pay TV subscription windows are secured under exclusive contracts with individual studios. In the UK, Sky has exclusive agreements with all six Major Hollywood Studios<sup>409</sup>, typically acquiring the rights to show a film a given number of times over the pay TV subscription window (a period of up to 15 months), approximately twelve months after cinematic release in the UK<sup>410</sup>. This means that these rights are not available for that period to any competing wholesalers within the UK. [ X ].
- A4.24 Exclusivity enables wholesalers and pay TV retailers to differentiate their services and thereby attract and retain subscribers<sup>411</sup>, and it generates revenue for studios. The exclusive licensing, however, limits the availability of alternative products to Sky's Core Premium Movies channels in the wholesale and retail markets.
- A4.25 Exclusivity can also provide a mechanism for the studios to recover the fixed costs of content production without competitive pressures driving downstream prices close to zero. As we discussed in our First Pay TV Consultation, where content is sold on a fixed fee basis, content providers are likely to prefer to sell on an exclusive basis. Otherwise, the first purchaser of the content would face the risk of the content being sold to additional wholesalers and downstream competition would potentially drive prices down to a low level (particularly given zero marginal costs to wholesale channel providers). This would substantially reduce the amount purchasers would be prepared to pay. Thus, where content is sold on a fixed fee basis, exclusivity is generally a more profitable strategy for the content seller.
- A4.26 By contrast, where content is sold on a per subscriber basis, this rationale for exclusivity is likely to be much less important to rights holders. The threat of downstream competition driving prices to very low levels is much weaker because

<sup>402</sup> [ X ].

<sup>403</sup> [ X ].

<sup>404</sup> [ X ].

<sup>405</sup> [ X ].

<sup>406</sup> [ X ].

<sup>407</sup> [ X ].

<sup>408</sup> [ X ].

<sup>409</sup> Contracts as at 31 March 2010. Exclusive agreements between pay TV providers and the film studios are called 'output deals' and run for several years.

<sup>410</sup> Annex 11 to First Pay TV Consultation, page 87 -

[http://www.ofcom.org.uk/consult/condocs/market\\_invest\\_paytv/annex11.pdf](http://www.ofcom.org.uk/consult/condocs/market_invest_paytv/annex11.pdf).

<sup>411</sup> The OFT's 2002 Decision -

[http://www.of.gov.uk/advice\\_and\\_resources/resource\\_base/ca98/decisions/bskyb2](http://www.of.gov.uk/advice_and_resources/resource_base/ca98/decisions/bskyb2).

wholesale channel providers at least need to ensure that they recover their marginal costs in relation to upstream content, as reflected in the per subscriber charge. In principle, a studio could therefore charge the same (or similar) per subscriber fees to multiple wholesale channel providers without facing the risk of a collapse in downstream prices – although we recognise that this type of arrangement can lead to ‘double marginalisation’<sup>412</sup>.

A4.27 The current contracts [ X ]<sup>413</sup>.

A4.28 In terms of the first pay TV subscription window itself, we have found that:

- Paramount Pictures has not contemplated plans to alter the way the first pay TV linear and SVoD rights are distributed in the UK<sup>414</sup>. [ X ]<sup>415</sup>.
- [ X ]<sup>416</sup>.
- [ X ]<sup>417</sup>.
- [ X ]<sup>418</sup>.
- [ X ]<sup>419</sup>. [ X ]<sup>420</sup>.

### Other restrictions in contracts

A4.29 As discussed, Sky currently holds the SVoD and linear rights for the same movies in the first pay TV subscription window. There are a number of conditions attached to acquiring these rights:

- firstly, [ X ]<sup>421</sup>; and
- secondly, [ X ]<sup>422</sup>.

A4.30 In some cases broadcasting films from a particular studio on an SVoD basis is conditional [ X ] for example:

- [ X ]<sup>423</sup>. [ X ]<sup>424</sup>; and

---

<sup>412</sup>Double marginalisation is an efficiency loss that may arise when a retailer purchasing content from a third-party wholesale channel provider does not see the true marginal cost of supplying content to individual consumers, which is close to zero, but instead sees a per-subscriber wholesale subscription charge. Thus the retailer’s incentive to make the content widely available is weakened. As a result, the retailer is likely to set higher retail prices and may be discouraged from promoting / advertising the channel. In contrast, a vertically integrated retailer sees the true marginal cost of content.

<sup>413</sup> [ X ].

<sup>414</sup> Non-confidential version of Viacom’s response to Ofcom’s Information Request dated 20 May 2009.

<sup>415</sup> [ X ].

<sup>416</sup> [ X ].

<sup>417</sup> [ X ].

<sup>418</sup> [ X ].

<sup>419</sup> [ X ].

<sup>420</sup> [ X ].

<sup>421</sup> [ X ].

<sup>422</sup> [ X ].

<sup>423</sup> [ X ].

- [X]<sup>425</sup>.

A4.31 Contracts also contain [X]<sup>426</sup>.

A4.32 The restrictions described may have a direct impact on the flexibility of wholesalers to develop premium movie packages. One stakeholder told us that it had problems in acquiring [X]<sup>427</sup>. [X]. We note that in particular, the condition requiring [X] might be expected to affect competition in the retail market.

A4.33 Given that these contract restrictions are confidential, we recognise that stakeholders have been unable to comment on this feature. In light of this, we have also considered the extent to which the combination of all the features, absent this feature, has an adverse effect on competition. We believe that there are sufficient competition concerns relating to the combination of the remaining features that our overall conclusions on the making of the reference would not be affected.

A4.34 Therefore, whilst we continue to identify ‘other restrictions in contracts’ as a feature of these markets, we consider that this feature is not necessary for the purpose of deciding whether or not we may make a reference.

### Aggregation of substitutable premium movies

A4.35 As we would expect, content aggregation is a particularly important characteristic of the way in which movie services are put together. Content aggregation is significant because consumers have widely differing content preferences. There is a limited amount of content which is highly valued by large groups of consumers, plus a long tail of content that is attractive to some individual consumers, but not to others.

A4.36 The content available from a single studio does not provide the volumes required to create an attractive package. As explained above, a single studio might release around 30 movies per year. Given this, content aggregation is necessary in order to assemble a credible pay TV proposition.

A4.37 Sky currently purchases the rights to movies in the first pay TV subscription window from all six Major Hollywood Studios<sup>428</sup>. At the wholesale level, Sky aggregates different movies into channels and bundles of channels. While we recognise that content aggregation is often good for consumers and necessary to create attractive retail propositions, it may also cause us concern, particularly where it contributes to market power.

A4.38 Aggregation of a high proportion of available premium movie rights from Major Hollywood Studios may have significant implications for the market, especially since the content being bundled is substitutable. By doing this, a buyer may be able to dampen the competition that would otherwise exist between competing premium movie services. This would allow a wholesaler to extract greater rents from retailers and ultimately final consumers.

---

<sup>424</sup> [X].

<sup>425</sup> [X].

<sup>426</sup> [X].

<sup>427</sup> [X].

<sup>428</sup> Contracts as at 31 March 2010.

## Staggered availability of content rights and duration of contracts

- A4.39 Sky has had contracts with the six Major Hollywood Studios for the subscription pay TV subscription window since [X]<sup>429</sup>. Contracts tend to cover a number of years, and we note that the rights award process is not particularly transparent as contracts are negotiated confidentially between a broadcaster and individual studios<sup>430</sup>. As a result, the precise duration of each contract is not widely known. We have reviewed Sky's contracts with the Major Hollywood Studios and found that duration ranges between [X].
- A4.40 Typically, the rights are agreed for varying durations and contracts do not run in parallel. As a result, rights become available on a staggered basis rather than all at once.
- A4.41 Figure 11 below shows the dates on which Sky's current contracts with the Major Hollywood Studios expire to 31 March 2010. The length of time between Sky's contracts with different Studios expiring ranged from [X] months to [X] months. Since there is no guarantee that a rival bidder would win the next set of available rights, in practice a new entrant could face a significant delay before it could acquire additional rights<sup>431</sup>. We also note that [X].

### Figure 11 Expiry dates of Sky's contracts with the Major Hollywood Studios, to 31 March 2010

[X]<sup>432</sup>

- A4.42 A wholesaler wishing to launch a new service will typically need to acquire the movie output from more than one studio. Constructing an appealing film package is likely to require a large volume of movies, in order to be able to offer a critical mass of content to consumers<sup>433</sup>. Because of the staggered availability of rights, this cannot be achieved simultaneously. As set out above, Virgin Media noted that assembling a portfolio of attractive movie content across the Major Hollywood Studios is essential to compete with Sky Movies<sup>434</sup> which may take a few years to achieve. Additionally, Virgin Media pointed out the "movie rights from more than one studio [act] as a risk pooling measure because the success of studios in producing popular titles ... will vary from year to year"<sup>435</sup>. This is likely to constitute a barrier to entry for a wholesaler.

## Sky's market power

- A4.43 The various features we have discussed above, in particular the joint sale of linear and SVoD rights on an exclusive basis, enable first movers in the sector to

<sup>429</sup> The year depends on the studio. Source: Sky response to information request of 20 December 2007. Note however that Disney premieres its animated films on its Disney Cinemagic channel, before they are shown on Sky Movies (see for example [http://media247.co.uk/skydigital/newsarchive/2006/02/sky\\_launch\\_conf.php](http://media247.co.uk/skydigital/newsarchive/2006/02/sky_launch_conf.php)).

<sup>430</sup> A more transparent alternative could be publishing calls for tenders, notifying contract awards and publishing award criteria.

<sup>431</sup> The timing of negotiations between a Major Hollywood Studio and potential bidders is not fixed. For example, [X]. This was over [X] in advance of the expiry of Warner's then agreement with Sky (in [X]). [X].

<sup>432</sup> [X].

<sup>433</sup> See also Section 6 of this document.

<sup>434</sup> Virgin Media response to Second Pay TV Consultation, paragraph 4.15.

<sup>435</sup> Ibid, paragraph 4.10 .

monopolise the acquisition of content. We consider that, as a result, Sky has an advantage in relation to the acquisition of premium SVoD rights.

- A4.44 Our view is strongly supported by the historical evidence. In the UK Sky has managed to maintain its position over a prolonged period of time; over a period of almost 20 years Sky has never lost any of the premium movie rights. We regard this as clear evidence, contrary to Sky's claims that these rights are "contestable", that in practice there are significant barriers to other parties winning sufficient rights away from Sky.
- A4.45 In Section 6 of the Pay TV Statement we have concluded that Sky has market power in the wholesale supply of packages including Core Premium Movies channels, and is likely to for the next three to four years. This is based on Sky's very high and sustained market shares, the existence of barriers to entry, a lack of countervailing buyer power, and evidence that current prices are above the competitive level.
- A4.46 We note that Sky has a 100% share in the market for the wholesale of packages including Core Premium Movies channels. However, we also acknowledge that this market share figure substantially overstates the degree of market power held by Sky. There are a variety of other ways of watching films, and the aggregate constraint from these may be significant. Retail DVDs and films on free-to-air channels are the two types of service that offer the strongest constraint, as they are the closest substitutes that are of significant scale.
- A4.47 We have assessed the strength of this aggregate constraint by calculating market shares under a variety of assumptions for the market boundary. Considering the constraint to be as strong as it plausibly could be, Sky would have a market share of around [ X ] 30-40 to 40-50%. This figure understates the degree of market power held by Sky, since it treats moderate substitutes as if they were close substitutes. The balance of evidence leads us to take the view that Sky has market power.
- A4.48 Our view on whether potential competition is sufficiently strong to undermine the market power suggested by Sky's market shares is as follows<sup>436</sup>:
- we consider that Sky is likely to maintain its wholesale position unless it loses the majority of premium movie rights;
  - we consider that Sky is likely to win the majority of premium movie rights that become available. This reflects the advantages that Sky enjoys when bidding for these rights. These advantages constitute barriers to entry and expansion from the perspective of competitors seeking to enter the wholesale market for Core Premium Movies channels; similarly they prevent other players from negotiating successfully for pay TV subscription movie rights; and
  - accordingly, we consider that the threat of entry is not strong enough to prevent Sky maintaining and exercising its market power. The weakness of existing and potential competition is consistent with Sky possessing market power, and potentially a dominant position.
- A4.49 In addition, our view that Sky has market power is supported by evidence that Sky's returns from the wholesale of movies channels are above the competitive level.

---

<sup>436</sup> Pay TV Statement, paragraphs 6.300 to 6.319, contained in Annex 7.

Sky’s persistently high returns are directly indicative of market power<sup>437</sup>, and this is not dependent on the precise market definition or market shares. Under our central case we find that Sky makes a return on sales for wholesale movie channels of [ X ]%, and a margin over direct costs of [ X ]%<sup>438</sup>. These estimates are subject to some uncertainty, but are materially higher than would be expected in a competitive market.

A4.50 In our Pay TV Statement, we have also projected future market shares, particularly for relatively new services like legal movie downloads and Sky’s proposed SVoD service. The key implication that we have drawn is that Sky’s market power is unlikely to materially decline in the next few years. In particular, [ X ]<sup>439</sup>.

## Vertical integration

A4.51 Closely related to Sky’s market power is vertical integration across wholesale and retail activities, a common feature in the pay TV sector, as illustrated in Figure 12.

**Figure 12 Table showing operators’ participation at different levels of the value chain**

	Content generation	Wholesale channel	Wholesale platform services	Retail services
BT Vision			✓	✓
Discovery	✓	✓		
Disney	✓	✓		
MUTV	✓	✓		
Sky	✓	✓	✓	✓
Top Up TV			✓	✓
Virgin	✓	✓	✓	✓

Source: Ofcom

A4.52 Vertical integration can enable firms to exploit synergies between different layers of the value chain and contribute to consumer benefits<sup>440</sup>. On the other hand, vertical integration combined with market power can result in incentives to act in ways which limit competition<sup>441</sup>. This is because a vertically integrated firm will also take into account the impact of its actions at one level of the supply chain on other parts of its businesses.

<sup>437</sup> OFT’s Guidance paragraph 6.6.

<sup>438</sup> Pay TV Statement, paragraph 6.334, contained in Annex 7.

<sup>439</sup> Pay TV Statement, paragraphs 6.338 to 6.344, contained in Annex 7.

<sup>440</sup> See our Pay TV Statement, paragraph 4.89, contained in Annex 7, for our discussion of efficiencies of vertical integration.

<sup>441</sup> We recognise that vertical integration is commonplace and only problematic in certain circumstances. This poses the question whether those conditions apply in the present circumstances. We assess this question in detail in Section 7 of the Pay TV Statement.

- A4.53 For example, absent regulation, there is a potential incentive for a vertically integrated firm to refuse to supply wholesale services to other retailers, or to supply them on less favourable terms than it supplies itself. A firm with market power at the wholesale level may also seek to restrict downstream competition if it considers that downstream competitors may ultimately challenge its upstream position. In a contest for rights to TV content, a firm which was the leading retailer on a pay TV platform would have an advantage over other bidders, and this advantage would be greater the larger the firm's subscriber base.
- A4.54 In addition, if Sky retails it can influence the movement of subscribers between platforms through retail packaging and pricing, thereby ensuring that it as far as possible locks subscribers into its core satellite platform. On the other hand, if it wholesales to others, while it still gets the wholesale revenue associated with subscribers on other platforms, it loses the control over cross-platform retail packaging and pricing, which means that it faces a greater risk of losing customers from its satellite platform.



## Annex 5

# Prevention, restriction and distortion of competition

## Introduction

- A5.1 In this Annex we present our updated analysis in relation to the prevention, restriction and distortion of competition. Respondents' views on the analysis set out in the Consultation, and our final views on this topic in light of those responses, are presented in Section 6 of this document.
- A5.2 In the previous Annex and Section 5, we have identified a set of features in relation to the supply of premium movie content. In this Annex, we assess how the combination of these features prevents, restricts and distorts competition at the upstream and wholesale levels. This takes into consideration the historical development of the pay TV sector and the impact that the features have had to date. We also consider the impact of the prevention, restriction and distortion of competition on consumers in the retail market for the supply of television bundles containing Core Premium Movies channels, particularly in terms of choice, innovation and price. Moreover, we also consider likely future developments, in order to provide context for our analysis of potential remedies in Section 7 and Annex 6.
- A5.3 We interpret the phrase “prevent, restrict or distort” competition broadly, to encompass any reduction or dampening of actual or potential competition<sup>442</sup>, noting that markets will operate effectively when firms engaged in the market are subject to competitive constraint from other firms already in the market and/or from firms that could readily enter it, and from their customers<sup>443</sup>.
- A5.4 In considering whether the s131 EA02 test is met, we have borne in mind that we need only to establish “reasonable grounds to suspect” that one or more features of a relevant market prevents, restricts or distorts competition.

## Features affecting competition

- A5.5 The features set out in Section 5 and Annex 4 are inter-related<sup>444</sup>. We are concerned with the way the features work in combination, which we suspect tends to prevent, restrict and distort competition in the markets identified. The features affect the operation of the supply chain and have a direct impact on consumers in terms of choice, innovation and the price they pay. In particular, we believe that the combination of the features enables and incentivises one player to limit competition.
- A5.6 We have identified the **release windows structure** as a relevant feature of the markets, noting that it determines when films in different formats become available for viewing. Conceptually, while this structure may be economically efficient, we suspect it has also contributed to the position whereby there is a single wholesale

---

<sup>442</sup> OFT's Guidance, paragraph 4.2.

<sup>443</sup> OFT's Guidance, paragraph 4.1.

<sup>444</sup> Given that these features are inter-related, and have developed over the course of a number of years, we consider that evaluating the effect of each on an individual basis would be an artificial exercise.

supplier of services based on rights sold in the first pay TV subscription window. Our key concern arises from the fact that **the linear and SVoD rights within that window are sold jointly and exclusively** to one broadcaster. Indeed, we note that in the UK Sky aggregates all substitutable premium movie content from the Major Hollywood Studios within this window. Moreover, the joint licensing of rights and **other contractual restrictions limit** the possibility that the supply of SVoD services will constrain linear channel services and vice versa.

- A5.7 In addition, the **limited pool of premium content** from the Major Hollywood Studios is such that an entrant seeking to challenge Sky would have to acquire rights from a number of these studios, since the amount of content available from one studio is unlikely to be sufficient to undermine **Sky's wholesale market power**. A wholesaler that has managed to **aggregate** most or all available rights is in a strong position to build a subscriber base. This in turn delivers bidding advantages; a large base of subscribers may enable a wholesaler to pay more for the underlying rights because it can monetise them more effectively than could a new entrant.
- A5.8 We consider that Sky has considerable advantages in winning key premium movie rights in future, particularly due to the efficiency advantages (such as greater certainty about wholesale income) that flow from bidders such as Sky being vertically integrated with pay TV retailers with a significant premium movie subscriber base. Any competitor would face a delay in establishing such a subscriber base – or would have to negotiate access to Sky's subscriber base. The existence of the **limited set of key content rights**, which only become contestable on a **staggered basis** makes entry extremely difficult as the process of assembling a viable portfolio of rights may take months or years.
- A5.9 These advantages constitute barriers to entry and expansion from the perspective of competitors seeking to enter the wholesale market. As such we consider it unlikely that other wholesalers would be able to bid successfully for enough premium movie rights to erode Sky's position.
- A5.10 Furthermore, we suspect that **content aggregation** can contribute to the creation of **market power** which in conjunction with **vertical integration** then enables a wholesaler to act in a way that restricts competition. In practice, by aggregating a significant volume of premium movie rights, a wholesaler is able to dampen the competition that would otherwise exist between competing premium movie services.
- A5.11 We suspect that the combination of identified features has resulted in a situation in which all movie rights in the first pay TV subscription window are controlled by one player, i.e. Sky. They effectively underpin Sky's market power at the wholesale and retail level, giving rise to various effects, which we discuss below in turn:
- limited exploitation of premium SVoD movies services;
  - restricted distribution of Sky's Core Premium Movies channels; and
  - high wholesale prices for Sky's Core Premium Movies channels.
- A5.12 We also assess the extent of the impact this has on consumers in terms of:
- choice of platform and content:
    - choice for consumers of platform and of content once platform selection is made;

- switching between retailers and platforms should not be artificially difficult; and
- generation and availability of a broad range of high-quality content: a variety of content should continue to be generated and made available to consumers on all platforms;
- innovation:
  - in platform services, for example in terms of interactivity, set-top box functionality such as DVR capabilities, or VoD options; and
  - in retail service bundling, packaging and pricing;
- pay TV services priced competitively and efficiently:
  - prices which give consumers good value and allow efficient producers to earn a reasonable return on their investment; and
  - a sufficient variety of price points / bundles to allow consumers to tailor their purchases to meet their preferences.

### **Competition issues: limited exploitation of premium SVoD rights**

- A5.13 As discussed earlier, Sky has exclusive access to the SVoD rights in the first pay TV subscription window as part of its contracts with Major Hollywood Studios. In this context, we note Sky's Board paper indicating that [REDACTED]<sup>445</sup>.
- A5.14 Additionally, [REDACTED] Sky offers its premium movie SVoD services (via Sky Player) only to consumers who subscribe to Sky Movies channels. This means that SVoD services are not available on a standalone basis. For example, other operators of cable and IPTV platforms have been capable of delivering true VoD services for several years. [REDACTED] and as a result offerings have been limited to PPV and PictureBox. [REDACTED]<sup>446</sup>.
- A5.15 We have a number of reasons for believing that the importance of SVoD to competition will increase in the future. Several stakeholders expressed the opinion that SVoD is likely to take over from linear channels as the main way of delivering movies. SVoD services could provide a very similar experience to subscribing to a linear channel<sup>447</sup>, but with the added convenience of allowing consumers to view a wide range of content when they want to. This view is also confirmed by the fact that the consumption of VoD services has significantly increased, suggesting that consumers want to have more control over watching programmes<sup>448</sup>. For example,

---

<sup>445</sup> [REDACTED].

<sup>446</sup> [REDACTED].

<sup>447</sup> They offer a payment mechanism that is likely to be attractive to consumers.

<sup>448</sup> However, as noted in paragraph 5.36, Virgin Media told us that consumers had demonstrated a clear preference for SVoD over PPV services. Research for Virgin Media showed that around 60% of respondents had shown strong interest in an SVoD service where there was no cost per movie. Virgin Media added that Telewest's experience indicated that free and SVOD services promoted customer acquisition, while ntl achieved relatively poor returns from a PPV service (Virgin Media response paragraph 5.21). As paragraphs A2.71 to A2.74 show, comments by pay TV operators and studios about the future of pay TV movies have focused on SVoD, rather than PPV services.

more than half of Virgin Media digital TV customers - 58% - regularly used VoD, including catch-up TV, at Q4 2009, up from 47% at Q4 2008<sup>449</sup>.

- A5.16 Additionally, wider availability of premium SVoD movie rights would give others the opportunity to develop an SVoD movie service which would compete effectively with Sky's linear subscription movie offering.
- A5.17 The fact that other competitors do not have access to premium SVoD content impacts on their ability to offer innovative SVoD movie services. SVoD is not only important to the development of platforms that are well suited to deliver it, such as those using IPTV, but also to investment in the underlying superfast broadband networks. Lack of access to SVoD content could affect IPTV's prospects in the UK in the future. In this context we note that in the UK IPTV penetration in 2008 was only 0.2%, compared with 13% in France and 10% in Sweden<sup>450</sup>. IPTV is an example of an innovative way of supplying TV which has proved popular in other countries such as US, France and Germany.
- A5.18 We acknowledge that as Sky becomes able to find technical solutions to delivering an SVoD service, our concerns related to limited exploitation may be somewhat reduced. However, there is a risk that the combination of the features of the markets, will allow Sky to maintain and/or extend its market power. In particular we note the concern that over time, as Sky is increasingly able to deliver a true SVoD service, its current market power could simply be transferred across to the new service, without other operators ever having had a meaningful opportunity to compete.

### **Competition issues: restricted availability of Sky's Core Premium Movies channels**

- A5.19 We set out in detail our concerns in relation to the restricted availability of Sky's Core Premium Channels in the Pay TV Statement<sup>451</sup>. We summarise these here.
- A5.20 We are concerned that Sky, as a vertically integrated firm, with market power in a key upstream market, distributes its Core Premium Movies channels in a manner that favours its own platform and its own retail business. Sky's behaviour demonstrates that it has the incentive to limit wholesale distribution of its premium channels, with the effect of restricting downstream competition. In this context, we consider that Sky:
- has restricted wholesale supply of its Core Premium Movies channels to other retailers on the DTH, DTT or IPTV platforms<sup>452</sup>;
  - has restricted wholesale supply of its HD premium channels to Virgin Media<sup>453</sup>; and

<sup>449</sup> Pay TV Statement, paragraph 4.162.

<sup>450</sup> World Television Markets – Idate (2008). We interpret international comparisons with care, as there can be a range of historical contextual reasons for differences in penetration.

<sup>451</sup> Note that in our Pay TV Statement we have assessed both Core Premium Sports and Movies channels - see Section 7. Here in this document, we specifically refer to Core Premium Movies channels.

<sup>452</sup> Paragraphs 7.59 to 7.171; 7.190 to 7.201; 7.210 and 7.219 to 7.233 of our Pay TV Statement, contained in Annex 7.

<sup>453</sup> Paragraphs 7.291 to 7.312 of our Pay TV Statement, contained in Annex 7.

- supplies its premium channels to Virgin Media at prices which do not allow Virgin Media to compete effectively against Sky at the retail level, taking into consideration the fact that Virgin Media does not (and could not) have the same scale as Sky<sup>454</sup>.

A5.21 This evidence of restricted supply, together with Sky's market power (which is underpinned by many of the features we discussed above) and its vertical integration, suggests that Sky is acting on a strategic incentive to restrict supply, in order to favour its own satellite platform as well as protect its position when bidding for key content rights in the upstream Movie Rights market. Competition in the supply of wholesale packages containing Core Premium Movies channels is prevented, restricted or distorted on the basis of both the absence of wholesale supply to new competitors and the terms of supply to Virgin Media.

### **Competition issues: high wholesale prices**

A5.22 In the Pay TV Statement<sup>455</sup>, we set out evidence from Oxera's analysis that Sky has achieved persistent and significant profits, based on the difference between its ex post returns (measured by the Internal Rate of Return -'IRR') and its ex ante cost of capital and we note that this is a strong indicator of the existence of barriers to entry. In a well-functioning competitive market, we would expect the entry of new firms to drive prices down and reduce returns. We also conclude on the basis of this evidence that the prices of packages including Sky's Core Premium Movies channels are above the competitive level. We therefore consider that competition in the supply of wholesale packages containing Core Premium Movies channels is prevented, restricted or distorted.

A5.23 Oxera's analysis shows that Sky's overall returns are around nine percentage points above its cost of capital, and that these high returns are concentrated in wholesale rather than retail services, and in premium rather than basic channels. Further disaggregated analysis shows that margins are likely to be higher in movies than sports, although this is likely to reflect the flow of money upstream to sports rights holders compared to movie rights holders.

A5.24 We have also explained that while the riskiness of Sky's early investments will have demanded returns in excess of its cost of capital for a period, we do not believe that such returns would be required on an ongoing basis unless there was evidence of continued significant risk-taking. Oxera's analysis suggests that more recent investments and innovations have involved considerably less risk, yet Sky has continued to earn returns materially above its cost of capital and appears likely to do so over the next few years. Consequently, we consider that the more recent profitability gap between Sky's IRR and its cost of capital is likely to go beyond the necessary rewards for significant risk-taking.

---

<sup>454</sup> Paragraphs 7.235 to 7.238; 7.246 to 7.259; 7.262 to 7.290 of our Pay TV Statement, contained in Annex 7.

<sup>455</sup> Paragraphs 5.519 to 5.573 and paragraphs 6.334 to 6.337, contained in Annex 7.

## Consumer effects

### Choice

#### Impact of limited exploitation of SVoD rights on consumer choice

- A5.25 UK consumers currently have very limited access to premium movies content on a full SVoD service.
- A5.26 Sky distributes SVoD content only to its Sky Player applications on games consoles (e.g. Microsoft's X-box 360), Computers (including PC and Apple Mac), IP enabled DTT set top boxes and connected TVs. The distribution of these services is fairly limited. For example, in October 2009, there were [ X ] Sky Player subscribers. [ X ]<sup>456</sup>.
- A5.27 In 2009, Sky announced the launch of a 'pull' video-on-demand service in 2010, to provide Sky+ HD customers with additional choice. Sky indicated that this service will use the broadband capability of existing Sky+ HD boxes. Although this could be an attractive service, it will only be available to about 25 % of Sky's subscriber base<sup>457</sup>. In this context we note in its press release on results for half year ended 31 December 2009, Sky announced that it switched to selling HD-enabled set-top boxes as standard<sup>458</sup>. [ X ].
- A5.28 The supply of SVoD services will continue to be restricted by the rate at which Sky can develop its own service, and by Sky's incentive not to cannibalise its linear channels. Sky will only exploit SVoD rights in terms of its own ability to retail SVoD services and therefore other operators will not be able to innovate in this area. Operators of cable and IPTV platforms have had the capability to offer true VoD services for several years. That they are unable to take advantage of this capability, by supplying content which is highly valued by consumers, leads to a restriction in consumer choice.
- A5.29 We also recognise that [ X ].
- A5.30 Our concerns on choice relate not only to the current situation for consumers, but also in particular how the pay TV sector is likely to develop in future. Looking forward, we are at a point where the potential choice of platforms is increasing, and is set to increase further. In our view there is potential for increased choice and innovation through the further development of IPTV services, and that the extent of such development is constrained by the lack of access to premium movie content, including SVoD.

<sup>456</sup> Sky's response to the Consultation, paragraph 4.17 – 4.29.

<sup>457</sup> According to Sky, on Q4 2009 there were 2.1 million households that had Sky+ HD boxes. The total number of Sky subscribers on Sky's satellite platform in September was almost 9.7 million - [http://corporate.sky.com/documents/pdf/press\\_releases/4ad9b907f137492d998022a042ac035b/280110\\_Interim\\_Results\\_Press\\_Release](http://corporate.sky.com/documents/pdf/press_releases/4ad9b907f137492d998022a042ac035b/280110_Interim_Results_Press_Release). It is important to note that when Sky launches pull VoD [ X ].

<sup>458</sup> See [http://corporate.sky.com/documents/pdf/press\\_releases/4ad9b907f137492d998022a042ac035b/280110\\_Interim\\_Results\\_Press\\_Release](http://corporate.sky.com/documents/pdf/press_releases/4ad9b907f137492d998022a042ac035b/280110_Interim_Results_Press_Release).

### Impact of restricted availability of Sky's Core Premium Movies channels on consumer choice

- A5.31 In Section 8 of the Pay TV Statement, we have analysed the impact that the restricted supply of the Core Premium Movies channels has on consumer choice and concluded that this situation leads to the distortions of choice which cause consumer harm<sup>459</sup>.
- A5.32 While there is a relatively wide range of options for basic-tier TV, consumers wanting Core Premium Movies channels have a choice of only two retailers – Sky or Virgin Media (and those outside cable areas do not have any choice of retailer). We have some concern about the terms on which these channels are supplied to Virgin Media, which create a situation in which consumer choice is likely to be distorted.
- A5.33 More fundamentally, consumers with a preference for other platforms, or who do not want a “big” pay TV package – such as the ten million households with DTT services – are currently unable to access Sky's premium channels. The development of new platform technologies should open up a wider choice of operators to consumers, but this will not happen if those operators are denied access to key content.
- A5.34 Although a substantial proportion of consumers still buy pay TV services on a standalone basis, bundles of pay TV and telecommunications services are becoming increasingly important. Particularly on a forward-looking basis, therefore, restricted distribution of Core Premium Movies channels limits choice of triple-play bundles.

### **Innovation**

#### Impact of limited exploitation of SVoD rights on innovation

- A5.35 We note that Sky would tend to favour only those innovations – in platform enhancement, and in pricing and packaging – which do not cannibalise its existing customer base and which tend to support its incumbent advantages over potential entrants. This would tend to inhibit the development of other services and platforms which could otherwise use premium movie content to drive demand, such as next generation networks, and mobile TV services.
- A5.36 In the UK there is growing interest in superfast broadband<sup>460</sup>, which is likely to have a significant impact on content distribution, for example via IPTV and may deliver significant benefits to consumers.
- A5.37 We are concerned that the lack of access to premium movie content may have a negative impact on the investment necessary to deliver superfast broadband and new IPTV platforms. This investment will in part depend on the ability to attract a wide range of TV subscribers including subscribers to premium movie content. For example, in our statement on the provision of superfast broadband we observed that HDTV and IPTV services have played a role in driving demand for NGA

---

<sup>459</sup> Paragraphs 8.47 to 8.102; 8.106 to 8.109; 8.113 to 8.114, contained in Annex 7.

<sup>460</sup> Superfast broadband networks ('Next Generation Access' or NGA) use various types of fibre network (FTTH or FTTC) to deliver greater bandwidth to consumers.

services in Europe<sup>461</sup>. On this basis we consider that access to premium movie content, in particular SVoD services is likely to prove important, albeit as one of several potential drivers of demand.

- A5.38 Superfast broadband networks and IPTV are capable of delivering both linear channels and VoD. VoD services are of particular interest, since they potentially offer consumers greater choice of content, and control over when it is viewed, than is provided by traditional broadcast platforms. VoD is a particular example of a delivery mechanism that does not favour satellite. Instead, VoD plays to the strengths of the broadband networks operated by BT and Virgin Media. Therefore, Sky does not have an incentive to encourage the development of VoD services.
- A5.39 Limited exploitation of premium SVoD movie rights is likely to hold back innovation to the detriment of consumers. The premium SVoD movie service could have been an innovative new service introduced several years ago. However, this has been and continues to be held back by the way in which the rights are sold, in particular the joint sale of SVoD and linear rights within the first pay TV subscription window. Our concerns in relation to innovation are also forward-looking. We think that the lack of access to premium SVoD content could also diminish the scope for future innovation.
- A5.40 Paragraphs A2.46 and A2.62 to A2.84 above describe some of the potential innovations we may see in the near future. For example, we have identified the potential for greater portability of devices and transferability of content between devices. We have also identified a trend towards hybrid devices which combine traditional broadcasting platform with an IP platform such as the proposed Canvas. These types of technologies would be able to provide a more interactive and participatory viewing experience where viewers can talk, text, game or otherwise interact during broadcasts. Where supply of the most important content is restricted, then firms wishing to enter or expand will face a lower incentive to innovate on such devices or platforms.

#### Impact of restricted availability of Sky's Core Premium Movies channels on innovation

- A5.41 In Section 8 of our Pay TV Statement,<sup>462</sup> we have set out the evidence on which we based our view that innovation will be harmed by the restricted supply of Core Premium Movies channels. We have also described how Sky's approach to supplying its content restricts the availability of retailers to price and package Core Premium Movies channels in innovative ways. We have concluded that this limits the range and variety of packages and price points that consumers would be able to access, compared with the case where Core Premium Movies channels were supplied to retailers on a wholesale basis on terms that enable them to compete at the retail level.
- A5.42 Access to the Core Premium Movies channels which Sky currently controls is highly important to new entrants or to other firms planning to expand (as, indeed, was the case when Sky entered the market). Without access to this content, the overall prospects for such a firm are likely to be greatly diminished, and so is the likelihood

<sup>461</sup> Delivering super-fast broadband in the UK, Promoting investment and competition, 3 March 2009, page 68. See for example:

[http://www.ofcom.org.uk/consult/condocs/nga\\_future\\_broadband/statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/nga_future_broadband/statement/statement.pdf). Page 68.

<sup>462</sup> Paragraphs 8.187 to 8.218, contained in Annex 7.



that it will be willing to take a risk on substantial innovation, and secure finance for the necessary investment.

## Retail prices

- A5.43 In Section 5 of the Pay TV Statement, we have described the evidence used to assess whether prices for consumers are high. Our analysis has concluded that Sky is earning returns significantly above its cost of capital, and that these returns are concentrated in Sky's wholesale premium sports and movies channels.
- A5.44 High wholesale prices for Sky's Core Premium Movies channels go hand in hand with high retail prices. Sky sets its retail prices and wholesale prices simultaneously, and it appears to determine its wholesale prices with reference to its understanding of the OFT's margin squeeze test<sup>463</sup>. Our assessment of profitability<sup>464</sup> indicates that consumers pay high prices for packages including Core Premium channels. High prices are detrimental both to subscribers who pay them, and households who do not currently subscribe to these channels, but who would do so at competitive prices.
- A5.45 One reason that high wholesale prices of linear channels have been able to persist is that no competitive constraint has developed from SVoD services. By selling the two sets of rights jointly, the studios allow Sky to aggregate not just the content from several different substitutable studios, but also two different, probably substitutable delivery mechanisms. This is likely to lead to prices for both that are above the competitive level. We explain above our view that Sky's prices for its Core Premium Movies channels are above competitive levels.

---

<sup>463</sup> [X].

<sup>464</sup> Section 5 paragraphs 5.519 to 5.573 of the Pay TV Statement, contained in Annex 7.

## Annex 6

# Discretion to make a market reference

## Introduction

A6.1 In this Annex we present the additional detail of our analysis in relation to exercising our discretion to make a reference. Respondents' views on the analysis set out in the Consultation, and our final views on making a reference in light of those responses, are presented in Section 7 of this document.

## Criteria for making a reference

A6.2 In order to assess whether it is appropriate to make a reference to the CC the OFT's Guidance outlines four criteria that we should consider before we decide to make a reference<sup>465</sup>, namely:

- the suitability or otherwise of using our CA98 or other sectoral powers;
- whether the problem could be addressed through undertakings;
- proportionality and whether the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response; and
- whether there is a reasonable chance that appropriate remedies will be available.

## Application of CA98 or Article 101/102 and alternative powers

A6.3 According to the OFT's Guidance, we need to consider whether the competition problem we have identified may involve an infringement of CA98 and, if so, we should only consider a reference to the CC in one of two circumstances:

- when we have reasonable grounds for suspecting that there are market features which prevent, restrict or distort competition, but do not breach CA98 prohibitions; or
- when action under CA98 has been or is likely to be ineffective for dealing with the competition issue identified<sup>466</sup>.

A6.4 We recognise that it may be possible to define some aspects of the concerns we have identified as potential infringements of CA98. However, we consider it doubtful that one or more CA98 investigations would be appropriate to address these as:

- a CA98 investigation is concerned with behaviour that has occurred in the past and would not address the specific competition concerns that we have identified as likely to develop in the future;
- we are concerned about the consequences of a combination of features, some of which may not raise competition concerns if considered in isolation and some of which are unrelated to the conduct of a particular person, but which are likely to

<sup>465</sup> The OFT's Guidance, paragraph 2.1.

<sup>466</sup> The OFT's Guidance, paragraph 2.3.

have a significant detrimental impact on competition when considered together. A CA98 investigation which targeted one issue might therefore not be able to address an underlying cause of the competition concern; and

- we have also identified a variety of effects on competition. A CA98 investigation is geared to address specific conduct or issues and any remedies aimed at addressing the infringement identified would be likely, in our view, to be inadequate to deal with the set of industry-wide competition issues we have identified.

- A6.5 Our findings on restricted distribution extend to Sky Movies channels, but the importance of linear movies channels appears to be gradually declining over time. This was demonstrated by the limited demand for wholesale linear movie channels in responses to our Third Pay TV Consultation.
- A6.6 Subscription services offering recent movies on demand seem to present a more compelling long-term proposition and a stronger proposition for securing effective competition, particularly as IPTV and VoD services provided over the open internet come of age.
- A6.7 We therefore consider that a linear channel wholesale must-offer remedy on all platforms would not by itself be an effective forward-looking solution to our competition concerns. At the same time, our powers under s316 CA03 do not adequately extend to SVoD services.
- A6.8 In our Pay TV Statement, we also considered whether to put in place a wholesale must-offer remedy now for the period until any reference to the CC reaches a conclusion. However, we concluded that it would not, on balance, be appropriate to put in place a wide-ranging interim wholesale must-offer remedy, because of the likely limitations on new demand for linear movies channels on existing platforms over the immediate time horizon.
- A6.9 We would have a specific concern if Sky were to launch a service on DTT during this interim period which contained Core Premium Movies channels as well as Core Premium Sports channels. We addressed this in our separate statement on Picnic, where we decide that a launch by Sky on DTT should be subject to any such channels being made available to other DTT retailers.
- A6.10 Overall, we conclude that it would not be more appropriate to address the concerns using either CA98 or our sectoral powers.

### **Undertakings in lieu of a market reference**

- A6.11 We also need to take account of possible undertakings that could be offered by the studios and / or Sky to address the concerns raised and so obviate the need for a market investigation reference.
- A6.12 Ofcom has power under s154 EA02 to accept undertakings instead of making a reference to the CC. We have shown that the adverse effects on competition arise from the complex interrelationship between several features of the market and involving unilateral conduct of several firms as well as industry structure. Therefore, there are difficulties in assessing with any certainty whether particular undertakings would effectively address the problems identified. Moreover, trying to negotiate undertakings with several parties, in circumstances in which possible adverse

effects on competition have not been fully analysed, is likely to pose serious practical difficulties.

A6.13 In any event, as set out in Section 7, no undertakings in lieu were offered in response to the Consultation.

### Proportionality and scale of the suspected problem

A6.14 According to the OFT Guidance, we should only make a reference where we have reasonable grounds to suspect that the adverse effects of the combination of features on competition are significant. In order to assess this we have considered whether the suspected adverse effects are likely to have a significant detrimental effect on customers through higher prices, lower quality, less choice or less innovation<sup>467</sup>.

A6.15 We realise that a reference to the CC would involve considerable costs to the CC itself, and would impose a substantial burden on the businesses affected. Where adverse effects are not likely to be significant, we take the view that the burden on business, particularly in terms of management time, and the public expenditure costs of an investigation by the CC are likely to be disproportionate in relation to any benefits that may be obtained from remedying the adverse effects. The OFT Guidance notes three factors which are relevant to determine whether a market reference is proportionate:

- the size of the market;
- the proportion of the market affected by the feature giving rise to adverse effects on competition; and
- the persistence of the features giving rise to adverse effects on competition.

A6.16 We consider these in turn below alongside the detrimental consumer effects that arise out of the combination of market features we have identified.

### The size of the sector

A6.17 The pay TV market in the UK is worth some £4.32 billion annually in subscription revenues<sup>468</sup>. In terms of premium movies, the amounts paid by Sky for exclusive rights to movies content are substantial<sup>469</sup>, indicating the importance of this content to its business. In addition, Sky's expenditure on premium movies content alone represents over [ X ] of the total expenditure on all TV movie programming in the UK<sup>470</sup>. Moreover, retail and wholesale revenues from Sky's Core Premium Movies channels [ X ] in 2008<sup>471</sup> are worth more than half of the total revenue associated with retail DVDs, and are therefore highly significant in revenue terms.

<sup>467</sup> OFT's Guidance paragraph 2.27.

<sup>468</sup> See for example paragraphs 2.1.2 and 2.2.2 in <http://www.ofcom.org.uk/research/cm/cmr09/cmr09.pdf>.

<sup>469</sup> £278 million in 2009 – see [http://annualreview.sky.com/pdf-downloads/annualReview/sections/Sky\\_AnRev\\_ROT\\_Y.pdf](http://annualreview.sky.com/pdf-downloads/annualReview/sections/Sky_AnRev_ROT_Y.pdf).

<sup>470</sup> Source: Broadcasters' licence returns to Ofcom.

<sup>471</sup> Source: based on Sky implied premium over basic package as of February 2010; film on video retail sales (98% of which are DVDs) from UK Film Council Statistical Yearbook 2009 p.90.

## The proportion of the market affected

- A6.18 We consider that a significant proportion of the markets we have identified is affected by the combination of the features that we believe prevents, restricts or distorts competition.
- A6.19 Premium SVoD services have not been fully exploited by Sky to date. We believe that the inability of retailers other than Sky to provide a competing premium SVoD service is likely to be of material detriment to consumers in the future. In addition, a significant number of people could already have benefited from SVoD services if they were more widely available<sup>472</sup>. Furthermore, the lack of access to SVoD content means that retailers are less likely to develop innovative services that would particularly appeal to subscribers.
- A6.20 The second concern we have is that currently premium movie services (i.e. premium SVoD and Core Premium Movies channels) are not widely available on a wholesale basis, which is likely to distort choices for those consumers who have a strong interest in premium content. While there is a relatively wide range of options for basic-tier TV, consumers wanting Core Premium Movies channels have a choice of only two retailers – Sky or Virgin Media (and those outside cable areas do not have any choice of retailer)<sup>473</sup>.
- A6.21 As we have explained in our Pay TV Statement, a lack of wholesale access to Sky's Core Premium channels inhibits the range and variety of packages on offer to consumers<sup>474</sup>. This means that some consumers chose a package that does not closely reflect their preferences, or that they choose not to consume.
- A6.22 We have a particular concern that this may result in limited availability of entry-level packages, which might provide a reduced range of channels, at a lower price than the large bundles which are purchased by most of Sky's existing customers. This means that some existing customers may be paying more than they would in a competitive market, because they would be better off purchasing smaller packages of channels. Consequently, there is likely to be a level of unmet demand among other potential consumers, in particular the 10 million households whose primary means of viewing TV is via free-to-air platforms such as Freeview.
- A6.23 Although a substantial proportion of consumers still buy pay TV services on a standalone basis, bundles of pay TV and telecommunications services are becoming increasingly important<sup>475</sup>. Particularly on a forward-looking basis, therefore, restricted distribution of Core Premium Movies channels also limits choice of triple-play bundles.
- A6.24 The restricted supply of Core Premium Movies channels diminishes the scope for other retailers to invest in innovative products or services to enter or expand in the

---

<sup>472</sup> We note that impacted directly around [ X ] million consumers who subscribe to packages containing Sky Movies 1, Sky Movies 2 or Sky Movies Pack.

<sup>473</sup> This could have impacted on over 10 million households, in particular around 9.7 million homes that rely on DTT as their primary means of TV reception; Virgin Media subscribers that are out of cable area; almost 0.5 million of BT Vision customers (based on Q4 2009 data – see <http://www.btplc.com/News/ResultsPDF/q310release.pdf>), 0.05 million TalkTalk TV subscribers (see [http://www.ft.com/cms/s/0/a76f1918-70ad-11de-9717-00144feabdc0\\_s01=1.html](http://www.ft.com/cms/s/0/a76f1918-70ad-11de-9717-00144feabdc0_s01=1.html)), [ X ].

<sup>474</sup> Pay TV Statement, paragraphs 8.82 to 8.89, contained in Annex 7.

<sup>475</sup> Source: Ofcom communications tracking survey. In 2009, 44% of adults were buying communications services in bundles, up from 31% in 2005. In Q1 2009, 34% of bundles purchased by consumers were of landline, broadband and multichannel TV, up from 12% in Q1 2005.

market. IPTV, the proposed project Canvas and NGA are all examples of innovative ways of delivering TV services which could be constrained if retailers are unable to access potential consumers of Core Premium Movies channels<sup>476</sup>.

- A6.25 Also, the unavailability of Sky's channels to third parties at an appropriate wholesale price has the effect of keeping retail prices high for almost [ X ] million consumers who subscribe to packages containing Core Premium Movies channels<sup>477</sup>. High prices are detrimental not only to subscribers who pay them, but also to households who do not currently subscribe to these channels, but who would do so at competitive prices<sup>478</sup>.

### **The persistence of features giving rise to adverse competition effects**

- A6.26 The features we have identified are likely to persist. We have no reason to believe that, absent regulatory intervention, there will significant new entry of either sellers or purchasers of premium movie rights. In particular, in our Pay TV Statement we have concluded that Sky's market power is likely to continue for the next three to four years<sup>479</sup>.
- A6.27 We consider it very unlikely that the pool of rights for broadcasting movies produced by the Major Hollywood Studios will increase, that contracts will cease to be exclusive or to contain restrictions, or that studios will cease to sell SVoD and linear rights jointly. There is little prospect that buyers in the rights market (who are sellers in the wholesale channels market) will cease to be vertically integrated or to aggregate rights. The end dates of contracts are likely to remain staggered.
- A6.28 Also, the costs and risks involved in producing mainstream films are such that there are likely to be economies of scale and scope associated with operating a film studio - especially one that is comparable to the Major Hollywood Studios. As such, upstream entry is unlikely to provide an opportunity for a downstream broadcaster to enter the market based on a new set of premium movie rights.
- A6.29 At the wholesale level, a number of players, including Virgin Media<sup>480</sup> and BT, have sought to purchase the movie rights in the first pay TV subscription window. However, none of these have been successful. Moreover, we have identified a number of features, such as the nature and timing of contracts, which limit the ability of anyone entering the market in future.
- A6.30 There may be some changes to the way rights are sold in the future. However, we do not believe that these would involve changing the way the rights are sold in the first pay TV subscription window. It is unlikely, therefore, to have any significant impact on resolving the identified concerns.

<sup>476</sup> Section 8 of the Pay TV Statement paragraphs 8.197 to 8.209, contained in Annex 7.

<sup>477</sup> These subscriber numbers are correct as of June 2009: [ X ].

<sup>478</sup> This may have an impact on the wider market. In this context we note that at the end of 2009, Sky had 9.7 million subscribers, Virgin Media had 3.7 million subscribers, and TalkTalk TV had approximately 0.05 million subscribers. This contrasts with the [ X ] million who currently subscribe to packages containing Core Premium Movies channels.

<sup>479</sup> Section 6 of the Pay TV Statement, contained in Annex 7.

<sup>480</sup> Virgin Media's response to Second Pay TV Consultation dated 18 December 2008, paragraph 4.6. - [http://www.ofcom.org.uk/consult/condocs/second\\_paytv/responses/Virgin/VirginMedia.pdf](http://www.ofcom.org.uk/consult/condocs/second_paytv/responses/Virgin/VirginMedia.pdf)

## **Detrimental effects on consumers**

A6.31 In Section 6 and Annex 5, we have outlined the detrimental effects on consumers in relation to higher prices, lower quality, less choice and less innovation. We have also referred to direct evidence of consumer detriment, since Sky's margins appear higher in movies. In addition, we anticipate that consumer harm arising from lack of innovation may be even greater in the future.

A6.32 We acknowledge that the pay TV sector has delivered substantial benefits to consumers, both through investment in high-quality content and through innovative services, many of which have been driven by Sky. There may be offsetting consumer benefits, in that the Major Hollywood Studios may be better able to continue to produce high volumes of quality films for consumers. However, in a well-functioning market it is competition that drives consumer benefits. The current restricted distribution of key content and services prejudices fair and effective competition, reducing choice of platforms and retail packages and dampening innovation:

- Consumers with a preference for platforms other than satellite or cable – such as the ten million households with digital terrestrial television – are currently unable to access Sky's Core Premium Movies channels at all.
- Consumers on cable can access Sky's Core Premium channels, but in standard definition only, without the associated interactive services, and purchased from a retailer whose incentive is to use the channels solely as a retention tool, rather than as a source of added value.
- While there are a large number of package combinations in the market, consumers have less variety of price points available to them than we would expect to see in an effectively competitive market. In particular, consumers who want an entry-level pay TV package rather than a 'big-mix' are under-served by current offerings.
- Bundles of TV and telecommunications services are becoming increasingly important. This is partially because regulation has been successful in ensuring that retail telecommunications markets are competitive. However, if the same is not true in pay TV markets, there is a risk that the forms of reduced choice we set out above will extend into these wider bundles.
- Although there has been considerable innovation in the sector, much of it has historically been of a type that suits Sky's satellite platform. Sky is unlikely to innovate in ways which are suited to platforms other than its own. This is a particular concern looking forward, given the significant benefits we see for consumers in the effective exploitation of new distribution technologies.
- In particular, new broadband networks could offer consumers an unprecedented choice of content, and the ability to access that content on demand. This is a significant driver for investment in superfast broadband, but new content distribution platforms will not develop if they are denied access to key content.

## **Conclusions on proportionality**

A6.33 In conclusion, we believe that a market reference is a proportionate response to the persistent nature of competition concerns and the scale of the sector impacted by these concerns.

- A6.34 As explained above, this is a substantial market both in terms of the sums paid for content rights and in terms of the revenues from pay TV premium services. We therefore believe that the benefits of remedying any adverse effects which might be found to exist should outweigh these costs. We disagree with Sky's argument that the harm is small and limited to a single issue and therefore a market investigation is inappropriate<sup>481</sup>.
- A6.35 We believe that in seeking to address the conditions which currently allow Sky to control the premium movie rights and to sustain high prices to pay TV subscribers, we would be acting in the interests of consumers.

## Availability of remedies

### Introduction

- A6.36 In accordance with the OFT's Guidance<sup>482</sup>, we have taken into account the likely availability of appropriate remedies in the event that the suspected adverse effects on competition were found by the CC to exist. Where Ofcom has a reasonably good understanding of a market, it may identify the possible remedies. In light of the pay TV market investigation, we believe this applies in this case.
- A6.37 In the Consultation we reviewed the likely availability of appropriate remedies in the event that the suspected adverse effects on competition were found by the CC to exist and identified two broad approaches:
- the CC could seek to address the identified concerns at source, by intervening to change the way in which key premium movie rights are bought and sold. Such intervention may involve restrictions on the ability of firms to aggregate different types of rights or the requirements to make the sale process more contestable. Depending on the precise form of a remedy, it could facilitate new players in entering the market, but also promote innovation around new platforms and / or increase competitive pressure on wholesale margins; and
  - the CC could intervene to reduce Sky's ability to act on incentives to exploit market power, by requiring it to provide wholesale access to linear and SVoD premium movie content on regulated terms that goes beyond linear channels and includes SVoD services. Such an obligation would enable other operators to develop pay TV offers which include premium content, thereby facilitating choice and innovation.
- A6.38 We received a number of comments on remedies in response to the Consultation. These are set out in detail in Section 5 alongside our response to them.

---

<sup>481</sup> Sky's response to Ofcom's Third Consultation, Annex 6, paragraph A6.21 – [http://www.ofcom.org.uk/consult/condocs/third\\_paytv/responses/org/sky/Annex\\_6.pdf](http://www.ofcom.org.uk/consult/condocs/third_paytv/responses/org/sky/Annex_6.pdf).

<sup>482</sup> OFT's Guidance, paragraphs 2.30 to 2.32.