



# Determination to resolve a dispute between Rapture Television plc and British Sky Broadcasting Ltd about EPG listing charges

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Determination

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## Section 1

# Determination

**Determination under sections 188 and 190 of the Communications Act 2003 (the “Act”) for resolving a dispute between Rapture Television plc (“Rapture”) and British Sky Broadcasting Ltd (“Sky”) about charges for an Electronic Programme Guide (“EPG”) listing between November 2005 and November 2006.**

### Whereas:

- A. Section 188(2) of the Act provides that Ofcom must consider a dispute and make a determination for resolving it where Ofcom has decided under section 186(2) that it is appropriate for Ofcom to handle it. Ofcom has decided that this is a dispute which it is appropriate for Ofcom to handle as it is a dispute relating to network access and that the dispute is between a communications provider and a person making an associated facility available. The determination that Ofcom makes for resolving the dispute must be notified to the parties in accordance with section 188(7) of the Act, together with a full statement of the reasons on which the determination is based.
- B. Section 190 of the Act sets out the scope of Ofcom’s powers for resolving a dispute which may include, in accordance with section 190(2)(a) of the Act, making a declaration setting out the rights and obligations of the parties to the dispute.
- C. Sky’s provision of an EPG listing service to Rapture is subject to a number of regulatory obligations, including the conditions set out in the class licence issued under the Telecommunications Act 1984 to run telecommunications systems for the provision of conditional access services for the purposes of the provision of EPG services (the “EPG Conditions”). The EPG Conditions were carried over from the previous regulatory regime and continued to have effect from 25 July 2005 within the new regulatory regime set up under the Act.<sup>1</sup>
- D. EPG Condition 1 imposes the requirement on the Licensee, to provide EPG services to third parties on a “*fair reasonable and non-discriminatory basis*”. EPG Condition 11 imposes on the Licensee a specific prohibition on showing undue preference to or undue discrimination against particular persons or persons of any class or description as respects “*the provision of any Electronic Programme Guide Services*”.
- E. Between September and November 2005, Rapture and Sky entered into negotiations over contractual terms for the provision by Sky of EPG listing services to Rapture. Discussions continued until 11 November 2005 when Rapture signed a contract with Sky for EPG listing services. Rapture stated that although it was signing the contract it did not consider that a fair outcome had been reached and informed Ofcom of this position.

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<sup>1</sup> Continuation notice to a class of persons defined as the licensee for the purposes of the provision of electronic programme guide services under paragraph 9 of Schedule 18 to the Communications Act 2003, 23 July 2003, which continued certain provisions of the class licence to run telecommunications systems for the provision of conditional access services granted by the Secretary of State for Trade and Industry on 1 August 2001 under section 7 of the Telecommunications Act 1984, available at: [http://www.ofcom.org.uk/static/archive/Oftel/publications/eu\\_directives/cont\\_notices/epg\\_class.pdf](http://www.ofcom.org.uk/static/archive/Oftel/publications/eu_directives/cont_notices/epg_class.pdf)

- F. On 24 August 2006, Rapture wrote to Ofcom to object to the terms of its contract with Sky.
- G. On 11 September 2006, Rapture wrote to Ofcom referring to it a dispute between Rapture and Sky relating to the contractual terms of Sky's provision of EPG listing services to Rapture.
- H. On 10 November 2006, after conducting an enquiry and holding discussions with both parties, Ofcom decided pursuant to section 186(2) of the Act that it was appropriate for it to handle the dispute and informed the parties of this decision.
- I. In order to resolve the dispute, Ofcom has considered, among other things, the information provided by the parties and Ofcom's relevant duties as set out in sections 3 and 4 of the Act.
- J. A fuller explanation of the background to the dispute and Ofcom's reasons for making this Determination is set out in sections 2 to 5 accompanying this Determination.
- K. A draft Determination was issued to the parties for their comments on 12 February 2007 and published on 13 February 2007. Responses were received by 23 February 2007.

**Now, therefore, pursuant to sections 188 and 190 of the Act, Ofcom makes the following Determination:**

- 1.1 It is hereby declared that the charge for Sky's provision of EPG listing services to Rapture between 14 November 2005 and 10 November 2006 set out in the contract signed by both parties in November 2005 is fair, reasonable and non-discriminatory as those terms apply under the EPG Conditions.
- 1.2 The Determination shall take effect on 9 March 2007.
- 1.3 Words and expressions used in this Determination (including the recitals above) shall have the same meaning as in the Act, except as otherwise stated in this Determination.

For the purpose of interpreting this Determination, the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.

**David Stewart**

**Director of Investigations**

**A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002**

## Section 2

# Summary

- 2.1 On 11 September 2006 Rapture asked Ofcom to resolve a dispute between Rapture and Sky in relation to Sky's charges to Rapture for an EPG listing service.
- 2.2 Rapture alleged that Sky's offered terms for an EPG listing on Sky's digital satellite platform (the "Sky Platform") were not fair, reasonable and non-discriminatory, as required by Sky's regulatory obligations under the EPG Conditions.<sup>2</sup>
- 2.3 After an initial enquiry, which began on 15 September 2006, Ofcom accepted the dispute for resolution on 10 November 2006.
- 2.4 Ofcom has investigated whether Sky's charges are fair, reasonable and non-discriminatory as those terms apply under the EPG Conditions.
- 2.5 This investigation has considered Oftel's guidelines entitled *Terms of supply of conditional access*, published on 22 October 2002 ("2002 Guidelines").<sup>3</sup> Ofcom recently reviewed its policy on Sky's charges to third parties for access to the Sky Platform and revised the 2002 Guidelines. Ofcom consulted on a draft explanatory statement and guidelines on 21 April 2006 and published a finalised explanatory statement and guidelines on 21 September 2006 which were stated to apply from 1 January 2007 ("2006 Guidelines").<sup>4</sup>
- 2.6 In its analysis of Sky's charges to Rapture, Ofcom has applied the 2002 Guidelines. For most of the period of this dispute, the 2006 Guidelines were either not yet published or only available in draft form and were, in any case, stated to apply from 1 January 2007.
- 2.7 Ofcom has also considered whether it should deviate from the 2002 Guidelines to reflect changed conditions since the 2002 Guidelines were published that could mean that Sky's charges were inconsistent with its regulatory obligations – for example, changes in relative bargaining power in negotiations between Sky and third party users of the Sky Platform (a concern already reflected in the 2006 Guidelines).
- 2.8 On the particular facts of this dispute, Ofcom considers that there are no reasons for it to find that the application of the 2002 Guidelines would not result in an outcome that was fair, reasonable or non-discriminatory or that there are any other reasons not to apply the 2002 Guidelines in this dispute.
- 2.9 In summary, based on the evidence gathered in this dispute and set out further in this Determination, Ofcom's conclusion is that Sky's charge to Rapture for an EPG listing between November 2005 and November 2006 was fair, reasonable and non-discriminatory. Ofcom therefore has made a direction to this effect.
- 2.10 This Determination is structured as follows:

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<sup>2</sup> Continuation notice to a class of persons defined as the Licensee for the purposes of the provision of electronic programme guide services under paragraph 9 of Schedule 18 to the Communications Act 2003, 23 July 2003, published at:

[http://www.ofcom.org.uk/static/archive/oftel/publications/eu\\_directives/cont\\_notices/epg\\_class.pdf](http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/epg_class.pdf).

<sup>3</sup> *Terms of Supply of Conditional Access: Oftel guidelines*, 22 October 2002, published at

<http://www.ofcom.org.uk/static/archive/oftel/publications/broadcasting/2002/cagu1002.htm>

<sup>4</sup> *Provision of Technical Platform Services: Guidelines and Explanatory Statement*, 21 September 2006, published at: <http://www.ofcom.org.uk/consult/condocs/tpsguidelines/statement/>.

- 2.10.1 the background to the investigation is set out in **section 3**;
- 2.10.2 the regulatory framework is set out in **section 4**; and
- 2.10.3 Ofcom's consideration of whether Sky's charge to Rapture is fair, reasonable and non-discriminatory is set out in **section 5**.

## Section 3

# Background to the dispute and submissions

## Summary

- 3.1 This section sets out the background to Ofcom’s investigation to resolve this dispute.
- 3.2 It describes:
  - 3.2.1 each of the parties to the dispute and the nature of their business;
  - 3.2.2 Rapture’s dispute referral and the allegations made by Rapture in its submission;
  - 3.2.3 Ofcom’s analysis to determine whether it had jurisdiction to resolve the dispute and the appropriate scope of the dispute; and
  - 3.2.4 evidence gathered by Ofcom from Rapture, Sky and third parties during its investigation.

## The parties

### Rapture

- 3.3 Rapture is a public limited company<sup>5</sup> which operates a digital television channel (“Rapture TV”).
- 3.4 Rapture TV is “*a free to air digital entertainment and lifestyle channel*”, which broadcasts predominantly a mixture of music, animation and films targeted at primarily younger audiences. Its major revenue streams are advertising and revenues from SMS messages sent by viewers.<sup>6</sup> The channel is made available to viewers on the Sky Platform.<sup>7</sup>
- 3.5 In April 2002, the Rapture brand was acquired by David Henry (Rapture’s Managing Director) and licensed to a company owned by Mr Henry, Power TV Limited (“Power TV”). Power TV is Rapture’s majority shareholder. Since April 2002, Rapture TV has broadcast on the Sky Platform for the periods from June 2002 to August 2002 and from May 2003 to July 2004. The current service was launched on 14 November 2005 and has been broadcasting continuously since then.

### Sky

- 3.6 Sky is a private limited company<sup>8</sup> wholly owned by British Sky Broadcasting Group plc (“BSkyB Group”). BSKyB Group is a publicly listed company that operates a satellite TV platform and a retail pay TV business in the UK and Ireland. Sky also broadcasts a number of channels, some of which are available on other platforms, including cable and digital terrestrial TV.

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<sup>5</sup> Company number 04808047.

<sup>6</sup> [X].

<sup>7</sup> See paragraph 3.10 *et seq.*

<sup>8</sup> Company number 02906991.

- 3.7 A variety of pay TV and free-to-air channels (including Rapture TV) are available via the Sky Platform. In order to enable third party channels to be offered over the Sky Platform, Sky provides those broadcasters with ‘technical platform services’ including conditional access (for encrypted channels), channel listings on Sky’s EPG and access control services (which make use of the interactive functions of the Sky Platform). As discussed further in **section 4**, the provision of technical platform services including EPG services is subject to a number of regulatory conditions.
- 3.8 BSkyB offers EPG listing services directly to third party broadcasters, whilst conditional access services are provided by another BSkyB Group company, Sky Subscribers Services Limited (“SSSL”). SSSL is wholly owned by British Interactive Broadcasting Holdings (“BiB”), which in turn is wholly owned by BSkyB Group.
- 3.9 In this Determination, the term “Sky” is used to refer collectively to BSkyB, BSkyB Group and/or SSSL, except where Ofcom is quoting from documents provided by parties to the investigation and where it is necessary to use the names of the different businesses for clarity.

### **Sky’s digital satellite platform**

- 3.10 Sky launched its digital satellite platform in the UK in 1998 and, as at 30 September 2006, the platform was viewed in over 8.5 million households.<sup>9</sup> By comparison, the terrestrial digital platform is viewed in approximately 7 million households and cable pay TV has approximately 3.3 million subscribers.<sup>10</sup>
- 3.11 Consumers with a satellite dish and a Sky set-top box are able to view channels from a number of different broadcasters via the Sky Platform.
- 3.12 Some of these channels are available on a pay TV basis, for which the viewer requires a valid viewing card with the appropriate channel entitlements. A number of pay TV retailers, including Sky’s own pay TV business, offer packages of pay TV channels to viewers on the Sky Platform.
- 3.13 In addition, consumers with a Sky set-top box are able to receive, free of charge, channels broadcast on a “free-to-air” basis. The channels which are broadcast free-to-air include channels with public service obligations such as BBC1, BBC2, ITV1, Channel 4/S4C and five, as well as a number of other channels, including Rapture TV.<sup>11</sup>
- 3.14 A valid viewing card is required to view a very small number of the free-to-air channels (currently Channel 4, five, five Life, five US and Sky Three), though no subscription is required to view these channels. Sky has informed Ofcom that consumers are able to obtain a viewing card from Sky without subscribing to any pay TV services.<sup>12</sup>

### **Technical platform services**

- 3.15 Broadcasters who want their channels to be available on the Sky Platform are offered a range of “technical platform services” by Sky. An EPG listing is one example of a technical platform service.
- 3.16 Viewers of digital TV use EPGs primarily to navigate between channels, access channels by unique channel numbers, and browse through

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<sup>9</sup> Source: Ofcom Quarterly Digital Updates.

<sup>10</sup> Ibid.

<sup>11</sup> Information for consumers on Sky’s website states that there are over 180 non-subscription TV channels. (<http://www.sky.com/portal/site/skycom/products/packages/nonsub>).

<sup>12</sup> Letter from Emma McCormack (Sky) to Anthony Szykaruk (Ofcom), 23 February 2007.

programming schedules and related data. The EPG listing service involves assigning an EPG channel number to each broadcaster's channel and providing a technical interface by which the broadcaster can deliver and amend programme schedules and related data.

- 3.17 If a broadcaster wants its channel(s) to be listed on Sky's EPG, it must buy the appropriate number of EPG listings. Indicative prices for EPG listings have been published from time to time on Sky's website.
- 3.18 On 11 November 2005, when Rapture signed an agreement with Sky to purchase an EPG listing on the Sky Platform, the indicative annual charge for an EPG listing was £36,000 per annum for each TV channel if the broadcaster also purchased conditional access services from Sky (see the following paragraph *et seq*) for £76,800 per annum if the broadcaster was only buying an EPG listing. Different charges applied to EPG listings for radio channels and for interactive services.<sup>13</sup>
- 3.19 A second form of technical platform service is a conditional access service. In summary, these are services making use of encryption to restrict access to a channel either to viewers who have paid for the channel or otherwise to restrict access (for example, to ensure a channel is only received in a particular country where the broadcaster is licensed to offer its service). In August 2003, Sky published (on its website) its method for establishing conditional access charges, which remained in place during the period under dispute.<sup>14</sup> Sky's method for establishing conditional access charges included indicative prices only. There were a number of other variables (discussed in Sky's methodology) which determined the actual charge to an individual broadcaster.
- 3.20 A third form of technical platform service is an access control service. These services enable a viewer's use of the interactive functions of the Sky Platform (e.g. services accessed by viewers of the Sky Platform using the red button on the set-top box remote control).
- 3.21 Of these services, Rapture purchases only an EPG listing from Sky. As a result, Ofcom has not considered the charging of conditional access and access control services as part of this investigation, except to the extent that underlying costs may be common to the provision of EPG listing services.
- 3.22 The term "platform business" is used later in this document to describe the provision of all types of technical platform services, irrespective of the corporate entity which supplies them.

### **Background to the dispute**

- 3.23 Rapture initially submitted a complaint to Ofcom about EPG listing services offered by Sky in June 2005, primarily in relation to what Rapture considered to be "excessive delays" in launching Rapture TV on to the Sky Platform. Rapture was asked to provide additional information and evidence to enable Ofcom to investigate.<sup>15</sup> Rapture provided some additional information but it

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<sup>13</sup> See Annex 1 for details of Sky's indicative EPG listing charges in November 2005. Details of Sky's current charges for EPG listings are published on Sky's website.

<sup>14</sup> See Annex 2 for the version of Sky's "*Method for establishing conditional access charges*" current during the dispute. Details of Sky's current methodology for determining conditional access charges are published on Sky's website.

<sup>15</sup> Keith Loader's (Ofcom) letter of 28 June 2005 in response to David Henry's (Rapture) letter of 12 June 2005.

did not provide any evidence to support its concerns. Ofcom therefore did not proceed to an investigation.<sup>16</sup>

- 3.24 Rapture copied Ofcom on correspondence sent by Rapture to Sky in November 2005 in which Rapture stated that “[Rapture and Sky] have not been able to agree on a fair level of fee for the EPG service.”<sup>17</sup>
- 3.25 Rapture reiterated its concerns to Ofcom in a meeting in January 2006, during Ofcom’s first consultation on the *Provision of Technical Platform Services*.<sup>18</sup>
- 3.26 On 24 August 2006, Rapture wrote to Ofcom to explain that Sky’s terms “are not based on any ability to pay or the level of income or the audience’s size viewing a channel and therefore are discriminatory to smaller less popular channels.”<sup>19</sup>
- 3.27 On 11 September 2006, Rapture sought to refer a dispute under section 185(1) of the Act to Ofcom between itself and Sky in relation to what it considered were its failed negotiations with Sky over Sky’s charges for its EPG listing. A full account of Rapture’s negotiations with Sky follows in **section 5**.

### Rapture’s submission to Ofcom

- 3.28 Rapture’s submission of 11 September 2006 alleges that Sky’s charge to Rapture for the provision of EPG listing services was not made on fair, reasonable and non-discriminatory terms.
- 3.29 Rapture argues in its submission that:

*“the cost of EPG services was too high for an independent channel and that [Sky] were acting in an anti-competitive manner by not entering into meaningful commercial negotiations about price.”*

- 3.30 Rapture, which states in its submission that its annual turnover is “under £150,000”, argues that Sky’s standard EPG listing charge of £76,800 “was unduly high.” Rapture notes that even as the number of broadcasters on the Sky Platform has grown, Sky:

*“increased the level of the charge on the 31st of December 2002 to a fee of £75,000 per annum for the supply of EPG services for ‘free to air’ digital TV channels. Prior to this date the same service was supplied for a fee of £28,000 per annum, this represents an increase of over 150%.”*

- 3.31 Rapture considers that the EPG listing charge:

*“should be calculated on the actual economic level of costs incurred in the supply of the technical service. This should not include development costs as these were incurred by BSkyB for the purpose of providing a Pay TV Service and the EPG software is not an open platform, as it does not detect those channels that have not purchased BSkyB’s EPG Services and no other provider has been allowed to offer an alternative to the EPG Service.”*

- 3.32 Rapture submits that the cost of Sky’s EPG listings service is shown to be excessive when it is compared with what Rapture considers to be similar services offered by cable operators. Rapture states that technological developments made by Sky to the Sky Platform “have little or no value to free to air channels” that do not take conditional access services from Sky.

<sup>16</sup> David Stewart’s (Ofcom) letter of 26 July 2005 in response to David Henry’s (Rapture) letters of 12 and 30 June 2005.

<sup>17</sup> Email from David Henry (Rapture) to Emma McCormack (Sky), 11 November 2005.

<sup>18</sup> Meeting between Ofcom and Rapture, 13 January 2006.

<sup>19</sup> Letter from David Henry (Rapture) to David Stewart (Ofcom), 24 August 2006.

- 3.33 Ofcom's assessment as to whether Sky's charge to Rapture was fair, reasonable and non-discriminatory follows in **section 5**.

### Ofcom's enquiry

- 3.34 The dispute resolution procedure set out in Chapter 3 of Part 2 of the Act enables, and requires, Ofcom to apply a specific set of powers and duties to a dispute that has been referred to it. The Act imposes limits both on the undertakings that can bring a dispute and the nature of the disputes that Ofcom can accept.
- 3.35 Therefore, before accepting this dispute for resolution, Ofcom was required by section 186 of the Act to decide, when it received Rapture's dispute referral, whether or not it had jurisdiction to handle the dispute (i.e. whether the dispute had been referred to Ofcom under and in accordance with section 185 of the Act).
- 3.36 As noted in Ofcom's *Guidelines for the handling of competition complaints, and complaints and disputes about breaches of conditions imposed under the EU directives* ("Complaint Guidelines"),<sup>20</sup> the question of whether Ofcom can and must accept a dispute for resolution is considered during the enquiry phase. This phase is also used to consider the issues relevant to the scope of the dispute and to undertake other preparatory work.<sup>21</sup>
- 3.37 Ofcom opened its enquiry to consider this dispute on 15 September 2006.
- 3.38 During the enquiry, Ofcom considered whether the dispute fell within one of the two types of regulatory dispute described in sections 185(1) and 185(2) of the Act.<sup>22</sup>
- 3.39 Under section 185(2) of the Act, a dispute may be referred to Ofcom where it:

*"a)...relates to rights or obligations conferred or imposed by or under this Part [i.e. Part 2 of the Act] or any of the enactments relating to the management of the radio spectrum that are not contained in this Part".*

- 3.40 Rapture suggested in its submission that the dispute related to "SMP conditions imposed following a market review" and "access conditions on providers of electronic programme guides".
- 3.41 In its letter to Ofcom of 22 September 2006, Sky stated that it did not consider that Ofcom had the power to accept the dispute for resolution as none of the types of dispute covered by section 185(2) applied. It also noted that:

*"Rapture has not specified any ex ante condition to which Sky is subject that is relevant to the supply of EPG services. As Ofcom is aware, there is no SMP finding against Sky, so the sections of Rapture's submission relating to SMP conditions are irrelevant. Although Rapture has mentioned that there are "access conditions on providers of electronic programme guides", it has not specified what those conditions are, or how Sky is alleged to be in breach of them."<sup>23</sup>*

<sup>20</sup> *Guidelines for the handling of competition complaints, and complaints and disputes about breaches of conditions imposed under the EU Directives*, July 2004 published at:

[http://www.ofcom.org.uk/bulletins/eu\\_directives/guidelines.pdf](http://www.ofcom.org.uk/bulletins/eu_directives/guidelines.pdf).

<sup>21</sup> See Complaint Guidelines and also the further guidance provided in the *Draft Enforcement Guidelines: Ofcom's draft guidelines for the handling of competition complaints, and complaints and disputes concerning regulatory rules*, July 2006, published at:

<http://www.ofcom.org.uk/consult/condocs/enforcement/enforcement.pdf>.

<sup>22</sup> On 19 October 2006, Ofcom wrote to Sky and Rapture to provide both parties with an opportunity to comment on whether the dispute fell within section 185 of the Act.

<sup>23</sup> Letter from Emma McCormack (Sky) to Louise Marriage (Ofcom), 22 September 2006.

- 3.42 Ofcom did not consider that section 185(2) of the Act was relevant in this case because:
- 3.42.1 Ofcom had not carried out a market review in this sector and no SMP conditions have been imposed on Sky under Part 2 of the Act; and
- 3.42.2 although Sky is subject to Condition 1 and Condition 11 of the EPG Conditions, these are not access conditions imposed under Part 2 of the Act but instead operate by virtue of the Continuation Notice to a Class of Persons Defined as the Licensee for the Purposes of the Provision of Electronic Programme Guide Services under paragraph 9 of Schedule 18 to the Act.
- 3.43 Therefore, Ofcom accepted the dispute as one which falls within the scope of section 185(1) of the Act.
- 3.44 Section 185(1) of the Act provides that:

*“This section applies in the case of a dispute relating to the provision of network access if it is-*

*(a) a dispute between different communications providers; [or]*

*(b) a dispute between a communications provider and a person who makes associated facilities available...”*

- 3.45 Therefore, Ofcom considered:
- 3.45.1 whether the alleged dispute related to the “*provision of network access*”; and
- 3.45.2 whether the alleged dispute was between “*different communications providers*” or “*a dispute between a communications provider and a person who makes associated facilities available*”.
- 3.46 These questions are considered briefly in paragraphs 3.49 to 3.76 below.
- 3.47 Ofcom notes that it rejected Rapture’s submission to Ofcom of 24 August 2006 as not meeting the requirements of Ofcom’s Complaint Guidelines.
- 3.48 Rapture’s further submission of 11 September 2006, while falling short of the full requirements of the Complaint Guidelines, stated Rapture’s dispute with sufficient clarity to allow Ofcom to accept the dispute, as noted in Ofcom’s letter to the parties of 10 November 2006. In this letter, Ofcom stated that the issue and scope of the dispute was clear – whether Sky’s charges to Rapture for the provision of EPG services were fair, reasonable and non-discriminatory.

### **Does the dispute relate to “network access”?**

- 3.49 “*Network access*” is defined in section 151(3) of the Act, which sets out two alternative criteria by which that term is defined. The first relates to ‘interconnection’, and is not relevant to this dispute.<sup>24</sup> Therefore, if this dispute relates to network access, it does by virtue of section 151(3)(b)(ii), which defines network access as including:

*“services, facilities or arrangements by means of which a communications provider or person making available associated facilities is able, **for the purposes of the provision of an***

<sup>24</sup> Neither party has suggested that this dispute relates to interconnection, and Ofcom has not considered this point further.

**electronic communications service** (whether by him or by another), to make use of anything mentioned in subsection (4)". (emphasis added)

3.50 Subsection (4) of section 151 includes:

*"(a) any electronic communications network or electronic communications service provided by another communications provider;*

*(b) any apparatus comprised in such a network or used for the purposes of such a network or service;*

*(c) any facilities made available by another that are associated facilities by reference to any network or service (whether one provided by that provider or by another);*

*(d) any other services or facilities which are provided or made available by another person and are capable of being used for the provision of an electronic communications service."*

3.51 Thus, network access in this context comprises "services, facilities or arrangements" used by a communications provider or a person making associated facilities available "for the purposes of the provision of an electronic communications service".

3.52 Based on the evidence available to Ofcom at the time of making the decision to accept the dispute, Rapture appeared to purchase its EPG listing from Sky in order to facilitate Rapture's provision of a content service.

3.53 The meaning of "content service" is defined in section 32(7) of the Act to include "the provision of material with a view to its being comprised in signals conveyed by means of an electronic communications network". Section 32(2) of the Act states that a content service is *not* an electronic communications service for the purposes of the Act.<sup>25</sup>

3.54 A narrow reading of section 151(3)(b)(ii) would, therefore, suggest that the dispute does not relate to "network access" on the basis that Rapture requires access for the purposes of the provision of a content service and not "for the purposes of providing an electronic communications service".

3.55 However, Article 5(4) of the Access Directive<sup>26</sup> requires Member States of the European Community to ensure that national regulatory authorities (such as Ofcom) are empowered to intervene in order to resolve disputes with regard to "access" as it is defined in Article 2(a) of the Access Directive, in accordance with the procedures referred to in Article 20 of the Framework Directive.<sup>27</sup> Article 5(4) states that:

*"With regard to access and interconnection, Member States shall ensure that the national regulatory authority is empowered to intervene at its own initiative where justified or, in the absence of agreement between undertakings, at the request of either one of the parties involved, in order to secure the policy objectives of Article 8 of the Directive 2002/21/EC (Framework Directive), in accordance with the provisions of this Directive and the procedures referred to in Articles 6 and 7, 20 and 21 of Directive 2002/21/EC (Framework Directive)."*<sup>28</sup>

3.56 Access, as defined in Article 2(a) of the Access Directive, is defined in wide terms. Article 2(a) does not provide for an exclusion of content services. The

<sup>25</sup> Section 32(2) of the Act states that an "electronic communications service" means a service consisting in, or having as its principle feature, the conveyance by means of an electronic communications network of signals, except in so far as it is a content service."

<sup>26</sup> Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities ("Access Directive").

<sup>27</sup> Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services ("Framework Directive").

<sup>28</sup> Access Directive, Article 5(4).

first sentence of the definition contains the same limitation as is included in the definition of “network access” set out in section 151(3)(ii):

*“access’ means the making available of facilities and/or services, to another undertaking, under defined conditions, on either an exclusive or non-exclusive basis, **for the purpose of providing electronic communications services.**” (emphasis added)*

3.57 Article 2(a) then sets out a non-exhaustive list of terms that are included within the definition of “access”:

*“It covers inter alia: access to network elements **and associated facilities**, which may involve the connection of equipment, by fixed or non-fixed means [...] access to physical infrastructure including buildings, ducts and masts; access to relevant software systems including operational support systems, access to number translation or systems offering equivalent functionality, access to fixed and mobile networks, in particular for roaming, access to conditional access systems for digital television services; access to virtual network services.” (emphasis added)*

3.58 Ofcom notes two important points about this definition: firstly, “associated facilities” are expressly included within the definition of access; and secondly, that the reference to “*conditional access systems for digital television services*” indicates an intention not to limit the concept so as to exclude networks used for the distribution of broadcasting content services.<sup>29</sup>

3.59 The definition of “associated facilities” in Article 2(e) of the Framework Directive states the following:

*“associated facilities’ means those facilities associated with an electronic communications network and/or an electronic communications service which enable and/or support the provision of services via that network and/or service. **It includes conditional access systems and electronic programme guides.**” (emphasis added)*

3.60 It is well established within case-law that a court will give a statute a purposive construction to ensure consistency with a Directive. Ofcom has, therefore, considered the provisions of the Act in light of the Directives which the Act seeks to implement. As a result, Ofcom assessed whether the provision of an EPG service by Sky to Rapture would fall within the definition of “access” contained in the relevant Directives.

3.61 Although the definition of “access” in the Access Directive refers to access “*for the purposes of providing electronic communications services*”, the express inclusion of EPGs in the definition of “associated facilities” in the Framework Directive could be devoid of meaning if Ofcom were required to demonstrate that the reference to EPGs was solely for the purpose of providing electronic communications services, as the situations in which an EPG could be used for such purposes appear to Ofcom to be very limited.

3.62 Therefore, taking a purposive approach to the definition of “access” in the Directives, and therefore “network access” under section 151 of the Act, Ofcom considers that the provision of an EPG listing (for the purpose of the provision of a content service, which is the only purpose of an EPG listing service known to Ofcom) is capable of being a facility that is an “associated facility” and, hence, a form of “network access” under section 151(3) of the Act.

3.63 A narrow reading of the term “network access” in section 151 of the Act in this context could defeat the clear intent of Article 2(e) of the Framework Directive, which is that the provision of conditional access systems and EPGs should be included within the ambit of “access” (by virtue of both terms being

<sup>29</sup> To be clear, except insofar as EPG services fall within that definition, Ofcom does not consider that this dispute relates to “conditional access services”.

“associated facilities”). The direct implication of this is that national regulatory authorities are required to be empowered to intervene to resolve disputes where they relate to the provision of conditional access systems and EPGs.

### **Are Rapture and Sky “communications providers” or “a person who makes associated facilities available”?**

3.64 Section 185(1) of the Act states that:

*“(a) a dispute between different communications providers; [or]*

*(b) a dispute between a communications provider and a person who makes associated facilities available;”*

are types of dispute that Ofcom can accept for resolution.

3.65 Under section 405(1) of the Act, the term “communications provider” is defined as:

*“a person who (within the meaning of section 32(4)) provides an electronic communications network or an electronic communications service”.*

3.66 The terms “electronic communications network”, “electronic communications service” and “associated facilities” are defined in section 32 of the Act.

3.66.1 “Electronic communications network” is defined in section 32(1)(a) as:

*“a transmission system for the conveyance, by the use of electrical, magnetic or electro-magnetic energy, of signals of any description...”*

3.66.2 “Electronic communications service” is defined in section 32(2) as:

*“a service consisting in, or having as its principle feature, the conveyance by means of an electronic communications network of signals...”*

3.66.3 “Associated facility” is defined in section 32(3) as:

*“...a facility which –*

*(a) is available for use in association with the use of an electronic communications network or electronic communications service [...]; and*

*(b) is so available for the purpose of-*

*(i) making the provision of that network or service possible;*

*(ii) making possible the provision of other services provided by means of that network or service; or*

*(iii) supporting the provision of such other services.”*

3.67 Ofcom was required, therefore, to determine whether Sky and Rapture were communications providers and/or providers of associated facilities.

3.68 Ofcom considered that Sky was a person making an associated facility available, i.e. its EPG. Although the definition of “associated facility” in the Act does not specifically mention EPGs, Ofcom refers to the discussion at paragraphs 3.59 to 3.63 regarding the interpretation of the Act in the light of Article 2(e) of the Framework Directive, which expressly includes EPGs within the definition of an associated facility. For the purposes of this dispute, Ofcom has not made any finding as to whether Sky was also a communications provider.

- 3.69 Prior to Ofcom's decision to accept the dispute, Ofcom understood that Rapture operated an electronic communications network based on the following submissions and comments made by Rapture:
- 3.69.1 Rapture operated its own purpose-built playout encoding package delivery system and delivers data packages using a 45Mbit ASI telecommunications circuit between its then premises at 79 Brewer Street and those of Arqiva at 64 Newman Street;
  - 3.69.2 Colt Telecommunications plc ("Colt") provided the leased lines linking the two premises;
  - 3.69.3 Rapture owned terminal equipment at each of the two premises;
  - 3.69.4 upon termination at the Arqiva premises, the signal was connected into Arqiva's equipment where it was multiplexed in with other channels and passed through the Sky Adaptation Hub, where Sky's EPG data stream was inserted; and
  - 3.69.5 the complete multiplex was then sent by Arqiva to the satellite uplink station.<sup>30</sup>
- 3.70 During the enquiry phase, Ofcom put its preliminary conclusions based on the facts noted above to the parties for their comment. Ofcom considered the submissions put by both parties and the available evidence as to Rapture's status. Ofcom concluded that by virtue of the fact that it 'operated' a network that was an electronic communications network (as defined in the Act), Rapture was a "communications provider" as that term is defined in the Act.
- 3.71 Upon accepting the dispute and gathering further and more detailed evidence on this point than could be acquired and considered in an enquiry phase, Ofcom has since established that the facts are more complex than described above.<sup>31</sup>
- 3.72 Ofcom has established that Rapture benefited from a leased line that was in fact provided by means of a line leased by Colt to Power TV, rather than to Rapture. Rapture did not provide full documentation to Ofcom in relation to any approval to transfer the benefit of these leased lines to Rapture from Power TV. However, the terminal equipment operated by Rapture is transmission equipment amounting to a "*transmission system for the conveyance, by the use of electrical, magnetic or electro-magnetic energy, of signals of any description*", in accordance with section 32(1) of the Act. Section 32(6) of the Act makes it clear that the definition of a transmission system "*includes a reference to a transmission system consisting of no more than a transmitter used for the conveyance of signals.*"
- 3.73 What is clear is that, to the extent that the facilities and leased line described above comprise an electronic communications network, then Rapture is, in practice, operating that network. Given that the regulatory status (and obligations) attaching to communications providers are governed by the substance of a person's activities, not the form of their contractual arrangements, Ofcom continues to consider that Rapture is a communications provider by virtue of its operation of an electronic communications network.

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<sup>30</sup> Email from David Henry (Rapture) to Emma McFadyen (Ofcom), 13 September 2006.

<sup>31</sup> This has been established on the basis of Rapture's responses to Ofcom's information requests of 15 December 2006 and 16 January 2007.

- 3.74 Section 32(4)(a) of the Act specifies that “*references to the provision of an electronic communications network include references to its establishment, maintenance or operation*”. Rapture’s *de facto* operation of that electronic communications network is, therefore, sufficient to establish that Rapture is a communications provider.

### **The nexus argument**

- 3.75 In its letter of 2 November 2006 to Ofcom, Sky raised an objection to Ofcom’s acceptance of the dispute: that there was an insufficient connection between the type of communications provider that Rapture was, and the subject matter of the dispute (what it termed a “nexus” between these elements):

*“... even if Rapture does provide an electronic communications network in relation to its play-out, we submit that such provision is entirely incidental to Rapture’s procurement of EPG services from Sky (noting specifically that the EPG datastream is not transmitted via the leased line and terminal equipment which are alleged to constitute the network). We submit that Ofcom must demonstrate that there is a nexus between the provision of an electronic [communications] network by Rapture and Rapture’s procurement of EPG services. Ofcom has not even attempted to make out any such case.*

*We submit it would be an absurd result indeed if Ofcom believes that it has the power to resolve disputes without even showing that the alleged provision of a network by Rapture is closely related to the alleged dispute about EPG services, not least of all because such a position would mean that the question of whether or not a broadcaster was able to seek dispute resolution from Ofcom depended on the technical means by which it played-out its channel.”*

- 3.76 Ofcom notes Sky’s comments and considers that in light of the fact that Rapture is a communications provider and that Sky is a person who makes associated facilities available, as discussed above, and because access to associated facilities, such as Sky’s EPG, was intended by the Directives to fall within the definition of “network access”, Ofcom was required to accept the dispute between Rapture and Sky over the cost of that access. In any event, although Ofcom did not consider the matter in detail, Ofcom considered that the electronic communications network in question was being used to transmit content (the Rapture TV signal) that was to be accessed via the EPG listing services being supplied by Sky.

### **Are there alternative means for resolving the dispute?**

- 3.77 Once Ofcom is satisfied that it does have jurisdiction to handle a dispute, under section 186(3) of the Act, Ofcom must consider whether there are alternative means available for resolving the dispute which will lead to a prompt and satisfactory outcome.
- 3.78 Although Sky contended that Rapture’s submission “*does not demonstrate a failure of commercial negotiation*”,<sup>32</sup> Ofcom concluded that no alternative means of dispute resolution existed and that negotiations between the parties, as set out in paragraphs 3.24 to 3.27 above and 5.120 to 5.148 below, had failed.

### **The enquiry concluded that Ofcom must handle the dispute**

- 3.79 Given Ofcom’s conclusions that:
- 3.79.1 Rapture was a communications provider;
  - 3.79.2 Sky was a person who made associated facilities available; and

<sup>32</sup> Letter from Emma McCormack (Sky) to David Stewart (Ofcom), 2 November 2006.

- 3.79.3 as discussed above, because access to associated facilities, such as Sky's EPG, was intended by the Directives to fall within the definition of "network access",

Ofcom accepted Rapture's submission that it must resolve the dispute.

3.80 Given that:

3.80.1 Rapture began broadcasting on the Sky Platform on 14 November 2005; and

3.80.2 the dispute related to Rapture's EPG listing charge only,

Ofcom limited the scope of its investigation to Sky's charge to Rapture for EPG services between 14 November 2005 and the date on which the dispute was accepted, 10 November 2006.

### Competition Bulletin

3.81 On 15 November 2006, Ofcom issued a Competition Bulletin stating that the scope of the dispute was "*to determine whether Sky's charges to Rapture for the provision of EPG services between November 2005 and November 2006 are fair, reasonable and non-discriminatory.*"<sup>33</sup>

### Ofcom's conduct of the dispute

3.82 Ofcom opened an investigation into Rapture's dispute with Sky on 10 November 2006.

3.83 Ofcom obtained documents and information from the parties to the investigation and from other channels transmitting on the Sky Platform as noted below.

3.84 As well as requiring it to provide certain information and documents, Ofcom also invited Sky to comment on the allegations made against it by Rapture and Rapture's submissions in support of such allegations.

### Rapture

3.85 Rapture's initial submission to Ofcom included a number of documents relating to, and commentary on, its negotiations with Sky for the provision of EPG services from 14 November 2005.

3.86 Ofcom sent Rapture two requests for documents and information under its information gathering powers on 15 December 2006 and 16 January 2007.

3.87 Rapture provided, in response to Ofcom's request for information, documents and information including:

3.87.1 a copy of Rapture's most recent audited annual accounts and a spreadsheet detailing Rapture's income and expenses;

3.87.2 copies of Rapture's initial and most recent business plans;

3.87.3 copies of Rapture's agreements with various providers for the provision of transmission equipment and services; and

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<sup>33</sup> See [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ocases/open\\_all/cw\\_920/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ocases/open_all/cw_920/)

- 3.87.4 copies of Rapture's agreements with various providers for the provision of telecommunications services.
- 3.88 Ofcom met with Rapture to discuss aspects of the dispute on 23 November 2006, 23 January 2007 and 20 February 2007.
- 3.89 Rapture has made additional submissions and had numerous telephone discussions with Ofcom throughout the investigation of the dispute.
- 3.90 Rapture submitted comments on Ofcom's draft Determination on 23 February 2007 and 26 February 2007.

## Sky

- 3.91 Ofcom sent Sky a request under its information gathering powers on 16 January 2007. In that request, Ofcom also asked Sky to confirm that, in discharging Sky's obligation to provide certain documents or information, it agreed instead to the use by Ofcom of documents and information previously supplied by Sky in a different context.
- 3.92 Sky provided, in response to Ofcom's request for information, documents and information including:
  - 3.92.1 documents and information relating to negotiations between Sky and Power TV about the provision of EPG listing services in 2003;
  - 3.92.2 documents and information relating to negotiations between Sky and Rapture about the provision of EPG listing services during the second half of 2005;
  - 3.92.3 documents and information relating to discussions between Sky and Rapture about the provision of EPG listing services in August and September 2006;
  - 3.92.4 details of Sky's agreements with EPG customers including details of broadcasters whose EPG listing charges deviated from the relevant standard charge during the period covered by the dispute;
  - 3.92.5 quantitative information about Sky's EPG customers;
  - 3.92.6 a copy of the rate card which was current at the time that Rapture signed its contract with Sky in November 2005; and
  - 3.92.7 a copy of Sky's most recent EPG regulatory accounts.
- 3.93 In addition, Sky confirmed that documents and information previously provided by it to Ofcom could be taken as Sky's response to certain information requests.<sup>34</sup>
- 3.94 Ofcom held discussions by conference call with Sky on 5 December 2006, 15 December 2006, 18 January 2007 and 24 January 2007.
- 3.95 On 7 February 2007 Sky made a further submission relating to the affordability of its EPG charges, the costs recovered through EPG charges, and the 'pricing off the platform' issue.<sup>35</sup>

<sup>34</sup> In particular, Sky provided relevant information during the course of Ofcom's investigation into the *ITV Complaint about Sky's proposed charge for ITV1 Regionalisation* in 2005. See [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_807/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_807/)

<sup>35</sup> Letter from Emma McCormack (Sky) to David Stewart (Ofcom), 7 February 2007.

- 3.96 Sky submitted comments on Ofcom's draft Determination on 23 February 2007.

### **Issues raised by Rapture outside the scope of this dispute**

- 3.97 Rapture made further submissions to Ofcom during the course of the investigation, including:
- 3.97.1 submissions about Rapture's negotiations with Sky prior to the launch of Rapture TV on the Sky Platform;<sup>36</sup>
  - 3.97.2 submissions about Sky's behaviour in seeking to recover charges for an EPG listing supplied by Sky to Power TV in 2002;<sup>37</sup> and
  - 3.97.3 submissions about the historical funding of the Sky Platform, in particular the role played by Sky's subsidiary BiB (see paragraph 5.41) and conditions placed on BiB by the European Commission and the Office of Fair Trading.<sup>38</sup>
- 3.98 Ofcom was mindful both of the practicalities of assessing such matters within its statutory four month period for dispute resolution and, as explained to Rapture in a meeting on 23 November 2006, did not consider that either Sky's historical funding, Sky's allocation of a channel number on the EPG or the time period taken by Sky to launch Rapture on to the Sky Platform in November 2005 could reasonably be viewed as matters about which the parties were in dispute in late 2006. On 8 December 2006, therefore, Ofcom wrote to Rapture noting that these allegations fell outside the scope of its dispute resolution powers. As a result, Ofcom has not examined these matters in this investigation.

### **Other parties**

- 3.99 Ofcom sent information requests under its information gathering powers to four smaller broadcasters on the Sky Platform who provided information on channel operating costs which Ofcom has used in its analysis of the 'willingness to pay' issue.
- 3.100 Ofcom received one response to its draft Determination from an independent broadcaster. The respondent stated that small broadcasters had, in its view, historically had little scope to negotiate reduced EPG listing charges from Sky and that the regulatory framework in place had been insufficient to take account of the strength of Sky's position as a provider of technical platform services.

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<sup>36</sup> Rapture made allegations to Ofcom during the course of the investigation (including by way of letter dated 3 November 2006) that Sky unreasonably delayed the launch of Rapture TV onto the Sky Platform and that Sky's policy towards the allocation of channel numbers put Rapture at a commercial disadvantage. Rapture's argument in both cases was that Sky "*operated in an anti-competitive manner towards Rapture Television plc.*"

<sup>37</sup> Letter from David Henry (Rapture) to Anthony Szykaruk (Ofcom), 23 February 2007.

<sup>38</sup> See paragraph 5.49.

## Section 4

# Legal and regulatory analysis

- 4.1 This section sets out the legal and regulatory framework which Ofcom has applied in considering this dispute.
- 4.2 It describes:
  - 4.2.1 Ofcom's statutory duties and general regulatory principles, as they apply to this dispute;
  - 4.2.2 Ofcom's role as a regulator in resolving disputes; and
  - 4.2.3 the regulatory instruments and guidelines applicable to the provision of EPG listing services, which Ofcom has applied to this dispute.

## Ofcom's duties

- 4.3 Ofcom has general duties under the Act in relation to all of its activities in particular under sections 3 and 4 of the Act which include:
  - 4.3.1 the principal duty to further the interests of citizens in relation to communications matters (section 3(1)(a)) and to further the interests of consumers in relevant markets, where appropriate by promoting competition (section 3(1)(b));
  - 4.3.2 the duty to secure the availability throughout the United Kingdom of a wide range of television and radio services which (taken as a whole) are both of high quality and calculated to appeal to a variety of tastes and interests (section 3(2)(c));
  - 4.3.3 the duty to secure the maintenance of a sufficient plurality of providers of different television services (section 3(2)(d));
  - 4.3.4 the duty to promote competition in relevant markets (sections 3(1)(b) and 3(4)(b));
  - 4.3.5 in relation to certain of its functions (including the EPG Conditions imposed under section 74(2)) to act in accordance with the six Community requirements as set out in Article 8 of the Framework Directive (these are summarised in paragraph 4.8 below);
  - 4.3.6 the requirement to ensure that its regulatory activities are transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed (section 3(3)(a)); and
  - 4.3.7 the duty to consider the desirability of encouraging investment and innovation in relevant markets (section 3(4)(d)).
- 4.4 This dispute relates to Sky's charge for the provision of EPG listing services to Rapture. Ofcom has also specific duties in relation to platform access services, including EPG listing services, which result in the imposition of certain duties on Sky.

- 4.5 Ofcom has had regard to all of its statutory duties and regulatory principles in considering whether Sky's charges for EPG listing services in this dispute infringes the applicable regulation and considers that the conclusion it has reached is consistent with these duties and principles.

### **Ofcom's role in resolving a dispute**

- 4.6 When Ofcom is required to resolve a regulatory dispute, it does so as the regulator, and not in the role of a third party arbitrator. Ofcom's Determination is a form of regulation, which must therefore reflect and be consistent with Ofcom's statutory duties, as well as being sufficient to resolve the dispute.<sup>39</sup>
- 4.7 The resolution of regulatory disputes must be aimed at achieving the policy objectives of Article 8 of the Framework Directive. Section 4(2) of the Act therefore requires that, when resolving such disputes, Ofcom acts in accordance with the six Community requirements that give effect to Article 8. In summary those requirements are:
- 4.7.1 to promote competition in communications markets;
  - 4.7.2 to secure that Ofcom contributes to the development of the European internal market;
  - 4.7.3 to promote the interest of all European Union citizens;
  - 4.7.4 to act in a manner which, so far as practicable, is technology-neutral;
  - 4.7.5 to encourage to the extent Ofcom considers it appropriate, the provision of network access and service interoperability; and
  - 4.7.6 to encourage such compliance with certain international standards as is necessary for facilitating service interoperability and securing freedom of choice for the consumers of communication providers.
- 4.8 Where the parties to a dispute are unable to agree on the terms and conditions for network access, Ofcom is under a duty to consider those disputes which it has decided to handle. Ofcom must then make a determination resolving each dispute and has to do so in the light of the Community principles noted above.
- 4.9 Ofcom must resolve disputes within four months of the date of the decision by Ofcom to accept the dispute, unless exceptional circumstances apply.<sup>40</sup>
- 4.10 In practical terms, this strict statutory timeframe means that the evidence and submissions made by the parties to the dispute are particularly important. In addition, Ofcom makes every effort to use the available time to gather what additional evidence it can to assist it in resolving the dispute.

### **Relevant regulatory instruments**

- 4.11 As described in paragraphs 3.34 to 3.80, Ofcom has accepted the dispute under section 185(1) of the Act as being a dispute relating to the "*provision of*

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<sup>39</sup> The section on regulatory disputes in Ofcom's "*Draft guidelines for the handling of competition complaints, and complaints and disputes concerning regulatory rules*" has a more expansive discussion on this topic. See: <http://www.ofcom.org.uk/consult/condocs/enforcement/>

<sup>40</sup> Section 188(5) of the Act.

*network access” and being a dispute between “a communications provider and a person who makes associated facilities available”.*

- 4.12 In resolving this dispute Ofcom has considered the relevant conditions continued into the new regulatory regime, set up under the Act, by paragraph 9 of Schedule 18 to the Act.
- 4.13 Under Schedule 18 Ofcom continued certain provisions, the EPG Conditions, of the class licence (issued under the Telecommunications Act 1984) to run telecommunications systems for the provision of conditional access services for the purposes of the provision of EPG services over into the new regime set up under the Act. Ofcom issued the continuation notice on the basis that it corresponded to provisions authorised by section 73(2) for inclusion in access-related conditions.<sup>41</sup>

### **The regulation of EPGs and the EPG Conditions**

- 4.14 Article 5(1) of the Access Directive makes specific provision for the regulation of EPGs, requiring that:

*“National regulatory authorities shall [...] encourage and where appropriate ensure, in accordance with the provisions of this Directive, adequate access and interconnection, interoperability of services, exercising their responsibility in a way that promotes efficiency, sustainable competition, and gives the maximum benefit to end-users.”*

*In particular, [...] national regulatory authorities shall be able to impose [...] (b) to the extent necessary to ensure accessibility for end-users to digital radio and television broadcasting services specified by the Member State, obligations on operators to provide access to the other facilities referred to in Annex I, Part II on fair, reasonable and non-discriminatory terms.”*

- 4.15 Annex I, Part II of the Access Directive includes “Access to electronic programme guides (EPGs)”.

- 4.16 Section 74(2) of the Act enables Ofcom to impose:

*“...conditions imposing obligations on a person providing facilities for the use of application programme interfaces or electronic programme guides as OFCOM consider to be necessary for securing -*

*(a) that persons are able to have access to such programme services provided in digital form as OFCOM may determine; and*

*(b) that the facility for using those interfaces or guides is provided on terms which –*

*(i) are fair and reasonable; and*

*(ii) do not involve, or tend to give rise to, any undue discrimination against any person or description of persons.”*

- 4.17 Before Ofcom took over the responsibilities and assumed the powers of the five former regulators it replaced on 29 December 2003, the regulation of EPG services was the responsibility of the Director General of Telecommunications (the “Director”). The Director imposed on SSSL a number of obligations relating to the provision of EPG services. As noted at paragraph 4.13, these EPG Conditions were carried over from the regulatory regime that was in place prior to 24 July 2003 to the new regulatory regime set up under the Act.<sup>42</sup> The Director explained in a Statement in September 2003, *Continuing Licence Conditions after 25 July*, at paragraph 3.122 that:

<sup>41</sup> [http://www.ofcom.org.uk/static/archive/Oftel/publications/eu\\_directives/cont\\_notices/epg\\_class.pdf](http://www.ofcom.org.uk/static/archive/Oftel/publications/eu_directives/cont_notices/epg_class.pdf)

<sup>42</sup> Continuation notice to a class of persons defined as the licensee for the purposes of the provision of electronic programme guide services under paragraph 9 of Schedule 18 to the Communications Act 2003, 23 July 2003, which continued certain provisions of the class licence to run telecommunications

*“...insofar as it related to EPGs and until such time as appropriate Access-Related Conditions on EPGs can be imposed under the Act, the Director has retained certain Conditions of the Conditional access class licence. These Conditions are being continued until the consultation on the future regulation of EPGs has been completed. The Director has continued these provisions pursuant to Article 7(6) of the Framework Directive.”<sup>43</sup>*

4.18 The EPG Conditions define an EPG Service as:

*“a service which consists of-*

*(a) the listing or promotion, or both the listing and promotion, of some or all of the programmes included in any one or more programme services the providers of which are or include persons other than the provider of the guide; and*

*(b) a facility for obtaining access, in whole or part, to the programme service or services listed or promoted in the guide.”<sup>44</sup>*

4.19 EPG Condition 1 imposes the following requirement on SSSL (the “Licensee”) to provide EPG services to third parties on a fair, reasonable and non-discriminatory basis:

*“Where a Third Party requires the provision of an Electronic Programme Guide Service in respect of decoders administered by the Licensee, the Licensee shall offer that Service to that person on a fair, reasonable and non-discriminatory basis.”*

4.20 In addition, EPG Condition 11 imposes on SSSL a specific prohibition on undue preference or undue discrimination in the provision of EPG services to third parties:

*“11.1 The Licensee shall not (whether in respect of the charges or other terms or conditions applied or otherwise) show undue preference to or exercise undue discrimination against particular persons or persons of any class or description as respects:*

*(a) the provision of any Electronic Programme Guide Services [...]*

*11.2 The Licensee shall be deemed to have shown such undue preference or to have exercised such undue discrimination if it unfairly favours to a material extent a business carried on by it in relation to the doing of any of the things mentioned in paragraph 11.1 so as to place at a significant competitive disadvantage persons competing with that business.”*

4.21 Ofcom considers that the EPG services that Sky provides to Rapture are ‘Electronic Programme Guide Services’ as that term is defined in the EPG Conditions. Ofcom recognises that EPG services were, in the past, regulated under the Conditional Access Class Licence, and notes that EPG services are currently regulated by virtue of a continuation notice which carried forward certain provisions of that licence (see paragraph 4.17 above).<sup>45</sup>

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systems for the provision of conditional access services granted by the Secretary of State for Trade and Industry on 1 August 2001 under section 7 of the Telecommunications Act 1984.

<sup>43</sup> Continuing Licence Conditions after 25 July, 10 September 2003,

[http://www.ofcom.org.uk/static/archive/oftel/publications/eu\\_directives/cont\\_notices/cont0903.pdf](http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/cont0903.pdf).

<sup>44</sup> Schedule 1, EPG Conditions. This follows the definition of “*electronic programme guide*” as set out in section 74(3) of the Act as being “*a facility by means of which a person has access to any service which consists of –*

*(a) the listing or promotion, or both the listing and the promotion, of some or all of the programmes included in any one or more programme services; and*

*(b) a facility for obtaining access, in whole or in part, to the programme service or services listed or promoted in the guide.”*

<sup>45</sup> Ofcom notes that on 15 January 2004 Ofcom proposed new access conditions for providers of EPG services which have not been finalised (see *The regulation of Electronic Programme Guides*, published at <http://www.ofcom.org.uk/consult/condocs/epg/epg/>). Ofcom also notes that the draft of the code of practice for providers of EPGs (Published at <http://www.ofcom.org.uk/tv/ifi/codes/EPGcode/241557>) was included in Ofcom’s consultation on the regulation of EPGs of 6 February 2004 (*The regulation of electronic programme guides* published at <http://www.ofcom.org.uk/consult/condocs/epg/epg/>). Ofcom adopted the EPG Code on 26 July 2004.

## The 2002 Guidelines

- 4.22 As noted in paragraph 4.17, prior to the vesting of Ofcom's powers on 29 December 2003, the regulation of conditional access, including the pricing of conditional access and related platform access services (including access to EPGs), was the responsibility of the Director.
- 4.23 On 22 October 2002, the Director published the 2002 Guidelines.<sup>46</sup>
- 4.24 The purpose of the 2002 Guidelines was to provide guidance on how the Director would approach any complaint raised with him regarding conditional access pricing (as noted in Oftel's statement *The pricing of conditional access services and related issues* issued on 8 May 2002 (the "Pricing of Conditional Access Statement")).<sup>47</sup>
- 4.25 The 2002 Guidelines include comments on how the Director would approach Sky's obligation to provide conditional access services on a fair, reasonable and non-discriminatory basis and how prices should be set for such services.
- 4.26 At that time, the Director was under no specific obligation to regulate access to EPGs. The Director took the view, however, that the 1995 Advanced Television Services Directive<sup>48</sup> (from which the obligation to regulate conditional access services derives) was sufficiently broad in scope to encompass access to EPGs.<sup>49</sup> The 2002 Guidelines therefore encompass the provision of EPG services.
- 4.27 In its EPG consultation, Ofcom stated it would have regard to the 2002 Guidelines in assessing a complaint about the provision of EPG services:

*"In interpreting the requirement to supply on terms that are fair, reasonable and not unduly discriminatory, Ofcom will have regard to relevant parts of the conditional access guidelines (which incorporate guidelines on EPG access regulation) published by Oftel, until such time as they are revised".<sup>50</sup>*

## Subsequent developments in relation to Technical Platform Services

- 4.28 In November 2005, Ofcom issued for comment a draft explanatory statement and revised Technical Platform Services ("TPS") guidelines.
- 4.29 This consultation invited stakeholders to comment on Ofcom's proposal to issue new guidelines on how Ofcom intends to interpret the existing regulatory conditions that apply to those operators of digital TV platforms who are required to provide access to conditional access, access control and EPG technical services on regulated terms. Ofcom adopted the term "TPS" to describe these technical services, and Ofcom referred to any such regulated providers as a "TPS Provider."

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<sup>46</sup> Published at:

<http://www.ofcom.org.uk/static/archive/oftel/publications/broadcasting/2002/cagu1002.htm>

<sup>47</sup> <http://www.ofcom.org.uk/static/archive/Oftel/publications/broadcasting/2002/cast0502.pdf>

<sup>48</sup> Directive 95/47/EC.

<sup>49</sup> This position is set out in Oftel's May 1999 guidelines, *Digital television and interactive television services: ensuring access on fair, reasonable and non-discriminatory terms* (published at <http://www.ofcom.org.uk/static/archive/oftel/publications/1999/consumer/dtv0599.htm>), which states at paragraph 1.12 that: "As general guidance, Oftel would take the view that conditional access services included those services need to control the supply of television services to viewers. This includes [...] listing in electronic programme guides in so far as the EPG is linked to the conditional access system or is itself is a mechanism for controlling the viewer's access to television services."

<sup>50</sup> EPG Code consultation, section 3, paragraph 19.

- 4.30 The consultation invited stakeholders to comment on Ofcom’s proposal to replace:
- 4.30.1 the 2002 Guidelines; and
- 4.30.2 the Pricing of Conditional Access Statement,  
with a new set of guidelines.
- 4.31 After having considered the responses to the first consultation, on 21 April 2006, Ofcom issued, for consultation, a further draft explanatory statement and guidelines.<sup>51</sup>
- 4.32 On 21 September 2006, Ofcom published its final statement and adopted the 2006 Guidelines.<sup>52</sup>
- 4.33 The 2006 Guidelines set out Ofcom’s approach to considering, in the event of a dispute or complaint, whether TPS Providers have complied with the conditions requiring them to provide access to TPS on fair, reasonable and non-discriminatory terms (the “TPS Conditions”).<sup>53</sup> The 2006 Guidelines are formed of two parts. The first part sets out the general principles that Ofcom would apply in assessing whether TPS Providers have complied with the TPS Conditions. The second part provides more detail on Ofcom’s normal approach to particular aspects of cost recovery and assessment of benefits received in assessing whether Sky has complied with the TPS Conditions.
- 4.34 Ofcom considered that for reasons of practicality Sky should be allowed a reasonable period of time to implement any changes to its charges or charge methodology as a consequence of the 2006 Guidelines. Therefore, the 2006 Guidelines applied as from 1 January 2007.

#### **Application of guidelines in this dispute**

- 4.35 This dispute covers the period from 14 November 2005 to 10 November 2006, as explained in section 2. The EPG listing charges that are the subject of the dispute were set at a time when the available guidance in effect comprised the 2002 Guidelines.
- 4.36 The 2002 Guidelines expressly state that they do not fetter the Director’s discretion in determining whether terms offered by providers of regulated services are fair, reasonable and non-discriminatory. Ofcom wrote to Sky in November 2004 to confirm that:

*“if a dispute were to be submitted in the near future concerning the terms of supply of conditional access services [...] Ofcom would not consider itself to be fettered by the approach previously taken by Oftel [...].”<sup>54</sup>*

- 4.37 Ultimately, what is fair, reasonable and non-discriminatory must be judged on the facts of each case, and guidelines provide a non-binding framework within which to consider those issues. In the current case, relating to the period ending in November 2006, Ofcom considers that it is most appropriate for it to have regard to the 2002 Guidelines in assessing whether Sky’s charges for EPG services are fair, reasonable and non-discriminatory and in reaching a decision in this case.

<sup>51</sup> <http://www.ofcom.org.uk/consult/condocs/tpsguidelines/consultation.pdf>

<sup>52</sup> <http://www.ofcom.org.uk/consult/condocs/tpsguidelines/statement/statement.pdf>

<sup>53</sup> The 2006 Guidelines only apply to Sky and the guidelines noted that if other operators were to be designated as regulated suppliers of TPS in the future, Ofcom would need to consider the appropriate guidelines to apply given the specific circumstances of the designated provider (paragraph A1.6)

<sup>54</sup> Letter from Jim Niblett (Ofcom) to Michael Rhodes (Sky), 26 November 2004.

4.38 Ofcom notes that many of the underlying principles of the 2002 Guidelines are reflected in the 2006 Guidelines:

*“the [2006] [G]uidelines .....share many of the underlying principles that formed the basis of the previous guidelines [ie the 2002 Guidelines]. These include the need to ensure costs are reasonably, necessarily and efficiently incurred, recovery of common costs based on willingness to pay (which in turn is related to the benefits received), the use of revenues earned as a proxy of benefits received and guidance on non price terms such as lead times and information relating to new TPS.”<sup>55</sup>*

4.39 Two important differences between the approaches set out in the two sets of guidelines, relevant to this dispute, are:

4.39.1 the basis for calculating the contribution towards common costs of different users of the platform; and

4.39.2 the role of the rate card.

4.40 These differences are discussed further in paragraph 5.224 *et seq.*

4.41 Deviating from the 2002 Guidelines would only be appropriate if there were reasons to find that the application of the 2002 Guidelines would not result in an outcome that was fair, reasonable and non-discriminatory or would otherwise be incompatible with Ofcom’s statutory duties (for example in relation to Ofcom’s statutory duties under section 3 and 4 of the Act, such as the duty to promote competition in communications markets).<sup>56</sup>

4.42 These issues could arise, for example, because changes in market conditions over time meant that the underlying rationale for earlier guidelines had changed. In this case, Ofcom has already been clear (in the 2006 Guidelines) that the application of the 2002 Guidelines could raise issues in certain cases.

4.43 In the event, Ofcom’s analysis of the facts of this case (paragraph 5.224 *et seq.*) revealed no reasons to conclude that it is necessary to deviate from the 2002 Guidelines in this case, whether because of concerns about outcomes being fair, reasonable and non-discriminatory, or to assist it in meeting its duties under sections 3 or 4 of the Act more effectively.

4.44 Ofcom has, therefore, examined whether Sky has complied with its obligations to provide services on a fair, reasonable and non-discriminatory basis to Rapture by reference to the 2002 Guidelines.

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<sup>55</sup> 2006 Guidelines, paragraph 2.27.

<sup>56</sup> Section 3(1)(b) of the Act.

## Section 5

# Was Sky's EPG listing charge to Rapture fair, reasonable and non-discriminatory?

### Ofcom's approach

- 5.1 This section sets out Ofcom's analysis of Sky's EPG listing charge to Rapture between November 2005 and November 2006 and in particular whether this charge was fair, reasonable and non-discriminatory as required under the EPG Conditions.

### Application of the 2002 Guidelines

- 5.2 As discussed in section 4, Ofcom has assessed whether Sky's EPG listing charges to Rapture were fair, reasonable and non-discriminatory in accordance with the 2002 Guidelines.
- 5.3 The 2002 Guidelines include and describe the following components to the assessment of whether charges are fair, reasonable and non-discriminatory. Each of the following points will be analysed respectively in later paragraphs of this section 5, as indicated.
- 5.3.1 Terms should be consistent with those in a competitive market (see paragraphs 5.12 to 5.14):

*"In assessing fairness and reasonableness, Ofcom will consider whether the terms offered are consistent with those which would be expected in a competitive market".<sup>57</sup>*

- 5.3.2 Input costs should be reasonably and necessarily incurred in providing the service (see paragraphs 5.15 to 5.69):

*"In any assessment as to whether charges are fair and reasonable, Ofcom will usually need to consider whether input costs are reasonably and necessarily incurred in supplying the services in question."<sup>58</sup>*

- 5.3.3 Charges should be set between the 'floor' of the incremental cost of providing the service, and the 'ceiling' of the stand-alone cost of the service and returns should not be excessive (see paragraphs 5.70 to 5.102):

*"all users of the service should pay a charge that is equivalent to incremental costs together with a reasonable contribution to common costs (i.e. a price that falls between the floor of incremental costs and a ceiling of the 'stand alone' cost of providing the system). This is the outcome that would be expected in a market where there was competitive supply of conditional access or access control services, although the relative contributions might well vary between different users."<sup>59</sup>*

- 5.3.4 The allocation of common costs should be negotiated between the relevant parties and where a rate card is published, this should

<sup>57</sup> 2002 Guidelines, paragraph 2.1.

<sup>58</sup> 2002 Guidelines, paragraph 2.2.

<sup>59</sup> 2002 Guidelines, paragraph 3.5.

serve as the starting point for negotiation (see paragraphs 5.103 to 5.158):

*“OfTel would expect that the result of negotiations between providers and the broadcaster is that common costs are likely to be distributed amongst different bundles or single channels at differential levels depending on the overall balance of benefits which could accrue to the provider and the broadcaster. OfTel recognises that there are economies of scale and scope which are available to both parties.”<sup>60</sup>*

*“OfTel considers that the publishing of indicative prices that can serve as the starting point for commercial negotiation is helpful for all parties. However, OfTel emphasises that those indicative prices are not set by or approved by OfTel and that OfTel would regard them as a starting point in negotiations, and that OfTel expects such negotiations to take place (as would be likely to occur in a competitive market)”<sup>61</sup>*

- 5.3.5 A range of factors should be taken into account in assessing charges, including the service required, benefits to the platform and willingness to pay (see paragraphs 5.159 to 5.204).
- 5.3.6 In assessing non-discrimination, comparable prices should be offered to comparable users for comparable services purchased at a similar time (see paragraphs 5.205 to 5.215).
- 5.4 In considering these points, Ofcom has taken into account the following three strands of evidence:
  - 5.4.1 the submissions of the parties made to Ofcom in the lead-up to, and during, the conduct of this investigation;
  - 5.4.2 the documents and information provided by the parties (and, where relevant, a number of third parties) under Ofcom’s statutory information gathering powers; and
  - 5.4.3 the Sky Platform Model (further described in paragraph 5.26 *et seq*), which was developed by Sky to enable Sky to monitor its own compliance with its regulatory obligations relating to the price of technical platform services such as EPG listing services.
- 5.5 Ofcom concludes, on the basis of this evidence taken as a whole, that Sky’s EPG listing charges to Rapture during the period November 2005 to November 2006 were fair, reasonable and non-discriminatory.
- 5.6 Ofcom therefore makes a declaration that Sky’s EPG listing charges to Rapture during the period under consideration were fair, reasonable and non-discriminatory (as those terms apply under the EPG Conditions).

### **Previous relevant disputes and complaints**

- 5.7 In assessing whether Sky’s EPG listing charges to Rapture were fair, reasonable and non-discriminatory, Ofcom had regard to the approach taken by OfTel and Ofcom in three previous complaints.
- 5.8 Firstly, the complaint received in 2001 from ITV Network Limited (“ITV”) regarding the supply of conditional access services by SSSL.<sup>62</sup> OfTel

<sup>60</sup> 2002 Guidelines, paragraph 3.6.

<sup>61</sup> 2002 Guidelines, paragraph 3.17.

<sup>62</sup> See [http://www.ofcom.org.uk/static/archive/oftel/publications/comp\\_bull/archive/bull28.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/comp_bull/archive/bull28.htm)

investigated certain aspects of ITV's complaint under the Conditional Access Class Licence.<sup>63</sup> Oftel found:

- 5.8.1 that the price that SSSL was charging ITV for conditional access services was not excessive;
  - 5.8.2 that the price that SSSL was charging ITV for conditional access services did not constitute price discrimination likely to have a material adverse impact on competition between ITV and other public sector broadcasters; and
  - 5.8.3 that the price that SSSL was charging public sector broadcasters for conditional access services did not constitute price discrimination likely to have a material adverse impact on competition between public service broadcasters and subscription funded broadcasters, in particular BSkyB.
- 5.9 Oftel therefore concluded that SSSL had not contravened the obligation included in its licence to provide conditional access services on fair, reasonable and non-discriminatory terms. Oftel notified the parties of this decision (referred to in this document as "Oftel's 2002 Decision") on 22 October 2002.
- 5.10 Secondly, the complaint received by Oftel in 2002 from Simply Television Limited ("Simply TV"), a broadcaster, regarding the pricing of listings on Sky's EPG.<sup>64</sup> The complaint related to the difference in Sky's charges for: (1) EPG listings for broadcasters which took EPG listings only; and (2) broadcasters which took EPG listings and additionally entered into contracts for conditional access services. This complaint applied the approach to assessing charges set out in the 2002 Guidelines, as described above, to assess whether prices for conditional access services were fair, reasonable and non-discriminatory. Basing its analysis on the 2002 Guidelines, Oftel concluded in a decision (referred to in this document as "Oftel's 2003 Decision") published on 30 June 2003 that Sky's EPG listing charges, and the differentiation in pricing, were fair, reasonable and non-discriminatory.
- 5.11 Thirdly, Ofcom received a complaint from ITV on 10 December 2004 regarding Sky's regionalisation services.<sup>65</sup> This complaint was subsequently withdrawn by ITV. Ofcom therefore closed the case and did not publish a decision.

### **Terms should be consistent with those in a competitive market**

- 5.12 The process by which Ofcom must assess whether charges are fair, reasonable and non-discriminatory incorporates the consideration of a number of factors, including whether the terms offered by the provider were consistent with those which would be expected in a competitive market.

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<sup>63</sup> The Conditional Access Class Licence, which applied to SSSL, included an obligation to provide conditional access services on fair, reasonable and non-discriminatory terms. These provisions were discontinued on 24 July 2003 when the Conditional Access Conditions came into force, although certain provisions of the Conditional Access Class Licence, relating to the provision of EPG services, were continued.

<sup>64</sup> See

[http://www.ofcom.org.uk/static/archive/oftel/publications/comp\\_bull/cases/closed\\_cases/cw\\_580.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/comp_bull/cases/closed_cases/cw_580.htm)

<sup>65</sup> See [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_807/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_807/)

5.13 As stated in the 2002 Guidelines:

*“OfTel’s primary consideration is to ensure that intra-platform competition (i.e. competition on the same platform, as opposed to competition between platforms) between broadcasters is not adversely affected by the terms under which conditional access services or access control services are offered on a platform”.*<sup>66</sup>

5.14 In particular, the 2002 Guidelines note that:

*“OfTel considers that it is appropriate that all users of the service should pay a charge that is equivalent to incremental costs together with a reasonable contribution to common costs (ie a price that falls between the floor of incremental costs and a ceiling of the ‘stand alone’ cost of providing the system). This is the outcome that would be expected in a market where there was competitive supply of conditional access or access control services, although the relative contributions might well vary between different users.”*<sup>67</sup>

## **Were the costs that Sky sought to recover from EPG customers reasonably and necessarily incurred in providing the EPG listing service?**

### **Introduction**

5.15 In assessing cost recovery, the 2002 Guidelines state that:

*“The general principle that OfTel would follow in assessing the costs to be recovered from conditional access or access control charges, is that those costs should be reasonably and necessarily incurred in the provision of those services.”*<sup>68</sup>

5.16 Determining the cost of providing a particular service, or of providing a service to a particular customer on the Sky Platform, is problematic for a number of reasons which are discussed below.

5.17 Costs which are wholly attributable to individual services offered on the Sky Platform (as distinct from costs incurred in running the Sky Platform in general) are relatively low. This is because the largest costs of establishing and running the platform (technology, systems and development, customer equipment, overheads) are used in providing a number of different technical platform services to third parties (EPG, conditional access, and access control services). Ofcom estimates that around 80% of the total cost of the Sky Platform is currently made up of such “common costs”.<sup>69</sup>

5.18 Overall pricing of platform services based on a cost recovery principle therefore requires Sky to recover its fixed and/or common costs across different customers, including its own retail business.

5.19 The 2002 Guidelines stated, in relation to the recovery of incremental and common costs, that:

*“OfTel considers that it is appropriate that all users of the service should pay a charge that is equivalent to incremental costs together with a reasonable contribution to common costs (ie a price that falls between the floor of incremental costs and a ceiling of the ‘stand alone’ cost of providing the system.”*<sup>70</sup>

5.20 The question therefore arises of how Sky should recover common costs:

5.20.1 for costs common to different services, across those services; and

<sup>66</sup> 2002 Guidelines, paragraph 2.1.

<sup>67</sup> 2002 Guidelines, paragraph 3.5.

<sup>68</sup> 2002 Guidelines, paragraph 3.1.

<sup>69</sup> Source: Ofcom calculation based on costs not allocated to particular services in Sky’s Platform Model (see paragraph 5.26 *et seq.*).

<sup>70</sup> 2002 Guidelines, paragraph 3.5.

5.20.2 for costs common to users of the same service, across those customers.

5.21 The 2002 Guidelines suggest that it is not necessary for common costs to be allocated to specific services or customers (in order to determine a reasonable price), but rather that the recovery of common costs can be left to negotiation:

*“OfTel would expect that the result of negotiations between providers and the broadcaster is that common costs are likely to be distributed amongst different bundles or single channels at differential levels depending on the overall balance of benefits which could accrue to the provider and the broadcaster.”<sup>71</sup>*

### **Sky’s approach to setting EPG listing charges**

5.22 Prior to January 2003, EPG listing charges for TV channels were £28,000 per listing per annum for a three-year agreement or £35,000 per year for an agreement with a 90-day termination right.

5.23 In January 2003, Sky published a rate card for EPG listings with indicative charges per channel. The indicative EPG listing charges were £36,000 per annum for TV channels which were also purchasing conditional access services from Sky and £75,000 for TV channels not additionally purchasing such services from Sky.

5.24 In February 2003, Sky set out the rationale for the new rate card, noting that:

*“In determining revised indicative charges for EPG listings, Sky took full account of OfTel guidance on CA pricing. In particular, in order to ensure that charges are fair and reasonable, Sky has sought to ensure that:*

- *Sky will recover its costs over a reasonable period, using its best estimates of CA related costs and revenues;*
- *EPG charges fall between the incremental cost of the services provided and their stand-alone cost;*
- *Indicative charges are set at level that, in general, reflect third parties’ willingness to pay for EPG listings, taking into account the considerable commercial benefits that they derive from such listings. Published tariffs are, of course, indicative and Sky is prepared to negotiate alternative charges when a broadcaster provides a compelling (and commercially rational) reason as to why the indicative charges are not appropriate in their particular case; and*
- *The differences in charges between different types of users of EPG listings are objectively justified.*

*The reasons for the changes to Sky’s EPG charges are, in summary, as follows:*

- i) There has been no change in EPG charges since the platform was introduced in 1998 – a period of over four years. In common with CA charges, EPG charges were initially set at low levels, to encourage entry onto the platform. It was always expected that these charges would increase at some point, as the platform became established. Revision of these charges has, however, been a relatively low priority and, as a result, broadcasters have had the benefit of low charges for far longer than might otherwise have been anticipated.*
- ii) The platform has become far more successful than was anticipated at the time of its launch. To a large extent, this is because Sky took the decision to provide significant subsidies of consumers’ reception equipment. As a result, the platform now reaches more than twice the number of households it was expected to at the*

<sup>71</sup> 2002 Guidelines, paragraph 3.6.

time of its launch. It is estimated that it now reaches around 7 million households, including pay-TV subscribers, churners and Solus households. This means that the cost per household of EPG listings has fallen dramatically – even taking into account the recent increase in charges. For example, in June 1999 at a charge of £28,000 per annum, the cost per home reached was around 3.7p per household per annum; in December 2002 at a charge of £35,000 per annum the cost per home reached was around 0.5p per household per annum, and at a charge of £75,000 per annum, the cost per home reached is around 1.1p per household per annum.

iii) *There has been a proliferation of in-the-clear television channels which use the platform. At the time that Sky reviewed its EPG charges in 2002, there were 77 in-the-clear channels listed on the EPG. More have launched since then. These channels have flourished as a result of the extensive reach of the platform, which is the result of investment on the part of Sky and the low costs of broadcasting channels via satellite, including the cost of an EPG listing. In contrast to channels which use Sky's CA services, to date in-the-clear channels have had a relatively free ride on Sky's investment in the platform. It is fair and reasonable that these channels make a contribution to the recovery of the costs of the development and operation of the platform via their EPG charge.*<sup>72</sup>

5.25 On 14 October 2004, Sky issued a new rate card, with rates being effective from 14 January 2005. The rates were predicated on three-year agreements, with rates increasing to take account of inflation. The rate card is attached as Annex 1.

### Common Costs

5.26 Until January 2007, Sky assessed its recovery of platform costs in a financial model (comprised in an Excel spreadsheet) (the "Platform Model") which included actual and forecast revenues and costs associated with the platform business over the period 1998 to 2010.

5.27 Sky has previously explained to Ofcom that costs in its Platform Model may relate to different companies in the Sky Group, and that the Model does not map directly onto any particular Sky Group business. Sky explained that it developed the Platform Model in order to verify internally that it was meeting its regulatory obligations.<sup>73</sup>

5.28 The version of the Platform Model assessed by Ofcom (which is the most recent version) covers the period 1998-2010 and includes actual revenues and costs from October 1998 to June 2005 (six years and nine months) and forecast revenues and costs for the period July 2005 to June 2010 (five years). This was also the most recent version of the Platform Model in November 2005 – the starting date of the period of charges considered in this dispute.

5.29 Historical accounting information used in the Platform Model was prepared in accordance with a set of accounting documents which Sky prepared pursuant to Conditional Access Condition 3.<sup>74</sup> Estimates of future costs are derived from a number of sources including the Sky Group business plan.

5.30 The Platform Model allocates certain direct revenues and costs to EPG, access control and conditional access services to determine a gross margin

<sup>72</sup> Letter from Michael Rhodes (Sky) to Jim Niblett (Ofcom), 25 February 2003.

<sup>73</sup> Comment by Alan Sewell (Sky) in a meeting with Ofcom on 3 February 2005.

<sup>74</sup> See The regulation of conditional access: Setting of Regulatory Conditions Explanatory Statement and Formal Notification pursuant to section 48(1) of the Communications Act 2003, 24 July 2003, published at

[http://www.ofcom.org.uk/static/archive/oftel/publications/eu\\_directives/2003/condac0703.pdf](http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/condac0703.pdf)

for each of these services. This gross margin can also be viewed as the contribution of these services to the recovery of costs common to more than one service. Common costs in the Platform Model are charged to the overall platform business which also includes all of the revenues and costs of the individual services to give a measure of the total profitability of the Sky Platform as a whole and therefore an indication of whether, on an overall basis, the platform business is reasonably recovering all costs.

- 5.31 One outcome of the 2002 Guidelines is that for each technical platform services customer there is a very wide range of potentially fair and reasonable charges. This is because there is a very large gap between the incremental cost and stand-alone cost of providing the service (see paragraph 5.70 *et seq.*)
- 5.32 The key factor in determining where an individual charge lies, within this wide range of potential charges, is the contribution each customer makes towards the common costs of the platform. The overall constraint on cost recovery means that common costs can only be recovered once (i.e. not every customer can be charged the stand-alone cost of providing the service). The 2002 Guidelines provide that the allocation of common costs across individual services and customers should be achieved through commercial negotiation (reflecting a number of different factors such as willingness to pay, relative benefits to the channel of being on the platform and benefits to the platform of carrying the channel).
- 5.33 EPG listing customers make only a very small aggregate contribution towards common costs (their combined contribution being less than [0-5]% of total common costs), and pay a charge that is less than [0-5]% of the stand-alone cost of providing the service. The constraints on charges provided by the need to avoid excessive overall cost recovery and an upper limit of a stand-alone cost therefore leave scope for a significant increase in the level of EPG listing charges (provided the requirements for non-discrimination and other considerations of fairness and reasonableness are met). Similarly, the wide limits of these constraints also means that it could be possible that a significant reduction in the overall level of common costs to be recovered from EPG listing customers would not affect the EPG listing charge for a particular customer (again provided the additional requirements for non-discrimination and other considerations of fairness and reasonableness are met).
- 5.34 So, for the purpose of addressing the fairness and reasonableness of Sky's charges to Rapture in this dispute, Ofcom has considered the following questions.
- 5.34.1 Are all of the categories of common costs included in the platform model relevant to the EPG listing service provided to Rapture?
- 5.34.2 Is the contribution towards common costs from Rapture reasonable, taking into account the factors which would be reflected in a charge negotiated in a competitive market?
- 5.35 The largest single cost in the Platform Model is the cost of consumer equipment (including set-top boxes). This accounts for approximately [x<] % of total nominal costs included within the Platform Model. Other costs include conditional access technology, smart card costs, marketing expenditure, capital expenditure, development costs and call centre costs. Ofcom's analysis of common costs has therefore focussed on Rapture's contribution to consumer equipment costs.

- 5.36 Ofcom's analysis of the negotiation of Rapture's charges is set out in paragraphs 5.103 *et seq.*
- 5.37 In resolving this dispute Ofcom does not consider that it is necessary to consider in detail either the absolute level of each common cost, or the reasonableness of contributions to common costs of other technical platform services. This is because the reasonableness or otherwise of the charge for Rapture's EPG listing will be insensitive to even quite large changes in the amount of any one cost included as a common cost and also because of the very small proportion that EPG listing charges contribute to common costs.

### Consumer equipment costs

- 5.38 In order to receive services, viewers of the Sky Platform require reception equipment (including a satellite dish and a set-top box) and, in order to watch encrypted channels, will require a viewing card with the appropriate entitlements.
- 5.39 The cost of this equipment and its installation has historically been shared between Sky's retail customers and Sky in a proportion that depends on Sky's marketing strategy at the time a retail customer begins his subscription and the type of set-top box provided. To date, Sky has provided various special offers to customers, offering reduced or free set-top boxes, dishes and installation, as well as reduced subscription fees for a limited period.
- 5.40 Oftel's 2002 Guidelines state that:

*"A vertically integrated supplier may wish to subsidise consumer equipment to promote take-up of its retail services. The question arises whether this subsidy may be treated as a cost to be recovered via conditional access or access control charges, or whether this should be borne entirely by the vertically integrated company.*

*In principle, Oftel considers that other broadcasters typically benefit from such a subsidy (in terms of increased viewer base), so it is therefore reasonable to expect them to contribute to the costs. Different broadcasters may benefit to different extents, in which case their relative charges should reflect this.*

*However, in certain cases, recovery of subsidy via conditional access or access control charges may have anti-competitive effects. In such cases, recovery would not be permitted. Each case would be examined on its merits. However, one example where Oftel would have serious concerns is where the granting of subsidy was tied to a requirement to subscribe to a retail service of a vertically integrated supplier."<sup>75</sup>*

### Rapture's view

- 5.41 In a meeting with Ofcom on 23 November 2006 Rapture stated that it did not believe that Sky was entitled to recover consumer equipment costs from EPG listing customers. Rapture suggested that such recovery was explicitly prohibited because of undertakings made by Sky at the time that it took full management control of British Interactive Broadcasting Holdings Limited ("BiB") in 2001.<sup>76</sup>
- 5.42 In addition, Rapture has claimed that:

*"There is therefore no cost to BSKyB Group for the subsidy of the equipment in fact the group makes a profit from the activity. No amounts should be allowed to be claimed by BSKyB Group for the EPG service linked to a [sic] equipment subsidy.*

<sup>75</sup> 2002 Guidelines, paragraphs 3.9-3.11.

<sup>76</sup> Meeting between Rapture and Ofcom, 23 November 2006.

*There is little or no benefit received by 'Free to Air' channels from the equipment its self.[sic] Most of the cost and investment made by BSkyB Group into the Sky equipment is to benefit BSkyB's pay TV service. [...]*

*Free to Air channels in fact enhance the Pay TV offering. The Pay TV package from Sky promotes only channels from Sky and its partners. It does not promote channels like Rapture. Therefore Rapture and other 'Free to Air' channels cannot be expected to contribute to Sky Digitals Pay TV advertising and marketing budgets.”<sup>77</sup>*

5.43 Rapture has also claimed that:

*“The [equipment] subsidy is reclaimed over the first 12 months of a consumer having either paid the high fitting price of £120 or has taken out a Sky Pay TV Package and therefore pays the subsidy back over the first 12 month period.”<sup>78</sup>*

5.44 Rapture has argued that as the retail revenues from a Sky subscriber are sufficient to recover the set top box subsidy within 12 months, Sky should not be able to recover these costs from free-to-view broadcasters on the Sky Platform:

*“There is a stated average **Revenue Per User of £400 per annum** claimed in [Sky's 2002/3 accounts]. This has been achieved and this is the reason Sky invests large sums of money in marketing and subsidising new subscribers. Since the satellite equipment is owned by the consumer after the initial 12 month contract has has [sic] been completed. Sky can no longer reclaim the Interactive Discount from the subscriber.*

*This is clear evidence that the claimed subsidy by BSkyB Group is limited to the first 12 months of a subscription agreement and that the subsidy is reclaimed from the subscriber during the first 12 months.”<sup>79</sup>*

5.45 Rapture has argued that the Sky Platform comprises two separate platforms, a pay-TV platform and a free-to-air platform which “*merely shares the same air space.*” Rapture considers that it receives no benefit from the Sky pay-TV platform because “*Rapture is not a Pay TV channel so does not receive any Pay TV subscription revenue or benefit from any Pay TV features or services.*” As a result, Rapture states that it “*cannot be expected to pay fees to BSkyB for a network that Rapture does not use.*”<sup>80</sup>

5.46 Rapture has also argued that, in any event, Sky is not permitted to recover the costs of set-top boxes on the basis that it does not own the boxes:

*“... the Sky TV agreement [between the subscriber and Sky...] is a simple transfer of all rights of use and profit in the goods from the seller in this case BSkyB Group to the End User and therefore BSkyB Group has no claim on the goods and cannot then charge fees to third parties for any potential benefit a third party may or may not receive as it does not own the goods.”<sup>81</sup>*

5.47 Finally, Rapture has argued that:

*“BSkyB owned SSSL (Sky Subscriber[s] Services Limited) has been found to be a dominant service provider for EPG, CA and AC technical services by Ofcom in the year 2000. Further more [sic] the OFT found BSkyB to be a dominant provider of premium sport and film channels and had restrictions place[d] on BSkyB for the supply of these services to cable companies. Despite these findings BSkyB has continued to sell and market the satellite equipment at below market value in order to build its Pay TV platform. This is a clear case of predatory pricing and is anti competitive [sic] as it restricts the ability of others to compete.”<sup>82</sup>*

<sup>77</sup> Email from David Henry (Rapture) to Anthony Szykaruk (Ofcom), 22 January 2006.

<sup>78</sup> Email from David Henry (Rapture) to Anthony Szykaruk et al (Ofcom), 27 November 2006.

<sup>79</sup> Email from David Henry (Rapture) to Anthony Szykaruk (Ofcom), 22 January 2007.

<sup>80</sup> Letter from David Henry (Rapture) to Anthony Szykaruk (Ofcom), 23 February 2007.

<sup>81</sup> Ibid.

<sup>82</sup> Ibid. On 12 November 1999, the Director General of Telecommunications of Ofcom issued a notice under the terms of the Class Licence for the running of telecommunications systems for provision of

## Sky's view

5.48 Sky has commented that:

*“Clearly the ability to reach such a vast number of potential viewers was of enormous value to Rapture, yet Sky's EPG charges amounted to less than £0.01 per household per annum. The development of a platform of this scale involved very substantial investment and risk-taking on Sky's part. It is entirely reasonable, therefore, for users of that platform to contribute towards the costs that Sky has incurred.”<sup>83</sup>*

## Ofcom's view

- 5.49 Firstly, Ofcom notes that the undertakings made by Sky in 2001 on its acquisition of the BiB joint venture related only to the provision of a “clean feed” of Sky's content to distributors and have no bearing on the question of recovery of set-top box subsidies from third party users of the Sky Platform.<sup>84</sup>
- 5.50 The provision of subsidised set-top boxes by Sky to viewers increases the number of viewers with access to the Sky Platform and, in Ofcom's view, this confers some benefit on channels such as Rapture who broadcast exclusively on the Sky Platform. It is not unreasonable for Sky therefore to seek to recover a proportion of the costs of subsidising set-top boxes from channels such as Rapture.
- 5.51 As noted at paragraph 5.33, the contribution of EPG listing customers towards common costs represents only a very small proportion of those costs, (EPG customers make a combined contribution of less than [0-5]% of total common costs and pay an individual EPG listing charge of less than [0-5]% of the standalone costs) and is at a level which does not appear to Ofcom to be unreasonable.
- 5.52 However, as acknowledged in the 2002 Guidelines, the recovery of subsidies through charges to Sky Platform users may have anti-competitive effects. In particular the 2002 Guidelines indicate that one situation which would give cause for concern *“is where the granting of subsidy was tied to a requirement to subscribe to a retail service of a vertically integrated supplier.”*<sup>85</sup>
- 5.53 Ofcom understands that Sky's provision of subsidised set-top boxes has historically not been tied to a contractual requirement to take a retail subscription (although, as noted below, Ofcom has not undertaken further investigation of this question in relation to this dispute).
- 5.54 The question of what amount, if any, of common costs associated with the provision of set-top boxes, should be recovered from third party users of the

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Access Control Services, issued on 31 August 1999 that stated that Sky Subscribers Services Limited ('SSSL') was in a dominant position in the relevant market for Access Control services. See <http://www.ofcom.org.uk/static/archive/oftel/publications/broadcasting/sssl0400.htm>. No such finding has been made in relation to EPG or conditional access services.

<sup>83</sup> Letter from Emma McCormack (Sky) to David Stewart (Ofcom), 7 February 2007.

<sup>84</sup> The European Commission was notified of the creation of the joint venture company BiB on 13 June 1997. The European Commission took a favourable view pursuant to Article 85 of the EC Treaty and granted BiB an individual exemption pursuant to Article 85(3) of the EC Treaty which took effect from the date that 15 conditions for compliance were met. (See

[http://eur-lex.europa.eu/LexUriServ/site/en/oj/1998/c\\_322/c\\_32219981021en00060028.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/oj/1998/c_322/c_32219981021en00060028.pdf)). On 17 July 2000, BSKyB Group announced that it would acquire 80.1% of the shares of BiB. The Office of Fair Trading decided in 2001 that this acquisition *“raised significant competition concerns”* and recommended that the issues could be addressed by an undertaking in lieu of a reference to the Competition Commission. *“One consequence of the merger was that ten conditions imposed on the pre-existing BiB joint venture by the European Commission would cease to apply”* (See <http://www.oft.gov.uk/Business/Mergers+FTA/Advice/Advice+on+undertakings/British+Sky+Broadcasting+.htm>). The only condition that continued to apply was Condition 5 – the availability of a clean feed.

<sup>85</sup> 2002 Guidelines, paragraph 3.11.

platform is not straightforward. In particular, there are a number of complex issues which might arise in relation to set-top boxes summarised below. Ofcom does not consider that it is necessary to investigate these issues beyond this summary in the context of this dispute as explained below.

- 5.54.1 A proportion of the costs of set-top boxes could be argued to be attributable to providing functions that are not relevant to free-to-air channels – e.g. encryption. Determining an appropriate amount of costs of the set-top box attributable to these functions would require an assessment of the alternative technologies, hardware and set-top box components.
- 5.54.2 Whilst Sky does not contractually tie customers receiving a subsidised set-top to a Sky retail subscription, Ofcom considers it is likely that only a very small number of customers not taking a Sky retail subscription actually received a free set-top box.<sup>86</sup> Ofcom has not considered further the question of whether and to what extent the nominal lack of a tie between set-top box subsidies and Sky's retail services has, in fact, been borne out in practice. To the extent that the provision of a subsidised set-top box favoured Sky's own retail business over its competitors in related retail pay-TV markets, this could give rise to competition concerns in retail pay-TV markets. The potential effects of this practice on competition in retail pay-TV markets are complex and would require a detailed assessment of retail markets in order to determine whether the practices were capable of harming competition. However, Ofcom notes that Sky contributes by far the largest proportion of revenues to the platform (see paragraph 5.61), to some extent mitigating any potential negative effects on competition. As Rapture is a free-to-air channel, for the purposes of this dispute Ofcom does not consider that the potential competition issues in relation to retail pay-TV markets are relevant.
- 5.54.3 The costs associated with installation of dishes and set-top boxes to Sky's own retail customers are not included in the Platform Model. There is an argument that at least some of these costs could reasonably be recovered from third party users of the Sky Platform.
- 5.54.4 For channels which are available on alternative platforms (such as analogue, terrestrial digital and cable), it is not straightforward to assess the relative benefits of a larger number of viewers on the Sky Platform.
- 5.54.5 In addition to the "standard" set-top boxes, Sky also provides "Sky+" boxes with added personal video recorders (PVR) functionality which are partially subsidised. The supply of these subsidised boxes to viewers is subject to the viewer taking out a Sky retail subscription. However, the platform business also receives a notional monthly subscription fee for each Sky+ registered

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<sup>86</sup> Ofcom's latest estimate is that 755,000 homes currently use satellite equipment to receive free-to-view channels on the Sky Platform, less than 10% of those who currently subscribe to one of Sky's pay-TV packages (Source: Ofcom Quarterly Digital Update). In addition to those customers who have received a subsidised set-top box from Sky, the figure of 755,000 includes former Sky pay-TV customers who have 'churned' from a Sky pay-TV service as well those who have purchased Sky's Freesat service.

subscriber which from the platform business' perspective offsets the cost of the subsidy.

- 5.55 In the context of this dispute, Ofcom has not considered it necessary to undertake a detailed review of all of these complex and inter-related issues. Ofcom considers that for free-to-air channels which are not available on any other television platform, such as Rapture, there is clearly a benefit from a larger number of platform viewers who are able, if they so choose, to watch that channel. In Ofcom's view it is reasonable for such channels to make a contribution to the costs associated with this larger platform – including the cost of set-top box subsidies – in return for access to an increased pool of potential viewers.
- 5.56 Ofcom accepts that EPG customers should not be expected to contribute to the direct cost of components of the Sky Platform from which they derive no benefit. Whilst there are components of the Sky Platform that are not used by free-to-air channels (such as access control technology and encryption), the direct costs associated with conditional access and access control services comprise only a relatively small proportion of total platform costs (less than [0-20] %) and are not included in Ofcom's calculation of relevant common costs. Given that the majority of platform costs relate to the common cost of building up a base of viewers and the contribution of EPG listing customers to common costs is small (less than [0-5]%) it is reasonable to conclude that EPG customers are not contributing towards the direct costs of other technical platform services from which they do not derive a benefit.
- 5.57 The relevant question then becomes what level of contribution is “fair, reasonable and non-discriminatory” and, in particular, whether the recovery of set-top box subsidies was set at a level likely to price Rapture off the platform. To answer this question, the willingness to pay of each channel would need to be considered on a case by case basis in order to determine whether the charge was reasonable. The 2002 Guidelines require Sky to consider a channel's willingness to pay when setting charges. Ofcom's conclusion is that Rapture did not provide Sky with a basis on which to justify a reduced EPG listing charge and that even if Rapture had submitted details of its 2004 Business Plan or 2005 Financial Projections<sup>87</sup> to Sky, these would not have provided a compelling argument for Sky to reduce its EPG listing charges in Rapture's case.<sup>88</sup>
- 5.58 Ofcom does not consider that the ownership of the set-top box is relevant to the issue of Sky's ability to recover costs incurred in the supply and distribution of those boxes to viewers. This is because, irrespective of who owns the boxes, it is reasonable for Sky to recover the appropriate costs it incurred in supplying those boxes (subject to any concerns regarding tying the provision of a subsidised box to a retail subscription as discussed in paragraph 5.52 *et seq*).
- 5.59 Finally, Ofcom does not consider that Rapture's other arguments relating to the recovery of set-top box subsidies from Sky's own retail revenues have merit, for two reasons. Firstly, Sky's retail revenues as a broadcaster are required to recover a much wider set of costs than set-top box subsidies – e.g. retail marketing and content acquisition costs. Secondly, the 2002 Guidelines indicate that it is reasonable for all users of the Sky Platform to make a

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<sup>87</sup> See paragraph 5.176.

<sup>88</sup> See paragraph 5.157.

contribution towards the common costs of the Sky Platform, including set-top box subsidies.<sup>89</sup>

### **Allocation of common costs between Sky and third parties and between different services**

5.60 Sky has been, and is forecast to be, by some margin the largest contributor to the common costs of the Sky Platform, as illustrated in Figure 1 below which shows the proportion of platform revenues split between Sky and third party users:

#### **Figure 1: Source of Platform revenues – Sky and third party users**

[X]

Source: Platform Model

5.61 Figure 1 shows that Sky has consistently contributed a significant majority of the total revenues of the Sky Platform, with the remainder being contributed by third parties.

5.62 Figure 2 below shows the split of the Sky Platform revenues between different services:

#### **Figure 2: Source of Platform revenues including EPG, Conditional Access and Access Control**

[X]

Source: Ofcom analysis of Sky's Platform Model

5.63 Figure 2 above shows that revenues for EPG listing services contribute less than [0-5]% of the total revenues of the Sky Platform business.

5.64 Figure 3 below shows the proportion of total revenues from third party EPG customers:

#### **Figure 3: EPG revenues from third party EPG customers as a proportion of total revenues**

[X]

Source: Ofcom analysis of Sky's Platform Model

5.65 Figure 3 above shows that over the period of the Platform Model EPG listing charges to third parties (ie other than Sky's own channels) have averaged less than [0-5]% of the total platform revenues.

5.66 In Ofcom's view, the small proportion of total revenues represented by EPG charges to third parties is consistent with the relative benefits to Sky and third parties of being on the Sky Platform. In particular, it does not provide evidence that would suggest that third party broadcasters are making a disproportionately high contribution towards common costs compared to Sky itself.

### **Conclusion**

5.67 As discussed above at paragraph 5.49 *et seq*, based on the facts of this case, Ofcom considers it is a reasonable requirement that free-to-air channels with

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<sup>89</sup> 2002 Guidelines, paragraph 3.5.

an EPG listing on the Sky Platform, such as Rapture, make a contribution towards the common costs of operating the Sky Platform. In particular, there is no basis for a finding on the evidence before Ofcom in this investigation that it would be unreasonable for Rapture to contribute to the largest single common cost, that of providing set-top box subsidies, during the period covered by this dispute. Such subsidies increase the number of viewers on the Sky Platform and free-to-air channels (particularly in the case of a channel such as Rapture that is not available on other distribution platforms) will benefit to some extent from an increased pool of potential viewers.

- 5.68 For the reasons given in paragraph 5.37, in resolving this dispute Ofcom does not consider that it is necessary to consider in detail either the absolute level of each common cost, or the reasonableness of contributions to common costs of other technical platform services.
- 5.69 The key question in relation to common cost recovery to be addressed in this dispute is whether Rapture's contribution towards common costs is reasonable, taking into account the factors which would be reflected in charges negotiated in a competitive market. Ofcom's analysis of this question is set out in 5.159 *et seq.*

### **Were Sky's charges set between the "floor" of the incremental cost of providing the service and the ceiling of the stand-alone cost of the service?**

#### **Incremental costs**

- 5.70 The incremental costs of providing an EPG listing to a new channel are very small in comparison to the total costs of the Sky Platform. Incremental costs include:
- 5.70.1 the costs of preparing, negotiating and signing the EPG contract; and
  - 5.70.2 the costs of integrating the broadcaster's telecommunications link and testing the format and transfer of scheduling information, configuring the Sky adaptations hub and undertaking pre-launch testing.
- 5.71 Sky's Platform Model identifies those direct costs which Sky has allocated to EPG services (such as staff costs, computer costs and transponder capacity). The average direct cost per channel over the life of the Platform Model is £[10,000-20,000] per channel per annum. The incremental cost of adding a new channel to the EPG will, on average, be lower than this average cost as certain costs, such as computer systems will be fixed costs.

#### **Stand-alone cost**

- 5.72 Consistent with the points made above, the stand-alone cost of providing an EPG listing service in this context is very sensitive to the question of whether the cost of set-top box subsidies should be included. In Ofcom's view, the relevant platform to consider in assessing the stand-alone cost would be one with a similar number of viewers as those on the Sky Platform. It is reasonable to argue that the volume of viewers on the Sky Platform is at least in part attributable to its strategy of providing subsidised set-top box subsidies and that, in the absence of those subsidies, the number of viewers would not be as large as it is. Therefore, for the purposes of assessing the facts of this

case, Ofcom considers that the costs associated with those subsidies should be included in the stand-alone cost used to set a ceiling price.

- 5.73 Calculating the stand-alone cost of an EPG service using the Sky Platform is not straightforward - it would require assumptions regarding the elimination of the incremental costs of providing encryption and interactive services. However, given that the relevant stand-alone cost would include an element of set-top box subsidy costs, it is clear that the relevant stand-alone cost would amount to hundreds of millions of pounds.

## Conclusion

- 5.74 Sky's charge of £76,800 per annum to Rapture for EPG listing services during the period in question fell between the 'floor' of the incremental cost of providing the service and the 'ceiling' of the stand-alone cost of the service.

## Was Sky's return on the platform excessive?

### Rapture's comments

- 5.75 Rapture has commented that:

*"The charge that BSKyB makes for provision of EPG Services is not cost orientated. As BSKyB Limited increased the level of the charge on the 31<sup>st</sup> December 2002 to a fee of £75,000 per annum for the supply of EPG services for "free to air" digital TV channels. Prior to this date the same service was supplied for a fee of £28,000 per annum, this represents an increase of over 150%.*

*There were no new features or technical changes to the supply of the service and there was no evidence of an increase in the cost of supplying the service. Therefore the increase was not cost related. More broadcasters had entered into EPG Service Agreement [sic] prior to the increase, than afterwards. Therefore the cost of providing the service is likely to have been reduced through economies of scale."<sup>90</sup>*

### Ofcom's view

- 5.76 Ofcom has considered Sky's return on the platform by analysing Sky's Platform Model to review whether the return could be excessive for the purposes of this dispute. The 2002 Guidelines note that:

*"Ofcom's approach would be to consider whether the pricing framework was such that the provider would be expected on average to make a return on its investment that was neither inadequate nor excessive, taking proper account of risk and uncertainty applying to the investment at the time it was made."<sup>91</sup>*

- 5.77 The Platform Model assessed cost recovery through a discounted cashflow ("DCF") analysis in which cash flows (historic and future) are discounted, to arrive at a single measure of profit, the internal rate of return ("IRR"). The IRR represents the discount rate at which the cashflows of the business give a total discounted cashflow for the business, or net present value ("NPV"), of zero.
- 5.78 In determining whether a particular IRR represents an excessive level of profitability or cost recovery, one should compare the IRR to the cost to the company of financing the project being assessed – its cost of capital. While there are a variety of methods for estimating a company's cost of capital, it is usually calculated as a weighted average of the cost of debt and equity finance, referred to as the weighted average cost of capital ("WACC").

<sup>90</sup> Rapture's submission to Ofcom, 11 September 2006.

<sup>91</sup> 2002 Guidelines at paragraph 2.5.

- 5.79 In the context of cost recovery, rates of return significantly in excess of the cost of capital (WACC) would suggest profits higher than is consistent with a competitive outcome and, therefore, imply excessive cost recovery.
- 5.80 If the business is part-way through its investment cycle (as is the Sky Platform at the time of this dispute), it is important to consider whether the relevant cost of capital is that at the time of the investment or the current cost of capital or some average cost of capital for the duration of the project. This cost changes over time, as the cost of capital at the beginning of the investment, when the range of possible outcomes was large and the risk of failure relatively high, is likely to be higher than the cost of capital for the project once it is up and running and an established commercial success and the risk of subsequent failure much reduced.

5.81 The 2002 Guidelines state that:

*“The treatment of risk over time is important: Oftel would not use the benefit of hindsight to review the pricing structure. The existence of high returns in the short to medium term, if the investment turned out to be more successful than originally projected, would not necessarily be regarded as evidence that prices were too high. The supplier would have [to] bear the losses if the business were less successful, and must conversely be allowed to reap the benefits of greater success than was guaranteed.”<sup>92</sup>*

- 5.82 In the context of this dispute, Ofcom has not undertaken work to estimate a specific cost of capital which would be appropriate for Sky to apply for each period of the Platform Model. Estimating a cost of capital for the platform business is not straightforward, and in particular requires a consideration of the changing level of risk over the period of the Platform Model.
- 5.83 However, a number of benchmarks exist which Ofcom has used in order to determine a reasonable range for the cost of capital, and Ofcom considers that this provides an appropriate basis to assess overall cost recovery in the context of this dispute, given the relatively limited contribution of EPG listing charges to overall cost recovery and the robustness of the range of acceptable EPG listing charges to changes in the cost of capital.<sup>93</sup>
- 5.84 In Oftel’s 2002 decision, Oftel estimated a range for Sky’s pre-tax nominal WACC of between 12.7% and 16.4%, with an average of 14.5%.<sup>94</sup> At the time, Oftel considered the cost of capital for the entire business to be a reasonable proxy for the WACC of Sky’s platform business on the basis that:
- 5.84.1 the leverage of the platform business was no greater than that of the business as a whole; and
- 5.84.2 the degree of correlation between the firm’s revenues and returns of the stock market as a whole were unlikely to differ substantially between the firm as a whole and the platform business.
- 5.85 Oftel also considered that an additional risk premium should be added to the WACC of the platform business in considering pricing of the digital platform to reflect *“the high degree of uncertainty facing SSSL in its first years of operation”*,<sup>95</sup> and found that a WACC adjusted for the probability of failure would be in the region of 17% implying a “risk premium” in the order of 2.5%. This was calculated on the basis of a cost of capital of 35% in year 1, 17.5%

<sup>92</sup> 2002 Guidelines, paragraph 2.6.

<sup>93</sup> One implication of the 2002 Guidelines is that a finding that Sky’s overall level of cost recovery was excessive would not necessarily result in a reduction in any one particular charge – see paragraph 5.33.

<sup>94</sup> Oftel’s 2002 Decision, paragraph 56.

<sup>95</sup> *Ibid.*

in year 2 and 14.8% thereafter. The 17% overall WACC was calculated as the average of the cost of capital for the first five years weighted average by the total cost of the project in each year.

- 5.86 Ofcom believes that in considering the appropriate cost of capital against which to assess overall cost recovery, a balance needs to be struck between, on the one hand, allowing Sky to earn a profit that is consistent with a successful investment decision in a competitive market (which could imply an *ex post* return higher than the cost of capital at the time of the initial investment), and, on the other hand, not allowing Sky excessive cost recovery from third party users of the Sky Platform.
- 5.87 In Ofcom's view the allowed rate of return should enable the investor to retain any upside return that could have reasonably been expected at the time of the initial investment needed to generate an acceptable expected or average rate of return at the outset.
- 5.88 In this case this is represented by the higher than average costs of capital of 35% and 17.5% in the first two years which were used to calculate the risk adjusted WACC. For years three and beyond, Oftel used a WACC of approximately 15%. In addition, actual and expected future changes in the cost of capital to should be reflected in the allowed rate of return.
- 5.89 Ofcom's approach to estimating a range within which a reasonable rate of return would fall is to use the historic Oftel estimates for the first three years.
- 5.90 It is unlikely that the risk adjusted WACC would have increased beyond the 15% estimated by Oftel in 2002, particularly given the continued strong performance of the Sky Platform and the likely lower perception of risk. Therefore Ofcom considers that a 15% WACC for 2003 and beyond represents the upper limit of an estimated reasonable rate of return on the Sky Platform from 2003 onwards.
- 5.91 The lower limit is less significant (given that the purpose of this test is to assess whether Sky is likely to be over-recovering costs). Ofcom has used 5%, as an approximation of the rate of return on an effectively "risk free" asset such as UK gilts as a prudent estimate of the lower boundary for a reasonable rate of return on the platform from 2003 onwards.
- 5.92 Ofcom has considered alternative approaches, including using Sky's current cost of capital or, conversely, including a risk premium to compensate for the initial risk of the Sky Platform. Use of the current cost of capital without adjustment would mean that Sky was not allowed a sufficient return to compensate for the additional risk it took in setting up the platform. Conversely, use of an additional risk premium beyond the point at which the platform had become established and the launch risk successfully mitigated, would mean that Sky was compensated for risks over and above the initial launch risk.
- 5.93 Ofcom has therefore calculated a weighted average cost of capital based on the following assumptions:

**Table 1 B SkyB WACC**

<b>Period</b>	<b>WACC – Upper Estimate</b>		<b>WACC – Lower Estimate</b>	
1999	35%	As per Oftel's 2002 decision	35%	As per Oftel's 2002 decision
2000	17.5%	As per Oftel's 2002 decision	17.5%	As per Oftel's 2002 decision
2001-2002	15%	As per Oftel's 2002 decision	15%	As per Oftel's 2002 decision
2003-2010	15%	As per 2002 Oftel estimate	5%	Approximating a risk-free return

Source: Ofcom calculations

- 5.94 Weighting these WACCs by the absolute net cashflow in each year provides a weighted average WACC of 11% at the lower limit and 18% at an upper limit. Ofcom would therefore expect that an internal rate of return consistent with the principle of cost recovery would be likely to fall within that range.
- 5.95 The internal rate of return as calculated by Sky's Platform Model is 14% over the period of the model (11.75 years). However, Ofcom has adjusted Sky's calculation to take account of an alternative methodology in relation to the calculation of terminal values.
- 5.96 At the end of the period of the cashflow forecasts, the business will comprise certain assets (the platform and a subscriber base), which have a value that needs to be incorporated into the overall return.
- 5.97 Sky's Platform Model calculates the terminal value by calculating the net present value of a notional depreciation charge for subscriber acquisition costs that would be charged in periods after the terminal value date assuming subscriber acquisition costs are depreciated over 10 years. In Ofcom's view, this approach is likely to overstate the economic depreciation of subscriber acquisition costs, which should be depreciated over the period in which the costs generate benefit to the company. Assuming a churn rate of 10% per annum, at the end of 10 years, 35% of customers will remain, yet a straight line depreciation approach will have written off the cost of acquiring those customers.
- 5.98 In Ofcom's view, a more appropriate methodology is to depreciate subscriber acquisition costs in line with the subscriber churn rate as this more closely matches the depreciation rate to the reduction in value of the underlying asset. This alternative method has the effect of increasing the terminal value and thereby increasing the internal rate of return by 3%. In Ofcom's view this approach provides a better measure of the return on investment in the platform and should be used to assess expected rates of return against the appropriate cost of capital.
- 5.99 After making an adjustment to reflect Ofcom's methodology for assessing the terminal value as set out above, the rate of return is 17%.

**Table 2 Platform Model: Internal rate of return**

	<b>Internal rate of return</b>
Model as provided by Sky	14%
Incorporating Ofcom's terminal value methodology	17%
WACC – Lower Limit	11%
WACC – Upper Limit	18%

Source: Ofcom calculations

## **Conclusion**

- 5.100 In Ofcom's view, the expected rate of return calculated by Ofcom at 17% falls within the lower and upper bounds of the range which Ofcom set out above. Ofcom considers that sustained levels of prices generating returns above these levels could indicate pricing inconsistent with a competitive market, and therefore excessive cost recovery. However, given the long-term nature of Ofcom's analysis, and the inherent uncertainties in the future cashflows of the business, Ofcom considers that the 17% rate of return generated by the model (as adjusted by Ofcom) is not sufficiently high to conclude that Sky's overall return is excessive (or that Sky is likely to be in breach of its obligation to provide the services on a fair, reasonable and non-discriminatory basis).
- 5.101 Also as referred to in paragraph 5.83, if overall returns on the Sky Platform were found to be excessive, under the 2002 Guidelines, it is not necessarily the case that any adjustment in charges to reduce Sky's return would imply a reduction in the EPG listing charge.
- 5.102 The evidence before Ofcom in this dispute does not support a finding that Sky's EPG listing charge to Rapture was unfair or unreasonable on the basis of excessive returns by Sky.

### **Did Sky offer Rapture a reasonable opportunity to negotiate a fair, reasonable and non-discriminatory EPG listing charge taking into account Rapture's circumstances?**

5.103 The 2002 Guidelines state:

*"Some conditional access and access control providers publish indicative prices under their obligation to publish the methodology for arriving at charges and other terms and conditions. Oftel considers that the publishing of indicative prices that can serve as the starting point for commercial negotiation is helpful for all parties. However, Oftel emphasises that those indicative prices are not set by or approved by Oftel and that Oftel would regard them as a starting point in negotiations, and that Oftel expects such negotiations to take place (as would be likely to occur in a competitive market). Oftel believes that it would be wrong to constrain those discussions by indicating how far it may or my [sic] not be reasonable for the prices to move during the negotiation process."*<sup>96</sup>

5.104 Paragraph 5.115 *et seq* sets out Sky's stated approach to negotiating EPG listing charges.

<sup>96</sup> 2002 Guidelines, paragraph 3.17.

5.105 The following paragraphs review the correspondence and other evidence relating to Rapture's signing of an EPG contract with Sky in November 2005 and considers whether or not Sky's approach to negotiations with Rapture was consistent with the 2002 Guidelines and Sky's own stated process for ensuring it complied with the requirements of the 2002 Guidelines.

### Rapture's view

- 5.106 Rapture's submission alleges that Sky was unwilling to enter into "any meaningful commercial negotiation" regarding the EPG listing charge.
- 5.107 Rapture has also argued that Sky failed to consider amendments which Rapture proposed to its contract for EPG listing services and that Sky, by acting as gatekeeper to the Sky Platform, was effectively forcing smaller broadcasters such as Rapture to accept terms which were unfair.<sup>97</sup>
- 5.108 In its response to Ofcom's draft Determination on this dispute,<sup>98</sup> Rapture has claimed that "previous attempted negotiations with BSkyB between Power TV Limited and BSkyB had similarly been frustrated by BSkyB". Rapture has supplied Ofcom with copies of correspondence between Sky and Power TV during 2002 and 2003 relating to Rapture TV's position on the EPG and charges which Sky believed it was owed following Rapture TV's brief broadcasting period in 2002. These negotiations and indicated charges between Sky and Power TV are outside the scope of this dispute (but provide some indication of the history of the full negotiations between Sky and Power TV and Rapture).

### Sky's view

- 5.109 Sky has referred Ofcom to a document entitled "Electronic Programme Guide Negotiation Process"<sup>99</sup> which Sky has confirmed was followed in the period of the dispute<sup>100</sup> subject to a number of observations set out in Sky's comments to Ofcom of 23 January 2007. In that document, Sky stated that it required channels who seek a lower EPG listing charge to "show that objectively justifiable differences between their channel and others on the platform justified a reduced charge."
- 5.110 In Sky's response of 23 January 2007 to Ofcom's information request of 16 January 2007, Sky submitted details of negotiations which it had in 2003 with Rapture's managing director, David Henry (who at the time was acting in his role as a director of Power TV) to secure a lower EPG listing charge for an earlier version of the Rapture channel. Sky has argued that in 2005 "Rapture made no attempt at all to show that the content, business plan or audience for the channel had changed in any way since May 2003"<sup>101</sup> and that Sky was "prepared to negotiate charges with Rapture".<sup>102</sup>
- 5.111 Sky argued that it assessed and rejected arguments from Power TV in 2003 for a lower EPG listing charge and in its response supplied to Ofcom internal correspondence relating to its discussions with Power TV.
- 5.112 In Sky's view, Rapture's letter of 22 September 2005 "did not constitute a credible attempt to persuade Sky that it should set a lower charge for an EPG

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<sup>97</sup> Email from David Henry (Rapture) to Emma McCormack (Sky), 10 November 2005 and a comment made by David Henry (Rapture) in a telephone call with Anthony Szykaruk (Ofcom), 17 November 2006.

<sup>98</sup> Letter from David Henry (Rapture) to Anthony Szykaruk (Ofcom), 23 February 2007.

<sup>99</sup> Letter from Michael Rhodes (Sky) to Jim Niblett (Ofcom), 7 July 2003.

<sup>100</sup> Letter from Emma McCormack (Sky) to Anthony Szykaruk (Ofcom), 7 February 2007.

<sup>101</sup> Sky's response of 23 January 2007 to Ofcom's information request of 16 January 2007.

<sup>102</sup> Letter from Emma McCormack (Sky) to Anthony Szykaruk (Ofcom), 7 February 2007.

*listing.*” Sky has noted that many channels with limited resources paid the standard EPG charge “yet Rapture made no attempt to differentiate itself from those channels or any others on the platform” and that “Rapture had not made clear how the relationship between the cost of transponder capacity and EPG charges was relevant, nor did it attempt to show that the EPG charges were not affordable”.

5.113 Sky has acknowledged that Rapture sent an email to it on 7 November 2005 in which Rapture stated that “Rapture is one of a handful of channels that offers satellite viewers some real entertainment not just a rip off quiz games or religious doctrine pretending to be entertainment. Frankly I think Sky should be paying us for the added value we offer.” Sky has argued that “it did not consider this email to be a genuine attempt to engage Sky in relation to the level of EPG charges, nor did it consider that it constituted objectively justifiable reasons for a different charge.”

5.114 As described in the following paragraphs, Sky indicated to Ofcom in 2003 that it was willing to negotiate away from the standard EPG listing charges in certain circumstances, but that this was the exception rather than the rule. Nevertheless, Sky submitted that there were channels on the Sky Platform which had paid amounts differing from the charges specified on the rate card and that Sky had consented to lower charges where it considered that the channel was a special case and there was objective justification.

### **Sky’s stated basis for negotiation**

5.115 Sky’s published rate card for the charges during the period considered in this dispute stated that the EPG listing charges on the rate card were “indicative”.<sup>103</sup>

5.116 The EPG rate card stated that:

*“Charges for listings on Sky’s EPG are established in a similar manner to Sky’s conditional access (CA) charges. This document should, accordingly, be read in conjunction with the “Method for Establishing Conditional Access Charges.”*<sup>104</sup>

5.117 That methodology explains that the charges published on the rate card are a starting point for negotiations:

*“It is important to note that these charges should only be treated as indicative, as differences in actual charges will arise due, among other things, to:*

- *Objectively justifiable differences between broadcasters within the same category;*
- *The date at which a broadcaster enters into a CA agreement (see below); and*
- *Different requirements (whether technical, commercial or otherwise) in respect of the service supplied to different broadcasters.”*<sup>105</sup>

5.118 Sky has previously indicated to Ofcom the basis on which they would negotiate EPG listing charges for individual customers:

*“As with CA charges, the EPG charges that Sky publishes are indicative and therefore there is in principle scope for the negotiation of alternative charges. It must be recognised, however, that such negotiation is expensive, in terms of both time and resources, for both parties and in view of the relatively low level of charges, this means that in the vast majority of cases it would not be cost-effective to develop bespoke charges for EPG listings. Sky anticipates, therefore, that unlike in the case of CA services, bespoke charges for EPG services are more likely to be the exception than the rule.*

<sup>103</sup> Annex 1.

<sup>104</sup> Annex 1.

<sup>105</sup> The methodology is attached in Annex 2.

*During discussions over EPG charges, Sky will, where appropriate, invite broadcasters to put forward compelling reasons as to why they should be treated differently from other broadcasters. Sky will have due regard to any objectively justifiable reasons for a difference in pricing. Sky will, during such discussions, take into account the factors identified by Oftel in its Statement of 8 May 2002 and in its revised Guidelines of 22 October 2002.*

*Oftel should note, however, that broadcasters should not expect **only** to pay whatever EPG charges their business models enable them to pay. For example [X] currently leases [X] 24/7 transponders, although it currently broadcasts [X] channels. It achieves this by broadcasting some of these channels during very limited periods; for example [X], is only broadcast between the hours of [X] and [X]. [X] has, however, procured a discrete EPG listing for [X]. Sky has, to date, not been persuaded by the argument that [X] should be entitled to lower EPG charges because [X] is allegedly not sufficient to justify all the costs (including Sky's EPG charges) incurred in providing this service."<sup>106</sup>*

5.119 In July 2003, Sky provided Oftel with further details on the process Sky would follow in negotiating EPG listing charges:

*Periodically Sky publishes indicative charges for the listing of TV channels, radio stations and interactive services (together the "Services") on Sky's EPG. These indicative charges are designed to recover costs incurred by Sky in the provision of EPG services together with a contribution towards the common costs associated with the platform.*

*All broadcasters are given the opportunity to discuss the level of charges with Sky when they are sent a draft agreement to review prior to the launch of a new Service. If they wish to discuss the charges they may make representations in writing or attend a meeting with Sky.*

*Broadcasters who seek to pay lower charges than the published indicative rate must establish objectively justifiable grounds for being treated differently to other broadcasters. In practice, therefore negotiation over EPG charges must involve more than merely haggling.*

*Objectively justifiable differences, which might lead to different EPG charges, could arise, among other things, in the following situations:*

- *Where different technical services are being provided;*
- *Where the terms and conditions of the EPG agreement being negotiated vary materially from the standard draft agreement made available to broadcasters from time-to-time. This might have the effect of increasing or reducing EPG charges from the published indicative charges when considering the EPG agreement "in-the-round"; and*
- *Where broadcasters enter into risk sharing arrangements with Sky. For example, where the EPG agreement is limited in scope to one or more channels, or particular genres of channels (e.g. charities).*

*In practice, broadcasters frequently seek to convince Sky that their content contributes uniquely to the ongoing development of the platform and that a price reduction is justified. It should be noted that the same argument could be run about other broadcasters on the platform, including BSkyB. In most instances, content differences are unlikely to be considered compelling grounds for differentiating the broadcaster so as to achieve a reduction in EPG charges.*

*It is the responsibility of the broadcaster to put forward reasoned arguments for why Sky should treat it differently to other broadcasters. It is not, however, Sky's policy to reward broadcasters and lower their EPG listing charges simply because they negotiate more heavily than other broadcasters."<sup>107</sup>*

<sup>106</sup> Letter from Michael Rhodes (Sky) to Jim Niblett (Oftel), 25 February 2003.

<sup>107</sup> Letter from Michael Rhodes (Sky) to Jim Niblett (Oftel), 7 July 2003.

## Negotiations between Sky and Rapture

5.120 The 2002 Guidelines state that:

*“Of tel considers that the publishing of indicative prices that can serve as the starting point for commercial negotiation is helpful for all parties. However, Of tel emphasises that those indicative prices are not set by or approved by Of tel and that Of tel would regard them as a starting point in negotiations, and that Of tel expects such negotiations to take place (as would be likely to occur in a competitive market). Of tel believes that it would be wrong to constrain those discussions by indicating how far it may or may not be reasonable for the prices to move during the negotiation process.”<sup>108</sup>*

5.121 Ofcom has reviewed the history of negotiations between Sky and Rapture in relation to the EPG listing charge. There have been a number of different EPG agreements relating to the Rapture TV channel as set out below:

- April 2002 Power TV plc initiates discussions for an EPG listing for Rapture TV channel
- June 2002 Power TV plc and Sky enter an EPG Services Agreement for Rapture TV channel
- July 2002 Power TV plc ceases to broadcast Rapture TV channel
- March 2003 Sky terminates 2002 EPG Services Agreement for non-payment of EPG listing charges
- May 2003 Power TV plc signs new EPG services Agreement with Sky
- May 2003 Power TV plc begins broadcasting of Rapture TV channel
- July 2004 Power TV plc ceases broadcasting Rapture TV channel
- August 2004 Sky terminates 2003 EPG Services Agreement for non-payment of EPG listing charges
- November 2005 Rapture TV plc signs EPG Services Agreement for Rapture channel with Sky
- November 2006 Sky issues termination notice for non-payment of EPG listing charges. In the event, Sky did not exercise its right to terminate during the investigation by Ofcom.

5.122 Rapture attempted to negotiate an EPG charge lower than the indicative rate card at the time it was discussing both the 2003 and 2005 EPG Services Agreements.

5.123 In 2003 Power TV requested an EPG agreement on *“favourable terms”*. This was initially rejected by Sky who stated *“EPG Services will be supplied on terms which are fair and reasonable and non-discriminatory as regards other broadcasters receiving EPG services”*.

5.124 On 1 May 2003 Power TV wrote to Sky to object that the proposed charge of £75,000 was discriminatory as other channels were paying the pre-2003 indicative EPG cost of £28,000.

5.125 Power TV wrote to Sky on 2 May 2003 to state:

*“...BSkyB will not offer favourable terms or negotiate the price of a new EPG agreement. As I know you are aware any product or service offered for sale is only an offer to trade. There is no such thing as a fixed price for anything. By law everything is negotiable.*

<sup>108</sup> 2002 Guidelines, paragraph 3.17.

*With this in mind I offer to purchase EPG service from BSkyB for the annual sum of £1.00 sterling + VAT. This would be subject to an increase in line with the official published inflation percentage.*<sup>109</sup>

5.126 Sky declined to accept Power TV's offer and wrote in response that:

*"There comes a point... when the behaviour of a prospective EPG customer is so obstructive and irrational that it is fair and reasonable for Sky to cease dealing with that prospective customer.*

*From the myriad issues that you have raised, I would cite here ... your proposal ... that you will only pay Sky £1 per annum for EPG charges under the new agreement. By raising these issues at this stage, it appears that you are merely seeking to make mischief.*"<sup>110</sup>

5.127 On 3 May 2003, Rapture wrote to Sky to reiterate its arguments:

*"As you have pointed out previously BSkyB has more than 300 EPG agreements in place. All of which are paying BSkyB for access to the EPG system. In addition the broadcasters are also paying for they're [sic] own data streams and have to include capacity for re-broadcasting BSkyB's EPG data which can reach a substantial size at times. This is achieved at the broadcasters expense.*"<sup>111</sup>

5.128 Sky met with Power TV on 6 May 2003 to discuss the level of the EPG listing charge. Sky's summary of this meeting notes that the arguments put forward by Power TV to justify a lower than standard EPG listing charge were:<sup>112</sup>

- 5.128.1 that the increase in the indicative charge from £28,000 to £75,000 was "excessive";
- 5.128.2 that a delay in launching Rapture which Power TV considered Sky was liable for had resulted in unfavourable EPG terms for Power TV;
- 5.128.3 that the Rapture channel's content mix contained an unusually high level of UK original programming; and
- 5.128.4 that Rapture would "add value to the Sky platform through filling a gap in the market" which should be recognised by a reduced EPG listing charge.

5.129 Sky's record of the meeting<sup>113</sup> notes the following points about Power TV's representations:

- 5.129.1 the large number of channels that had launched on to the Sky Platform suggested that the charge did not represent a barrier to entry;
- 5.129.2 that Sky did not accept it was liable for any delay in launching Rapture;
- 5.129.3 that, in Sky's view, Rapture was "directly comparable (in aggregate) to many other channels on the platform" and that it would be discriminatory to offer Power TV a reduction over "competing channels"; and

<sup>109</sup> Email from David Henry (Power TV) to Esther Johnson (Sky), 2 May 2003.

<sup>110</sup> Email from Esther Johnson (Sky) to David Henry (Rapture), 2 May 2003.

<sup>111</sup> Email from David Henry (Power TV) to Esther Johnson (Sky), 3 May 2003.

<sup>112</sup> Email from Gary Smith (Sky) to Robert Odendaal (Sky), 7 May 2003.

<sup>113</sup> Ibid.

5.129.4 that the benefit to the Sky Platform of Rapture TV was “(a) insignificant and (b) should not influence the EPG charge anyway since any such benefit to the platform is counterbalanced by the benefits that the platform brings to the broadcasters using it.”

5.130 Sky wrote to Power TV rejecting its request for a lower EPG listing charge on 8 May 2003:

“... we have carefully considered the arguments you put forward for lower charges...  
As we made clear to you during the meeting, we have successfully negotiated EPG agreements based on the current level of indicative charges with various broadcasters since the charges were introduced in January which has demonstrated to us that the indicative charges are fair and reasonable for a broad range of channels, some of which broadcast material directly comparable to that proposed for “Rapture”.  
We have also made it clear to you that we would need to have strong, economically justifiable reasons for treating “Rapture” differently from other free to air channels if we are to consider lower charges. We therefore confirm our verbal offer [of £75,000]... We are willing to consider any further arguments that you may wish to put forward on this issue if you feel that relevant issues have yet [sic] been taken into account.”<sup>114</sup>

5.131 At this point, Power TV agreed to enter into an EPG contract with Sky at the level of the indicative charge. Rapture TV was subsequently broadcast on the Sky Platform from May 2003 until July 2004.

5.132 In June 2005, Rapture, now a separate company, contacted Sky to enter into negotiations concerning the terms on which Sky might provide Rapture with EPG listing services.<sup>115</sup>

5.133 On 18 August 2005, Sky wrote to Rapture to confirm a provisional date for the launch of Rapture TV on to Sky’s EPG. This letter confirmed that Sky’s proposed annual charge to Rapture for this service would be £76,800 per annum, subject to an RPI increase.<sup>116</sup>

5.134 On 22 September 2005, Rapture wrote to Sky about the proposed EPG listing charge, noting that:

“... BSkyB wishes to charge Rapture Television PLC the annual fee of £76,800 per year for access to the ‘Open Satellite Platform.’ This level of fee is excessively high for small channels. Especially when taken in context of the total transmission costs and the fact that only 2 years ago senior BSkyB executives made representations to the select committee for Culture, Media and Sport and told them that the satellite platform was a ‘Open Platform and anyone could launch on it.’ With our channel having a total transmission cost of approximately £[x] per year for uplinking and digital capacity, then the £76,800 per annum proposed fee would be equal to [x]% of transmission costs. There is also the fact that costs for satellite capacity has been reducing will [sic] the EPG charge went up over 250% from £28,000 to £76,800.  
I therefore wish the level of the fee for EPG services to be reviewed. If an acceptable fee level cannot be reached, then Rapture Television PLC will agree to pay the fee demanded by BSkyB on the understanding that Rapture Television PLC will reserve the right to seek a legal and or regulatory review to obtain a fair level of fee or an EPG service agreement without any fee for accessing the ‘Open Platform.’”<sup>117</sup>

<sup>114</sup> Email from Esther Johnson (Sky) to David Henry (Power TV), 8 May 2003.

<sup>115</sup> Email exchange between Wouter van Ruth (Rapture) and Marijana Cranmer & Kristine Ryan (Sky), 8 June 2005 – 30 June 2005.

<sup>116</sup> Letter from Marijana Horvatovic (Sky) to David Henry (Rapture), 18 August 2005.

<sup>117</sup> Letter from David Henry (Rapture) to Marijana Cranmer (Sky), 22 September 2005.

5.135 On 20 October 2005, Sky wrote to Rapture rejecting the suggestion that its proposed EPG listing charge was excessive and submitted a draft contract for EPG listing services to Rapture.<sup>118</sup>

5.136 On 7 November 2005, Rapture submitted an amended draft contract for EPG listing services to Sky.<sup>119</sup>

5.137 In separate correspondence with Sky on the same date Rapture stated:

*"I'm aware that Ofcom have announced their plan to regulate the level of fees charged for EPG services. It is with this in mind that we would like to have the additional clauses to take into account any reduction in fees that Ofcom will require."<sup>120</sup>*

5.138 A number of amendments proposed by Rapture were not accepted by Sky.<sup>121</sup>

5.139 On 10 November 2005 Rapture wrote to Sky noting Rapture's view that although Rapture TV was technically able to broadcast on the Sky Platform without an EPG listing:

*"... only very technically knowledgeable viewers are able to scan and add channels into the digital satellite equipment..."*

*Sky's EPG and Open software does not allow added channels to be seen without leaving the normal EPG channel listings and therefore it represents a barrier to viewers finding added channels and therefore reduces consumer viewing choice.*

*The fact that there is [sic] virtually no broadcasters in the UK broadcasting without a [sic] EPG channel number is proof of the need for a [sic] EPG channel number listing. [...]*

*We also do not believe the fee that is being charged is at a fair level or reflects the true cost of a [sic] EPG channel listing and unless this is negotiable [sic] we are looking for a [sic] official review of EPG charges to ascertain a fair level of fee."<sup>122</sup>*

5.140 On 11 November 2005, Sky responded to Rapture:

*"As we have previously stated, we will not reduce the EPG charge for Rapture. However, nothing in the EPG agreement prevents Rapture from seeking such redress as it is legally entitled to..."<sup>123</sup>*

5.141 On the same day, Rapture signed a contract with Sky for EPG listing services, noting that in Rapture's view *"we have not been able to agree on a fair level of fee for the EPG service."<sup>124</sup>*

5.142 Rapture and Sky did not exchange further correspondence in relation to the cost of EPG listing services until August 2006.

5.143 On 8 August 2006, Sky wrote to Rapture requesting payment of EPG listing charges which were outstanding under the terms of Rapture and Sky's contract for EPG services.

5.144 Also on 8 August 2006, Rapture wrote to Sky stating that:

*"There is a reason for the withholding of funds. [...]"*

<sup>118</sup> Letter from Marijana Cranmer (Sky) to David Henry (Rapture), 20 October 2005.

<sup>119</sup> Throughout November 2005 Rapture and Sky exchanged numerous drafts of the contract for EPG services.

<sup>120</sup> Email from David Henry (Rapture) to Emma McCormack (Sky), 7 November 2005.

<sup>121</sup> In its response of 23 January 2007 to Ofcom's information request of 16 January 2007 Sky stated that it *"did not agree to these proposed amendments due to their lack of clarity in drafting and because Sky considered that the provisions did not provide Rapture with any rights that it did not have as a matter of law"*.

<sup>122</sup> Email from David Henry (Rapture) to Emma McCormack (Sky), 10 November 2005.

<sup>123</sup> Email from Emma McCormack (Sky) to David Henry (Rapture), 11 November 2005.

<sup>124</sup> Email from David Henry (Rapture) to Emma McCormack (Sky), 11 November 2005.

*At the time of being asked to sign an agreement we made it clear that we believed that BSKyB was charging fees that were too high and requested a review by BSKyB however this was refused [sic]. [...]*

*The charges are too high and small channels like ours can't afford them. [...]*

*I wish to see a considerable reduction in the fees being charged by BSKyB for a free to air EPG listing.*

*I have read the official Ofcom guidelines and in line with them are [sic] giving this opportunity for [Sky] to agree a 'Fair and Non Discriminatory' level of fee for the supply of EPG service."<sup>125</sup>*

5.145 On 14 August 2006, Sky responded to Rapture that it was “*not persuaded that there is any justification for Rapture Television plc's non-payment and maintain that our charges are fair and reasonable.*”<sup>126</sup>

5.146 On 24 August 2006, Rapture wrote to Sky disputing whether Sky's conduct was consistent with its regulatory obligations:

*“...there was no agreement on the level of fees BSKyB Limited could charge Rapture Television PLC. It also makes it clear that Rapture was being forced to pay a deposit and the level of fee was not negotiable as required by the regulator. The fee was to [sic] high for a small free to air channel. [...]*

*The EPG agreement dated 11<sup>th</sup> of November 2005 is governed by English law as detailed in clause 22. Your refusal to negotiate in good faith and in a 'Fair Reasonable and non-discriminatory' manner the level of fees for the supply of EPG services is both illegal under English law and also is in breach of your requirements under the Communications Bill as regulated by Ofcom.*

*There is a well established and legally binding process for the recovery of debts through the English courts of law. Your issue and threat of termination of the supply of EPG service is unreasonable and not fair and is discriminatory as defined by Ofcom the regulators code of practice. [sic]”<sup>127</sup>*

5.147 On 11 September 2006, Rapture wrote to Sky to propose an EPG listing charge based on:

*“... the actual cost of providing an EPG service as 'Basic EPG Listing' service as described by Ofcom.*

*The communication act 2003 [sic] allows for network providers to supply electronic network services to other electronic network providers a service at actual cost of providing that service.*

*On this basis we calculate that the only actual cost of providing an EPG service is the cost of the staff needed to supply the service. We have taken a view and have been informed that another EPG operator in the digital cable market operates a similar EPG service with less than 6 staff. With IT staff being paid an average salary of £17k per year this would mean that the actual cost of providing a 'Basic EPG Listing service would be £102,000 per annum. This cost would be divided by the number of broadcasters being supplied with a 'Basic EPG Listing' as described by Ofcom.*

*Free to air channels require only a 'Basic EPG Listing' and therefore those providers should be charged a proportion of the cost of providing the electronic network service. We estimate that there are more than 30 electronic network providers purchasing the 'Basic EPG Listing' from BSKyB Limited. This means that each provider should pay an average of £3,400 per annum or a monthly fee of £283.34 per month.”<sup>128</sup>*

<sup>125</sup> Email from David Henry (Rapture) to Marijana Cranmer (Sky), 8 August 2006.

<sup>126</sup> Email from Marijana Cranmer (Sky) to David Henry (Rapture), 14 August 2006.

<sup>127</sup> Letter from David Henry (Rapture) to Sky's Company Secretary, 24 August 2006.

<sup>128</sup> Letter from David Henry (Rapture) to Sky's Company Secretary, 11 September 2006.

5.148 On 12 September 2006 Sky wrote to Rapture rejecting Rapture's proposal and asserting that *"our provision of EPG services to Rapture under the EPG Agreement [of 11 November 2005] complies with all of our regulatory obligations."*<sup>129</sup>

### Ofcom's view

5.149 The 2002 Guidelines describe a number of relevant factors which should be taken into account by the service provider when negotiating an appropriate price for an EPG listing and state that:

*"Where a channel generates retail revenues, either through subscription, advertising or otherwise, Oftel considers that such revenue is a key indicator of 'willingness to pay' and would expect a reasonably close linkage between retail revenues and conditional access or access control charge. This is not the only factor to be taken into account, as there would be other attributes a broadcaster might ask to be considered in negotiations [...]. Oftel is not suggesting that this should form the basis of a 'formula' between retail price and conditional access/access control charges, but would expect the agreements as a whole to be broadly reflective of the retail revenues expected by the broadcaster when offering its service to the end-user."*

5.150 Ofcom recognises that where, as for Sky's EPG customers, there are a large number of customers purchasing the same service, the use of a published rate card to set prices can help reduce transaction costs and, to the extent similar charges are paid by similar broadcasters for similar services, help ensure prices are not discriminatory. However, in order to ensure that channels that are able to cover the incremental cost of providing the EPG service are not "priced off the platform" by the level of common costs included in the rate card charge, it is important that, where appropriate, there is an effective process for ensuring that EPG customers can negotiate a price below that on the rate card which does not exhaust their willingness to pay.

5.151 The evidence assessed in Ofcom's investigation suggests that, although Sky rarely offered non-standard charges, it anticipated giving broadcasters the opportunity to *"discuss the level of charges"* and *"make representations in writing or attend a meeting"*. Ofcom received one response to its draft Determination from an independent broadcaster stating that in its view small broadcasters had little scope to negotiate reduced EPG listing charges from Sky.

5.152 Ofcom notes that Sky's statement to Oftel in 2003 includes:

*"During discussions over EPG charges, Sky will, where appropriate, invite broadcasters to put forward compelling reasons as to why they should be treated differently from other broadcasters. Sky will have due regard to any objectively justifiable reasons for a difference in pricing. Sky will, during such discussions, take into account the factors identified by Oftel in its Statement of 8 May 2002 and in its revised Guidelines of 22 October 2002."*

*Oftel should note, however, that broadcasters should not expect **only** to pay whatever EPG charges their business models enable them to pay."*

5.153 Ofcom does not accept Sky's view that a broadcaster's inability to pay the indicative rate card EPG listing charge would not be a significant consideration in negotiation. In particular, if the broadcaster was able to demonstrate credibly that Sky's proposed EPG listing charge had a material adverse impact on the viability of the broadcaster's business and that an alternative charge set above the incremental cost floor would result in a viable opportunity to use the Sky Platform, the 2002 Guidelines would require Sky to take this into account during negotiations.

<sup>129</sup> Letter from Emma McCormack (Sky) to David Henry (Rapture, 12 September 2006.

- 5.154 In Ofcom's view, the relevant issue is whether, in negotiations, Sky complied with its regulatory requirement to treat Rapture, as a purchaser of EPG listing services, in a fair, reasonable and non-discriminatory manner. Ofcom has assessed whether the evidence suggests that Sky offered Rapture a reasonable opportunity to demonstrate in commercial negotiations that the indicative rate card charge for an EPG listing would have been unfair, unreasonable or discriminatory in Rapture's particular circumstances.
- 5.155 Ofcom considers that Sky did provide Rapture with the opportunity to make submissions of the kind anticipated in the 2002 Guidelines. In particular, Ofcom notes that the Managing Director of Rapture had, in his former role as a Director of Power TV, met Sky in 2003 to discuss the EPG listing charge for Rapture TV. Ofcom notes that when Sky wrote to Power TV on 8 May 2003 to reject Power TV's arguments, Sky stated that it would require "*strong, economically justifiable reasons for treating "Rapture" differently from other free to air channels*". Ofcom notes that Sky continued to engage in correspondence with Power TV and Rapture in both 2003 and 2005 as to the level of the charge.
- 5.156 Ofcom notes that both Power TV's arguments (in 2003) and Rapture's arguments (in 2005) for securing a lower charge related to content and a repeated assertion that the EPG listing charge was too high. Ofcom considers that Rapture's arguments were general in nature and that Rapture failed to provide Sky with any specific evidence to demonstrate that the viability of the channel was materially affected by the EPG listing charge. On each occasion, Rapture chose not to substantiate its arguments with documentation about its business or any other objectively justifiable evidence which would justify Rapture benefiting from a lower charge.
- 5.157 In the absence of such evidence Ofcom considers Sky's behaviour in rejecting Rapture's proposals does not therefore imply an unwillingness to negotiate on Sky's part that would lead to an unfair, unreasonable and discriminatory outcome and that, indeed, the evidence suggests that Sky had no basis on which to justify a reduced charge to Rapture that met with its obligations to offer terms on a non-discriminatory basis.
- 5.158 Rapture also provided Ofcom with documents relating to discussions between Power TV and Sky in 2002 and 2003 relating to Rapture's location on the EPG and the payment of unpaid invoices. Ofcom has not considered these documents in this dispute as they are not relevant.

### **Did Sky's EPG listing charge to Rapture take into account all relevant factors including the service required, benefits to the Sky Platform and willingness to pay?**

#### **Application of Oftel's 2002 Guidelines**

- 5.159 The 2002 Guidelines state that a customer's willingness to pay may be a significant consideration in determining whether a charge is fair, reasonable and non-discriminatory:

*"Where a channel generates retail revenues, either through subscription, advertising or otherwise, Oftel considers that such revenue is a key indicator of 'willingness to pay' and would expect a reasonably close linkage between retail revenues and conditional access or access control charge. This is not the only factor to be taken into account, as there would be other attributes a broadcaster might ask to be considered in negotiations [...]. Oftel is not suggesting that this should form the basis of a 'formula' between retail price and conditional access/access control charges, but would expect the agreements as a whole to be broadly*

reflective of the retail revenues expected by the broadcaster when offering its service to the end-user.

*“This approach should also ensure that a single channel broadcaster would not be unduly impaired in competing with a similar channel provided by another broadcaster as part of a package of channels.”<sup>130</sup>*

5.160 The 2002 Guidelines state that:

*“Ofcom would expect that the result of negotiations between providers and the broadcaster is that common costs are likely to be distributed amongst different bundles or single channels at differential levels depending on the overall balance of benefits which could accrue to the provider and the broadcaster.”<sup>131</sup>*

5.161 The 2002 Guidelines suggest that factors which purchasers and providers of services might take into account in setting prices might include:

- *“any increase in revenues expected to be associated with broadcast on the platform (which may include subscriptions, advertising or other);*
- *the number of viewers available through the platform;*
- *the type of service offered; and*
- *the number of channels in the package which the broadcaster wishes to offer.”<sup>132</sup>*

5.162 The 2002 Guidelines suggest that possible benefits to the platform from carriage of the broadcaster's channel(s) might include:

- *“the attractiveness of the content offered to the platform's current viewers – with the likelihood of a positive effect on retention;*
- *the complementarity between the platform and the content which may attract new viewers to the platform; and*
- *the element of risk for the platform, including factors such as the length of contract and the certainty of income for the platform provider.”<sup>133</sup>*

### **Rapture's view**

5.163 Rapture has stated that it considers Sky has “benefited substantially” from the presence of free-to-air channels which broadcast unique content that “enhances the Pay TV offering.”

### **Sky's view**

5.164 Sky has stated that:

*“By November 2005, when Sky entered into an EPG Services Agreement with Rapture, a very significant number of broadcasters had contracted to pay charges of £75,000 or more, either when launching new channels or when renewing existing agreements. Accordingly, whilst Sky remain open, in the period before and after signature of Rapture's EPG Services Agreement in November 2005 to receiving reasoned representations for any broadcasters as to why their individual charges should be reduced, such requests were considered in the context of the fact that Sky's standard, undiscounted, charges were paid in respect of a very substantial number of television channels and that those channels included a very diverse range of content and earned revenue from a very diverse range of sources.”<sup>134</sup>*

*“Sky notes that ...as at 1 January 2007, more than 120 broadcasters were paying EPG charges of £75,000 or more per channel listing per annum in respect of free to air channels....*

<sup>130</sup> 2002 Guidelines, paragraphs 3.7-3.8.

<sup>131</sup> 2002 Guidelines, paragraph 3.6.

<sup>132</sup> 2002 Guidelines, paragraph 3.13.

<sup>133</sup> 2002 Guidelines, paragraph 3.14.

<sup>134</sup> Sky's response of 23 January 2007 to Ofcom's information request of 16 January 2007.

*Sky considers that the huge volume of broadcasters who were paying charges at this level... demonstrates that the charges were not set at a level which resulted in material pricing off*<sup>135</sup>

5.165 Sky continues:

*"Sky did not, in the period November 2005 to November 2006, entirely rule out reducing EPG charges after signature of an EPG Services Agreement. However, we are not aware of the EPG charges in any agreement being amended post-signature. Sky considers that it should be entitled to assume that broadcasters who sign EPG Services Agreements have business models which provide for payment of the EPG charges. Accordingly, unless either the nature of the technical service provided to the broadcaster and/or the non-price terms in the EPG Services Agreement are to change, Sky would expect to modify the charges set out in a signed agreement only in exceptional circumstances."*<sup>136</sup>

5.166 Sky have made the following comments in relating to Rapture's willingness to pay:

*"Sky estimates that, excluding operating costs for content, interest and tax, the broadcaster of a television channel like Rapture will incur generally incur operating costs in excess of £530,000 in its first year after launch (ex VAT)."*

*"Thus, whilst we estimate that the EPG charges which Rapture agreed to pay are equal to less than 15% of its operating costs when content, interest and tax charges are excluded, we anticipate that the EPG charges will be a significantly lower percentage of total costs of broadcasting Rapture TV on the digital satellite platform when those costs are taken into account"*

*"...given the value of access to the platform to Rapture...a charge of less than 15% of operating costs (when excluding content, tax and interest costs) cannot be regarded as unfair or unreasonable"*<sup>137</sup>

5.167 Sky further comment that:

*"We note that Rapture has claimed to Ofcom that it has "turnover" of less than "150,000 p.a". If true, given Sky's estimate of Rapture's costs, including its current investments in new studio facilities, it must be the case that either (i) Rapture has access to significant capital to fund its current and ongoing operating losses, or (ii) Rapture's business is commercially unviable. If Rapture cannot afford its EPG charges, that fact in no way demonstrates that the EPG charges are not fair and reasonable."*<sup>138</sup>

### **Ofcom's view**

5.168 Ofcom considers that willingness to pay is a relevant factor in ensuring that prices are fair and reasonable because it is a significant part of the process of commercial negotiation. The 2002 Guidelines consider a range of factors following an underlying principle that prices should be broadly in line with those which could be expected in a competitive market.<sup>139</sup> Therefore, the 2002 Guidelines argue that it is legitimate to take into account a customer's willingness to pay in considering the appropriate charge for access to the Sky Platform, because this reflects what would be found in a competitive market. In such markets, prices are set as a result of commercial negotiation that is influenced by, among other factors, a customer's willingness to pay.

5.169 A broadcaster's willingness to pay for an EPG listing can be measured by the amount of sustainable profit it reasonably expects to make from being on the platform. At the extreme, therefore, the reasonableness of an EPG listing charge can be addressed by the test: "Does the price being charged amount to one which could price the channel off the platform?" Ofcom notes that this

<sup>135</sup> Letter from Emma McCormack (Sky) to David Stewart (Ofcom), 7 February 2007.

<sup>136</sup> Sky's response of 23 January 2007 to Ofcom's information request of 16 January 2007.

<sup>137</sup> Letter from Emma McCormack (Sky) to David Stewart (Ofcom), 7 February 2007.

<sup>138</sup> Letter from Emma McCormack (Sky) to David Stewart (Ofcom), 7 February 2007.

<sup>139</sup> See paragraphs 5.12 to 5.14 above.

does not imply that Sky could reasonably charge broadcasters the entire amount of a channel's profits as an EPG listing charge. Rather, that if the proposed charge approaches the sustainable level of profits the principles of fairness and reasonableness would require Sky to negotiate a reduced charge, subject to the other requirements of non-discrimination, fairness and reasonableness. The test is however not in itself determinative, and the charge would also need to take account other factors as described in the 2002 Guidelines which would feature in commercial negotiations.

- 5.170 In considering whether Rapture was "priced off" the platform, Ofcom has noted Oftel's 2003 Decision.<sup>140</sup> In that case, Oftel considered whether the pricing of EPG listings on the Sky Platform was fair, reasonable and non-discriminatory. In its decision document, Oftel stated:

*"Given the relatively low level of the EPG listing charges, the Director considers that the "willingness to pay" threshold (as set out at paragraph 12 above) is not a difficult one to pass. This is in contrast to the threshold for encryption charges which is typically many times higher. Nevertheless, this does not imply that SSSL can simply assume willingness to pay at these level of charges. Whilst the Director has found that EPG channel listing charges do fall between the floor of the incremental cost and the ceiling of the stand-alone costs of the service, it remains the case that SSSL must also take into account willingness to pay.*

*In this case, the evidence available to the Director suggests that rational parties are in general willing to pay charges at the new levels. The Director understands that nine (9) EPG agreements have been signed on the new terms. The Director further considers that the new EPG charges cannot reasonably be said to be fatal to the business plans of either of the two complainants when the scale of other costs which are involved in the running of a TV or radio channel on the digital satellite platform (not least the significant costs associated with the purchase of satellite transponder capacity) far outweigh the level of the new charges."<sup>141</sup>*

- 5.171 Ofcom has considered Rapture's willingness to pay by reviewing its business plans and actual financial results.

### **Analysis of Rapture's willingness to pay**

- 5.172 In order to assess Rapture's willingness to pay, Ofcom has examined whether or not the EPG listing charge levied by Sky of £76,800 was sufficiently high to "price off" Rapture from the Sky Platform.

### **Ofcom's view**

- 5.173 In principle, Ofcom notes that a preferred approach to setting charges on the Sky Platform is one which provided for charges which reflected the relative willingness to pay of different channels. In practice, Ofcom accepts that the use of an indicative rate card charge to set prices is one which is administratively convenient and can help to reduce administration costs. However, in applying a unitary rate card charge significantly in excess of the incremental cost of providing a service, Sky must also ensure that the application of the rate card takes into account those factors which would feature in negotiations in a competitive market. One such factor is a broadcaster's willingness to pay.
- 5.174 Ofcom recognises that this approach has drawbacks for both parties and concerns about this were one of the reasons behind Ofcom's decision to consider the reforms of TPS pricing which led to the 2006 Guidelines.
- 5.175 In order to assess whether Rapture's business case justified an EPG listing charge lower than the indicative rate card charge, Ofcom obtained various business plans and financial information from Rapture in order to determine

<sup>140</sup> See paragraph 5.10 above.

<sup>141</sup> Oftel's 2003 Decision, paragraphs 17-18.

whether the EPG listing charge levied by Sky was one which could be argued to have priced Rapture off the Sky Platform. As set out in paragraphs 5.149 to 5.157, Ofcom considers that, on the basis of the submissions made to it, Sky acted reasonably in not agreeing to a discounted EPG listing charge to Rapture, on the basis that Rapture failed to demonstrate that the indicative rate card charge was not justified in Rapture's particular circumstances.

5.176 Rapture provided Ofcom with the following information relating to its financial performance:

- 5.176.1 a 2004 business plan which was not updated at the time Rapture entered into its 2005 EPG contract with Sky (the "2004 Business Plan");<sup>142</sup>
- 5.176.2 a cash flow projection dated May 2005 (the "2005 Financial Projections");<sup>143</sup>
- 5.176.3 a spreadsheet detailing Rapture's cash receipts, cash payments, cheques paid and invoices issued for the period 17 March 2005 to 10 December 2006;<sup>144</sup>
- 5.176.4 a schedule of Rapture's estimated accruals and prepayments as of February 2006;<sup>145</sup> and
- 5.176.5 a document entitled "[redacted]" which was prepared subsequent to the period of this dispute.<sup>146</sup>

Ofcom notes that these documents were not supplied by Rapture to Sky in their negotiations to seek a lower price.

5.177 Rapture stated to Ofcom that the first business plan dated from 2004 and therefore related to Rapture TV's previous appearance on the Sky Platform.<sup>147</sup> The first monthly period covered in the plan was May 2004 and "Year 1" of the 2004 Business Plan covered the seven months to December 2004. Year 2 covered the calendar year 2005 and Year 3 covered the calendar year 2006. Rapture did not broadcast on the Sky Platform from July 2004 until November 2005 and stated that no other formal business plan was produced prior to Rapture's reappearance on the Sky EPG in November 2005.

5.178 Rapture stated that the 2004 Business Plan had been based upon its experiences of broadcasting on the Sky Platform prior to May 2004 and, previously, the experiences of Power TV. However, given that the 2004 Business Plan did not anticipate Rapture TV's absence from the Sky Platform between July 2004 and November 2005, it is of only limited use in considering Rapture's business plan at the time that it entered into its new EPG contract with Sky in November 2005. Rapture has also stated that the 2004 Business Plan was designed "*to show an up side to investment... [it] was a speculative plan, not an actual plan*".<sup>148</sup> Ofcom has therefore also considered Rapture's

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<sup>142</sup> Submission from Rapture to Ofcom received 19 January 2007.

<sup>143</sup> Submission from Rapture to Ofcom received 19 January 2007.

<sup>144</sup> Submission from Rapture to Ofcom received 11 January 2007.

<sup>145</sup> Submission from Rapture to Ofcom received 25 January 2007.

<sup>146</sup> Submission from Rapture to Ofcom received 19 January 2007.

<sup>147</sup> Meeting with Ofcom on 23 January 2007.

<sup>148</sup> Letter from David Henry (Rapture) to Anthony Szykaruk (Ofcom), 23 February 2007.

2005 Financial Projections which better reflected Rapture's expected financial performance at the time it was negotiating an EPG listing charge in 2005.

- 5.179 Ofcom has considered the level of EPG listing charges from two perspectives – firstly the proportion of EPG listing charges as a percentage of total costs and revenues and secondly the impact of Sky's proposed charges on the viability of Rapture's business. However, Ofcom notes (as set out above) that none of these documents were supplied to Sky as part of Rapture's negotiations. However, Ofcom has considered whether these documents could have provided evidence that Rapture would be priced off the Sky Platform, had they been supplied to Sky.

### **Rapture's 2004 Business Plan**

- 5.180 Rapture's 2004 Business Plan included EPG listing costs of £75,000 per annum. Net of this, and other expenses, the 2004 Business Plan showed that the business anticipated reaching a pre-tax operating profit after [X] months of operation.
- 5.181 This profit included costs and revenues which were related to "off-air" activities, such as [X] and internet advertising sales. Ofcom considers that these activities have a strong causal link to Rapture TV and that, in line with the business plan of many other channels, income which is generated from "off-air" activities can be considered to be an intrinsic part of the funding sources available for the purposes of operating the channel. Summary profit and loss accounts for the 2004 Business Plan are shown in Table 3 below.

**Table 3 Summary Profit and Loss Account – Rapture's 2004 Business Plan**

[X]

Source: 2004 Business Plan

- 5.182 Total costs and revenues for the period of the 2004 Business Plan were £[X] and £[X] respectively. Sky's indicative rate card charges (which were included in the plan) totalled £200,000 and comprised [0-10]% of total costs and [0-10]% of the total revenues forecast for the period.
- 5.183 The business was expected to move into profitability in [X] and would have recovered initial losses in [X].
- 5.184 In Ofcom's view the 2004 Business Plan does not suggest that Rapture was being priced off the platform as a result of Sky's proposed level of charges and that such charges were clearly "affordable" on the basis of that plan.

### **Rapture's 2005 Financial Projections**

- 5.185 Rapture has provided Ofcom with a set of financial projections dated May 2005 covering the period May 2005 to December 2007 (the "2005 Financial Projections").
- 5.186 These projections included an assumed EPG listing charge of £[X] per annum (compared to the rate card charge of £76,800). A summary of the projected profit and loss is shown in Table 4 below.

#### **Table 4 Summary Profit and Loss Account – Rapture’s 2005 Financial Projections**

[REDACTED]

Source: 2005 Financial Projections

- 5.187 Total costs and revenues over the two years and eight months of the 2005 Financial Projections amounted to £[REDACTED] and £[REDACTED] respectively. The total assumed EPG listing charges of £[REDACTED] therefore amounted to [0-10]% of costs and revenues.
- 5.188 Sky’s proposed charges during the same period would amount to £204,800 or [0-10]% of costs.
- 5.189 [REDACTED]
- 5.190 The 2005 Financial Projections do not extend beyond year three and Ofcom considers that it is not possible to determine whether, on the basis of these projections, Rapture could afford to pay the indicative rate card charge of £76,800 over the long term, particularly given the rapid forecast rise in revenues over the short duration of the projections.
- 5.191 In addition, the 2005 Financial Projections are not supported by any details of the business’ strategy, details of assumptions or risk analysis.
- 5.192 In summary, it is Ofcom’s view that the 2005 Financial Projections do not cover a sufficiently long period and are insufficiently detailed or supported to be able to illustrate that Sky’s indicative rate card charge would be unfair or unreasonable in Rapture’s case.
- 5.193 As stated in paragraph 5.157, Ofcom has concluded that on the basis of Rapture’s submission to Sky, Sky had no grounds on which to justify a reduced EPG listing charge to Rapture. In Ofcom’s view even if Rapture had submitted details of its business plan or financial projections to Sky, these would not have provided a compelling case for Sky to reduce its EPG listing charges in Rapture’s case.

#### **Evidence of willingness to pay from other broadcasters**

- 5.194 In the course of its investigation Ofcom obtained details of channel operating costs from a sample of broadcasters of smaller free-to-air channels on the Sky Platform in order to consider whether there was any evidence that suggested Sky’s charges could be considered to be capable of pricing smaller commercial channels off the Sky Platform. In particular, Ofcom considered the level of EPG costs as a proportion of total operating costs to be a useful indication of the significance of the level of EPG listing charges and its ability to price a channel off the Sky Platform.
- 5.195 In considering evidence of other channels, Ofcom notes that the channels on the Sky Platform vary widely in their business models and that revenues and costs could vary very significantly across channels. However, Ofcom identified certain minimum costs common to all channels which provide a useful benchmark against which to assess EPG listing charges.
- 5.196 Summary results from Ofcom’s survey are shown in Table 5 below, together with cost estimates from a third party market report (which whilst prepared for a typical pay-TV channel provide a useful cross check on certain operating

costs which are similar for free-to-air and pay-TV channels, in particular distribution costs).<sup>149</sup>

**Table 5 Operating costs of commercial TV channels**

Source:	Third Party Broadcasters			Third Party Report
	£'000			
Costs (Pre-Content)	Min	Max	Average	Business Plan
Distribution - Transponder & Uplink	180	250	224	450
Distribution - Play out	12	200	124	300
BARB	26	30	28	-
PRS/PPL	10	80	33	-
Marketing/Advertising	10	180	61	1,700
Staff	50	150	95	490
Premises	17	75	42	-
Other costs	12	135	62	510
EPG	77	79	79	50
<b>Total Operating Costs</b>	<b>394</b>	<b>1,179</b>	<b>748</b>	<b>3,500</b>

Source: Ofcom analysis and *Pay TV Business Planning – An Analysis of Pay-TV Business Planning, Channel Operation and Economics, International Marketing Reports, 2003*

- 5.197 In addition to the costs shown in Table 5 above, broadcasters will have to purchase or create some form of content. The cost of this may vary significantly but is unlikely to be less than £500,000 for a commercial channel.
- 5.198 Based on the results of Table 5, in Ofcom's view, a rate card EPG listing charge of £76,800 typically represents between 7-20% of operating costs excluding content costs or around 5-10% of total costs including content costs.
- 5.199 In Ofcom's view the likelihood that any one cost might be at a level which is capable of pricing a channel off the Sky Platform is related primarily to the proportion of total costs it represents. For example, an individual cost of, say, 75% of total costs is clearly more likely to be capable of pricing a channel off a platform than one which comprises say 2% of total costs.
- 5.200 In Ofcom's view, there is a possibility that the indicative rate card charge for an EPG service could be one which is determinant to the viability of a channel and, therefore under the 2002 Guidelines, Sky was required to consider each individual broadcaster's willingness to pay in negotiating individual charges. Ofcom has analysed Rapture's willingness to pay in the above section and its conclusion is set out below.

<sup>149</sup> *Pay TV Business Planning – An Analysis of Pay-TV Business Planning, Channel Operation and Economics, International Marketing Reports, 2003*. Whilst the report considers the business case for pay-TV channels, rather than free-to-air channels such as Rapture TV, the operating costs of the two businesses will be similar.

## Conclusion

- 5.201 Ofcom has not considered the actual willingness to pay of comparable broadcasters in the context of this dispute. Ofcom has, however, considered the overall business costs of comparable broadcasters in order to assess the materiality of the indicative EPG listing charge to their businesses.
- 5.202 Based on cost data from a number of small, free-to-air channels, Ofcom believes that it is possible that the level of the EPG listing charge could price a channel off the Sky Platform.
- 5.203 However, Ofcom is not currently aware, through complaints or by way of responses to this dispute, of any comparable broadcasters being priced off the Sky Platform due to the level of the rate card EPG listing charge.
- 5.204 On the facts of this case, Rapture's 2004 Business Plan indicates that the indicative rate card charge for an EPG listing was not set at a level which would price Rapture off the Sky Platform and was clearly "affordable". The 2005 Financial Projections are of insufficient duration or detail to draw any meaningful conclusions about Rapture's willingness to pay in respect of the indicative rate card charge. In Ofcom's view, even if Rapture had submitted details of its 2004 Business Plan or 2005 Financial Projection to Sky, these would not have provided a compelling case for Sky to reduce its EPG listing charges in Rapture's case. On the contrary, the 2004 Business Plan would have indicated that Sky's EPG listing charge was not at a level which could have plausibly priced Rapture off the Sky Platform.

## Was Sky's EPG listing charge to Rapture discriminatory?

### Application of the 2002 Guidelines

- 5.205 The 2002 Guidelines state in summary that:

*"In assessing non-discrimination, Ofcom regards it as acceptable for differential prices to be offered where there is no material adverse effect on competition; but that the basic approach should be that comparable prices should be offered to comparable users, for comparable services, at comparable times."*<sup>150</sup>

- 5.206 The 2002 Guidelines provide more detail on the approach to discrimination as follows:

*"2.9 Non-discrimination does not necessarily mean that there should be no differences in treatment between broadcasters, rather that any differences should be objectively justifiable, for example by differences in underlying costs or the absence of a material adverse effect on competition. As outlined at 2.4-2.7, justifications for differentiation may also include the degree of risk presented or an overall benefit to competition through facilitating entry to platform. This would be considered on a case-by-case basis. For example, an agreement entered into at the launch of a platform, and which hence implicitly or explicitly involved the sharing of risk, could not be considered as having been entered into 'at a similar time' as one signed at a different date, even if the conditional access or access control services provided are similar. This would also apply to any rollover agreements in the earlier contract. Similarly, the value to digital platform operators of having broadcasters' content on their platforms will in general be greater in the platform's infancy. This is because, at such times, the need for quality content to make its platform attractive will be of premium importance to the operator*

[...]

*2.11 In order to ensure compliance with the non-discrimination obligation, a provider should ensure, amongst other things, that:*

<sup>150</sup> 2002 Guidelines at S3.

- *it applies equivalent conditions in equivalent circumstances to other broadcasters providing equivalent services;*
- *it provides services and information to other broadcasters under the same conditions and of the same quality as it provides to its own broadcasting channels; and*
- *it can objectively justify any differentiation.*

[...]

2.12 Ofcom's key non-discrimination principles for conditional access and access control pricing are that:

- *comparable broadcasters, purchasing comparable services at broadly similar times, should pay comparable prices; and*
- *where broadcasters are not providing directly competing services, differentiation in pricing is unlikely to have a material adverse impact on competition, and should therefore not be prohibited in itself.*

2.13 To assess whether different users of conditional access or access control are comparable or not, Ofcom initially identifies the following three categories:

- *free to air television broadcasters;*
- *pay TV broadcasters; and*
- *interactive broadcasters (who require access control, and are also likely to need conditional access).*

2.14 Ofcom's initial presumption is that there would not be a material effect on competition if a provider offered different prices for the same or similar services to these different categories of broadcaster. For example, the provider may offer different terms and conditions to free-to-air broadcasters from those offered to subscription broadcasters.

2.15 Within any one category of broadcaster, Ofcom presumes that comparable terms and conditions offered to one would be available to another similarly situated at the same time. When examining the prices charged towards different broadcasters within the same category, Ofcom expects that, where those broadcasters are requiring different services, the prices charged should reflect, amongst other things, any differences in the cost of providing those services. Other considerations may include revenue issues and willingness to pay (as noted at 3.7-3.8).<sup>151</sup>

### **Rapture's view**

5.207 Rapture has argued that Sky's proposed listing charge to Rapture during the period under dispute was discriminatory because:

*"[it was] the same amount as charged to other channels like ITV2 during the same period only ITV2 has substantially larger audiences and many £millions of advertising revenue, when Rapture does not have a equal [sic] amount of revenue as ITV2 it is therefore discriminatory to Rapture".*

### **Ofcom's view**

5.208 In Ofcom's view, the use of an indicative rate card charge which applies to all broadcasters, together with a process for identifying channels which merit a lower charge (ie on the basis that they are sufficiently differentiated such that the indicative rate card charge is not reflective of their willingness to pay), is one which will help ensure that charges are not discriminatory, provided that the process is itself undertaken in a non-discriminatory way.

5.209 Sky's submission to Ofcom of 23 January 2007 stated that 419 television channels were listed on the EPG on 1 November 2005. It is Ofcom's

<sup>151</sup> 2002 Guidelines, paragraph 2.9-2.15.

understanding that the only exceptions made by Sky to the rate card for television channels on the Sky Platform during the period of the dispute were:

5.209.1 [redacted]<sup>152</sup>.

5.209.2 [redacted];<sup>153</sup>

5.209.3 [redacted];<sup>154</sup>

5.209.4 [redacted];<sup>155</sup> and

5.209.5 [redacted].<sup>156</sup>

5.210 These exceptions to the EPG listing charges on the indicative rate card relate to non-commercial channels, public service broadcasters and a group of channels effectively continuing existing contractual arrangements rather than negotiating a new charge.

5.211 Further, although some of these channels would fall within the same free-to-air category outlined by Ofcom in the 2002 Guidelines, none of these circumstances are comparable to Rapture's situation. As a result, in the absence of an objective, economically verifiable justification for a lower EPG listing charge, the evidence does not suggest that Sky's treatment of these broadcasters in relation to Rapture was discriminatory.

5.212 Ofcom has also considered Rapture's argument that it was discriminatory for Sky to charge small channels such as Rapture the same EPG listing charge as that paid by larger channels. Under the 2002 Guidelines, non-discrimination implies that: "*comparable broadcasters, purchasing comparable services at broadly similar times, should pay comparable prices*". The 2002 Guidelines identify all free-to-air broadcasters as a category of user between which Sky should not discriminate, in the absence of objectively justifiable criteria. The Guidelines identify potential grounds for different prices for different services or different broadcasters as being differences in costs incurred in providing the service and also differences in revenues or willingness to pay.

5.213 Ofcom notes that the cost of providing an EPG listing service for different channels is unlikely to vary significantly between channels and would, in itself, be unlikely to justify different prices.

5.214 The 2002 Guidelines provide for an assessment of a channel's willingness to pay in determining discrimination. Ofcom's analysis of this topic is set out in paragraphs 5.159 to 5.204. Ofcom has found that Sky did provide Rapture with a reasonable opportunity to demonstrate that its willingness to pay objectively justified a lower charge than the indicative rate card charge, but Rapture failed to do so.

5.215 In Ofcom's view, it was not discriminatory for Sky not to have charged Rapture a lower price than that charged to other larger channels. Rapture was charged the same price as other smaller broadcasters purchasing EPG listings.

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<sup>152</sup> Sky's response of 23 January 2007 to Ofcom's information request of 16 January 2007.

<sup>153</sup> [redacted]

<sup>154</sup> [redacted]

<sup>155</sup> [redacted]

<sup>156</sup> [redacted]

## Are there any other factors which suggest Sky's EPG listing charge to Rapture was not fair, reasonable or non-discriminatory?

### Rapture's view

5.216 Rapture submitted that:

*"Telewest Communications operate a cable digital EPG service, which is of a similar technical standard, with less than [sic] 6 staff at no cost to the channels that use it".<sup>157</sup>*

5.217 Rapture also commented that:

*"[Canal Plus][a French satellite TV platform operator] do not attempt to charge the 'Free to Air' channels in the 'Free to Air' bouquet."<sup>158</sup>*

5.218 Rapture also stated:

*"The basic charge should be no more than the cost of providing the service; a fee of less than £1,000 per month per channel should be adequate. This would be sufficient to cover the cost of the personnel at BSkyB whose involvement is necessary to the supply of the technical service.*

*The justification for this level of fee is that there are a large number of channels being supplied the same service from BSkyB and the cost of the supply of the technical service is shared over a small number of technical staff. There are over 30 free to air channels on the DSat platform at £75,000 means [sic] BSkyB is receiving over £2.25 million pounds from broadcaster [sic] who are delivering valuable content to DSat users. The revenue received by BSkyB should be calculated on the actual economic level of costs incurred in the supply of the technical service. This should not include development costs as these were incurred by BSkyB for the purpose of providing a Pay TV Service and the EPG software is not an open platform, as it does not detect those channels that have not purchased BSkyB's EPG Services and no other provider has been allowed to offer an alternative to the EPG Service.*

*A reasonable number of staff needed to operate the "Basic EPG Listing" would be no more than 6 IT staff. Using an average salary for IT staff at £17,000 per annum would mean the actual cost of supplying the "Basic EPG Listing" technical service would be £102,000 per annum. Divided by 30 free to air broadcasters would equal an annual fee of just £3,400 per broadcaster per channel."<sup>159</sup>*

### Ofcom's view

5.219 Cable companies are under no obligation to include third party channels on their platform and there is therefore no regulatory requirement for them to provide an EPG listing. In Ofcom's view, Rapture's submissions in respect of the resources required by a cable operator to operate its EPG listing do not provide a meaningful comparison against which to assess the costs of providing an EPG listing on a digital satellite platform.

5.220 While Ofcom understands that it is the case that free-to-air channels in France are not charged for EPG listing services, the Conseil Supérieur de L'Audiovisuel has informed Ofcom that this was a policy decision taken by satellite platform providers in France reflecting their regulatory obligation to carry Public Service Broadcasters free of charge. No analogous obligation exists in the UK.

5.221 In Ofcom's view, Rapture is effectively arguing that free-to-air broadcasters as a group of customers should only be required to pay the incremental costs of providing a service to that group of customers and that they should not be

<sup>157</sup> Rapture's submission to Ofcom of 11 September 2006.

<sup>158</sup> Email from David Henry (Rapture) to Anthony Szytkaruk (Ofcom), 23 January 2007.

<sup>159</sup> Rapture's submission to Ofcom of 11 September 2006.

required to pay a contribution towards the common costs of running the platform (and the costs of set-top box subsidies in particular).

- 5.222 Rapture's argument is not consistent with the 2002 Guidelines which state that the incremental cost would represent a "floor" and that a fair and reasonable charge would take account of both incremental costs and some contribution to common costs up to a "ceiling" of standalone cost, subject to Sky taking account of the customer's willingness to pay and considerations around pricing customers off the platform. Rapture's willingness to pay, and the extent to which its EPG listing charges may serve to price it off the platform are considered further in previous sections. However, Ofcom does not consider that the only charge that could be fair and reasonable, in line with the 2002 Guidelines, would be one based on incremental cost alone.

### **Ofcom's 2006 Guidelines**

- 5.223 As explained in paragraph 4.38 *et seq* Ofcom has applied the 2002 Guidelines in its analysis of this dispute. However, Ofcom has also considered whether, in the particular circumstances of this dispute, there is any basis for concluding either that:
- 5.223.1 an application of the 2002 Guidelines would not provide an outcome consistent with Sky's underlying regulatory obligations to set charges which were fair, reasonable or non-discriminatory; or
  - 5.223.2 a deviation from the 2002 Guidelines was necessary in order for Ofcom to fulfil its statutory duties.
- 5.224 Ofcom's 2006 Guidelines provide a useful reference point in considering these questions, because those guidelines were introduced, in part, to reflect changing market conditions since 2002 and therefore are relevant to consider whether to deviate from the 2002 Guidelines.

### **Changes in Sky's charges for EPG services following the introduction of the 2006 Guidelines**

- 5.225 Sky introduced a new rate card on 20 December 2006 following the publication of the 2006 Guidelines in September 2006. The new rate card applied from 1 January 2007 and provides for a broadcaster to make two payments for an EPG listing service:
- 5.225.1 an EPG Listing Charge of £14,000 per annum per channel; and
  - 5.225.2 a "Platform Contribution Charge" which varies from channel to channel, but with a minimum of £65,000 per annum.
- 5.226 The Platform Contribution Charge for Rapture is £65,000 (providing for a total charge for EPG services of £79,000 per annum).
- 5.227 Ofcom understands that Sky has calculated the Platform Contribution Charge for each channel based on an assessment of each channels' revenues, but applied a minimum charge of £65,000 for channels with revenues below a certain minimum level.
- 5.228 Ofcom has not assessed Sky's new rate card in this dispute as it falls outside the scope of the matters disputed between the parties when the matter was referred to Ofcom for resolution.

### **Differences between the 2002 Guidelines and 2006 Guidelines**

5.229 In issuing the 2006 Guidelines, Ofcom noted that:

*“the [2006] [G]uidelines .....share many of the underlying principles that formed the basis of the previous guidelines [ie the 2002 Guidelines]. These include the need to ensure costs are reasonably, necessarily and efficiently incurred, recovery of common costs based on willingness to pay (which in turn is related to the benefits received), the use of revenues earned as a proxy of benefits received and guidance on non price terms such as lead times and information relating to new TPS.”<sup>160</sup>*

5.230 As noted in paragraph 4.39, two major differences between the two guidelines which are relevant to this dispute are: (1) the basis for calculating the contribution towards common costs of different users of the Sky Platform; and (2) the role of the rate card. Each of these issues is considered below.

### **Contribution towards common costs**

5.231 The 2002 Guidelines provide that a broadcaster’s contribution to the common costs of the Sky Platform should be set by negotiation, and that any rate card charges should be regarded as “a starting point” for negotiations.<sup>161</sup> The advantage of this approach was flexibility and it reflected Ofcom’s view at that time that, in relation to conditional access markets, negotiated outcomes, rather than more prescriptive regulation of prices, would more closely reflect those consistent with a competitive market in a situation when the costs and benefits associated with the platform were highly uncertain.<sup>162</sup>

5.232 As noted in Ofcom’s 2006 Guidelines:

*“The previous guidelines stated that Sky’s published prices were only a starting point for negotiations and should not be rigidly adhered to. Sky was therefore able to negotiate different charges with TPS customers on the basis of their willingness to pay. Where the relative negotiating positions of the parties were balanced or when the costs and benefits of the platform were highly uncertain, it may have been appropriate to adopt this approach to allow some freedom for charges to be determined by commercial negotiation.*

*“In the start up phase of a platform business, negotiations were more likely to be balanced as Sky was dependent on securing attractive content on to its platform in order to stimulate retail customer growth. It was therefore more appropriate to allow TPS charges to be determined through commercial negotiations, which provided the flexibility for TPS charges to be tailored to the specific needs of broadcasters and interactive service providers.”<sup>163</sup>*

5.233 Ofcom’s 2006 Guidelines recognise that following the success of the Sky Platform, Sky is now in a much stronger negotiating position vis-à-vis third party users of the Sky Platform.<sup>164</sup> In particular:

*“The relatively higher growth in Sky’s retail customer base compared to the next best alternative is likely to have tipped the balance of negotiating strength in favour of Sky.”<sup>165</sup>*

5.234 This shift in negotiating power in Sky’s favour raises a number of concerns which have the potential to harm consumers. Ofcom’s 2006 Guidelines have, therefore, replaced negotiation as the preferred approach to determining the level of common costs to be recovered from third party users of the Sky Platform with an approach that allocates common costs amongst platform users in proportion to the incremental benefits from being on the Sky Platform (using incremental revenues as a proxy for benefits).

### **Rate Card**

<sup>160</sup> 2006 Guidelines, paragraph 2.27.

<sup>161</sup> 2002 Guidelines, paragraph 3.19.

<sup>162</sup> 2002 Guidelines, paragraph 3.4.

<sup>163</sup> 2006 Guidelines, paragraph 2.22 and 2.23.

<sup>164</sup> 2006 Guidelines, paragraph 2.24.

<sup>165</sup> 2006 Guidelines, paragraph 2.24.

5.235 Both Guidelines recognise the benefits of using a published price list (termed a “rate card”) when setting regulated charges.

5.236 Under the 2002 Guidelines the rate card charges are to be viewed as indicative and only a starting point for negotiations, allowing broadcasters to negotiate a lower charge where appropriate:

*“Ofcom considers that the publishing of indicative prices that can serve as the starting point for commercial negotiation is helpful for all parties.”<sup>166</sup>*

5.237 In contrast, the 2006 Guidelines enable Sky to set a minimum contribution for channels which derive relatively small amounts of benefit from being on the Sky Platform leading to a charge which is not the subject of negotiation:

*“...for channels that have a very small incremental viewing share or revenue it may be reasonable for Sky to use one or more simple “per EPG listing” charges to approximate the incremental benefits these channels receive.*

*Such an approach may be appropriate for channels with viewing shares that are too small to measure accurately and provide small start up channels increased certainty of charges in their early stages of growth. The simple approach may also reduce the administrative costs associated with calculating and collecting charges.*

*If such an approach were adopted, Ofcom would expect Sky to use transparent and objective criteria in deciding which channels were charged a particular fixed charge and which were charged based on using a suitable proxy.”<sup>167</sup>*

5.238 The impact and role of a published rate for EPG listing services is directly relevant to this dispute. In particular, Rapture was a relatively small channel, and there was therefore a risk that Rapture would, in the extreme, be priced off the Sky Platform by the application of a rate card charge. Under the 2002 Guidelines, this risk was mitigated by the requirement for Sky to consider, through negotiation, whether Rapture was justified in arguing for a lower charge, and if so, to offer one. There is no similar right to negotiate a charge below that on the rate card in the 2006 Guidelines, rather, Sky has an obligation to ensure that:

*“In the event of a dispute or complaint Ofcom would require Sky to provide evidence that this differentiation did not lead to undue discrimination for the purposes of the Conditions”.<sup>168</sup>*

5.239 To illustrate the comparison in the two approaches, Ofcom notes that a critical question that would therefore need to be addressed in considering whether Sky’s EPG listing charge to Rapture was consistent with the 2006 Guidelines would be: “on what basis did Sky set the minimum Platform Contribution Charge of £65,000 and is that sufficient to ensure that smaller channels such as Rapture are not charged at a level which could be regarded as unfair, unreasonable or discriminatory?”

5.240 Ofcom notes that the basis for allocating common costs in the 2006 Guidelines is that all channels should pay the same proportion of the incremental benefits (as measured by incremental revenues) they derive from the Sky Platform, as a contribution towards common costs. In Sky’s new tariff structure, a channel’s contribution towards common costs is principally contained within the Platform Contribution Charge (ie the EPG listing charge can for the purposes of this analysis be regarded as the incremental cost).

5.241 For those channels with very low revenues, there is a risk that the minimum level of contribution represented by the minimum Platform Contribution

<sup>166</sup> 2002 Guidelines, paragraph 3.17.

<sup>167</sup> 2006 Guidelines, paragraphs 6.25-6.27.

<sup>168</sup> 2006 Guidelines, paragraph 6.27.

Charge will be a very high proportion of their revenues. This may put those channels at an increased risk of being priced off the platform.

- 5.242 Further, for smaller channels, the minimum Platform Contribution Charge may represent a materially higher percentage of benefits or revenues than larger channels, an outcome that could be discriminatory.
- 5.243 Ofcom's limited review of the costs of small channels as set out in paragraph 5.194 *et seq* finds that Sky's EPG charge could be material to such channels and has the potential to price a channel off the Sky Platform. However, Ofcom considers that this analysis is preliminary, does not necessarily draw on a representative sample of small channels and is limited in scope. Specifically, while the analysis is sufficient for the purposes of establishing that Rapture's charge *could* be material (relevant, under the 2002 Guidelines, to the question of whether Sky needed to consider Rapture's willingness to pay), it is not sufficient to reach even a provisional view about the question posed at paragraph 5.239 above. Therefore, a more detailed analysis on the facts of a case brought to Ofcom would be needed to assess whether Sky's minimum Platform Contribution Charge, as applied by Sky with effect from 1 January 2007, was unfair, unreasonable or discriminatory in relation to those channels. Ofcom makes no findings in this dispute with respect to these questions.
- 5.244 As set out above, Ofcom has reviewed Rapture's willingness to pay and concluded:
- 5.244.1 that Rapture was granted a reasonable opportunity to demonstrate credibly through negotiation that, in its particular circumstances, it warranted a lower charge and that it failed to do so; and
- 5.244.2 the evidence of Rapture's actual and forecast profitability is insufficient to suggest that Rapture was at risk of being priced off the platform as a direct result of Sky's EPG listing charge.
- 5.245 Further, Ofcom has found that the evidence does not suggest that Rapture has been treated in a discriminatory manner.
- 5.246 Therefore, in Ofcom's view, the evidence suggests that in Rapture's case, a key concern underlying the introduction of the 2006 Guidelines - that negotiation may fail to deliver a fair, reasonable and non-discriminatory outcome - was not realised and that therefore in the context of this dispute there is no basis for concluding that Ofcom should deviate from the 2002 Guidelines in order to deal with this concern.

## Summary

- 5.247 Ofcom has considered whether, based on the concerns that led to the issuing of the 2006 Guidelines, there is a basis for deviating from the 2002 Guidelines in this case, and finds that there is no reason to do so.
- 5.248 A key issue which Ofcom sought to address in publishing the 2006 Guidelines was the concern that an approach that relied on negotiation to provide an allocation of common costs may not result in fair, reasonable and non-discriminatory charges. Given Ofcom's findings in relation to the negotiations between Sky and Rapture, this concern does not arise in this case.
- 5.249 Therefore Ofcom has not, in this case, found it necessary to undertake a more detailed consideration of what, if any, modifications would be needed to be made to the approach set out in the 2002 Guidelines to address this issue and, specifically, has not applied the approach set out in the 2006 Guidelines.

## Conclusion

- 5.250 As mentioned at the beginning of **section 5**, the 2002 Guidelines include and describe certain components to the assessment of whether charges are fair, reasonable and non-discriminatory. Ofcom has concluded that Sky has satisfied the requirements of each of the following components.
- 5.250.1 Terms should be consistent with those in a competitive market (see paragraphs 5.12 to 5.14).
  - 5.250.2 Input costs should be reasonably and necessarily incurred in providing the service (see paragraphs 5.15 to 5.69).
  - 5.250.3 Charges should be set between the 'floor' of the incremental cost of providing the service, and the 'ceiling' of the stand-alone cost of the service and returns should not be excessive (see paragraphs 5.70 to 5.102).
  - 5.250.4 The allocation of common costs should be negotiated between the relevant parties and where a rate card is published, this should serve as the starting point for negotiation (see paragraphs 5.103 to 5.158).
  - 5.250.5 A range of factors should be taken into account in assessing charges, including the service required, benefits to the platform and willingness to pay (see paragraphs 5.159 to 5.204).
  - 5.250.6 In assessing non-discrimination, comparable prices should be offered to comparable users for comparable services purchased at a similar time (see paragraphs 5.205 to 5.215).
- 5.251 On the basis of the evidence available to Ofcom and this analysis, Ofcom considers that Sky's charge to Rapture for an EPG listing service during the period November 2005 to November 2006 was fair, reasonable and non-discriminatory.

## Annex 1

# Sky's published EPG charges – 14 October 2004

## Electronic programme guide (EPG) charges

Charges for listings on Sky's EPG are established in a similar manner to Sky's conditional access (CA) charges. This document should, accordingly, be read in conjunction with the "Method for Establishing Conditional Access Charges" published by Sky Subscribers Services Limited (SSSL).

EPG charges recover both the costs of developing and operating the EPG, and also make a contribution to the recovery of some of the common costs of developing and operating the digital satellite platform. Channels that take SSSL's CA services make a contribution to such common costs via CA charges and, therefore, it is appropriate that they pay lower EPG charges than those channels that do not take such CA services.

The indicative charges set out below apply to agreements where the intended launch date into the EPG is on or after 14 January 2005 and are predicated on the agreements being for a duration of 3 years (with a right of termination by the broadcaster on 90 days' notice). The agreements will provide that the charges are to increase on 1 January each year to reflect any increase in the all items Retail Prices Index (RPI) (published by the Office for National Statistics) over the previous year. The indicative charges are:

Category of service	Charge Per EPG listing
TV channels (taking SSSL's CA services)	£36,000 per annum
TV channels (not taking SSSL's CA services)	£76,800 per annum
Radio channels (taking SSSL's CA services)	£10,260 per annum
Radio channels (not taking SSSL's CA services)	£20,520 per annum
Interactive platforms	£720,000 per annum
Niche interactive platforms	£205,020 per annum

These charges are exclusive of VAT.

TV channels include pay per view and pay per night services.

An interactive platform is a service listed on the Interactive Main Menu (IMM) which offers access to five or more different kinds of interactive services (banking, shopping, e-mail etc.) A niche interactive platform is a service listed on the IMM which offers fewer than five different kinds of interactive services.

14 October 2004

## Annex 2

# Sky's method for establishing conditional access charges

This Annex reproduces Sky's method for establishing conditional access charges, which is published on Sky's website.

## **Published on behalf of Sky Subscribers Services Limited**

### **Method for Establishing Conditional Access Charges**

#### **Introduction**

This document describes the method that SSSL has employed in the context of establishing charges for conditional access (CA) services. It also specifies indicative CA charges.

It should be noted that:

- The method that has been employed is not one that is intended to lead to a deterministic, rigid rate card. The regulatory regime permits SSSL to enter into commercial negotiations with prospective CA customers rather than develop a rate card. The method that is described in this document is one which SSSL has used to form a basis for its starting point for negotiations.
- Agreements for the provision of CA services are considerably more complicated than a simple statement of charges. It is expected that otherwise similar broadcasters may request CA services under different terms and conditions of supply. The charges quoted in this document apply to a basic level of provision of CA services and it should be expected that bespoke requests could result in higher prices.

#### **Approach to CA Charges**

The approach adopted by SSSL is one of charges recovering costs incurred plus a return commensurate with the level of risk.

SSSL does not, however, intend to recover costs at the time they are incurred as a number of categories of cost are far greater in the early years of developing the platform than later. Charges that sought to recover costs as they were incurred would therefore have resulted in high charges at the outset, with charges falling over time. Such a trend in charges would not have been in the interests of broadcasters or the DSat platform as a whole, as it would have discouraged entry onto the platform in its early years. Instead SSSL set charges initially at low levels, and has reasonably increased charges over time, particularly as the number of households which broadcasters can reach via the DSat platform has increased. The DSat platform currently reaches around seven million households.

Broadcasters have often tended to seek from SSSL charges which are fixed over a number of years in order to provide them with business certainty. Under such circumstances costs will also not necessarily be recovered at the time they are incurred.

Accordingly, SSSL has forecast a number of variables in order to offer charges which ensure that, over a reasonable period, CA charges recover the costs incurred in connection with the provision of CA services. It is not possible for SSSL to disclose the details of these forecasts as they are principally based on SSSL's view of market developments and are therefore commercially confidential. Such a disclosure would also result in a breach of the duty of confidentiality which is owed by SSSL to its CA customers.

#### **Categories of Broadcasters**

Oftel has stressed that it is concerned to ensure that comparable broadcasters purchasing comparable services at comparable times should pay comparable prices. Following this approach, SSSL proposes different charges to different categories of broadcasters.

The method employed by SSSL distinguishes between broadcasters as follows:

A. according to the category of viewer to whom a channel or event is being shown:

- residential premises ; and
- commercial premises;

B. according to the CA service being provided and the content of the television service being broadcast:

(i) for residential premises these categories can be broken down into:

- automatically entitled (AE) broadcasters (i.e., those who wish to be automatically entitled on all active pay television cards that have been distributed by SSSL at the request of one of the pay TV broadcasters in receipt of CA services);
- pay per view (PPV) broadcasters of live events, adult and other services; and
- subscription broadcasters. Subscription services are further divided into those that include premium channels and those that comprise only non-premium channels.

(ii) for commercial premises there may also be a number of different categories of broadcasters, and different types of commercial premises, specified on a case by case basis.

Oftel’s approach also enables SSSL to agree different charges with broadcasters in the same category where the broadcasters are offering dissimilar content (such as sport and movies) or where different charges are otherwise objectively justifiable. Oftel considers it reasonable that the basis of CA charging should broadly follow the basis of charging for the underlying television service so that PPV is charged on a per buy basis and subscription services on a per customer per month basis.

**Indicative CA Charges**

By employing the method described above, SSSL has established the following indicative charges (for CA agreements of three to five years duration) for these different categories of broadcaster to residential viewers as follows:

Category of Broadcaster	Charge Per Residential Customer
Automatically Entitled	£0.30 per month
Pay Per View: Adult	£0.75 per buy
Pay Per View: Other	£0.60 per buy
Subscription: package containing one or more premium channels	£3.20 per month
Subscription: package which does not contain premium channels	£2.00 per month

Charges in CA agreements are subject to an annual increase by the annual change in RPI so that they remain constant in real terms over the duration of a CA agreement.

**Subscription broadcasters**

Within the category of subscription broadcasters, CA charges are differentiated between packages containing premium channels and packages which do not contain premium channels. SSSL acknowledges that there may not be a precise distinction between premium and non-premium channels. In practice, a range of factors would be taken into account to determine into which category a channel falls, including:

- how the channel is sold to consumers (e.g. on a stand-alone basis or in conjunction with

- other channels);
- the level of revenue from the channel;
- the number of subscribers able to be attracted by the channel; and
- the nature of the programming content on the channel.

With respect to the nature of the programming content on the channel, the Office of Fair Trading (OFT) has indicated that it considers that some content will only appear on premium sports channels. It is clear, therefore, that channels broadcasting such content should be regarded as premium channels. To date, the OFT has identified only live English Football Association Premier League (FAPL) matches as falling into this category. The OFT has stated:

"The Director concludes that FAPL football will only be broadcast live on a premium sports channel."

Accordingly, a subscription channel on which live FAPL football is broadcast would be considered to be a premium channel.

The OFT has also indicated that it considers a subscription channel that broadcasts successful films (measured in terms of their box office receipts and/or video and DVD rental receipts) in the "pay television window" to be a premium subscription channel. The OFT has stated:

"The Director considers that the presence of a "pay television" window, first run Category A and Category B films (i.e. not yet available on free-to-air channels) differentiates premium film channels from other TV services..."

Accordingly, a subscription channel on which such films are broadcast would be considered to be a premium channel. This approach is not exhaustive, and it may well be the case that other content could be regarded as identifying a premium subscription channel.

#### ***PPV services: live broadcasts***

The charges set out above for PPV buys apply to the broadcast of non-live programming, such as films. The indicative charges for the broadcast of live events, including sports, concerts and so on, on a PPV basis to residential viewers are as follows:

- 0 - 25,000 buys:  $20\% \times R \times B$
- 25,001 - 100,000 buys:  $25\% \times R \times B$
- over 100,000 buys:  $30\% \times R \times B$

Where R = retail price for viewing the event (excluding VAT); and B = the number of buys between the thresholds of each range (inclusive).

Charges are cumulative, so that, for example the broadcaster of an event attracting 120,000 buys at an ex-VAT charge of £5 would pay a CA charge of £148,750, calculated as follows:

$$(20\% \times £5 \times 25,000) + (25\% \times £5 \times 75,000) + (30\% \times £5 \times 20,000)$$

Where a PPV broadcaster retails a series of linked programmes/events for a single price (for example, a home and away leg of a football competition), SSSL will charge for each of the programmes/events in the series that is viewed by the customer as a separate programme/event in accordance with the indicative charges set out above. This reflects the nature of the PPV CA service being delivered, which is based on individual decisions by the customer to 'select' and 'view' a particular programme/event.

#### ***Commercial premises***

With regard to the different categories of broadcaster to viewers in commercial premises, it is not currently possible for SSSL to set out a series of indicative charges. SSSL will therefore negotiate such charges on an individual basis according to the types of services that the retailer concerned is proposing to broadcast for reception in commercial premises (for example, business to business, sports PPV etc.)

#### ***Other reasons for differences in charges***

It is important to note that these charges should only be treated as indicative, as differences in

actual charges will arise due, among other things, to:

- objectively justifiable differences between broadcasters within the same category;
- the date at which a broadcaster enters into a CA agreement (see below); and
- different requirements (whether technical, commercial or otherwise) in respect of the service supplied to different broadcasters.

In addition, it is important to note that these indicative charges are quoted on a variable basis. There is scope for broadcasters to enter into a range of risk sharing arrangements with SSSL. For example, while one broadcaster might prefer to operate on a wholly variable basis, paying by the month for actual customers, another might prefer to enter into a longer term arrangement and agree to pay a fixed sum per annum which would be calculated by reference to projected customer numbers. In the latter case, any change in the risk borne by SSSL could be reflected in the actual charges.

### **Future Variations**

Although SSSL's charges are based on forecasts utilising the best available information, it is in the nature of forecasts that they are unlikely to be wholly accurate. SSSL will reconsider its charges periodically in light of new information. Accordingly, it should be stressed that these indicative charges are not being set once and for all.

This reconsideration of charges could result in two otherwise comparable broadcasters paying different charges at the same time. Guidance from Oftel indicates that Oftel would not consider this to be discriminatory as the key issue is to ensure that comparable terms are offered to comparable broadcasters in respect of comparable services at a comparable time.

This reconsideration of charges should, however, not affect extant commercial arrangements. Thus, SSSL does not intend to revisit long term deals with broadcasters if actual events lead to under recovery. Similarly, Oftel's guidance has made clear that SSSL's charges will not be retrospectively affected in the event that the development of the DSat platform exceeds forecasts.

### **August 2003**