OFCOM PAY TV INVESTIGATION

ACCESS TO PREMIUM CONTENT

SECOND CONSULTATION

Response to second consultation from the FA Premier League

12 December 2008

Submitted by DLA Piper UK LLP

For and on behalf of the FA Premier League

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RESPONSE TO SECOND CONSULTATION DOCUMENT BY THE FA PREMIER LEAGUE

1. EXECUTIVE SUMMARY

1.1 The Consultation contains a number of conclusions that result from Ofcom's principal theory that there is a separate economic market for pay TV. Ofcom's view is that within that market, there are narrow economic markets for the wholesale supply of core premium content, namely sport and movies; and that core premium sport is defined as including live FAPL matches.

1.2 Ofcom does not accept that there is one market for *"all television*".

1.3 Ofcom concludes that core premium content is available exclusively on pay TV and is the content that has the broadest appeal. This leads Ofcom to the view that core premium content is sport and first run Hollywood movies. However, Ofcom's analysis of these wholesale markets is flawed, highly subjective and ignores all evidence (even its own evidence) that runs counter to its views.

1.4 Ofcom further concludes that as a result of its market share, Sky has market power in the wholesale supply of this core premium content. This is based on (1) a historic analysis of market share; (2) a forward looking analysis of barriers to entry; and (3) the lack of any countervailing buyer power.

1.5 Consequently, Ofcom considers that competition between platform operators is weak and that consumers are suffering in terms of choice and innovation.

1.6 However, these conclusions are reached on the basis of a market definition that is far from convincing and much too narrow. The market definition analysis ignores the most recent precedent from the Competition Commission which finds a market for *"all TV"* and is also heavily reliant on the alleged existence of a cellophane fallacy even though this Consultation does not contain any finding that wholesale (or retail) pricing is above competitive levels.

1.7 Nevertheless, Ofcom concludes that Sky's vertical integration, and dominance in the wholesale supply of core premium content, gives it an incentive to deny access to premium content to other platform operators by, allegedly, setting wholesale prices too high. According to Ofcom, the result of this is that new platform operators are unable to compete with Sky because they cannot gain access to the two types of premium content identified in the Consultation as being core to the pay tv offer; and customers suffer through reduced choice.

1.8 Ofcom concludes that it must take action to remedy this situation and its preferred remedy is to impose an obligation on Sky to wholesale its channels containing core premium content (on the basis of conditions, including pricing conditions, to be imposed by Ofcom) in order to allow third party platform operators to develop premium content offerings thus replicating a competitive market.

1.9 However, Ofcom recognises that there are key issues to be decided in relation to pricing and the terms of the wholesale remedy. The PL understands that Ofcom is keen to ensure that it does not impose a remedy that gives rise to unintended consequences for content owners such as the PL.

1.10 This is welcomed by the PL as it has significant concerns that Ofcom's preferred remedy will potentially affect competition in the upstream content acquisition market. One risk of such a remedy is that the incentive for other platform operators/retailers to bid for the PL's rights will be removed if they are able to purchase Sky's sports channels at a downstream wholesale level on terms which disincentivise them from creating their own channels and services.

1.11 The remedy potentially risks creating free-riding problems for the PL and may reduce the incentive on Sky to bid for the PL's rights if Sky has obligations imposed on it which limit Sky's ability to monetise the rights it has acquired.

1.12 Any reduction in the platform operators/broadcasters' incentive to bid for the PL's rights would reduce competition for the PL's rights and distort the natural auction process.

1.13 Distortion in the upstream content rights market will no doubt give rise to a diminution in value of the PL's rights which will in turn have an adverse effect on football as a whole. The European Commission has recognised the value of the revenue achieved from the PL's rights and the way in which these revenues are utilised for the benefit of the sport as a whole.

1.14 When reaching its final conclusions and imposing any remedies on Sky, Ofcom must take into account the clear and serious risk of the consequences of its preferred remedy on consumers, on the pay-tv industry and on content owners such as the PL.

1.15 Ofcom should at all costs avoid an outcome where the natural operation of the market is prevented or distorted by unnecessary or disproportionate regulatory intervention. Maintenance of the status quo would, therefore, be a more proportionate result of this consultation.

2. INTRODUCTION

2.1 This response to Ofcom's pay TV Investigation Second Consultation (the **"Consultation"**) is submitted for and on behalf of the FA Premier League (the **"PL"**) by DLA Piper UK LLP.

2.2 The PL is a private limited company whose shareholders are its member football clubs which participate in the PL competition in each football season (which runs annually from August to May).

2.3 The PL has sought to address all issues raised in the Consultation that may affect its member clubs, the operation of the commitments (the **"Commitments"**) given by the PL to the European Commission (the **"Commission"**) in 2006[1] and/or the sale and use of PL live rights. Where appropriate the PL has also responded to the consultation questions.

2.4 The PL is not to be taken as agreeing with or accepting any issues or conclusions which it has not directly addressed.

2.5 The Consultation is significantly narrower in focus than the consultation that was issued by Ofcom in December 2007 (the "First Consultation"). Whereas in that First Consultation Ofcom had concerns in relation to the manner in which premium content as a whole is distributed, the focus is now on wholesale channel provision and Sky's alleged dominance in the market for wholesale supply of core premium sports and core premium movies.

[1] http://ec.europa.eu/comm/competition/antitrust/cases/decisions/38173/decision_en.pdf

2.6 Nevertheless, where appropriate the PL refers Ofcom back to its response to the First Consultation and does not propose to repeat verbatim the same arguments in this document.

2.7 This response focuses on the key issues of the importance of premium content and the PL's role in the supply of premium content, market definition and the proposed remedy.

2.8 The remainder of this response follows the headings in the Consultation document.

3. OFCOM CONSULTATION SECTION TWO - INTRODUCTION

3.1 Ofcom addresses two consultation questions under Section Two "Introduction". The PL does not have any specific responses to these questions; however it does wish to comment generally on the matters considered in this section of the Consultation.

3.2 Ofcom concludes that further to the responses it received to the First Consultation, and the work that it carried out in relation to these responses, its concerns are now **more focussed** on *"access to premium content, and the effects that restricted access could have on competition in pay TV"*[2].

3.3 Nevertheless, it is clear that the major focus of Ofcom's concerns in the Consultation are still related to the fact that Sky currently has content on its channels that other broadcasters or platform operators must buy from Sky, on a wholesale basis, in order to compete with Sky's own retail offering. The PL is not able to comment on Sky's incentives to wholesale this content.

3.4 The Consultation now also concludes that the relevant core premium content includes live PL rights.

3.5 However, as Ofcom is aware, the PL sells its rights in an open auction to the highest compliant bidder. Any broadcaster or platform operator can bid for the PL's rights (subject to the rule against no single buyer) and obtain on a platform neutral basis the content to which Ofcom wishes to ensure access.

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2 Consultation paragraph 2.9

3.6 The auction process is highly competitive and must be conducted in compliance with the Commitments given to the Commission. These Commitments were designed and accepted by the Commission in order to meet any competition concerns there may have been in either the upstream content markets **or** in the downstream broadcast markets.

3.7 Any intervention by Ofcom should be carefully considered and balanced against the fact that competition at the upstream level is working well and should not be disturbed by any theoretical concerns that Ofcom may have about what incentives Sky has at a downstream level.

3.8 Ofcom sets out that the purpose of this Consultation is to consult on its views on market definition and market power[3]. In relation to market definition the PL does not accept that; firstly, there are separate economic markets for pay tv and free to air tv; or, secondly, that there are narrow economic markets based on core premium content. Ofcom has approached market definition in a highly theoretical way and has not found any clear evidence to support its conclusions. Sky's alleged market power is not an issue on which the PL is in a position to comment. Nevertheless, it is not clear to the PL that the evidence referred to by Ofcom supports a conclusion that such market power exists. Therefore, it is not clear that there is any need for a remedy to be imposed at all.

3.9 Section 3(5) of the Communications Act 2003 requires Ofcom to *"have regard to the particular interests of those consumers in respect of choice, price, quality of service and value for money"*.

3.10 The criteria against which Ofcom will judge its compliance with this requirement are set out in paragraph 2.39 of the Consultation. These include choice of platform and content, innovation in platform services and the objective that pay TV services are (to be) priced competitively and effectively.

3.11 However, neither the First Consultation or this Consultation refers to any evidence that consumers believe that they are actually suffering in terms of choice of platform

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[3] Consultation paragraph 2.10

(whether on a free to air or pay tv basis); the retail prices charged by any pay tv retailer; or quality of service or value for money in their purchase of pay TV services.

3.12 Customers have a wide range of choices between different platforms, channels and services and this includes the channels and services offered by free to air broadcasters. In the sports context there is a significant range of sports offered on the different platforms and on the many different channels and services available to consumers. Innovation in platforms and channels and the choice available to customers in these areas drives competition for acquisition of the PL's rights. The PL is keen to ensure that fierce competition for its rights remains.

3.13 Instead of identifying any real evidence that consumers are suffering, Ofcom sets out a number of characteristics that it would expect to see in a market that it would regard as desirable for consumers[4]. Whilst these characteristics are all within the control of the broadcasters/platform operators the PL is concerned that any action by Ofcom aimed at forcing particular outcomes may affect competition for its rights. Currently, operators choose whether or not to bid for the PL's rights, and if so, how much, on the basis of what fits with their particular business models and plans for future expansion. Any intervention by Ofcom that forces the winner of the auction to wholesale that content to all platform operators on specified terms may have the effect of artificially equalising competition for the PL's rights and reducing the incentives to bid for those rights in the next auction. This consequence must be avoided.

4. OFCOM CONSULTATION SECTION THREE - THE IMPORTANCE OF PREMIUM CONTENT

4.1 Ofcom addresses four consultation questions in Section 3. The PL is not in a position to answer directly the Consultation questions in this section. Nevertheless, it does have some observations on Ofcom's approach and conclusions in relation to premium sports content. It is not in a position to comment on first run Hollywood movies.

4.2 Ofcom's main conclusion in this section of the Consultation is that consumers' choice of pay TV retailer is primarily influenced by content and that this content must have two characteristics: a significant appeal to a broad audience and limited availability

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[4] See paragraphs 2.51-2.56

via free to air TV channels. The only two types of content that apparently fit into these characteristics are "live top-flight sports" and first run Hollywood movies[5].

4.3 However, Ofcom appears to have overstated or misinterpreted much of the evidence it has gathered in order to support its conclusions. In particular, it has placed undue importance on "live top flight sports" and live PL matches in its assessment of what is “premium content”.

4.4 Ofcom has defined premium content as that which is *"particularly high valued by consumers"* and has limited availability on free-to-air but, nevertheless, accepts that such content is found on both free-to-air and pay TV[6].

4.5 Furthermore, Ofcom disregards the consumer evidence it cites about the importance of content other than sport because this is content that is typically available on free to air TV. This leads to a self fulfilling analysis that the only content that can be considered as “premium” is live sports which are currently only available on pay TV. This, firstly, entirely ignores customer preferences for a diverse range of programming and, secondly, the significant quantity of "live top flight sports" that is available on free to air tv.

4.6 Of the 88% of pay TV customers for whom content is important, only 33% of these customers also consider sport to be a "must have"[7]. It should be noted therefore that only 29% of all pay TV consumers consider sport, <u>in general</u>, to be essential. Similarly only 31% of free to air customers for whom content was a "must have" considered sport in general to be essential.

4.7 Ofcom's own figures demonstrate that sport does not appeal to the majority of pay-TV and free-to-air television consumers with nearly 70% considering other key genres to be more important. Indeed, the second highest programme genre that is essential for both pay TV and free-to-air television consumers is soap operas, with 27% and 31% of pay-TV and free-to-air TV customers respectively citing it as "must-have". On the basis of Ofcom's own research, soap operas are therefore just as important to consumers as sports.

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[5] Consultation, paragraphs 3.1 and 3.2
[6] Consultation, paragraphs. 3.12
[7] Consultation, paragraphs 3.40, Figure 5

4.8 With this in mind, the PL does not accept that sport can be considered to meet Ofcom's first criteria for what content is premium (i.e. having a *"significant appeal to a broad audience"*) since less than one third of both free-to-air and pay TV consumers deem it to be important.

4.9 Ofcom's second criteria for defining premium content i.e. *"the content must be available on an exclusive basis to pay TV providers, with limited substitutes available free-to-air"*[8] has also under-estimated the wide range of important sporting events that are available live on free-to-air television . Furthermore, it is based on a superficial consideration of the importance of irrelevant issues e.g. consumers' take up of premium channels; prices paid for content by pay tv operators; statements made by companies operating in pay tv; and parallels from international pay tv markets[9].

4.10 There are a significant amount of very important sporting events available on free-to-air tv and these include the "listed events". These events are listed precisely because of their "premium" nature and cultural and historical significance.

4.11 In light of this fact alone it cannot be right to state that premium content is defined by its availability on a pay tv or free-to-air platform[10].

4.12 Indeed, when defining "premium content" Ofcom accepts that this is a subjective analysis and that there is content on free-to-air channels that is premium and that this content is highly valued by, and available to, consumers[11].

4.13 It is clear from Ofcom's research that consumers as a whole consider a wide range of television content to be essential to their viewing. For this very reason pay TV operators retail an extensive and diverse range of channels to consumers. They also include a wide range of innovative features in order to attract subscribers. All channel providers on whatever platform compete with each other for subscribers and viewers. Channels that simply show sport must compete with all other channels (both free-to-air and pay tv channels) showing all genres of content in order to attract viewers and subscribers.

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8 Consultation, paragraph 3.38

9 Consultation, paragraph 3.43

10 Consultation, paragraphs 4.60 and 4.61 for Ofcom's recognition that free-to-air broadcasters hold listed sports events and many other valued sports rights.

11 Consultation, paragraph 3.12

4.14 For all these reasons the PL believes that Ofcom's definition of "premium content" is flawed.

5. OFCOM CONSULTATION SECTION FOUR - MARKET STRUCTURE AND MARKET DEFINITION

5.1 This section of the Consultation contains four questions. The PL is not in a position to respond directly to Questions 9 or 10, however, it sets out below its comments on Questions 7 and 8. The PL also refers Ofcom back to the submissions it made on market definition in its response to the First Consultation.

5.2 Firstly, the PL does not agree that there are separate wholesale markets for pay tv and free to air tv or that there are even narrower wholesale markets for premium sports channels.

5.3 Secondly, Ofcom's approach to market definition is flawed.

5.4 Attached at Annex 1 is a report by RBB Economics which further analyses Ofcom's conclusions on market definition.

Question 7: Do you agree with our overall approach to market definition analysis?

5.5 In relation to defining the relevant market Ofcom sets out that the key question for its analysis is *"to what extent content found on FTA or basic-tier TV channels constrains the pricing of premium sports channels. Given a small but significant increase in the price of a wholesale premium sports channel, would a downstream firm switch to an alternative wholesale input, absorb the price increase or pass the increase onto its subscribers? In the event of the latter, would those subscribers switch to FTA and discontinue their subscriptions to the premium sports channels"*[12].

5.6 Firstly, the PL notes that the original complainants make it clear to Ofcom that it has overstated the importance of the PL in its assessment of what constitutes a premium sports channel[13]. The PL agrees that Ofcom has understated the importance of other sports but continues to dispute the conclusion that the sports content on free to air tv does not constrain pay tv.

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12 Consultation, paragraph 4.62

13 Consultation, paragraph 4.65

5.7 Ofcom's approach to the market definition analysis is flawed and wrongly relies on the following:

5.7.1 An alleged cellophane fallacy when deciding on the relevant price point for the purposes of answering the question referred to in paragraph 5.4 above. Ofcom cannot rely on a cellophane fallacy in a situation in which there is no evidence to suggest that prices are above competitive levels[14]. Ofcom wrongly uses the cellophane fallacy in order to ignore all evidence that does not support its conclusions; and

5.7.2 Its conclusion that free to air does not provide a competitive constraint on premium sports channels despite the fact that there is a significant quantity of live top flight sports on free-to-air television, that there has been significant growth in the number of customers who have Freeview and access to the PSBs digital channels and that Ofcom's own evidence demonstrates that (in relation to sport - never mind other programming content such as soap operas, drama and comedy) competitions such as the UEFA Champions League and the FA Cup are just as important to viewers as PL matches.

5.8 Ofcom's approach also fails erroneously to follow the precedent set in the Competition Commission’s (**the "CC"**) analysis of the relevant product markets in its merger inquiry into the acquisition of a shareholding in ITV by BSkyB (**"ITV/Sky"**)[15].

The Cellophane Fallacy

5.9 Ofcom has accepted that in broadcasting markets it is difficult to identify the competitive price, as a large proportion of production costs are fixed and marginal costs are very low[16]. While Ofcom expects the competitive price to be well above the marginal cost, it accepts that it is difficult to assess how much higher it will be. It

14 Ofcom itself admits that there is no evidence that prices are above competitive levels.

15 Report by Competition Commission to Secretary of State (BERR) dated 14 December 2007 "Acquisition by British Sky Broadcasting Group Plc of 17.9 per cent of the shares in ITV Plc" (the "**Report**")

16 Consultation, paragraphs. 4.47

makes no finding of what the competitive price is even though such a finding is essential to any reliance on a cellophane fallacy when undertaking the hypothetical monopolist test in a market definition.

5.10 Nevertheless, as set out above Ofcom admits that its assessment of whether Sky earned excessive profits was inconclusive[17]. This was also the case in relation to the figures provided for wholesale margins[18].

5.11 Moreover, without any supporting evidence or explanation, Ofcom concludes that, even if Sky is earning normal profits from the wholesale of its premium channels the fact that rights are aggregated on these channels prevents Ofcom from finding that the wholesale prices of those channels are at a competitive level.[19]

5.12 Ofcom has made an assumption about the existence of a cellophane fallacy that is not based on any evidence. It cannot be assumed that the wholesale prices do not reflect competitive prices and, in consequence, that when applying the hypothetical monopolist test the cellophane fallacy is relevant and leads to a conclusion that premium sports channels do not form part of a wider relevant market.

Narrow Market Definition

5.13 The narrow market definition is disputed, not least because that definition is based on an incorrect presumption that there are separate markets for pay tv and free to air tv.

5.14 Furthermore, Ofcom's initial conclusions about what content drives pay tv subscriptions are based on conclusions that (1) only particular types of content drive pay TV subscriptions; and (2) there are only two types of this content: live top flight sports and first run Hollywood movies. The first conclusion is based on a further initial assumption that content that drives pay tv subscriptions must be of broad appeal and available exclusively on pay tv.

5.15 As set out above the PL disputes both these conclusions.

5.16 When assessing the constraint posed by sports content on free-to-air Ofcom ignores its own analysis that the "*growth of Freeview and a greater number of basic channels*

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17 Ibid, paragraphs 1.12
18 Ibid, paragraphs. 1.13
19 Ibid, paragraphs. 1.21

featuring sport have increased availability of sports and other programming on FTA and basic tier television"[20].

5.17 Ofcom also apparently ignores the fact that "*the growth in availability of FTA digital channels and the greater range and quantity of available sport means that FTA TV may now be a closer substitute for premium sports channels than ten years ago*". Further, "*the additional digital channels mean that the PSBs are able to broadcast live sporting events in greater depth and there has been enormous growth in numbers of Freeview consumers*"[21].

5.18 It has also noted that, as free-to-air channels are less capacity constrained and are able to devote extended coverage to sport, such channels therefore may be able to compete more directly with premium sports channels[22].

5.19 Free-to-air television channels provide exclusive live access to many highly valued sports events which compete directly with pay TV channels including sports channels. Indeed these sporting events include the "crown jewels" of sports content - namely, listed events that must be broadcast live on free-to-air television such as the FA Cup Final. For example, free-to-air television viewers have live access to highly valued sports events such as the UEFA Champions League, the FA Cup, the FIFA World Cup, the UEFA European Championships, the UEFA Cup, England international football matches, Rugby Union Six Nations matches, the Rugby World Cup, Wimbledon, Formula 1 Motor Racing, the Winter and Summer Olympics, the World Athletics Championships, the Grand National, the Cheltenham Festival (as well as all other leading horse racing meetings), the US Masters, the British Open and numerous other leading golf tournaments. In addition:

5.19.1 74% of FA Cup matches with PL teams and 50% of all games broadcast were shown exclusively on free-to-air television in the 2007/08 season[23];

5.19.2 50% of matches in the UEFA Champions League involving PL teams were shown exclusively on free-to-air television in the 2007/08 season[24];

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20 Consultation, paragraphs. 4.97
21 Consultation, paragraphs 4.103
22 Consultation, paragraphs 4.61
23 Consultation, figure 17
24 Ibid.

5.19.3 68% of UEFA Cup games with PL teams and 50% of all games were shown exclusively on free-to-air television in the 2007/08 season[25]; and

5.19.4 50% of England international football matches were shown on free-to-air television[26].

5.20 Despite the live football available on free-to-air Ofcom has concluded that live football featuring PL teams (on free-to-air TV) is a weak substitute for live football featuring PL teams on premium sports pay TV channels. This is allegedly due to the relatively low number of matches that are shown on free-to-air TV[27]. As evidenced above however, the majority of games in the FA Cup, UEFA Champions League and UEFA Cup featuring PL teams are shown exclusively live on free-to-air. There is not, therefore, a "relatively low" number of live football matches involving PL teams shown on free-to-air.

5.21 In any event, the PL disputes the use of live PL games as the basis for the definition of core premium sports channels.

5.22 Sports coverage is available on free to air TV and there is insufficient evidence to conclude that there are narrow economic markets for the wholesale supply of core premium sports channels. Moreover, Ofcom presents statistical evidence that emphasises the high value that consumers place on the sports content shown on free-to-air channels. For example, 43% of consumers who subscribe to Sky Sports and Setanta and who watch sport weekly, continue to watch sport on BBC 1 at least three times a week. 35% of the same consumers also continue to watch sport on ITV 1 at least three times a week[28].

Competition Commission's Report[29]

5.23 The CC’s conclusions in ITV/Sky are clearly relevant as the only recent UK case that analyses market definition in relation to the provision of television services. It cannot be disregarded simply on the grounds that the CC was considering a different competition issue (eg; a substantial lessening of competition).

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25 Ibid.
26 Ibid.
27 Consultation, paragraphs. 4.125
28 Consultation, Annex 10, figure 14
29 Report by Competition Commission to the Secretary of State (BERR) dated 14 December 2007 "Acquisition by British Sky Broadcasting Group Plc of 17.9 percent of the shares in ITV plc"

5.24 The CC's decision provides the most up-to-date analysis of the relevant market in which the PL's UK licensees operate and contains a finding (with which the PL agrees) that free to air services do constrain Sky's pricing.

5.25 The PL does not agree with Ofcom's view that the market analysis should be carried out using a totally fresh approach[30] that ignores the importance of the CC report to the UK television market and the amount of research that was undertaken to compile it.

5.26 In light of this the PL disagrees with Ofcom's overall approach to the market definition analysis. As set out by the CC in its Report into ITV/BSkyB there is a UK market for "all television" which includes both pay TV and free-to-air services[31]

Question 8: Do you agree with our definition of the market for Core Premium Sports channels or do you believe it to be narrower or wider than we have suggested? If so what specific evidence do you have to support your view?

5.27 The PL does not agree with Ofcom's conclusion that there is a narrow economic market for the wholesale of premium sports channels. The relevant market is "all television". However, even if there were such a narrow market (which is disputed) the PL considers that Ofcom's definition of "core premium sports" is much too narrow. Sports content covers a wide range of sporting events and is not limited to live PL matches. As set out above and in the PL's response to the First Consultation, there is a wide range other high quality sports content on free-to-air channels and on pay TV channels (most notably, but not only, on Setanta's sports channels) that are substitutes for live PL matches.

5.28 Ofcom itself admits that it has taken a narrow approach and that it may in fact be too narrow. Other sporting events are clearly important to consumers and this is recognised by the evidence that Ofcom has gathered and is clear from the fact that the original complainants also believe that Ofcom has overstated the importance of the PL.

5.29 As presented, the evidence shows that while the PL is considered to be "very important" by 75% of premium sport channels subscribers, 72% also said the same for Champions League football and 71% for both the FA Cup and England

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30 Consultation, paragraphs 4.57

31 Consultation, paragraph 14 and 16

Internationals[32]. Indeed, it has been noted that a *"large number of consumers have extremely strong preferences"* for these events[33]. These statistics cannot simply be ignored when defining the market and are highly relevant to the definition of "Core Premium Sports".

5.30 At the very least, the UEFA Champions League, the FA Cup and England international football games should be included in the definition of "core premium sports". The same percentage of subscribers considered these competitions to the "very important" (plus over 50% for both said they were extremely important[34]).

5.31 In addition to the above mentioned football content, the Consultation confirms that other football and sports were identified as being "important" by consumers. In particular, Championship Football (50%), Scottish Premier League (35%), Rugby Union (37%), Cricket (32%), Tennis (32%) and Golf (28%)[35]. This emphasises the clear importance of other sports to consumers and yet is completely ignored by Ofcom in its definition of core premium sports.

5.32 Ofcom has concluded that other sporting events (i.e. other than football) are likely to be "relatively weak substitutes"[36] for live PL matches. The PL disputes this conclusion in light of the evidence set out above. Non-football content is clearly not a weak substitute, with Rugby Union, cricket and tennis being important to significant numbers of consumers. Indeed, 40% of consumers who do not value FAPL as important (one quarter of Sky Sports subscribers) consider one of cricket, Rugby Union or Rugby League to be very important[37]. This is a very significant proportion of customers who do not regard live PL matches as "core premium" content.

5.33 Ofcom is right to be concerned that its definition may be too narrow[38] and the PL refers Ofcom to its response to the First Consultation and the correct conclusion on market definition which is that pay TV and free-to-air television are part of one market for "all television".

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32 Consultation, Annex 10, figure 25.
33 Consultation, footnote 143,
34 Consultation, paragraphs 4.114
35 Consultation, Annex 10, figure 25
36 Consultation, paragraph 4.136
37 Consultation, Annex 6, paragraphs. 5.29 and 5.30
38 Consultation, paragraphs 4.146

6. OFCOM CONSULTATION SECTION FIVE - CONTENT AGGREGATION AND MARKET POWER

6.1 Ofcom addresses three consultation questions in Section 5 as follows. The PL is not in a position to respond directly to these questions. However, it does have more general comments in relation to Ofcom's conclusions on market power.

6.2 The PL notes Ofcom's acknowledgement that content aggregation is not necessarily a cause for concern, and that it is widespread in pay TV markets[39]. The PL further notes that Ofcom's concern lies where the possible existence of market power is created or enhanced by the aggregation of apparently critical content.

6.3 When assessing market power Ofcom considers three issues: existing circumstances; future outcomes and countervailing buyer power.

Existing circumstances - market shares

6.4 In relation to existing circumstances and current market shares the PL is not in a position to comment on the (very simplistic) calculations of market share that Ofcom has carried out. Nevertheless, it must repeat its rejection of Ofcom's view that that there are narrow wholesale markets based on PL rights. Therefore, the amount paid for PL rights is irrelevant to a market share calculation.

6.5 The PL would also point out that footnote 138 on page 102 of the Second Consultation document is misleading in its references to "first pick" PL matches. This is because the ability to select PL matches as part of each of the six live PL packages is constrained by a per season limit on the number of PL matches in which each Club can appear as part of each live package and an obligation to select at least one match per season featuring each Club as part of 5 of the 6 live packages. Therefore, although currently Sky has in theory the "first" 23 picks as part of Live Package A, in practice the minimum and maximum per Club selection obligations mean that Sky could not just pick 23 matches per season all of which, for example, feature one of the top 5 PL Clubs.

Future outcomes - barriers to entry and expansion

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[39] Consultations, paragraphs 5.25 and 5.27

6.6 Firstly, the PL does not agree that there are narrow wholesale markets based on its rights. A wide range of sporting content should have been considered when assessing what barriers to entry might exist to the acquisition of content; and as such it is not just acquisition of the PL's rights that should have been considered when assessing Sky's market power.

6.7 Ofcom also does not undertake any proper consideration of expansion by existing entrants.

6.8 In any event, the PL does not agree with Ofcom's conclusion that there are significant barriers to entry in acquiring PL content[40]. The Commitments are designed to ensure that there is effective competition for the purchase of PL's rights at the downstream level. The rights are auctioned under the mechanism that was calculated to meet the preliminary competition concerns raised by the Commission. The six live packages are carefully balanced to meet the requirements of the widest range of bidders and therefore ensure that competition between bidders is increased. By accepting the Commitments, the Commission has concluded that there are no longer any grounds for action and that competition in downstream markets is protected.

6.9 It is open to any company to bid for the PL's rights and make the necessary investment in doing so.

6.10 Ofcom's conclusion that the staggered availability of rights is an additional barrier to entry[41] is also erroneous. The PL's rights do only become contestable on a staggered basis every three years but this has been accepted by the Commission as the necessary minimum to allow licensees (including new entrants such as Setanta) to earn a return on their investment, thus accruing efficiency benefits, while not being able to foreclose the market for acquisition of PL rights.

6.11 The theory that staggered availability is a barrier to entry or expansion also runs counter to all of the available evidence. In particular, the launch by Setanta of a series of new premium sports channels in recent years clearly contradicts Ofcom's theory. The acquisition by Setanta in the last two or three years of a whole series of key

40 Consultation, paragraphs 5.4
41 Consultation, paragraphs 5.4

sports rights[42] supports a view that staggered availability assists market entry for a wholesale channel provider to be able to assemble rights packages over a period of time so that all of that channel provider's investments in new rights acquisitions do not have to be made at or around the same time.

6.12 As explained in our response to the First Consultation and paragraph 6.11 above (see also footnote 42), Setanta has acquired substantial quantities of highly valuable rights. Moreover, since that response, Setanta has, for example, secured the following additional rights:

6.12.1 the right to broadcast coverage of the One Day 2008 Asia Cricket Cup;

6.12.2 a three year exclusive deal to broadcast over 30 live UEFA Cup matches, including approximately 18 matches each season featuring British teams;

6.12.3 the right to broadcast Scottish Premier League football until the end of the 2013/14 season for £125 million; and

6.12.4 exclusive live rights for several top quality boxing matches.

Countervailing buyer power

6.13 The PL is not in a position to comment on Ofcom's conclusions about countervailing buyer power.

7. OFCOM CONSULTATION SECTION SIX - COMPETITION ISSUES RELATED TO CORE PREMIUM CONTENT

7.1 The PL is not in a position to respond to Questions 14 - 21 that are cited in this section.

8. OFCOM CONSULTATION SECTION SEVEN - EFFECTS ON CONSUMERS

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42 For example, PL matches, Scottish PL matches, FA Cup matches and England home Internationals, Blue Square Premium football, US PGA golf, French, Dutch and Portuguese football leagues, Indian premier league cricket, Australia rugby league, Magners league rugby and boxing.

8.1 The PL is not in a position to respond to Questions 22 - 24 that are cited in this section.

9. OFCOM CONSULTATION SECTION EIGHT - REMEDIES AND OFCOM CONSULTATION SECTION NINE - DETAILS OF A WHOLESALE MUST-OFFER REMEDY

9.1 As set out above the Consultation reaches the conclusion that Sky has market power in the provision of core premium content on pay TV. Ofcom argues that as a result Sky has reduced incentives to make premium content available to other retailers and that that leads to consumer detriment. In section eight of the Consultation Ofcom considers potential remedial action it could take to counter Sky's market power.

9.2 Ofcom proposes a number of possible options. The PL supports maintenance of the status quo and does not believe that Options 2 - 4 are necessary or proportionate.

9.3 For example, one of the remedies proposed by Ofcom is based on a theory it could address the existence of market power at source, by changing the way in which rights are sold at the content level to ensure no one provider has market power[43].

9.4 Ofcom has contemplated placing specific restrictions on the aggregation of content, and has considered, in relation to sports content, "*a behavioural rule which prevents the FAPL selling more than two of its six packages of rights to any one wholesale channel provider*"[44].

9.5 However, Ofcom has conceded that this approach is not likely to be suitable at this point in time for a number of reasons, including:

9.5.1 Content aggregation has positive effects and any remedy that prevents or restricts aggregation to the extent necessary to eliminate market power is also likely to risk sacrificing some of these benefits; and

9.5.2 In relation to PL rights, the Commitments are in place for a six year period and this has enabled Setanta to acquire two packages of live rights.

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43 Consultation, paragraph 8.25
44 Consultation, paragraph. 8.26

9.6 The PL agrees with Ofcom's conclusions in this regard. Intervention into the collective sale of PL rights is not appropriate at this stage in particular in light of the Commitments that are binding until the sale of the live rights with effect from the start of season 2013/14. Any intervention designed to eliminate upstream market power by ensuring no one provider could purchase more than two packages far exceeds the remedy that the Commission deemed sufficient to meet all the competition concerns in relation to the sale of PL rights for the seasons 2007/8 - 2012/13. Indeed, any such excessive and disproportionate interference with the market for PL rights would be strenuously resisted by the PL.

9.7 In any event, it is doubtful whether Ofcom could place further behavioural remedies on FAPL while the Commitments are still valid. As any such intervention would be through use by Ofcom of its powers under the Competition Act 1998 (the "**Act**"), Ofcom is under a duty to maintain consistency with EU Courts and must have regard to Commission decisions[45]. With this provision in mind, the Commission decision to accept the Commitments on the basis that there are no longer any grounds for concern cannot be ignored or overridden by Ofcom.

9.8 The Commitments were specifically designed, and go as far as is necessary, to meet any competition concerns and therefore it would not be appropriate for Ofcom to adopt a remedy at this stage that is far more onerous and disproportionate than the remedy accepted by the Commission just over two years ago.

9.9 In light of the above, the PL agrees with Ofcom's view that intervention by way of placing additional restrictions on the collective sale of PL rights is not appropriate.

9.10 Therefore, Ofcom has concluded that the most suitable remedy to correct the alleged market failing is to impose a wholesale must-offer obligation, whereby Sky will be obliged to wholesale its channels containing core premium content (on the basis of conditions, including pricing conditions, to be imposed by Ofcom). This will be in order to allow third party platform operators to develop premium content offerings and apparently to replicate "*the natural outcome of a competitive market*"[46].

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45 The Competition Act 1998, section 60.

46 Consultation, paragraph 8.1

9.11 However, Ofcom recognises that there are key issues to be decided in relation to pricing and the terms of the wholesale remedy[47].

9.12 These key issues relate to the following:

9.12.1 Eligible retailers;

9.12.2 Should the obligation cover residential and commercial subscribers;

9.12.3 What content/channels should be covered;

9.12.4 Product definition and technical characteristics;

9.12.5 Pricing;

9.12.6 Commercial terms; and

9.12.7 Review provisions

9.13 The PL also understands that Ofcom is keen to ensure that it does not impose a remedy that gives rise to risks of unintended consequences for content owners such as the PL. However, Ofcom must go further in considering the impact on rights holders than its current view that *"[a]s we have not set prices at this point, the precise impact on rights holders is difficult to quantify*"[48].

9.14 This is welcomed by the PL as it has significant concerns that Ofcom's preferred remedy will undermine competition in the upstream content acquisition market and investment in sports content. By regulating the ability of platform operators to purchase channels from Sky, and the wholesale price at which Sky must offer channels for purchase, at a downstream wholesale level, Ofcom is creating a significant risk that the incentive for platform operators and retailers to bid for the PL's rights will be removed or materially reduced.

9.15 It is clear that, if the remedy is to be at all effective, the value of rights achieved by rights holders in the initial award processes will be diminished since the attractiveness

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47 For example price and non price issues including ex-ante pricing rules, dispute resolution mechanisms and the scope of the obligation e.g. Sky Sports 1 only.

48 Consultation, paragraph 8.88

to and hence the willingness of broadcasters to pay for those rights will be reduced by their ability to purchase the content at a downstream wholesale level.

9.16 To see why the remedy undermines the competition for rights, first consider the case in which the winner of the rights is unable to recover the cost of obtaining rights. In this case the winner has to pay for the rights, but its competitors do not as they can obtain the rights in the regulated wholesale market. Therefore all bidders will reduce their bids to mitigate this risk; in the extreme the rights would be worthless as all bidders would prefer not to win but obtain the rights in the regulated wholesale market.

9.17 Now consider the case where the regulated wholesale price allows for recovery of costs incurred in obtaining rights. In this scenario all bidders in the rights auction have the incentive to bid below their true valuation. Consider the simple example with two bidders competing for one package of rights. If bidder A has a higher willingness to pay ("stronger" in Ofcom's parlance) than bidder B, both bidders will expect bidder A to obtain the rights.[49] Absent wholesale intervention bidder B has an incentive to bid close to his true valuation and bidder A to bid above what he considers bidder B's valuation. In a multiple round auction bidder A would win the rights when the price reaches or exceeds bidder B's maximum valuation, because at that point bidder B would to stop bidding and there are no other bidders remaining who can credibly force bidder A to increase his bid.[50] However, if the price bidder B faces for regulated wholesale access depends on the price bidder A pays in the auction, bidder B will no longer bid up to the level of his true valuation because by doing so not only would he fail to win (as bidder A is known to have a higher willingness to pay) but he would simultaneously raise the price in the wholesale market above his willingness to pay.[51] Therefore, bidder B has a *strong* incentive to bid nothing (or below his valuation) in the rights auction and gain access in the wholesale market as cheaply as possible. This reduces the amount that bidder A has

49 Ofcom claim that Sky is a stronger bidder from premium content because it has a larger subscriber base relative to other pay TV retailers. This is debatable. Due to its presence on multiple platforms Setanta's potential subscriber base if it were to win a significant quantity of FAPL rights (and if FAPL were essential as Ofcom infer) would be considerably larger than Sky's.

50 In a sealed bid a similar outcome would be expected, albeit that bidder A may increase its bid to mitigate the risk of losing below his valuation. However, this may be less of a concern for bidder A where multiple lots are auctioned.

51 Unless bidder A is more efficient and bidder B is able to free-ride on those efficiencies.

to pay for the rights.[52] Either scenario will lead to a distortion of competition for the rights and a diminution in the value of the rights.

9.18 In short, if the wholesale price is set low enough to attract entry in the retail market, the wholesale remedy will be seriously likely to undermine the competition for rights and as a result the price paid for those rights. The natural consequence of this is that rights providers (such as the PL) will reduce their investment in producing content because they no long have the funds available to invest at current levels.

9.19 Reduced investment will lead to lower quality content, which will be detrimental to consumers. Because investment in IP is not dependent on the retail channel it will not only be Sky's consumers that receive this lower quality product, but all consumers: in the case of premium movies, all movie goers; and in the case of FAPL (and sport in general) all those that watch or attend football matches (and sporting events in general). Therefore implementing Ofcom's proposed remedy will have a detrimental impact on consumers.

9.20 Furthermore, the imposition of wholesale pricing obligations on Sky could have the effect of restricting Sky's ability to recoup its investment in acquiring the PL's rights thereby reducing its incentives to bid.

9.21 Any reduction in platform operators/broadcasters' incentives to bid for the PL's rights would reduce competition for the PL's rights. This would have the effect of distorting the auction process for the rights in the upstream market.

9.22 Distortion in the upstream content rights market will give rise to a diminution in value of the PL's rights which would not only damage the PL but also football as a whole. The European Commission has recognised the value of the revenue achieved from the PL's rights and the way in which those revenues are utilised to benefit football as a whole and to promote good causes. In particular:

9.22.1 The revenue allows clubs to invest in playing talent in order to maintain the high quality of the Premier League competition for the benefit of football fans as a whole (not just television viewers);

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52 In the case of a single price sealed bid auction, bidder A would have an incentive to reduce the amount it bids.

9.22.2 The revenue is redistributed between stronger and weaker clubs in the PL competition and for the benefit of clubs in lower leagues of English football;

9.22.3 The revenue allows the promotion of the PL and English football generally;

9.22.4 The revenue received by clubs enable investment in safe stadia and high quality facilities for football fans; and

9.22.5 Part of the revenue is invested by the PL in good causes at home and abroad.

9.23 A reduction in the revenue generated by the sale of the rights will have an adverse effect on the inherent benefits that have proven to be advantageous to both consumers and football itself.

9.24 Ofcom's assessment of remedies is also cursory and incomplete. Whilst it is clear that Ofcom intends to undertake a further consultation there are a number of issues that should be dealt with now. The analysis of the remedy lacks evidence that it will be overall beneficial and does not address the practicalities of implementation.

9.25 Specifically, Ofcom should:

9.25.1 show that the extent of the remedy is necessary;

9.25.2 address the negative impact on consumers and stakeholders;

9.25.3 consider how the remedy would be implemented.

Is the extent of the remedy necessary?

9.26 Even if some form of remedial action were required (which is by no means evident), Ofcom itself is not even clear about what competition concerns it proposes to solve.[53] Therefore, the chances that the remedy proposed is disproportionate are high.

9.27 It is a rather drastic remedy and the fact that it gives rises to serious consequences for the sale of content rights means that Ofcom should very carefully consider whether it is necessary before imposing it.

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53 Consultation, paragraph 9.61 to 9.63 demonstrates that Ofcom does not know what competition concern it is trying to address

9.28 In the context of whether the remedy is necessary and proportionate it is interesting that Ofcom accepts the need to reimburse Sky for the investment risks it has previously taken and this suggests that it is far from clear that a remedy is required or appropriate:

"[W]e also acknowledge that in many respects the development of pay TV has been a success story. Furthermore, it is a success story that can largely be attributed to Sky, and its willingness to invest private capital in what was initially a highly risky business. Our consideration of possible remedies needs to take this into account."[54]

9.29 However, for the reasons explained in this response, the FAPL's view is that Ofcom's preferred remedy could result in very damaging consequences for consumers and rightsholders and jeopardise the success of pay TV in the United Kingdom.

Negative impacts of the remedy

9.30 As pointed out above, the primary detriment from the proposed remedy would arise from the reduced incentives on rightsholders to invest in premium content, which in turn will degrade the quality of that content. This will reduce the benefit viewers enjoy from watching premium content and that loss will not be restricted to Sky's viewers but will be felt more generally across all football supporters and movie goers.

9.31 Reducing the funds available to FAPL will reduce the benefits of football supporters. Theirs and the FAPL's ambitions are clearly aligned: the FAPL wishes to support the PL clubs, enhance the competition between them and promote English football more widely; supporters want strong clubs and interesting matches and to ensure that English clubs are in a strong position vis-á-vis their European counterparts. Consequently, any detrimental impact on the valuation of FAPL television rights will also have a detrimental impact on consumers.

Implementation of the remedy

9.32 Whilst it is clear that Ofcom intends to undertake a further consultation on the details of the wholesale remedy, should it decide to take it forward, there are a number of details on implementation that cannot be ignored in the first question of whether the

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[54] Consultation, paragraph 8.13

remedy should be pursued further. The specific practical issues will depend on the form the wholesale must-offer remedy will take and therefore the discussion here should not be considered exhaustive and will need to be supplemented in response to any further consultation on the details.

9.33 In relation to the other key issues set out in paragraph 9.12 above the PL comments as follows.

Eligible retailers

9.34 The PL agrees with Ofcom that it should not be taken for granted that all retailers would qualify for a wholesale offer[55]. Any obligation on Sky to wholesale its channels to third party retailers on the DTH platform would be excessive and disproportionate and would be likely to eliminate competition for the PL's rights and to result in all of the very damaging outcomes referred to in paragraphs 9.14 to 9.23 above.

9.35 Ofcom's Consultation is only concerned with inter platform competition and any requirement to wholesale to retailers on the DTH platform goes considerably further than necessary to address Ofcom's concerns.

9.36 Furthermore, any obligation on Sky to wholesale to retailers on the DTH platform would make it impossible for Sky to acquire exclusive DTH rights to **any** of the programming content on the sports and movie channels to which any wholesale must-offer obligation applies (and not just the content identified by Ofcom as "premium"). This in turn would make it impossible for Sky to differentiate its own retail offering on the DTH platform from that of other DTH retailers. That would seriously affect Sky's ability to monetise the rights to that programming content and, therefore, would hugely undermine the value of those rights to Sky and its incentive not only to bid for them but also to invest in the high quality of its own channels and its retail offering on the DTH platform for the benefit of consumers. This would be very harmful to the interests of consumers and rightsholders generally and would in particular cause irreparable damage to the PL, its clubs, lower leagues of English football, football fans and the sport of football as a whole.

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55 Consultation, paragraph 9.10

9.37 Furthermore, any wholesale remedy should not require Sky to wholesale its channels to multiple retailers on the same non-DTH platform or by the same non-DTH means of delivery - for example, to more than one DTT retailer or more than one IPTV retailer. Sky will have made a very significant investment in acquiring rights to the programming on those of its channels to which the remedy applies. Therefore, in relation to each non-DTH platform or means of delivery, Sky should be free to decide whether it would be more efficient to monetise those rights by wholesaling those channels to a single exclusive retailer, or to multiple retailers on a non-exclusive basis, on that non-DTH platform or means of delivery.

9.38 Sky should also be entitled to require that any third party non-DTH retailer should satisfy a number of important qualifications before Sky is obliged to wholesale any of its channels to that retailer. These would include the following:

9.38.1 the platform used by that retailer is able to deliver to its customers a signal which is not of materially lesser technical quality than that delivered by Sky to its digital satellite customers;

9.38.2 that retailer is either sufficiently well funded to pay the wholesale licence fees due to Sky in respect of its channels or provides security in respect of the payment of such licence fees which is reasonably satisfactory to Sky; and

9.38.3 the platform used by that retailer employs a secure encryption system which is able to prevent unauthorised viewing of Sky's channels (whether within or outside the United Kingdom).

9.39 In paragraph 8.13 of the Second Consultation Ofcom states as follows:

> *"In considering whether to adopt any remedy and if so which type of remedy to adopt, we must also recognise the benefits that the current market structure has delivered to consumers. As discussed in section 3, the pay TV industry has grown from almost nothing in the early 1990s to one that now provides services to over 12 million consumers, and is characterised by technical innovation as well as delivering reasonable levels of consumer satisfaction. We do have concerns about the current market structure, as set out in this document, but we also acknowledge that in many respects the development of pay TV has been a success story. Furthermore, it is a success story that can largely be attributed to Sky, and its willingness to invest*

private capital in what was initially a highly risky business. Our consideration of possible remedies needs to take this into account."

9.40 The PL agrees wholeheartedly with the above comments but is very concerned that, if Ofcom seeks to impose a misconceived wholesale remedy on Sky, Ofcom will put at risk not only the success story which is the UK pay TV industry but also all of the benefits for consumers which that success story has delivered. Those benefits include the creation and availability to viewers of high quality programming content (such as PL football). In this context, Ofcom should bear in mind that this high quality programming content is not only made available to pay-tv viewers but also free-to-air viewers. For example, the investment made by the PL and its clubs in the quality of the PL competition does not only benefit the pay-tv viewers of the channels of its current live licensees (Sky and Setanta) but also free-to-air viewers of the channels of its current highlights licensee (the BBC).

9.41 Therefore, if Ofcom were to impose a misconceived wholesale remedy on Sky which significantly reduces (or even eliminates) the incentive of Sky to bid for programming rights and invest in the high quality of its own channels and DTH retail offering (as well as the incentive of third party retailers to bid for programming rights), that misjudgement by Ofcom would have very serious and far-reaching adverse consequences for a very wide range of Stakeholders such as consumers (including sports fans and television viewers as a whole, not just pay-tv viewers) and rightsholders.

9.42 As explained in this response, the PL believes that Ofcom's proposed imposition of a wholesale remedy is fraught with many dangers. However, the principal ways in which Ofcom will ensure the disastrous outcomes referred to in paragraphs 9.40 and 9.41 above are achieved would be to impose on Sky:

9.42.1 regulated wholesale pricing which is flawed (see paragraphs 9.15 to 9.31 above and Annex 2);

9.42.2 an obligation to wholesale any of its channels to third party retailers on the DTH platform; and/or

9.42.3 an obligation to wholesale any of its channels to multiple third party retailers for distribution on the same non-DTH platform or by the same non-DTH means of delivery (e.g. DTT or IPTV).

Pricing

9.43 Attached at Annex 2 is a report by RBB which examines in more detail the implications of wholesale price setting mechanisms.

Residential and commercial customers

9.44 The PL agrees with Ofcom's conclusions that any wholesale remedy should only apply to residential customers. It is quite right that there are different considerations for commercial subscribers.

9.45 Ofcom's Consultation is only concerned with inter platform competition and the alleged effects on the choice of platform operator available to individual residential customers. Any requirement on Sky to wholesale to commercial customers is unnecessary and would be irrelevant to the concern identified by Ofcom. Moreover, any such requirement would further reduce the incentive of bidders to bid for the PL's rights.

Content and channels covered by the obligation

9.46 The PL is not in a position to comment.

Product definition

9.47 The PL is not in a position to comment on product definition.

Commercial terms

9.48 The PL agrees that there are a number of significant commercial terms that should be agreed before Sky is obliged to wholesale any of its channels. The PL has listed in paragraph 9.38 above those which it believes to be the most important from a rightsholder's perspective.

9.49 The PL is particularly concerned about any suggestion that retailers could self-certify their chosen conditional access technology. Sky should be entitled to impose whatever minimum standards or protections it considers are necessary to prevent access to its channels being obtained by unauthorised viewers. In the PL's view, complex or detailed contractual provisions defining Minimum Security Requirements

(MSRs) for a retailer's chosen CA system are not sufficient to ensure secure distribution of content. The key issue is the practical efficacy of the chosen CA system. If that system is not secure and effective in practice, detailed MSR definitions will not assist. Therefore, the focus needs to be on providing Sky with appropriate and effective contractual remedies in the event that in practice a retailer's chosen CA system is not secure and effective.

Review provisions

9.50 Any wholesale must-offer obligation should be subject to regular review by Ofcom and should in any event be reviewed in line with changes of ownership of the programming rights to which any such wholesale remedy applies.

9.51 Nevertheless, despite the fact that the remedy proposed by Ofcom in the second consultation has the potential to reduce the value of IP rights. Ofcom has not set out how it intends to monitor, and react to, the possibility that the value of IP rights is eroded by the remedy.

9.52 In the case of the PL, if in the future broadcasters believe they will be able to obtain access through mandated access to channels which carry IP content, they are likely to value rights less. In the extreme, a perverse situation may arise where, when rights are next allocated, no broadcaster wishes to hold those rights but rather each broadcaster would wish to obtain ex post access at a wholesale price. Put differently, Sky may lose out in the short-term as a result of regulated access, but in the long-term the detrimental effects of any misconceived intervention by Ofcom would fall to the FAPL and other rights holders.

9.53 Furthermore, periodically reviewing the wholesale market would never identify the loss to right holders. Indeed, the process of reviewing the market may lead to the value of those rights spiralling down until they are worthless because at each review the allocation of cost for IP rights in the calculation of the wholesale price would diminish.

Conclusion

9.54 When reaching its final conclusions and imposing any remedy on Sky, Ofcom must take into account the clear and serious risk of the consequences of its preferred remedy on consumers and on rightsholders such as the PL.

9.55 In light of the foregoing and the potentially huge adverse impact on consumers and on rightsholders such as the PL, maintenance of the status quo would be a more proportionate result of this Consultation.

ANNEX 1

RBB | Economics

Comments on Ofcom's definition of the relevant market and its assessment of market power.

RBB Economics, 26 January 2009

1. Introduction

The Second Consultation on access to premium content in pay TV (the Second Consultation[56]) assesses the potential for Sky to exploit market power in the provision of premium pay TV channels. As part of that exercise Ofcom seeks to define the relevant market. Section four of the Second Consultation sets out Ofcom's view on market definition. It concludes that premium sports channels (which include live PL matches) and premium movie channels on pay TV (TV services which require

[56] Ofcom, Pay TV Second Consultation – Access to premium content, 30 September 2008.

viewers to pay for access) constitute their own distinctive and separate markets. Ofcom dismisses the prospect of a wider market for all TV, as set by precedent in previous cases involving pay TV, on the grounds that those cases cited by Sky/FAPL in response to the First Consultation involved assessments of proposed mergers and therefore the relevant counterfactual of a competitive price was not applicable.

Section five of the Second Consultation deals with content aggregation and market power. On the wholesale supply of Core Premium Sports channels, Ofcom concludes that Sky has market power and that this is likely to remain the case for the next three to four years. However, if Sky was to win fewer than four of the FAPL rights packages when they are next auctioned, Ofcom considers that its assessment of dominance would need to need to be revisited.

Based on the markets defined and the finding of dominance, Ofcom goes on to assess the potential for abuse of those markets by examining the competition issues related to core content (Section 6 of the Second Consultation) and the impact on consumers (section 7). A summary of Ofcom's view is that Sky as a vertically integrated firm may deny access to premium content to third party broadcasters, or alternatively Sky may set wholesale prices to maximise wholesale profits. Ofcom believes that Sky is restricting content provision to third party providers and that this ultimately impacts consumers through reduced choice.

The PL does not agree with Ofcom's approach to market definition and considers the finding of market power to be, at best, inconclusive. The specific concerns about Ofcom's approach to market definition are dealt with below. However, they can be summarised as:

- Ofcom fails to identify the competition concern to be addressed – If the potential competition concern to be addressed is not explicitly identified, then it is not possible to address properly the questions that are central to the correct implementation of hypothetical monopolist test. As a result, the available evidence is likely to be incorrectly interpreted and this will imply that the resulting definition of the relevant market will most likely to be flawed.

- Notwithstanding the above, Ofcom's assessment of the available evidence is entirely selective. Indeed, the evidence upon which Ofcom relies is *consistent* with the relevant market being wider than Ofcom suggests.

- Ofcom's reliance on the cellophane fallacy to reject such evidence is not only arbitrary but actually self-circular; Ofcom invokes the cellophane fallacy on the presumption that Sky has market power in order to conclude that Sky has market power!

Each of these points are developed further in sections 2 and 3 below.

2. Ofcom's competitive assessment is incomplete and flawed

The purpose of defining the relevant market is to identify the primary sources of competitive constraints to which firms are subject. However, the definition of the relevant market represents only the first step in any competitive assessment of commercial behaviour. Moreover, any assessment of the appropriate definition of the relevant market needs to relate to the identified competitive concerns. Unless the alleged competition concern is explicitly articulated, the definition of the relevant market is likely to be flawed since it is not possible to identify and assess properly the questions that are central to applying the hypothetical monopolist test. As a result, it is likely that the available evidence is incorrectly interpreted and as a result the definition of the relevant market is likely to be flawed.

The primary concern of Ofcom appears to be a lack of choice for consumers i.e. consumers are harmed because premium content is not available across all platforms. In relation to consumer detriment Ofcom notes that *"the core competition concern we have identified relates to Sky's lack of incentive to supply premium content to retailers other than itself at affordable prices, and the consumer detriment to which [Ofcom] consider this is likely to give rise."*[57]

Ofcom notes further:

> *"[W]e believe that competition in pay TV is likely to be weakened by restricted distribution of Core Premium channels. This results in a lack of choice for consumers, in terms of the content that is available on some platforms, and for some consumers in terms of the platforms that are available to them. Markets where competition is weak, and consumers are unable to exercise a real choice between suppliers, are unlikely to deliver the best outcomes for consumers."*[58]

But these statements do not identify how consumers are harmed. Moreover, the Second Consultation does not explain how consumers are harmed by Sky's alleged market power in the wholesale market for certain types of programming. Put simply, Ofcom fails to articulate how the alleged lack of choice results in consumer detriment.

In theory, consumer detriment might arise through higher retail prices or a general lack of innovation. But the Second Consultation contains no evidence to support either such concern. Indeed, the contrary appears to be the case.

No evidence that retail prices are excessive

The Second Consultation provides no direct evidence that retail prices for pay TV are excessive. Instead Ofcom considers that "there is a risk that prices to consumers will be high, either because of Sky's ability to set high wholesale prices, or because of Sky's ability to leverage upstream market power into downstream retail markets and set high retail margins."[59] However, it is unclear which of these mechanisms Ofcom considers is relevant. Ofcom has not presented any evidence of either. Indeed, Ofcom acknowledges that its "analysis of whether retail prices are high remains inconclusive."[60] Moreover, if the concern relates to retail prices being too high, then the Second Consultation ought to have included an assessment of retail competition, including, but not limited to, defining the relevant market for those services.

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[57] Second Consultation, 8.11
[58] Second Consultation, 7.1
[59] Second Consultation, 7.7
[60] Second Consultation, 7.8

In short, the Second Consultation provides no evidence that retail prices are excessive. This lack of evidence is critical since it seriously undermines Ofcom's proposed remedy concern in this case; namely, that the terms upon which Sky provides its channels to competing pay-TV platforms should be regulated. If retail prices are not excessive and there is no adverse consequences for innovation there can be no basis for regulatory intervention regardless of the definition of the relevant market and Sky's position in that relevant market.

No evidence of a lack of innovation

On innovation Ofcom conveniently ignores the considerable innovation in UK broadcasting that Sky has been at the forefront of. Sky was the first broadcaster to roll out high-definition TV to UK viewers[61]. Sky is widely acknowledged as having introduced and promoted innovations in broadcasting; for example, multiple cameras at sports events. More recently, through its Sky+ product, Sky has improved its digital broadcast TV offering in a number of ways: the ability to pause and rewind live TV; to record entire TV series and to remotely activate the record facility so that viewers need never miss their favourite programs. All of this as occurred despite Sky's alleged market power in the wholesale market.

Conclusions

Ofcom fails to identify clearly its competition concerns and how these are related to Sky's alleged market power in the wholesale supply of certain programming. Rather, Ofcom launches directly into an assessment of the 'relevant' market. The failure to identify properly its competition concerns means that Ofcom's assessment of the relevant market and in particular its assessment of the available evidence is flawed, as the following section describes.

3. Ofcom interpretations of the available evidence is highly selective

Market definition is ultimately an empirical question in which a view on the appropriate definition of the relevant market draws upon the most plausible inferences suggested by the data. In the Second Consultation Ofcom has only reached the conclusion of a narrow market for premium content because:

- Ofcom misrepresents the evidence from its own surveys and infers that the data suggest a narrow market when in reality they are consistent with a competitive market; and,
- Ofcom repeatedly refers to the cellophane fallacy as grounds for dismissing evidence of a wider market (however this argument is entirely circular).

[61] OFT review of BSkyB's position in wholesale pay tv market, December 1996 and Competition Commission merger inquiry into BSkyB/ITV January 2008

These two points are discussed in further detail in turn and we then consider the implications if the analysis were repeated taking these points into account.

3.1. What evidence says about competition at prevailing prices

Consumer surveys, appropriately conducted, can provide an important source of evidence in determining the strength of competitive constraints. As part of its investigation into the pay TV industry Ofcom relies on data collected from four surveys.

We consider that there a number of problems with the methodologies of the different surveys which draw into question the reliability of results drawn from the data analysis Ofcom performs based on them. Nevertheless setting aside those issues, it is clear that Ofcom has been selective in its interpretation of the survey results, specifically:

- Ofcom only considers the bias in its surveys to go one way; i.e. to overstate the extent of the relevant market. However, it is also the case that Ofcom's surveys understate willingness to switch and are therefore biased towards a narrow definition of the relevant market.

- Much of the evidence presented by Ofcom in support of its interpretation of the relevant market is in fact consistent with a wider market definition. Predominately, Ofcom attempts to infer a narrow market because it considers that there is a considerable proportion of consumers unwilling to switch from Sky Sports packages. However, for the purpose of market definition this is entirely irrelevant. The relevant question is whether a sufficient proportion of consumers would switch to make a hypothetical price increase unprofitable. The evidence from Ofcom's surveys suggests that there is a considerable proportion of subscribers who remain a competitive constrain.

- Ofcom's assessment of price sensitivity seems to understate consumers demand for pay-TV subscriptions. Correcting for this may alter the conclusion of Ofcom's critical loss analysis (namely that consumers place insufficient competitive constraint on Sky's wholesale price).

Selective assessment of bias

Ofcom criticises the surveys that it commissioned for producing bias results. In effect, Ofcom claims that its oversight renders its own survey evidence useless for implementing the hypothetical monopolist test. It is surprising that all of the surveys are subject to this criticism given the sequential nature of the surveys and its own extensive history of commissioning market research.

However, and importantly for the definition of the relevant market, Ofcom only considers the bias in its surveys to go one way; namely consumers overstate the propensity to switch from Sky. This overlooks other, equally likely, potential biases that may influence the results in the opposite direction; the survey understating the propensity to switch. Such influences include:

- sample bias:[62] at least one survey excludes the Sky customers who are most likely to give up sports packages in response to a price increase by only surveying respondents who watch sport at least once a week, and as a consequence the results of that survey will underestimate the extent of consumers switching in response to a price increase; and

- response bias:[63] Ofcom note stated preference bias, particularly the potential for consumers to overstate willingness to switch in response to a price change, but it ignores the potential for respondents to claim a particular product or characteristic is essential when their actual behaviour may be different.

Erroneous interpretation of survey results

Ofcom relies on survey evidence to support its narrow market definition. Specifically, the survey results are used to show that there is a large proportion of Sports and Movie subscribers who are unwilling, or unlikely, to cancel their subscriptions. This incorrectly focuses on consumers who are unlikely to switch rather than potential switchers.

It is disingenuous to focus on consumers with a high willingness to pay for the purpose of the SNIPP test. The SNIPP test is **not** concerned with the customers who remain with Sky. So long as there remains 10% of consumers likely to switch if faced with a 10% price increase, the SNIPP test would suggest a wider market.[64] For the purpose of market definition it is *entirely* irrelevant whether 5, 10, or even 80 percent of consumers would never switch in response no matter what the price. So long as there remain sufficient consumers willing to switch in response to a price increase to make it unprofitable the hypothetical monopolist remains constrained and therefore the market should be widened.

Nevertheless, Ofcom concludes (incorrectly) "that there is a narrow economic market for the wholesale of certain premium sports channels[65], specifically those premium channels which contain live FAPL matches"[66] primarily on the basis that FAPL is highly valued by some consumers. Specifically, Ofcom notes that "75% of premium sport channels subscribers with an interest in sport consider FAPL to be *very important*"[67] and "71% of Sky Sports subscribers with an interest in sport said live FAPL was one of the top three most important sports events within their package"[68]. This focus on consumers with high valuation for FAPL however is misguided because: first it fails to

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[62] Sample bias refers to the pool of respondents not being representative of the general population. It may be possible re-weight data in order to make results representative, but to do this it is essential that there are at least some respondents of each *type*. However, Ofcom exclude *all* consumers who watch sports less than once a week, therefore it is impossible for the data to represent the general population.

[63] Response bias occurs where respondents provide answers that differ to what they would do (or have done) in practice.

[64] This is true in this special case because there are negligible avoidable costs associated with a Sky subscriber choosing a sports package and in general an individual will only have a single subscription. Therefore in response to a 10% price increase, the impact on profit is entirely dependent on the proportion of subscribers who choose to stop their subscription. If 9.1% or more stop subscribing, the price increase will be unprofitable.

[65] Later defined as Sky Sports One and Sky Sports Two.

[66] Second Consultation, 4.4

[67] Second Consultation, 4.113

[68] Ibid

address price sensitivity of consumers but rather attempts to infer that a substantial proportion of consumers would not switch in response to a price increase; and, second it ignores the remaining subscribers (25% and 29% respectively) who presumably are willing to switch. It is specifically these marginal consumers who are important for determining the competitive constrains on pay TV, and therefore determining the relevant market

Similar evidence from Ofcom's surveys supports the view that around one quarter of subscribers remain indifferent with respect to Sky Sports and/or the content on it, and therefore are potential switchers. For example:

- between 17% and almost half of Sky Sport subscribers have limited interest in sport;[69]
- around one third of subscribers did not consider FAPL on of the top three reasons for subscribing to Sky Sports;[70] and,
- only around one third of subscribers gave access to live football, or access to FAPL, as a reason for initially subscribing to Sky Sports.[71]

This large pool of potential switchers suggests that raising prices would not be a profitable strategy for a hypothetical monopolist. Therefore, a wider market would be relevant.

Price sensitivity is understated

Ofcom performs a critical loss analysis in which it attempts to determine the degree of consumers' price responsiveness (elasticity) necessary to constrain a hypothetical monopolist wholesaler of premium pay TV. To assess whether consumer reaction is above that level, Ofcom estimates the elasticities for different pay TV packages.

The description of the methodology used to estimate elasticities is insufficiently detailed for us to comment on its appropriateness. Nor does Ofcom provide confidence intervals for its point estimates (a standard practice in econometric analysis). Therefore it is difficult to consider whether the results are robust or not.

Nevertheless, Ofcom's analysis seems to grossly underestimate the propensity to subscribe, and as a result, considerably underestimates consumer elasticity. Specifically, using response data from its surveys Ofcom estimates the demand of current subscribers for pay-TV packages at different price points. Ofcom seems to understate demand because at (or even below) current prices not all current subscribers are predicted to subscribe. Specifically, Ofcom seems to predict that:

- only 40% of current subscribers would subscribe to a basic package even at a price of £5 per month;[72] and,

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[69] Second Consultation, Annex 10, Figure 10
[70] Second Consultation, Annex 10, Figure 20
[71] Second Consultation, Annex 10, Figure 15
[72] Second Consultation, Annex 10, Figure 34 and Figure 38.

- only between 25% and 55% of current sports channel subscribers would take out a sports channel subscription if it cost £5 per month.[73]

If Ofcom's predictions more closely reflected actual demand, the estimated response to a price increase would be greater. It follows that a larger elasticity may be sufficient to alter the conclusion of Ofcom's critical loss analysis and therefore provide evidence of a wider market. ***Conclusions***

Properly interpreted, the evidence from Ofcom's surveys suggests that FAPL is not an essential input into pay TV. Rather, the surveys suggest that there is a considerable proportion of subscribers who are indifferent to subscribing to premium packages, who do not place a large value on premium sports channels and who therefore act to constrain the pricing of pay-TV.

3.2. Inappropriate reference to the cellophane fallacy

Throughout the Second Consultation and supporting annexes the Cellophane fallacy (the notion that prices for pay TV may already be above the competitive level) is given as a rational for ignoring evidence for a wider market. Ofcom is correct to highlight the *potential* for the Cellophane Fallacy to exist. However, it is entirely without justification to use the Cellophane fallacy as grounds for dismissing any and all evidence of a wider market, thereby concluding that the relevant market must be narrow. This approach is:

- logically flawed and circular – Put simply, assuming that there is no unambiguous evidence of a wide market does not necessarily imply to a narrow market definition;
- a mere assertion on Ofcom's part – No evidence is offered by Ofcom to support its theory that prices are above the competitive level[74]; and
- inconsistent with the evidence – Evidence in the Second Consultation is inconsistent with Sky acting in a monopolistic manner.

We deal with each of these points in turn below.

Logically flawed

By appealing to the cellophane fallacy Ofcom speculates that Sky may have market power and notes that if this is indeed the case that any evidence of switching between Sky and its rivals may overstate the competitive constraint and is therefore invalid. However, this argument is entirely circular: Ofcom speculates that market power exists; based upon this it then disregards evidence that market power does not exist; and, thus concludes that its initial speculation was correct.

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[73] Second Consultation, Annex 10, Figure 36

[74] As noted below, Ofcom does not identify conceptually what it considers the competitive outcome, or the competitive price to be, therefore it seems entirely spurious to conclude that current price are above some undefined level.

In the SNIPP test, the relevant market is widened only if there is evidence of sufficient *aggregate* competitive constrains from consumers switching and/or alternative providers entering the market to make a price increase unprofitable. Ofcom does not attempt to assess what the extent of consumer switching would be at the 'competitive' level, rather it simply dismisses evidence of consumer switching constraining Sky. This ignores the fact that at the 'competitive' price there would be some consumer switching and therefore underestimates the *aggregate* effect of a price change.

Put simply, without any proof that prices are above the 'competitive' level it is wrong to assume that the market may not competitive as this leads to a conclusion of market power where none may exist.

Cellophane fallacy is mere assertion

If one considered that prices might be above the competitive level, it would be appropriate to provide some evidence which suggested they may be. In such a case it may be reasonable to give less weight to evidence of consumer switching for the purpose of market definition.

Ofcom does not present any evidence consistent with prices being above competitive levels, rather it asserts:

> "*Some previous findings give us reason to be cautious about the presence of the cellophane fallacy in these types of markets. It can be difficult to observe whether prices are above competitive levels. This suggests to us that wholesale prices may well be above competitive levels. In practice we observe high margins for Sky's wholesale channels and aggregation of a large proportion of relevant content*"[75]

However, the notion that prices are difficult to observe is neither, evidence that prices are above the competitive level, nor reasonable grounds for assuming that they might be. If Ofcom's logic were applied more widely, there would be reasonable grounds to conclude that the input costs for any good with multiple inputs are set at monopoly levels. This is clearly an untenable position and would inhibit anti-competitive assessment.

In addition, Ofcom does not find evidence of Sky making high margins, instead its analysis is inconclusive. Moreover, high margins are essential in broadcasting to enable broadcasters to recover the large fixed costs they incurred in acquiring rights and developing programs. Therefore, even if Ofcom found 'high' margins, that would be consistent with a competitive market and not as Ofcom suggests evidence that the cellophane fallacy is prevalent.

Evidence inconsistent with monopoly prices

In the Second Consultation there are two pieces of evidence which are inconsistent with Sky monopoly pricing premium channels and therefore cast doubt on Ofcom's assertion that the cellophane fallacy is a concern:

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[75] Second Consultation, Annex 6, 1.21

- Ofcom's own estimations of elasticities; and
- the fact that prices for sports subscriptions have fallen.

In annex 10 to the Second Consultation Ofcom estimates own price elasticities for Sky Sports packages, Movie packages, and for combined Sports and Movie packages.[76] In an industry characterised by large fixed costs and negligible marginal costs, a monopolist would attempt to maximise revenue, which coincides with raising the price until the own price elasticity of demand reaches one.

It is typical when presenting estimations to provide some measure of the confidence that can be placed in the magnitude of the results. Ofcom does not provide any such information. Nevertheless, the point estimates Ofcom present are largely dispersed and rarely close to one. Therefore it seems, based on Ofcom's evidence, that the prices for premium packages are not set at monopoly levels, and therefore that the cellophane fallacy is not a justifiable concern.

In addition, Sky presented Ofcom with evidence that the price of its retail Sport packages fell in real terms. Ofcom dismisses this evidence and claims that Sky's margins increase over the same period (albeit that Ofcom itself places little confidence in its analysis of margins). However, this ignores the basis fact that a monopolist would have no incentive to reduce prices unless consumers' preference for its product began to diminish (which would draw into question Ofcom's inference that the channels are essential).

Conclusions

As we have shown above, there are no reasonable grounds on which to consider the cellophane fallacy a justifiable reason for dismissing evidence of consumer switching behaviour. Conversely there is evidence that prices are not at monopoly levels. Logically, therefore, it would seem correct to include evidence of consumer behaviour in the SNIPP test. In addition, much of Ofcom's own evidence, when properly interpreted, suggests that there is a constraint on the ability of a hypothetical monopoly pay TV provider to extract monopoly returns from either the wholesale or retail sale of premium channels. The logical conclusion must therefore be for a wider market than that which is considered relevant by Ofcom.

[76] Ofcom does not accurately describe how it has estimate elasticities, therefore it is difficult to judge whether the estimates are reliable. Nevertheless, it remains that if Ofcom is sufficiently confident in its own analysis to present them, that it should have used these estimates to assess the feasibility of the cellophane fallacy.

ANNEX 2

RBB | Economics

Wholesale Pricing Mechanism

RBB Economics, 26 January 2009

Ofcom states that it is important that any remedy does not adversely affect the value of rights. However, for the reasons set out in the main response, the proposed wholesale must offer remedy will depress competition in the upstream markets for acquiring content rights (including, but not limited to, PL), in part because, as Ofcom acknowledges, there is considerable uncertainty as to how the wholesale price will be determined. Indeed, the task of setting a wholesale price in the broadcasting industry is extensively more complex than in a standard utility setting.

To ensure that the value of rights is not adversely affected by the wholesale remedy two issues must first be addressed:

- The mandated wholesale price must not reduce incentives to compete for content. Unlike standard products there is no single obvious charging mechanism for wholesale access to TV content. Different charging mechanisms change the incentives of retailers (and possibly the wholesaler). Those incentives need to be scrutinised to ensure that the content acquisition market remains competitive and broadcasters compete for content. And once the mechanism is determined:

- The price for wholesale access needs to be set at a level to ensure that the broadcasters' willingness to pay for content is not undermined because of regulatory intervention that hampers a wholesaler's ability to recoup the cost of obtaining rights.

This note is not intended as a complete assessment of these points. Rather, a brief assessment of each point in turn shows that without careful consideration of how the wholesale price is set there is likely to be considerable loss in the value of content rights.

The charging mechanism (e.g. a fixed licence fee or a per subscriber fee) is equally as important as the level of the price in setting incentives for retailers. The specifics of the charging mechanism can also considerably influence the ability of the wholesaler to recover the considerable upfront costs. This in turn influences the willingness to pay for content rights. Ofcom must make sure that it gets both the charging mechanism right and the wholesale price right.

The charging mechanism and wholesale pricing must allow and/or provide for the following:

- Co recovery by the wholesaler taking into account fluctuations in costs;
- A fair margin for the wholesaler ; and
- Differential pricing across retailers to reflect different platforms and subscriber bases and fluctuations in subscriber numbers.

Setting the wholesale price level

The value a wholesaler will place on rights will depend on their ability to recover those costs from retailers. This in part depends on the level at which the price is set, but also the risk wholesales face if in the future wholesale price will be reduced.

In addition to the points we have raised, Ofcom has noted that setting the wholesale price is a complex task because:

- It is not clear whether a retail minus approach or cost plus approach is appropriate. In this regard it is interesting that Ofcom states that "[w]hich of the two approaches ... is most appropriate could relate to the competition concern that [Ofcom is] seeking to address"[77]. Ofcom goes on to argue that "If the competition concern were primarily with high wholesale margin, a retail-minus approach would not directly address those wholesale profits"[78] and "if the competition concern were primarily that retail competitors were being foreclosed, then a retail-minus approach would seem to be more directly focused on tackling the competition concern"[79]. These statements are surprising; a remedy is justified only if there is a clear competition concern to address. This only confirms the concerns PL has expressed in

[77] Second Consultation, 9.61
[78] Second Consultation, 9.62
[79] Second Consultation, 9.63

relation to Ofcom's approach to market definition and assessment of market power and its lack of identification of the competition concern it is seeking to remedy.

- A cost plus approach estimates the costs of providing the wholesale premium channels and adds a appropriate margin. Before a cost plus approach can be applied the flowing issues need to be addressed:

  - *What are the relevant costs to include?* Sky (or any wholesaler) incurs considerable cost in providing TV services, some of those costs can be directly attributed to the different premium channels, some will be common costs shared with other channels and some will be entirely separate to premium channel provision. It is unclear that the information needed to accurately capture the costs in each category is available. Therefore the remedy runs a very real risk of underestimating costs, which would undermine the incentives to bid for content.

  - *How should common costs be allocated?* A large proportion of Sky's costs are common. That is they cannot be directly attributed to a single channel. For example, back-office services such as HR and finance. Such costs would clearly have to be incurred by a third party retailer providing its own premium channels in competition with Sky and therefore should (at least partially) be included. However, it is unclear what proportion of those costs should be incorporated when assessing the wholesale cost plus price.

  - *How can the endogeneity of the cost of acquiring rights be corrected?* As noted above, including the cost of acquiring content is essential if the wholesaler is to recover costs. However, doing so may undermine incentives to bid for those rights and so reduce the value of content rights.

  - *What is the relevant margin?* Setting too low a wholesale margin will undermine Sky's incentives to invest in content, because it will be unable to make an adequate return. However, it is unclear that the margin an efficient retailer is able to make can be accurately determined.

- A retail minus approach would take Sky's retail price and net off a margin for retailers. However, for it to be workable the following issues need to be addressed:

  - *What is the appropriate retail price?* Sky offers bundles of TV channels, not standalone Sky Sports or Sky Movies channels. The benefits of this approach are well documented and include significant economics of scope. However, it must be remembered that Sky sells multiple bundles of basic and premium channels at multiple retail prices. There is no standalone price for Sky's premium sports channels and no particularly obvious bundle from which to extract a retail price. Any attempt to assess a retail price for premium sports channels by reference to bundled prices would be arbitrary. For example, the incremental price of adding Sky Sports One and Two to a package that already contains Sky's premium movie channels is considerably less than adding it to a basic package.

  - *How should changes in retail pricing structure be treated?* If Sky is to compete with other broadcasters it must retain the flexibility to change its packages and the pricing of those packages. It is unclear how these dynamic considerations are to be incorporated in a retail-minus approach.

- *How is the impact that non core content on premium channels has on the price Sky can charge accounted for*? Each of the Sky Sports channels contains a huge range of sports content (not just FAPL) which contributes to the overall value and retail price of that channel. It is very difficult to see how Ofcom would take account of that fact in a retail minus approach. For example, if Sky were to win the rights to a major sporting event (other than FAPL) that would enable it (and other retailers) to attract more subscribers. In turn that would enable Sky to raise its retail price. A wholesale price that does not take this into account will undermine Sky's incentives to invest in rights. .

- *How is the relevant margin to be determined*? As with the cost-plus approach, a crucial factor in setting the wholesale price is the margin an efficient retailer is allowed. If the margin is set too high, retailers will benefit at Sky's expense.

Moreover, the difficulty of setting a wholesale price for TV channels is more complex than in a standard utility setting because paradoxically, the cost of providing a channel is dependent on the ability to recover the costs of rights; the more able the broadcasters are to recover costs, the more they will pay for rights and the more program makers will invest in developing content.

Given the difficulties in setting the wholesale price, it is natural to expect broadcasters to factor in the risk of not recovering costs into their willingness to pay for content. Clearly in this regard a higher wholesale price would better enable a wholesaler to recover costs, and so is less likely to reduce a broadcasters' willingness to pay for content. However, there is an additional factor that must be taken into account and that is what will happen to the wholesale remedy when it is reviewed? This is important because the period rights are issued for is unlikely to coincide with the remedy review period. Therefore, wholesalers face the risk that at review, their ability to recover the costs incurred in obtaining rights will be undermined because of the difficulty in accurately determining the appropriate price. This is likely to further reduce broadcasters' willingness to pay for content.