Movies market definition and market power appendices

Annex 5 to Pay TV Statement

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

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Appendix 1

Overview of this annex

Introduction

1.1 In this annex we set out the following discrete appendices that provide further detail on our assessment of market definition and market power in relation to premium movies.

- Appendix 2: Extent of substitutability with other means of watching movies.
- Appendix 3: Further details on our calculation of movies market shares.
- Appendix 4: The staggered expiry of Sky's contracts with the major Hollywood studios.

1.2 These appendices deal with topics that only relate to our assessment of movies. In addition, some of the material presented in the appendices to Annex 4, which primarily relates to sports, also applies here, namely:

- Appendix 3: Approach towards carrying out market definition for bundles.
- Appendix 6: Relevance of previous market definition findings.
- Appendix 7: The concept of entry barriers.
- Appendix 8: Factors explaining Sky's success when bidding for rights.
- Appendix 9: Other entry barriers mentioned by consultation respondents.
- Appendix 12: Position at the retail level if wholesale market power was not exercised.

Appendix 2

Extent of substitutability with other means of watching movies

Introduction

2.1 In Section 6, our focus is on assessing the constraint of four potential substitutes to Sky Movies: movies on retail DVDs; FTA movie channels and movies on other FTA and basic channels; non-movies content on television; and SVoD in the pay TV window. In this Appendix, we set out our assessment of other potential substitutes:

- Cinema.
- Online DVD rental.
- OTC (over-the-counter) DVD rental.
- Movie Downloads.
- PPV.
- SVoD after the first pay TV window.
- Disney Cinemagic.

Cinema

2.2 In our Third Pay TV Consultation, we said that cinema is different from pay TV in that it does not involve the provision of a wide range of films at home and is not free at the point of consumption[1]. We consider that these differences between cinema and pay TV are much more marked than those between cinema and, for example, DVD retail.

2.3 Cinema viewing is a qualitatively different **format** from subscription to a pay TV service. It is a communal event which takes place outside the viewer's home. In our view, the cinema is more of an 'event' or a 'night out' for consumers and is very different in nature from watching films at home. Cinema has a **timing** advantage over pay TV, in that movies appear in cinemas around 12 months before they appear on pay TV. However, the **price** of going to the cinema is markedly higher (particularly as each individual has to buy a ticket, unlike pay TV which is available to the whole household for a single subscription). The average UK cinema ticket price was £5.20 in 2008[2], so a household of three would pay over £30 to watch two movies a month. This is considerably more expensive than the £16 per month implied premium for Sky Dual Movies over basic on Sky's DSat platform (see Figure 22 in Section 4). Cinema is not usually paid for by subscription.

2.4 At any one time, a smaller **quantity** of films is available at the cinema than on Sky Movies. During the course of a week, Sky Movies shows a much wider range of

[1] Third Pay TV Consultation, paragraph 4.394.
[2] Source: Screen Digest from CAA/Nielsen EDI. See http://www.cinemauk.org.uk/ukcinemasector/ukcinema-industryeconomics/averageukticketprices/

films than are available at the cinema[3]. Also, Sky Movies includes ‘made for TV’ and “straight to DVD” releases. However, cinema can match the **quality** of the most important content on Sky Movies.

2.5 **[✂]**[4]**[✂]**

2.6 We recognise that the cinema is an attractive way of watching films for movie fans – both subscribers and non-subscribers to Sky Movies and that the higher price per film is reflected in the superior timing (and a bigger screen). However, we consider that the availability of movies in the cinema is unlikely to be seen by many current or potential Sky Movies subscribers as a close substitute. Respondents to our 2009 survey (Figure 79 in Section 6 of the main document) did not mention cinema as reason for not subscribing to Sky Movies.

Online DVD movie rental

2.7 Online DVD rental typically involves paying a monthly subscription in return for DVDs delivered by post. Typically, subscribers get to keep DVDs for as long as they like, but must return them to receive new ones. An example of such a service is Lovefilm. These services offer a number of packages that usually vary in terms of the number of DVDs posted per month (including unlimited packages) and the number of DVDs that consumers can keep at any one time.

2.8 In our Third Pay TV Consultation, we noted that online DVD rental services seemed to be growing at the expense of over-the-counter rentals and that the evidence did not suggest a strong degree of substitution between Sky Movies and DVD rentals[5]. We said that online DVD rental offers the same certainty of a fixed monthly subscription as pay TV, as well as a convenient means of choosing films[6]. However it does not provide the same degree of convenience as a pay TV service, since no matter how straightforward the ordering process, a consumer cannot view a movie until it has been delivered in the post. Consumers therefore need to be willing to plan their viewing several days in advance to be able to make effective use of such a service.

Representations on online DVD movie rental

2.9 Sky stated that it faces strong constraints from other means of watching movies including DVD rental services[7]. Sky noted that Figure 27 of the Third Pay TV consultation aggregates all movies on television and thus does not provide adequate information about the extent to which Sky Movies is substitutable with online DVD rental[8].

[3] The quantity of films available in a cinema is limited by the number of screens that it has (although cinemas can use the same screen to show different films at different times of the day). In 2006, there were 783 cinemas with an average of 4.6 screens each. Of these, 252 were multiplexes (defined as a site with 5 or more screens). Multiplexes had an average of 10 screens each. First Pay TV Consultation, annex 11, paragraphs 58-59.

[4] **[✂]**

[5] Third pay TV consultation, paragraph 4.338.

[6] Third pay TV consultation, paragraph 4.341.

[7] Sky response to Third Pay TV Consultation, paragraphs 5.28-5.29.

[8] October 2009 Sky Submission, paragraphs A2.54-A2.55.

Ofcom's view of online DVD movie rental

Our assessment of the characteristics of online DVD movie rental

2.10 Most, if not all, of the movies shown on Sky Movies at any given time are available on DVD along with many other movies. Online DVD rental services offer access to this very large range of films. So online DVD rental matches Sky Movies for **quality**, and exceeds it in **quantity**.

2.11 Online DVD rental is more attractive than Sky Movies in terms of **timing**. Online DVD rental subscribers can rent movies in the DVD window, so they can watch them before the movies are on Sky Movies.

2.12 Online DVD rental operates on a subscription basis and so has a similar price structure to Sky Dual Movies. However, it requires movies to be pre-ordered, delivered and returned. For many movie fans, the inconvenience of this is likely to outweigh the advantage of seeing more recent films. On balance, we consider online DVD rental a less attractive **format** than Sky Movies.

2.13 The BVA estimated that the average **price** per transaction was £2.40 in 2008[9]. Lovefilm offers 2 DVD rentals per month for £3.99 per month and an "unlimited" number of DVDs for £12.99 per month, which are both less than the incremental price of standalone Sky Dual Movies[10]. As such, the price of online DVD rental is relatively attractive for most standalone Sky Dual Movies subscribers[11]. However, subscribers who buy Sky Dual Movies as a cheap-add on to Sky Dual Sports will find the price of online DVD rental less attractive than Sky Dual Movies.

Our assessment of other evidence on online DVD movie rental

2.14 We considered changes in the total audience for DVD rentals, which we found to have declined over time[12]. We observed that the rise in the value of DVD rental subscription packages was at the expense of over-the-counter rentals and, when read in conjunction with Figure 81[13], does not appear to suggest a strong degree of substitution between Sky Movies and DVD rentals[14].

2.15 **[✂]**[15]**[✂]**

Our conclusions on online DVD movie rental

2.16 In our judgement, the difference in format (i.e. having to pre-order movies) outweighs the attractive characteristics of a potentially lower price, greater quantity and more recent movies. We have placed little weight on the lower price of online DVD rental services given the risk of the cellophane fallacy. We conclude that online DVD rentals are a moderate substitute to Sky's linear movies channels (i.e. outside the relevant market but still capable of exerting a constraint).

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[9] BVA Yearbook 2009, page 80.

[10] Source: http://www.lovefilm.com/dvd-rental/ (viewed on 16 March 2010)

[11] Only those subscribers who watch more movies than online DVD rental services could deliver in a month may find the price of online DVD rental services less attractive.

[12] Third Pay TV Consultation, paragraph 4.345 and Figure 35.

[13] An modified version of Figure 27 in our Third Pay TV Consultation.

[14] Third Pay TV Consultation, paragraph 4.338 and Figure 35; also paragraph 4.398, 4.400.

[15] **[✂]**

OTC DVD rental

2.17 OTC DVD rental typically involves obtaining a film from a rental shop and returning it within a few days.

2.18 In our Third Pay TV Consultation, we said that OTC DVD rental by comparison with pay TV provides a similarly wide choice of films, to be viewed on a one-off basis. However, these rental services do not share other product characteristics with Sky Movies packages, such as the convenience with which films can be chosen, and the certainty of a fixed monthly subscription[16]. We noted that online DVD rental services seemed to be growing at the expense of over-the-counter rentals and that the evidence did not suggest a strong degree of substitution between Sky Movies and DVD rentals[17].

Representations on OTC DVD rental

2.19 Sky stated that it faces strong constraints from other means of watching movies including rental services[18]. Sky noted that Figure 27 of the Third Pay TV consultation aggregates all movies on television and thus does not provide adequate information about the extent to which Sky Movies is substitutable with OTC DVD rental[19].

Ofcom's view of OTC DVD movie rental

Our assessment of the characteristics of OTC DVD movie rental

2.20 Most, if not all, of the movies shown on Sky Movies at any given time are available on DVD along with many other movies. OTC DVD rental services offer access to a relatively large number of DVDs. So OTC DVD rental matches Sky Movies for **quality**, and exceeds it in **quantity**.

2.21 OTC DVD rental is also more attractive than Sky Movies in terms of **timing**. This is because movies are available in the DVD window before they are on Sky Movies.

2.22 OTC DVD rental requires consumers to visit the rental store to both collect and return the film. In the Second Pay TV Consultaton we noted that the "convenience of not going to the DVD shop" was "must have" for 28% of marginal consumers[20]. OTC DVD rental is also not widely available on a subscription basis (paying for movies on a monthly basis was "must have" for 30% of marginal consumers[21]). The **format** of OTC DVD rental is therefore less attractive than Sky Movies.

2.23 Headline prices for renting a new release DVD are around £3.75[22], although this does not reflect special offers such as reduced prices for renting multiple titles or renting for multiple nights. The BVA estimated that the average OTC rental price in 2008 was £3.10[23]. Sky Dual Movies subscribers who watch many movies per month and/or buy it as a cheap add-on to Sky Dual Sports may find the **price** of

[16] Third Pay TV Consultation, paragraph 4.339.
[17] Third Pay TV Consultation, paragraph 4.338.
[18] Sky response dated September 2009 to Third Pay TV Consultation, paragraphs 5.28-5.29.
[19] October 2009 Sky Submission, paragraphs A2.54-A2.55.
[20] See Figure 24 in Annex 6 of the Second Pay TV Consultation.
[21] See Figure 24 in Annex 6 of the Second Pay TV Consultation.
[22] Source: British Video Association Yearbook 2009 page 80.

[23] BVA Yearbook 2009, page 80.

OTC DVD rental less attractive compared to Sky Dual Movies. Other Sky Dual Movies subscribers may find the price of OTC DVD rental more attractive than Sky Dual Movies.

Our assessment of the other evidence on OTC DVD rental

2.24 **[✂]**[24]**[✂]**

Our conclusions on OTC DVD rental

2.25 While we recognise that there is a degree of substitutability between OTC DVD rental and Sky Movies, we consider that, as with retail DVDs, the relative inconvenience of renting DVDs is likely to limit the degree of substitutability, particularly for frequent viewers of recent movies on Sky Movies. As such, we do not consider OTC DVD rental to be a close substitute, although it is likely to be a moderate substitute (i.e. outside the relevant market but still capable of exerting a constraint).

Movie downloads

2.26 The internet offers consumers a wide range of content that can be accessed relatively easily and viewed at their convenience. Movies are available for downloads either legally or illegally. Legal movie downloads can be downloaded for free (e.g. FTA broadcasters' websites) or at a price. This category thus encompasses a heterogeneous range of services.

2.27 We have not assessed it by reference to the five characteristics set out in Section 6 of the main document, partly because of its heterogeneity and partly because the volumes of movies downloaded by Sky subscribers are relatively low. In April/May 2008, we commissioned a survey to understand the current level of consumption of content delivered via the internet. Our survey indicated that relatively few consumers currently download content, and that the constraint is therefore relatively weak. For example, only 13% of respondents with access to the internet and that subscribed to Sky Sports and/or Sky Movies had downloaded content from the internet in the last month[25]. Moreover, of these respondents, only a minority had downloaded or streamed movies over the internet[26].

Legal movie downloads

2.28 **[✂]**[27]**[✂]**

2.29 On the other hand, we noted that Sky's decision to invest in offering content over broadband (and to renegotiate rights contracts where necessary[28]) could be a competitive response to the potential for increasing demand for downloading movie content, which would support the view that downloading content could become a more important competitive constraint.

[24] **[✂]**
[25] Source: Ofcom online content omnibus survey April/May 2008. Presented in Figure 48 of Annex 10 of the Second Pay TV Consultation.
[26] Second Pay TV Consultation, annex 10, figure 52.
[27] Annex 21 Sky response to Ofcom request for information of 29th May.

[28] See for example Sky response to First Pay TV Consultation, Annex 2, paragraph 3.135.

2.30 **[✂]**[29]**[✂]**[30]**[✂]**[31]

2.31 In Sky's response to our Third Pay TV Consultation[32], it stated in relation to downloading films that given Ofcom's analysis is intended to be forward looking, services that "may become a more important factor" in the future should be considered carefully by Ofcom, rather than being dismissed in a sentence.

2.32 While our analysis shows that the current indirect constraint is relatively weak, we consider that downloading content could be a significant constraint in the future as the popularity of downloads increases and capacity to download grows. The scale of the constraint is likely to grow as more homes have broadband internet connections and the average connection speed increases. It may also grow if it becomes easier for viewers to watch content on their TV screens rather than on a computer.

Illegal Downloads

2.33 We also considered the impact of illegal file downloading using file sharing applications such as BitTorrent as a constraint on providers of premium movie channels. **[✂]**[33]**[✂]**[34]

2.34 In our Third Pay TV Consultation, we quoted a study[35] which found that 4% of the UK population had illegally downloaded content from the internet in the last month. However, around half (48%) of these were students (either at school or in further education), who are relatively unlikely to subscribe to premium pay TV channels. From these figures, it appears likely that only a small proportion of actual or potential premium channel subscribers engage in illegal downloading.

2.35 Given the relatively small numbers of subscribers who are likely to have illegally downloaded content, we did not consider that constraint it posed was likely to be strong. Furthermore, as rights holders take action to protect their copyright[36], we consider the constraint is likely to weaken over time.

Our conclusions on legal and illegal downloads

2.36 As in the Third Pay TV Consultation, we consider that the current constraint from legally downloading content from the internet is weak, but may grow over time. However, as our market share analysis is forward-looking, potential growth in legal movie downloads is relevant. Legal downloads also have similarities with DVD sales, VoD and DVD rental. They can either be on a download to own basis or a download to rent basis (the former having some similarities with DVD sales and the

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[29] **[✂]**
[30] **[✂]**
[31] **[✂]**
[32] Sky's October 2009 response, footnote 63.
[33] **[✂]**
[34] **[✂]**
[35] British Video Association Yearbook 2008, page 112. The study found that 8.1 million people or 17% of the population had downloaded content in the last month, of which a quarter (or just over 4% of the population) had downloaded content illegally.

[36] For example the BPI, the British Film Industry, major internet service providers (ISPs) and government have signed a memorandum of understanding which aims to significantly reduce the amount of illegal file sharing in the next three years (see Third Pay TV Consultation, footnote 252)

latter having similarities with VoD and DVD rental). We consider legal movie downloads to be a moderate substitute (i.e. outside the relevant market but still capable of exerting some degree of constraint). The strength of this constraint may grow over time as downloads can more easily be viewed on a TV rather than a computer – although this would effectively make downloads equivalent to VoD services. As explained below, we consider that PPV VoD services are also a moderate substitute for Sky Movies, but SVoD services for films in the first pay TV window are likely to be a close substitute.

2.37 Users of illegal downloads are typically students, who are unlikely to subscribe to Sky Movies anyway. As in our Third Pay TV Consultation, we do not consider that this constraint is strong.

Pay Per View (PPV) through a television service

2.38 A number of TV retailers including Virgin Media, Sky, Tiscali / TalkTalk and BT Vision offer PPV[37] movies via VoD, allowing consumers a convenient way to access new movies. 'True' VoD[38] is possible on Virgin's cable network and Tiscali / TalkTalk's and BT's IP networks. Sky's DSat service provides 'Near' VoD[39]. The two largest TV VoD services by revenue are Sky Box Office and FilmFlex via Virgin Media as shown in Figure 1 below.

Figure 1 2008 TV VoD revenue split

[✂]

2.39 In 2008, Sky offered around 400 PPV movies (including HD) priced at £3.99 per movie. Sky's service has films from all major Hollywood studios and is available to 8.8 million satellite subscribers. Its films can be stored on PVRs.[40] However, only a few films are available at any one time.[41]

2.40 In 2008, FilmFlex via Virgin Media had around 500 films. New releases were priced between £2.50 and £3.50 and library titles were priced between 50p and £2. It offered films from all major Hollywood studios except Fox, and was available to 3.6 million cable subscribers[40]. FilmFlex offers more films at any one time than Sky Box Office via DSat.

2.41 Though these services are available to many households, take-up is relatively limited. In 2008, movie studios earned around **[✂]** from the rights to Sky and Virgin's PPV on-demand services compared to **[✂]** for the linear pay TV rights[42,43].

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[37] Most services (e.g. Filmflex via Virgin Media) allow the viewer to watch a film as many times as they want during a short rental period (e.g. a day). It is therefore not strictly Pay-per view.

[38] 'True' VoD means consumers can get instant access to the film of their choice.

[39] 'Near' VoD (nVoD) refers to a multiple linear channels that broadcast the same content at staggered start times.

[40] Page 106 of Film Council 2009 Statistical Year Book

[41] On page 8 of Sky's 2008 Annual Report, it states that the "Sky Box Office service currently offers our DTH subscribers over 50 screens of television premieres of movies and occasional live sports and other special events on a pay-per-view basis."

[42] Source: Virgin Media response dated 8 April 2009 to question 12 of Ofcom's information request dated 24 March 2009; Sky response on 22 December 2008 to question 15 of Ofcom's information

2.42 In our Third Pay TV Consultation, we noted that there is some evidence that premium movies on PPV may be substitutable for linear channels carrying premium movies[44], but that the data should be interpreted cautiously[45]. We considered VoD likely to be a less close substitute for Sky Movies than a subscription service (we discuss SVoD movies separately)[46].

Representations on PPV movies

2.43 Sky stated that it faces strong constraints from other means of watching movies including PPV services[47]. Sky said that the retail market definition section of the Third Pay TV Consultation failed to consider the constraint exerted by VoD services[48]. It also argued that having acknowledged some potential for substitution we ought to have included PPV in the market and said that the data we considered related not to the launch of a PPV service but the replacement of an nVoD service with a true VoD service.[49]

Ofcom's assessment of PPV movies

<u>Our assessment of the characteristics of PPV movies</u>

2.44 Consumers can access PPV via their TV remote control as is the case with Sky Movies, although consumers can watch a PPV film at any time. In this respect its **format** is better than Sky Movies. However, it is not available on a subscription basis. As discussed below, many Sky Movies customers are likely to see this as a drawback.

2.45 In terms of **timing**, PPV is more attractive than Sky Movies. Some of the movies on PPV are more recent than those on Sky Movies due to the PPV window being earlier than the Pay TV window. The **price** of PPV movies varies depending on the service the consumer accesses (e.g. Sky Box Office or Virgin's Film Flex) and which films the consumer watches. As set out in paragraphs 2.39 to 2.40 above, prices are as low as 50p for some library movies, but can rise to £3.99 for recent films on Sky Box Office. Sky Dual Movies subscribers who watch many movies per month and/or buy it as a cheap add-on to Sky Dual Sports may find the price of PPV movies less attractive compared to Sky Dual Movies. Other Sky Movies subscribers may find the price of PPV more attractive than Sky Dual Movies.

2.46 As PPV services show many of the same films as Sky Dual Movies and have deals with most of the major Hollywood studios the **quality** of the films on offer are similar to those on Sky Movies. The **quantity** of films varies by PPV service. In any given week, Sky Box Office shows fewer films than Sky Movies, while Film Flex has more films (500).

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request dated 12 November 2008, spreadsheet entitled "December Annex 5", cell B84 on sheet Q15 c) II.

[43] Source: Transmission and revenue return for BSkyB 1 January – 31 December 2008.

[44] Third Pay TV Consultation, paragraph 4.330.

[45] Third Pay TV Consultation, paragraph 4.329.

[46] Third Pay TV Consultation, paragraph 4.330.

[47] Sky response to Third Pay TV Consultation, paragraphs 5.28-5.29.

[48] October 2009 Sky Submission, paragraph 37.

[49] October 2009 Sky Submission, paragraphs A2.44-A2.46.

Other evidence

2.47 The characteristics evidence suggests PPV movies are similar to Sky Movies: PPV's less attractive format is counteracted by the attractive characteristic of having more recent movies. Further, **[✂]**[50]. This evidence suggests that there is a degree of substitutability between PPV movies and the Sky Movies channels.

2.48 However in the Second Pay TV Consultation we relied upon Virgin Media research into preferences of subscribers who were interested in a subscription Virgin Movies channel[51]. This research asked which features of the proposed service were 'key drivers of interest'. **[✂]**[52].

2.49 This evidence is reinforced by the amounts paid for the rights to PPV movies. In 2008, movie studios earned around £**[✂]**[53] from the rights to Sky and Virgin's PPV on-demand services compared to £**[✂]** for the linear pay TV rights[54]. This is despite the strong growth in PPV services in recent years[55]. The value of linear TV services to movie studios is **[✂]** than the value of PPV services. The scale of the difference in the value of the rights suggests that pay TV retailers regard PPV services as markedly less attractive than linear movie channels. We thus consider that PPV movies are a moderate constraint on Sky Movies (i.e. outside the relevant market but still capable of exerting a reasonable constraint).

The BBC Trust's consultation on Project Canvas

2.50 "Project Canvas" is a proposed joint venture involving (among others) the BBC to define and promote a standards based open environment for internet-connected television devices. The aim is to make these standards openly available to device manufacturers, ISPs and content providers to drive the development of new set top boxes and other devices and services that make available linear broadcasts, on-demand audiovisual content and other internet content via television sets.

2.51 Sky referred to a BBC Trust consultation on Project Canvas[56] (the "Canvas MIA")[57]. The Canvas MIA "assumed Canvas will likely result in the creation of a new platform which will distribute the same linear TV content as Freeview as well as providing another method of delivering nonlinear TV content"[58]. Sky stated that a "key finding" in the Canvas MIA was that it would reduce the revenues of pay TV

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[50] Sky response to information request received 13/11/09, question 5, annex 5, and Sky response to information request received 14/12/09 question 28, annex 2

[51] Second Pay TV Consultation, paragraph 4.194.

[52] Virgin Media response to Ofcom information request of 15 May 2007 tab 1.

[53] Source: Virgin Media response dated 8 April 2009 to question 12 of Ofcom's information request dated 24 March 2009; Sky response on 22 December 2008 to question 15 of Ofcom's information request dated 12 November 2008, spreadsheet entitled "December Annex 5", cell B84 on sheet Q15 c) II.

[54] Source: Transmission and revenue return for BSkyB 1 January – 31 December 2008.

[55] In 2008, the estimated value of PPV movies via TV VoD was £120m (Source: UK Film Council Statistical Yearbook 2009, table 14.1 on page 109). In 2005, this was £57m. We take this growth into account in our market power analysis by considering future shares of supply.

[56] Project Canvas is a proposed joint venture involving (amongst others) the BBC to define and promote a standards-based open environment for internet-connected television devices. The aim is to make these standards openly available to device manufacturers, ISPs and content providers to drive the development of new set top boxes and other devices and services that make available linear broadcasts, on-demand audiovisual content and other internet content via television sets.

[57] *Canvas: Market Impact Assessment*, BBC Trust, 22 December 2009. This document is available at http://www.bbc.co.uk/bbctrust/assets/files/pdf/consult/canvas/prov_conclusions/mia.pdf

[58] Canvas MIA, paragraph 3.21; footnotes omitted.

suppliers by £127m-£450m in the period up until 2015[59]. Sky considered that the BBC Trust's position was "entirely inconsistent" with the analysis of retail competition in the Third Pay TV Consultation[60].

2.52 The Canvas MIA estimated that there is a "modest negative impact on the future growth of non DTT based subscription platforms …"[61]. However it is important to recognise that the figures quoted by Sky reflect the impact on all pay TV subscribers, not just subscribers to Sky Movies. In fact the Canvas MIA argues that Sky Movies (and Sky Sports) subscribers are unlikely to switch away from these channels:

- "A key constraint on the potential negative impact of Canvas on Sky and Virgin is the proportion of pay TV subscribers who consume premium content. … Premium content on DTT is still very limited"[62].

- "What is clear is that a significant proportion of both Sky and Virgin's customer base subscribe to these platforms to obtain premium content which is not available on the DTT platform"[63]. "Canvas does not directly impact [sic] and therefore it is a reasonable hypothesis that subscribers to premium channels on either Sky or Virgin will continue have a very low propensity to churn from DTH to DTT"[64].

- "The margin impact [on Sky and Virgin Media] … is likely to be low. Most lost subscribers are likely to have a lower-than-average propensity to upgrade to premium channels or other higher value services"[65].

2.53 Thus, rather than being inconsistent with the position in the Canvas MIA, we consider that our view that there are no close substitutes for Sky Movies is in fact supported by that document.

Our conclusions on PPV through a television service

2.54 As explained above, the characteristics of PPV movies are similar to those of Sky Movies. We consider that the scale of the difference in the value of the rights suggests that pay TV retailers regard PPV services as markedly less attractive than linear movie channels (see paragraph 2.49 above). We thus consider that PPV movies are a moderate constraint on Sky Movies (i.e. outside the relevant market but still capable of exerting a reasonable constraint).

Subscription VoD (SVoD) after the first pay TV window

2.55 Sky's SVoD service shows movies in the pay TV window; clearly this will not constrain Sky's prices as it is controlled by Sky. We discuss this service further in paragraph 6.211 to 6.221 in the main document. Other SVoD services, including Lovefilm and Picture Box, only show films after the first pay TV window.

[59] Sky January 2010 Submission, paragraph 7.4. This cited the Canvas MIA, paragraph 2.36.
[60] Sky January 2010 Submission, paragraph 7.5.
[61] Canvas MIA, paragraph 1.13.
[62] Canvas MIA, paragraph 8.131.
[63] Canvas MIA, paragraph 8.133.
[64] Canvas MIA, paragraph 8.134. Similarly paragraph 2.148 stated that "the Canvas proposition will not significantly erode the competitive advantage of platforms using the satellite or cable methods due to the greater breadth of content that they will continue to be able to offer".
[65] Canvas MIA, paragraph 8.8.

2.56 Lovefilm streams films over the internet through a web browser as an SVoD service which is part of its “Unlimited” online DVD rental plans, from £9.99 per month (1 disc at a time) to £15.99 per month (3 discs at a time). In 2010, it had 1,024 films/features in its catalogue[66].

2.57 In 2009, Picture Box offered a narrow selection of ‘recent’ movies and a broad library selection from NBC Universal on SVoD. ‘Recent’ movies form a second pay TV window, which is immediately after the first pay TV window and prior to the FTA/library window. Subscription is on a monthly basis and can be purchased on a standalone basis or tied into a TV bundle. Subscribers are able to choose from a rolling selection of 28 titles (or more depending on platform) available every month. New titles are then added weekly or daily also dependant on platform. Movies can be watched over several sittings. Picturebox offers a film subscription service for a narrower range of older films on the Tiscali / TalkTalk, DTT and BT Vision platforms. It has about **[✂]** subscribers on TUTV and Tiscali / TalkTalk[67], less than **[✂]** % of Sky Movies’ subscriber base.

2.58 On the TUTV platform there are over 28 titles available every month; however films are refreshed daily rather than weekly. Seven films are made available to view at any one time. In 2009, TUTV’s service was available on a standalone basis at £7 per month.

2.59 Virgin Media’s SVoD shows a choice of 28 films at any given time, with 7 new films added every Friday. Most of these are available in HD. In 2009, this service cost an extra £5 per month as part of a Virgin TV package.

2.60 Tiscali / TalkTalk TV also offers 28 movies at any one time and new titles are refreshed weekly; however none are available in HD. In 2009, it cost an extra £5 per month on top of Tiscali / TalkTalk TV variety pack.

2.61 BT Vision also shows 28 films every month, with 7 new films added each Friday. In 2009, it cost BT Vision customers £4.89 per month as a standalone service.

Our assessment of SVoD movies after the first pay TV window

2.62 In the Third Pay TV Consultation we said that library films were not a substitute for consumers[68].

2.63 Clearly SVoD movie services after the first pay TV window are less attractive than Sky Movies in terms of **timing**, as they show films after Sky Movies has shown them. SVoD movie services after the first pay TV window show a smaller **quantity** of films than Sky Movies and their **prices** are lower than Sky Movies. However, they do show some of the same films, so the **quality** of films on offer is similar.

2.64 Picture Box’s **format** is similar in most aspects to Sky Movies, except that it offers movies on demand. Other SVoD services after the first pay TV window are only available through a PC so we consider their format less attractive than Sky Movies.

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[66] Source: http://www.lovefilm.com (as viewed on 22 January 2010)

[67] It is now also retailed on BT Vision. Source: **[✂]** emails to Ofcom 29 June 2008 from Michael Rhodes and Michael Barford.

[68] Third Pay TV Consultation, paragraph 4.365; see also paragraph 4.361.

2.65 **[✂]**[69]**[✂]**

Our conclusion on SVoD movies after the first pay TV window

2.66 SVoD services after the first pay TV window (e.g. Lovefilm and Picturebox) are distant substitutes to Sky Movies. In our judgement, their less attractive characteristics, specifically the older films that they show and the smaller range on offer, outweigh the attractive characteristics of a lower price and SVoD format. This is reflected in the number of subscribers to these services.

Disney Cinemagic

2.67 Disney Cinemagic is the only other channel that shows films from the 'first pay TV window' from a Major Hollywood studio as it shows a limited number of Disney's animated films alongside a range of children's and family-based programming. It is included within the Sky Dual Movies bundle on Sky's DSat platform or is available as a standalone channel on Virgin Media or Sky. In the Third Pay TV Consultation we concluded that Disney Cinemagic lay within the relevant market[70]. Since that consultation we have carried out further analysis of the types of movies broadcast on Disney Cinemagic.

2.68 Disney Cinemagic shows movies of similar **quality** to Sky Movies, but a smaller **quantity**. In terms of **timing**, it shows very few first run movies. Over a 60 day period in 2009 we only found 3 movies on Disney Cinemagic that had a theatrical release and were one to two years old[71]. This low figure reflects the fact that it only shows animated movies in the pay TV window that are owned by Disney. Most of its content is 'made for TV' and older films. We therefore consider the timing of films on Disney Cinemagic in general to be less attractive than Sky Movies. As Disney Cinemagic is a movie channel it has the same **format** as Sky Movies. Disney Cinemagic as a standalone channel is available for £5 per month on Sky[72] or Virgin Media[73]. It is therefore available at a lower **price** than Sky Movies.

2.69 **[✂]**

Our conclusion on Disney Cinemagic

2.70 Disney Cinemagic has far fewer first run movies than Sky Movies. This limits the extent to which consumers would substitute to this channel and suggests that it is at most a moderate substitute (i.e. outside the relevant market, but still capable of exerting a reasonable constraint).

[69] **[✂]**
[70] Third Pay TV Consultation, paragraph 4.378.
[71] Ofcom calculations using http://www2.disney.co.uk/DisneyChannel/cinemagic/tvguide.html filtered by "Films"
[72] http://www.sky.com/shop/tv/standalone-channels/disney-cinemagic/ (viewed on 09 March 2010)
[73] http://allyours.virginmedia.com/html/tv/kids-channels.html (viewed on 09 March 2010)

Appendix 3

Further details on our calculation of movies market shares

Introduction

3.1 This Appendix provides further details on our approach to calculating wholesale market shares, which takes into account the constraint exerted by moderate substitutes.

3.2 The underlying data used to calculate these market shares is set out in a confidential spreadsheet. Our calculations are based on retail revenues. However, retail revenues are not directly attributable to some broadcasters of movies, so we have calculated their shares based on a comparison of spending on movie rights.

3.3 We have calculated shares for the following based on retail revenues.

- **Sky's wholesale revenue:** We use Oxera's[74] 'preference-based' estimates of Sky Movies wholesale revenue. This includes revenues from the self-supply of Sky Movies to Sky's retail arm when calculating market shares[75].

- **Pay TV DVD retail:** In 2008, the total value of retail DVD sales of movies was £1,454m[76]. However this figure includes DVD sales when films are outside the pay TV window. We obtained data on DVDs released between August 2007 and October 2007 and, for these DVDs, approximately 17% of sales occurred during the pay TV window[77].Accordingly we have assumed that 17% of total DVD sales in 2008 (i.e. £247m) is attributable to DVDs within the pay TV window.

- **PPV movies:** Sky, Virgin Media, BT Vision, TUTV and Tiscali / TalkTalk TV retail PPV movies. We have used the retail revenues these companies earn from supplying PPV movies.

- **DVD rental subscription packages:** The value of online DVD rental services in 2008 was estimated as £92m[78].

- **Disney Cinemagic:** Disney provided us with details of the amount of wholesale revenue that it earned in 2009 from the supply of Disney Cinemagic in the UK[79].

[74] Oxera's report is in Annex 9 of our Third Pay TV Consultation
[75] The wholesale revenues of Sky proxy the attractiveness of its Sky Movies channels (since they reflect the number of people choosing to subscribe to such channels multiplied by a wholesale measure of their willingness to pay). Thus, as in the case of Core Premium Sports channels, it is appropriate to include revenues from self supply since otherwise a significant number of consumers that consider Sky Movies to be attractive would be omitted from our calculations.
[76] Statistical Yearbook 2009, UK Film Council, page 90.
[77] We do not have data on window associated with each particular film. Rather we assumed that the pay TV window began in month 9 and ended in month 20 for all DVDs (in this data set the month in which a DVD is first released is labelled "month 1"). Ofcom calculations based on data from The Official Chart Company.
[78] BVA Yearbook 2009, British Video Association, page 80.
[79] Disney response dated 22 January 2010 to information request dated 13 January 2010. This response did not include data for December 2009 so we uplifted the figures on a pro rata basis to generate an estimate for the entire year.

We have assumed that Disney also earned the same amount in the preceding year.

- **Legal movie downloads (to rent or own):** This is currently a nascent sector. In 2008, the estimated value of online PPV/VoD movies was £7m[80].

3.4 While some FTA broadcasters earn advertising revenues, others (notably BBC) do not. We derived market share figures for FTA and basic-tier broadcasters by calculating their spend on movie rights, compared in particular to Sky's, and applying an uplift to this spend as a proxy for retail revenues. Further details are set out in the confidential market share spreadsheet.

[80] BVA Yearbook 2009, British Video Association, page 97.

Appendix 4

The staggered expiry of Sky's contracts with the major Hollywood studios

Introduction

4.1 At paragraphs 6.309 to 6.319 of the main document, we explain why we consider that Sky is likely to win the majority of the Movie Rights in the future. Given Sky's history of success in bidding for these rights, we do not consider that it is necessary for us to conclude on which factors explain Sky's strong bidding position. Consultation respondents have not suggested that there is likely to be a material strengthening in the position of rival bidders in the future. However we have identified a number of factors that contribute to Sky's advantage over rival bidders:

- The delay that a new entrant would face in building a subscriber base.
- The efficiency advantages that may flow from bidders such as Sky being vertically integrated with pay TV retailers with a significant subscriber base.
- A range of bidder specific factors, including branding advantages in relation to movies coverage.
- The impact of the staggered expiry of Sky's contracts with the major Hollywood studios.

4.2 We consider that in aggregate these four factors are likely to contribute to Sky being likely to win the majority of the Movie Rights. The first three of these factors were discussed in Appendix 8 of Annex 4, since they also apply in the case of the Live PL Rights. Below we discuss the final one of these factors, namely the staggered expiry of Sky's contracts with the Major Hollywood studios.

Staggered expiry dates

4.3 The existing contracts licensing the Movie Rights to wholesale channel providers terminate at different times. In our First Pay TV Consultation (at Annex 13, paragraph 5.67) and in our Second Pay TV Consultation (at Annex 7, paragraphs 3.20-3.25) we considered whether the staggered availability of Movie Rights acted as a barrier to entry.

4.4 In paragraphs 2.57 to 2.58 of our Second Pay TV Consultation we explained why there are circumstances in which the staggered availability of rights could act as an entry barrier. This reasoning was not challenged and we thus continue to regard it as correct. We consider that the key issue is factual, namely: is there evidence that staggered availability of rights is in fact a barrier to entry?

4.5 A prerequisite for the staggered availability of rights to be an entry barrier is the existence of synergies between different rights that are sold at different times. We consider that there are two possible sources of synergy between Movie Rights from different suppliers:

- Competition dampening effects from combining substitutable rights.

- Potential benefits from having sufficient content to fill a pay TV channel.

4.6 In terms of the first synergy, we consider that the Movie Rights from different suppliers (i.e. from different Major Hollywood Studios) are substitutable[81]. By aggregating a significant volume of Movie Rights, a wholesale channel provider is able to dampen the competition that would otherwise exist at the wholesale level between competing Core Premium Movie channels. Dampening competition in this way is likely to enable the wholesale channel provider to extract greater rents from retailers and ultimately final consumers. Our market definition (i.e. that the supply of Core Premium Movies channels is a relevant market) suggests that, where a single wholesaler acquires a high proportion of the Movie Rights, this effect is material[82].

4.7 The second potential synergy is that a channel is more attractive to final consumers if it has a large volume of movies, for example because this reduces the number of repeats and ensures that there is sufficient regular, attractive content to fill the channel. Paragraph 3.21 of Annex 7 to our Second Pay TV Consultation discussed the minimum volume of rights needed to viably launch a Core Premium Movies channel. We consider that a broadcaster could viably enter the market with only a small amount of Movie Rights (as shown by Disney Cinemagic, which also broadcasts older films as well as non-movie content such as cartoons)[83]. However broadcasters with a small amount of Movie Rights will generate synergies by adding further Movie Rights.

- **[✂]**[84].
- **[✂]**[85]**[✂]**[86]

4.8 In its response to the Second Pay TV Consultation, Virgin Media argued that the rights of at least three studios would be required in order to assemble "an appealing package which could be marketed as a mid-priced alternative to Sky Movies" (paragraph 4.7). This is because "The movie rights available from a single studio simply do not provide the volumes required to create an appealing package. Depending on its size, a single studio might release in the region of 20 to 25 current movies per annum … of which … less than half will be significant titles for which there is a strong demand. A service which might only be able to offer less than one significant title a month is unlikely to attract significant subscribers" (paragraph 4.8). Further "movie rights from more than one studio [act] as a risk pooling measure because the success of studios in producing popular titles … will vary from year to year" (paragraph 4.10). This supports the view that there are synergies between Major Hollywood Studios' Movie Rights.

4.9 We consider that synergies exist between different suppliers' Movie Rights. Where the buyer currently has a significant amount of Movie Rights (as is the case with

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[81] In other words, we consider that the Major Hollywood Studios are competitors when they supply their Movie Rights.

[82] This is also consistent with our profitability analysis in section 6 of the main document in which we conclude that Sky's aggregate return is greater than its cost of capital and that its margin over direct costs is higher on Sky Movies than on Sky Sports.

[83] Similarly, in its response to the First Pay TV Consultation, Sky argued that evidence from the US shows that channels based on the Movie Rights of one or two Major Hollywood studios can be viable. Moreover, Sky argued that channels could combine movies with other content, such as sports, comedy, drama etc (e.g. HBO in the US).

[84] **[✂]**

[85] **[✂]**

[86] **[✂]**

Sky), the competition dampening effect is likely to be material. Where the buyer has few Movie Rights then adding further rights is likely to disproportionately increase the attractiveness of their channel.

4.10 This implies that a bidder which already has a small number of Movie Rights (from one or perhaps two Major Hollywood Studios) or a bidder with a large number of Movie Rights (say from four or five Major Hollywood Studios) generates more value from an additional set of Movie Rights than an entirely new entrant. This suggests that a putative new entrant (with no Movie Rights) may face difficulties in acquiring its first set of Movie Rights. However acquiring subsequent Movie Rights may be easier. This is supported by internal Virgin Media documents which state that a benefit of an agreement with **[✂]** is that it **[✂]**[87].

4.11 Having concluded that synergies exist between different Major Hollywood Studios' Movie Rights it is then necessary to consider whether the termination dates of their agreements to license their Movie Rights are sufficiently staggered that a new entrant would face a material disadvantage.

4.12 Figure 2 below shows the dates on which Sky's current contracts with the Major Hollywood Studios expire. The average gap between Major Hollywood studios' agreements with Sky expiring is **[✂]**(and obviously there is no guarantee that a rival bidder will win the next set of available rights, so in practice a new entrant may expect a longer delay in acquiring additional rights)[88].

Figure 2 Expiry dates of Sky's current contracts with the Major Hollywood Studios

[✂]

Sources: Sky response dated 13 May 2008 to question 1 of Ofcom's information request dated 20 December 2007 (as amended by Sky's letter of 6 August 2008 and Sky's letter of 19 February 2009).
[✂][89]
[✂]

4.13 In paragraph 3.23 of Annex 7 of our Second Pay TV Consultation we stated that **[✂]**. We observed that this would appear to give a new entrant a number of opportunities to acquire Movie Rights. However, new entrants have not taken advantage of this opportunity **[✂]**.

4.14 As noted in our Second Pay TV Consultation, it may be possible for a new entrant to reflect the synergies between different Major Hollywood Studios' Movie Rights through appropriate contractual terms. For example, a new entrant might reach an agreement with the first Major Hollywood Studio at a price that is conditional on acquiring the Movie Rights from a second Major Hollywood Studio. However since Sky has consistently won all the Movie Rights we have not observed such contractual provisions being used in practice and such arrangements would potentially be difficult to agree commercially.

4.15 In conclusion, we explicitly placed less weight on the staggered availability of Movie Rights in the Second Pay TV Consultation than in the First Pay TV Consultation. Nonetheless, the Second and Third Pay TV Consultations identified this as a

[87] **[✂]**
[88] The timing of negotiations between a Major Hollywood Studio and potential bidders is not fixed. For example, **[✂]**. This was over **[✂]** in advance of the expiry of Warner's then agreement with Sky (in **[✂]**). **[✂]**
[89] See the confidential to responses to Ofcom's Information request of May 2009 **[✂]**

material entry barrier (Third Pay TV Consultation, Annex 8, paragraph 2.271) and we maintain this position.