



Competition issues in premium pay TV movies

Proposed reference to the Competition Commission

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

Consultation

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Section 1

Summary

- 1.1 This consultation sets out our proposed decision to refer two closely related markets to the Competition Commission ('CC') for market investigation, under the Enterprise Act 2002 ('EA02'). This is with a view to asking the CC to remedy those competition concerns which we have identified, particularly in relation to the restricted exploitation of subscription video on demand ('SVoD') movie rights, which we cannot adequately address using our sectoral powers.
- 1.2 We are consulting on our proposed decision to refer the markets for:
- The upstream sale of movie rights from the Major Hollywood Studios¹ in the first pay TV subscription window. The purchaser of these rights is currently able to show movies on subscription linear channels as well as via SVoD services.
 - The wholesale supply of packages including Core Premium Movies channels². This market would include SVoD services, but few such services currently exist.
- 1.3 This proposed reference to the CC results from our pay TV market investigation, in which we set out to determine whether the UK pay TV sector was delivering benefits to consumers through competition in terms of choice, innovation and price.
- 1.4 Pay TV is now the single largest source of revenue in the UK's TV industry. The sector has historically been driven by cable and satellite offerings, but is now at a point where there is the potential for a wide variety of services over different delivery mechanisms including Internet Protocol Television ('IPTV') and pay Digital Terrestrial Television ('DTT').
- 1.5 This proposed reference to the CC concerns the rights to movies from the Major Hollywood Studios that are distributed in the first pay TV subscription window. It also concerns the wholesale services which are based on those rights. Such services are extremely important to competition in the pay TV sector, because they are highly attractive to a large number of consumers.
- 1.6 Our analysis has indicated that the markets we are proposing to refer are characterised by various features that, in combination, have an adverse effect on competition in the sector. This in turn will negatively affect innovation and the consumer experience, particularly in terms of reduced choice and relatively high prices. Specifically, these features are:
- A limited pool of premium content from the Major Hollywood Studios.
 - The way in which the rights to broadcast movies are made available over time (i.e. the release windows structure).

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

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

- Staggered availability of content rights and duration of contracts for premium movie rights³.
- Aggregation of substitutable premium movies into a single wholesale offering.
- The joint licensing of premium linear channel and SVoD rights⁴ by individual studios.
- Exclusivity of rights licensing agreements between individual studios and purchasers of rights.
- Other restrictions in contracts for the rights in the first pay TV subscription window, such as [X].
- Sky's market power in the distribution of Core Premium Movies channels, which in turn gives Sky a high degree of negotiating power with the Major Hollywood Studios in the upstream market.
- Vertical integration of firms over the pay TV supply chain. In particular, vertical integration in conjunction with its market power gives Sky an incentive to limit the exploitation of its SVoD rights, and restrict distribution of its wholesale channels.

1.7 We believe that the combination of these features prevents, restricts or distorts competition in relation to these closely linked markets. In particular we believe that the combination of the features identified creates a situation in which one player is enabled and incentivised to restrict, prevent and distort competition in the wholesale supply of premium subscription movie services. We see these issues being manifested in three ways:

- **Limited exploitation of premium SVoD rights:** Sky has exclusive access to the SVoD rights in the first pay TV subscription window as part of its contracts with Major Hollywood Studios, because they are sold exclusively together with the linear channel rights. However Sky currently only exploits these rights via Sky Player (on the PC or Xbox)⁵ because its satellite platform is not able to offer true VoD⁶. We note that Sky is planning to introduce a pull VoD service to the TV via broadband, but it appears that at least initially this will only be available to a minority of its installed base of set-top boxes. In contrast, operators of cable or IPTV platforms have been capable of delivering true VoD services for several years but have been unsuccessful in gaining access to premium SVoD rights. We believe that limited exploitation of premium SVoD rights means that consumers will increasingly lose out in terms of both choice and innovation.

³ Premium movie rights are the rights that are licensed by the Major Hollywood Studios in the first pay TV subscription window.

⁴ The term 'premium SVoD rights' is used to refer to the SVoD rights that are licensed in the first pay TV subscription window by the Major Hollywood Studios.

⁵ The distribution of these services, however, is fairly limited. For example in October 2009 there were only [X] Sky Player subscribers.

⁶ True or 'Pull' VoD means that consumers can get instant access to the film of their choice. In contrast Sky's satellite platform offers 'Push' VoD service, where content is downloaded to the hard drive of the set-top box and made available to view on demand, thus creating the effect of VoD. Push VoD services are limited by the capacity available to store programming on the set-top box, so generally offer much less on-demand programming than Pull VoD.

- **Restricted distribution of Sky’s Core Premium Movies channels:** As we set out in our Pay TV Statement, Sky exploits its market power by restricting wholesale distribution of its Core Premium Movies channels. The current importance of these channels to competition in the pay TV sector means that consumers lose out in terms of choice and innovation; selection of pay TV platform appears to be distorted by the limited choice of retailers of Core Premium Movies channels, and new innovative platforms are less able to develop without access to premium movie channels needed to establish premium movie services.
- **High prices for Sky’s Core Premium Movies channels:** The combination of identified features, in particular the joint licensing of the linear and SVoD rights and Sky’s market power in the wholesale supply of packages including Core Premium Movies channels, means that Sky is able to charge high wholesale prices for premium movie channels, which are reflected in high retail prices to consumers. We believe that SVoD services could impose a significant competitive constraint on linear channels and vice versa. As a result, if other operators could get access to SVoD or linear rights, they ought to be able to compete down the prices of premium movies. However, the exclusive joint licensing of the two sets of rights prevents rivals being able to offer competing services. As a result, consumers face relatively high prices for access to premium movie channels.

- 1.8 SVoD services have become an increasing focus through the course of our pay TV investigation. Whereas there was little mention of the importance of SVoD services in response to our First Pay TV Consultation, responses to our Second Pay TV Consultation highlighted limited exploitation of SVoD rights as an issue. We therefore consulted in our Third Pay TV Consultation on the possibility that we might address this by making a reference to the CC, but we did not at that time consult on the specifics of such a reference. That is the purpose of this consultation.
- 1.9 We note in the Pay TV Statement⁷ that the importance of linear movie channels appears to be gradually declining over time, as illustrated by the limited demand for them from pay TV retailers. Subscription services offering recent movies on demand seem to present a more compelling long-term proposition and a stronger proposition for securing effective competition, particularly as IPTV and video-on-demand services provided over the open internet come of age. They offer consumers many of the same characteristics as linear channels, but with the added benefit that they provide convenient access to a wide range of content on demand. The wider availability of these services would therefore provide an immediate benefit to consumers.
- 1.10 There is also a potential longer-term benefit, in that the ability to provide high-value video content on demand is one of the commercial justifications for investing in new superfast broadband networks. Movies are particularly important in this context, being both valuable to consumers, and well-suited to a true VoD service. Limited access to such content risks holding back such investment, with a wide range of resulting consequences for consumers.
- 1.11 Given Sky’s joint control of both premium SVoD and linear movie rights, we are concerned that it could be the only player to take advantage of these developments. As a result we are concerned that Sky will maintain its market power, and will exploit that market power by restricting exploitation of SVoD rights and restricting distribution

⁷ Pay TV Statement, Section 9, e.g. paragraphs 9.9 – 9.10.

of resulting services. We believe it is unlikely that, absent intervention, competition will develop or the market will deliver the full benefits of SVoD services.

- 1.12 As we set out in our Third Pay TV Consultation in June 2009, it would be possible for us to address at least one of our three concerns – restricted distribution of linear channels – using our powers under section 316 ('s316') of the Communications Act 2003 ('CA03'). However, the retail-minus wholesale must-offer obligation that we proposed in that consultation would not address our other concerns around limited exploitation of SVoD rights and high prices for premium movie channels. Given the likelihood that SVoD will increase in importance relative to linear channels, it risks being a remedy for yesterday's problem. This is illustrated by the limited demand for wholesale access to Sky's linear movie channels from other retailers. We therefore consider that a linear channel wholesale must-offer remedy on all platforms would not by itself be an effective forward-looking solution to our competition concerns.
- 1.13 A more forward-looking approach would be to seek the possibility of greater competition using access to SVoD rights. However, our powers under s316 CA03 do not extend to SVoD services, whilst action under Competition Act 1998 is unlikely to be effective as a means of addressing our concerns.
- 1.14 While an SVoD-focused remedy would be outside our powers, there is a reasonable prospect that the CC would have appropriate remedies open to it. We have given some initial thought to options for addressing our concerns, although this would be for the CC to consider. We have identified two broad approaches to potential remedies:
- The CC could seek to address the identified concerns at source, by intervening to change the way in which key content rights are bought and sold. Such intervention might involve restrictions on the ability of firms to aggregate content or requirements to make the sale process more contestable. Depending on the precise form of a remedy, it could facilitate new players entering the market, but also promote innovation around new platforms and / or increase competitive pressure on wholesale margins.
 - Second, the CC could intervene to reduce Sky's ability to exploit market power, by requiring it to provide wholesale access to particular content on regulated terms. Such wholesale access might go beyond what we can achieve with our sectoral powers, since it could include non-linear VoD services as well as linear channels. Such an obligation could enable other operators to develop pay TV offers which include premium content, facilitating choice and innovation.
- 1.15 We are consulting on our proposed decision to make a market investigation reference to the CC in order to examine these competition issues and consider possible remedies. We invite comments by 15 May 2010.

Section 2

Introduction

Summary

- 2.1 In this document we are consulting on a proposed market investigation reference to the CC under the Enterprise Act 2002. We are proposing to refer the markets for:
- The upstream sale of movie rights from Major Hollywood Studios in the first pay TV subscription window. The purchaser of these rights is currently able to show movies on subscription linear channels as well as via SVoD.
 - The wholesale supply of packages including Core Premium Movies channels. This market would include SVoD, although few such services currently exist.
- 2.2 This reflects our concern that features of these markets are restricting, preventing and distorting competition, leading to adverse effects for consumers in the related downstream retail market.
- 2.3 This consultation follows from our pay TV investigation, in which we set out to determine whether the UK pay TV sector was delivering benefits to consumers through competition in terms of choice, innovation and price. We announced the launch of this investigation in March 2007 following receipt of a preliminary submission from BT, Setanta, Top Up TV and Virgin Media ('The Four Parties')⁸ in January 2007. Since opening the investigation we have published three consultations and a final statement.

Legal powers

- 2.4 We have a concurrent power with the Office of Fair Trading ('OFT'), relating to commercial activities connected with communications matters, to make market investigation references to the CC under s.131 EA02⁹.
- 2.5 Section 131 provides:
- “(1) [Ofcom] may...make a reference to the Commission if [Ofcom] has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.
- (2) For the purposes of this Part any reference to a feature of a market in the United Kingdom for goods or services shall be construed as a reference to:
- (a) the structure of the market concerned or any aspect of that structure;

⁸'The Four Parties' became 'The Three Parties' following Setanta's demise in the middle of 2009.

⁹ S.370 CA03.

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

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

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

- 2.6 It is therefore clear that a “feature” of a market for the purposes of EA02 has a broad meaning. In cases where the s131 EA02 test has been met, we have discretion on whether to make a reference. We exercise that discretion having regard to the OFT’s guidance on market investigation references (the ‘OFT’s Guidance’)¹⁰.
- 2.7 Amongst the factors we consider in deciding whether or not to make a reference are our competition and sectoral powers. We have concurrent Competition Act 1998 (‘CA98’) powers under s371 CA03 in relation to activities connected with communications matters. We also have sectoral competition powers under s316 CA03. However, these powers exist only in relation to licensed and connected services.
- 2.8 This consultation is published in accordance with s169 EA02, which requires us to consult, so far as is practicable, any person on whose interests a proposed reference is likely to have a substantial impact and give reasons for the proposed decision.

The pay TV market investigation

Background

- 2.9 This process began as a general investigation into the pay TV sector, prompted by a request for a market investigation reference to the CC under the EA02.
- 2.10 Since opening the investigation we have published three consultations and a final statement.
- First Pay TV Consultation: in December 2007 we consulted on initial views on the operation of the pay TV sector.
 - Second Pay TV Consultation: in September 2008 we set out further analysis on sports and movies markets, and proposed to tackle our concerns over access to premium channels through a wholesale must-offer obligation using our sector-specific competition powers under s316 CA03.
 - Third Pay TV Consultation: in June 2009 we confirmed our view that content aggregation has enabled British Sky Broadcasting (‘Sky’) to gain a position of market power in the wholesale markets for premium sports and movies channels. We also set out the details of our proposed wholesale must-offer obligation. Additionally, we proposed to consider further whether there should be an intervention in the sale of Premier League and premium SVoD rights.

¹⁰ OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006 - http://www.of.gov.uk/shared_of/business_leaflets/enterprise_act/oft511.pdf.

- Pay TV Statement: in our Pay TV Statement, published at the same time as this document, we have decided to put a wholesale must-offer obligation in place on Sky Sports 1 and 2 on regulated terms.
- 2.11 On 16 January 2007 we received a preliminary submission from The Four Parties, which alleged that competition in the UK pay TV sector is not working properly, and that Ofcom should refer the industry to the CC for investigation. Subsequently, in December 2007 we published a First Pay TV Consultation Document, where we set out our preliminary views on the operation of the market. This outlined some initial concerns relating to the manner in which premium content is aggregated and distributed, which we believed may restrict competition in the retail market to the detriment of consumers. The responses to this consultation focused on the distribution of premium content via Sky’s linear Core Premium Movies channels.
- 2.12 Our Second Pay TV Consultation identified some particular concerns relating to access to linear premium content and consulted on the possible broad forms of remedy that Ofcom could use to address those concerns. Specifically, we were concerned that Sky, as a vertically integrated firm with market power in a key upstream market, will distribute premium content in a manner that favours its own platform and retail business. We also expressed the concern that Sky may have limited incentives to exploit its SVoD rights by developing an extensive SVoD movies service. Instead of making a reference to the CC, we proposed to tackle these concerns by putting in place a wholesale must-offer obligation using our sectoral competition powers under s316 CA03¹¹. However, as some of the Major Hollywood Studios’ rights were up for renewal in the near future, we emphasised this position was subject to change.
- 2.13 As set out below, responses to our Second Pay TV Consultation focussed more on issues around SVoD rights. In particular, BT expressed concerns over the ‘warehousing’ of SVoD rights by Sky alongside the contractual holdbacks in Sky’s agreements with the Major Hollywood Studios¹². Since the publication of the Second Pay TV Consultation, [X].
- 2.14 In our Third Pay TV Consultation, we argued that Sky had an incentive to restrict exploitation of its SVoD rights, in order to protect its own linear movie channels¹³. Consequently, we were concerned that innovation in the development of SVoD services may be stifled. This concern led us to believe that there may be a case for targeted intervention in the sale and purchase of SVoD rights. We suggested that making the SVoD rights available transparently and separately from linear rights could allow other companies to acquire SVoD rights and establish services which could appeal to consumers.
- 2.15 At this point, we saw a substantial change in the way these rights were awarded in the UK in the short to medium term as unlikely. However, we believed that before consulting formally on a reference, it would be constructive to engage further with the Major Hollywood Studios, to establish whether likely market developments would obviate the need for regulatory intervention.
- 2.16 Responses to our Third Pay TV Consultation emphasised the importance of SVoD rights, with stakeholders such as [X], [X] and Paramount providing their first submissions on this issue. As mentioned above, in order to analyse these responses

¹¹ Second Pay TV Consultation, paragraph 9.50.

¹² BT non-confidential response to Second Pay TV Consultation, page 5.

¹³ Third Pay TV Consultation, paragraphs 12.19 to 12.21.

and our identified competition concerns we engaged in discussions with all the Major Hollywood Studios on the issue of SVoD rights. [X].

- 2.17 In a separate but related process, we have also concluded on Sky and Arqiva's proposals to launch 'Picnic', a proposed pay TV service on DTT. We have published our Picnic Statement at the same time as this document. As part of that decision, we have put in place a requirement for Sky to have concluded a wholesale agreement with a third party retailer for any movies channels it wishes to include in Picnic before it launches.
- 2.18 In the remainder of this section we set out in more detail the content of the previous consultations that is particularly relevant to premium movies and SVoD services.

Second Pay TV Consultation

Movies wholesale must-offer obligation

- 2.19 In our Second Pay TV Consultation, we proposed to place a wholesale must-offer obligation on Sky, the scope of which would have covered all Core Premium Sports and Core Premium Movies channels supplied by Sky¹⁴. This would have included all the Sky Movies channels apart from Classics. In terms of SVoD, we said we would expect that where Sky uses those rights as the basis of a SVoD service to its own retail customers, it should make a wholesale version of this SVoD service available to other platforms¹⁵.

Consultation responses

SVoD rights

- 2.20 Sky objected to our proposed market definition in terms of movies, arguing that Ofcom had failed to have proper regard to the changes that had taken place in the availability of films to different windows and via different delivery mechanisms¹⁶. In addition, it argued a requirement for Sky to create a new SVoD service would be radical¹⁷. Sky stated that not including SVoD within the scope of a wholesale must-offer obligation would not preclude significant additional entry into the market¹⁸.
- 2.21 Sky noted that release windows prior to the pay TV window have been moving closer to the theatrical release date, and therefore are becoming relatively more attractive than the pay TV subscription window¹⁹. It also emphasised that more Pay Per View ('PPV') and VoD services are being offered via TV platforms than Ofcom had characterised previously²⁰. Sky stated that VoD services in the UK have grown significantly in terms of the number of providers, the content available and the features offered²¹.
- 2.22 In contrast, The Four Parties supported the proposal to require Sky to wholesale its Core Premium Movies channels on regulated terms and agreed that an ex ante

¹⁴ See Section 5 and 6 of the Pay TV Statement for the full description of these terms.

¹⁵ Second Pay TV Consultation, paragraphs 9.49 to 9.50.

¹⁶ Sky response to Second Pay TV Consultation, Annex 3, paragraph 1.3.

¹⁷ Sky response to Second Pay TV Consultation, paragraphs 8.14 to 8.16.

¹⁸ Ibid, paragraphs 8.14 to 8.16.

¹⁹ Sky response to Second Pay TV Consultation, Annex 3 paragraphs 2.1 to 2.7.

²⁰ Ibid, paragraph 4.1.

²¹ Sky response to Second Pay TV Consultation, Annex 2, paragraph 1.1.1.

pricing rule is necessary²². They also agreed with the proposed application of a wholesale must-offer obligation to SVoD rights and emphasised Ofcom should also prevent Sky enforcing its holdbacks in contracts with the Major Hollywood Studios²³.

- 2.23 In response to our Second Pay TV Consultation, BT considered access to SVoD rights as essential to the development of different consumer offerings, stating that without such access innovation will be stifled²⁴. [X]²⁵.
- 2.24 Similarly, [X] argued that [X]²⁶. It also emphasised that it is impossible for another platform to launch a competing service for movies with a premium linear channel or SVoD bundle, as Sky has exclusive licensing arrangements with the Major Hollywood Studios²⁷.
- 2.25 Virgin Media believed that deals with no fewer than three of the Major Hollywood Studios would be required to support a viable competitive offering. It argued that the barriers facing new entrants are very significant, even in relation to the acquisition of rights from only one of the six Major Hollywood Studios²⁸.

Third Pay TV Consultation

SVoD rights and movies wholesale must-offer

- 2.26 In our Third Pay TV Consultation, we suggested that making the SVoD rights available transparently and separately from the linear rights may address our concerns over the risk to developments in innovation. We also maintained a view that there was unlikely to be a substantial change in the way these rights are awarded in the UK in the short to medium term²⁹. Nonetheless, our principal concern was whether a reference would be an appropriate response at this time.
- 2.27 In our Third Pay TV Consultation, we proposed to impose a wholesale must-offer obligation on all the Sky Movies channels apart from Classics.

Consultation responses

Movies wholesale must-offer obligation

- 2.28 Sky expressed the view that we should not impose a wholesale must-offer on movies. Its view was predominately based on the idea that Sky's movies channels compete both with other ways of watching movies and with non-movies programming³⁰.
- 2.29 The BBC agreed that the wholesale market for movies channels contained all Sky movies channels apart from Sky Movies Classics³¹.

²² The Four Parties joint response to Second Pay TV Consultation, paragraph 1.3.

²³ Ibid, paragraph 9.

²⁴ BT non-confidential response to Second Pay TV Consultation, page 6.

²⁵ [X]

²⁶ [X]

²⁷ Ibid, page 9.

²⁸ Virgin Media response to Second Pay TV Consultation, q. 13.

²⁹ Third Pay TV Consultation, paragraph 6.150.

³⁰ Sky response to Third Pay TV Consultation, paragraph 9.30 to 9.31.

³¹ BBC response to Third Pay TV Consultation, page 2.

- 2.30 BT, Top Up TV and Virgin Media ('The Three Parties') believed that Sky enjoys a dominant position in retail markets for the supply of packages containing premium pay TV movie channels³².
- 2.31 In general, the responses also revealed a limited demand for linear movie channels, especially compared to the relative importance many operators placed on an SVoD movie service featuring movies from the first pay TV subscription window. We set out their views in further detail in Section 3 of this document.

SVoD rights

- 2.32 In response, Sky argued that Ofcom had a narrow view of the availability of movies on pay TV, ignoring that consumers were well served by many other options for viewing movies³³. It believed the issue of SVoD rights was unsuitable for a market investigation reference to the CC, citing it as inappropriate for such a small, limited issue³⁴. In terms of selling SVoD and linear rights separately, Sky also highlighted the possibility that removing exclusivity would result in a lower per subscriber wholesale fee, leaving the studios in a worse position³⁵. Sky further argued that under Ofcom's proposals, consumers wanting the choice to view both SVoD and linear channels might have to pay for two services³⁶.
- 2.33 Virgin Media argued that splitting the sale of SVoD and linear rights would be a much more effective remedy than requiring Sky to wholesale a channel containing SVoD rights³⁷. It also suggested an alternative remedy to open up the market to more competition, with SVoD rights sold on a platform exclusive basis within a territory³⁸.
- 2.34 BT also supported Ofcom's assertion regarding the attractiveness of SVoD, highlighting the success of these services in other markets where there are no apparent competitive distortions in accessing SVoD rights³⁹. It believed a market reference on SVoD rights was fully justified, stating that, if issues with the Hollywood studios are not resolved, Ofcom should make a reference to the CC as soon as practicable⁴⁰.
- 2.35 [X] agreed with our proposal to separate SVoD and linear rights, [X]⁴¹. [X]
- 2.36 Rights holders such as Paramount stressed that the removal of exclusivity would lead to a significant drop in the revenue that it receives from Sky for pay TV and SVoD rights. Furthermore, it did not believe that the separation of rights would improve consumer welfare either by lowering process or increasing choice⁴². Paramount said that the unbundling of rights might not necessarily lead to the wider availability of SVoD rights as in such a situation "studios may for example opt not to make SVoD available to any platform provider (...)"⁴³.

³² Three Parties response to Third Pay TV Consultation, page 8.

³³ Sky response to Third Pay TV Consultation, Annex 6, paragraph. A6.8.

³⁴ Ibid, paragraph A6.21.

³⁵ Ibid, paragraph A6.16.

³⁶ Ibid, paragraph A6.20.

³⁷ Virgin Media response to Third Pay TV Consultation, paragraph 11.6.

³⁸ Ibid, paragraphs 11.8 to 11.9.

³⁹ BT response to Third Pay TV Consultation, paragraph 6.1.

⁴⁰ Ibid, paragraph 6.6.

⁴¹ [X]

⁴² Paramount response to our Third Pay TV Consultation, page 2.

⁴³ Ibid, page 4.

- 2.37 Similarly, [X] argued that preventing one firm from purchasing both linear and SVoD rights was not an appropriate remedy and could dramatically undermine rights values⁴⁴. [X]. [X] also criticised Ofcom’s analysis for attaching insufficient weight to the fact that movies could be watched in a variety of media both before and after the first pay TV subscription window⁴⁵.
- 2.38 [X] welcomed Ofcom’s proposals for targeted interventions into SVoD and believed it was important to proceed with these issues immediately. It also considered that Ofcom should review the competitive impact of holdbacks, in addition to examining the bundling of SVoD and linear rights⁴⁶.
- 2.39 [X] proposed that Ofcom should extend its discussions with the studios to include an investigation of related holdback and exclusivity provisions in their agreements with Sky⁴⁷.
- 2.40 The BBC believed a better circulation of SVoD movies rights would increase choice for viewers and help the establishment and development of potential competitors⁴⁸.

Discussions with the Major Hollywood Studios

- 2.41 In our Third Pay TV Consultation, we stated that before consulting formally on a reference, it would be constructive to engage further with the Major Hollywood Studios. This reflected our view that we would prefer if possible to avoid the burden that a reference would entail and the potential additional regulation that could result, if studios’ commercial strategies obviated the need for it. We stated that these discussions would take place in the following months, with a possible consultation on a reference to follow depending on the outcome of that engagement.
- 2.42 We have engaged with the Major Hollywood Studios individually since we published our Third Pay TV Consultation. The Major Hollywood Studios’ strategies in relation to the sale of the rights are commercially sensitive. While we recognise the difficulty that that this poses to consultation respondents, we do not consider at this stage that we can disclose this information publicly. Overall, however, we concluded that it is appropriate to consult on a reference. Absent intervention, it is likely [X] that Sky will retain the rights it currently holds. [X].
- 2.43 A summary of studio’s comments is provided below:
- [X]⁴⁹. [X]⁵⁰. [X]⁵¹. [X]⁵².
 - [X]⁵³. One studio observed that a critical mass of available current feature film product is needed to establish a pay TV service; and that where rights become

⁴⁴ [X] response to Third Pay Consultation, page 2.

⁴⁵ For an explanation of the windowing structure of movie rights, see Section 3 of this document.

⁴⁶ [X] response dated 18 September 2009 to Third Pay TV Consultation, page 8.

⁴⁷ [X] response to Third Pay TV Consultation, section F.

⁴⁸ BBC response to Third Pay TV Consultation, page 7.

⁴⁹ [X].

⁵⁰ [X].

⁵¹ [X].

⁵² [X].

⁵³ [X].

available on a staggered basis, it may be hard for an entity to establish a service with that critical mass⁵⁴. [X]⁵⁵.

- In terms of possible remedies, [X] voiced the most substantial concern with a proposed wholesale must-offer on linear movies channels, as it believed this would not encourage investment or innovation⁵⁶. [X]⁵⁷. One studio believed that the wholesale must-offer proposal could have perverse results, strengthening the position of Sky as incumbent rather than opening up the market⁵⁸. It was unclear to [X] what impact a wholesale must-offer would have on third party incentives to acquire SVoD rights for premium movies⁵⁹.
- [X]. [X]⁶⁰. [X]⁶¹. [X]⁶². [X]⁶³. Paramount believed that the removal of exclusivity would lead to a significant drop in the revenue that it receives from Sky for linear and SVoD rights in the pay TV window⁶⁴. It added that there is no certainty that a move to require SVoD rights to be sold separately would result in more widespread availability of these rights. “Indeed, it could result in the reduced availability of these rights, in order to maintain the exclusive nature of other rights”⁶⁵.

Structure of this document

2.44 The remaining Sections of this document are set out as follows:

- Section 3: Movies sector overview
- Section 4: Market definition
- Section 5: Features of the market
- Section 6: Prevention, restriction and distortion of competition
- Section 7: Proposed decision on a reference

2.45 There are five annexes contained within this document, as follows:

- Annex 1: Proposed terms of the market investigation reference
- Annex 2: Responding to this consultation
- Annex 3: Ofcom’s consultation principles
- Annex 4: Consultation response cover sheet

⁵⁴ [X].

⁵⁵ [X].

⁵⁶ [X].

⁵⁷ Ibid.

⁵⁸ [X].

⁵⁹ [X].

⁶⁰ [X].

⁶¹ [X].

⁶² [X].

⁶³ [X].

⁶⁴ Paramount response dated 24 September 2009 to the Third Pay TV consultation, page 2.

⁶⁵ Ibid, page 3.

- Annex 5: Consultation questions

Section 3

Movies sector overview

Summary

- 3.1 In this Section, we explain some underlying characteristics of both the pay TV market and the broader movies sector. We observe that first-run Hollywood movies⁶⁶ are effective in driving pay TV subscriptions as they have two key characteristics: a significant appeal to a broad audience, and a high degree of exclusivity to pay TV⁶⁷.
- 3.2 Films can be viewed over a number of different formats, including traditional theatrical release in the cinema, DVDs and on-demand viewings via TV. The characteristics of the format vary by the release windows. Alongside the main pay TV services, a broad range of services exist in the UK which exploit movies content in its different release formats.
- 3.3 Release windows are different time periods during which different rights are licensed. Studios time these windows in order to maximise their total revenues. Sky currently holds exclusive rights to show linear and SVoD films in the first pay TV subscription window from the six Major Hollywood Studios. The movies licensed to Sky represent the vast majority of the Major Hollywood Studios' output per year.
- 3.4 Within the movies sector we have identified a number of current trends, including significant potential for change in the way movies are distributed, particularly facilitated by IPTV and greater broadband speeds and penetration. IPTV can offer not only linear channel capability but also new ways of delivering content such as VoD. In particular, movies content will become increasingly important for the delivery of VoD over IPTV, with the ability to offer movies in a more convenient and user-friendly manner.
- 3.5 This development in the distribution of movies content is also occurring alongside changes in the windowing structure, as the release windows prior to the first pay TV subscription window appear to be shortening. Both the Major Hollywood Studios and pay TV operators are experimenting with release timings more generally, in particular via the introduction of concurrent release across the DVD and PPV / VoD windows.

Introduction

- 3.6 In Section 4 of our Pay TV Statement we set out some key characteristics of the UK pay TV sector that are relevant to our assessment of whether it is appropriate to take action to ensure fair and effective competition. In this Section we illustrate the importance of movies content to consumers, in particular its role as a driver of pay TV subscriptions. We also describe how the movies sector operates in the UK, from the sale and acquisition of content rights to the available services which utilise these rights. Finally, we consider the current trends, in both the movies sector and the broader pay TV market, which we believe will drive growth in the future.
- 3.7 In summary, this Section will outline:

⁶⁶ We define 'first-run Hollywood movies' as movies from the six Major Hollywood Studios, shown in the first pay TV subscription window.

⁶⁷ As noted in paragraph 6.52 of our Pay TV Statement.

- An overview of the UK pay TV market.
- Movie sector overview.
- Summary of movie services.
- Premium movie content.
- Future developments.
- The market players.
- Current trends within the pay TV market and the movies sector.

Overview of the UK pay TV market

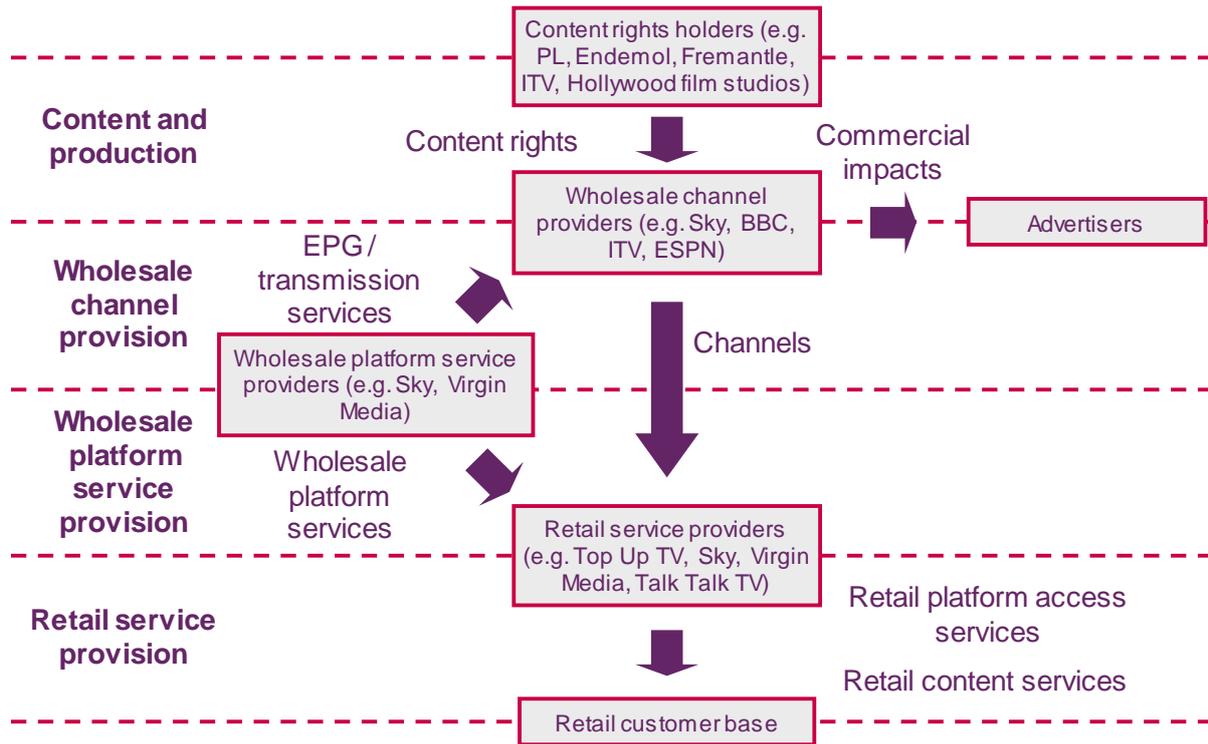
Value chain

3.8 In our Pay TV Statement, we outline the structure of the pay TV value chain⁶⁸. We present a model, illustrated in Figure 1 below, in which the supply chain for the UK broadcasting industry consists of four layers:

- Content production, for example creating and recording content which can be broadcast.
- Wholesale channel provision, which is the aggregation of content to bundle into channels. This could include acquiring rights to broadcast content or licensing content from other providers.
- Wholesale platform service provision, which is the provision of services to enable retailers to restrict the supply of content to consumers, or providing Electronic Programme Guide ('EPG') services to broadcasters.
- Retail service provision, includes the bundling of channels into packages to retail to consumers.

⁶⁸ Pay TV Statement, Section 4.

Figure 1 Pay TV value chain



Source: Ofcom

Vertical integration

3.9 As we have set out in Section 4 of the Pay TV Statement, it is very common for companies involved in pay TV to be vertically integrated. This is illustrated in Figure 20 of the Pay TV Statement, which shows which major companies are active at different levels of the value chain.

Premium content as a driver of pay TV subscriptions

3.10 In Section 4 of our Pay TV Statement, we look at what types of content are key drivers for pay TV. We examine the consumer and market based evidence on what is valued within a pay TV service and we explain that sports and movies are the genres which stand out as being among the most valued genres by consumers, and also having a high degree of exclusivity to pay TV.

3.11 Here we state that the content which is likely to be most effective in driving pay TV subscriptions must have two characteristics:

- A significant appeal to a broad audience.
- Limited availability via free-to-air TV channels.

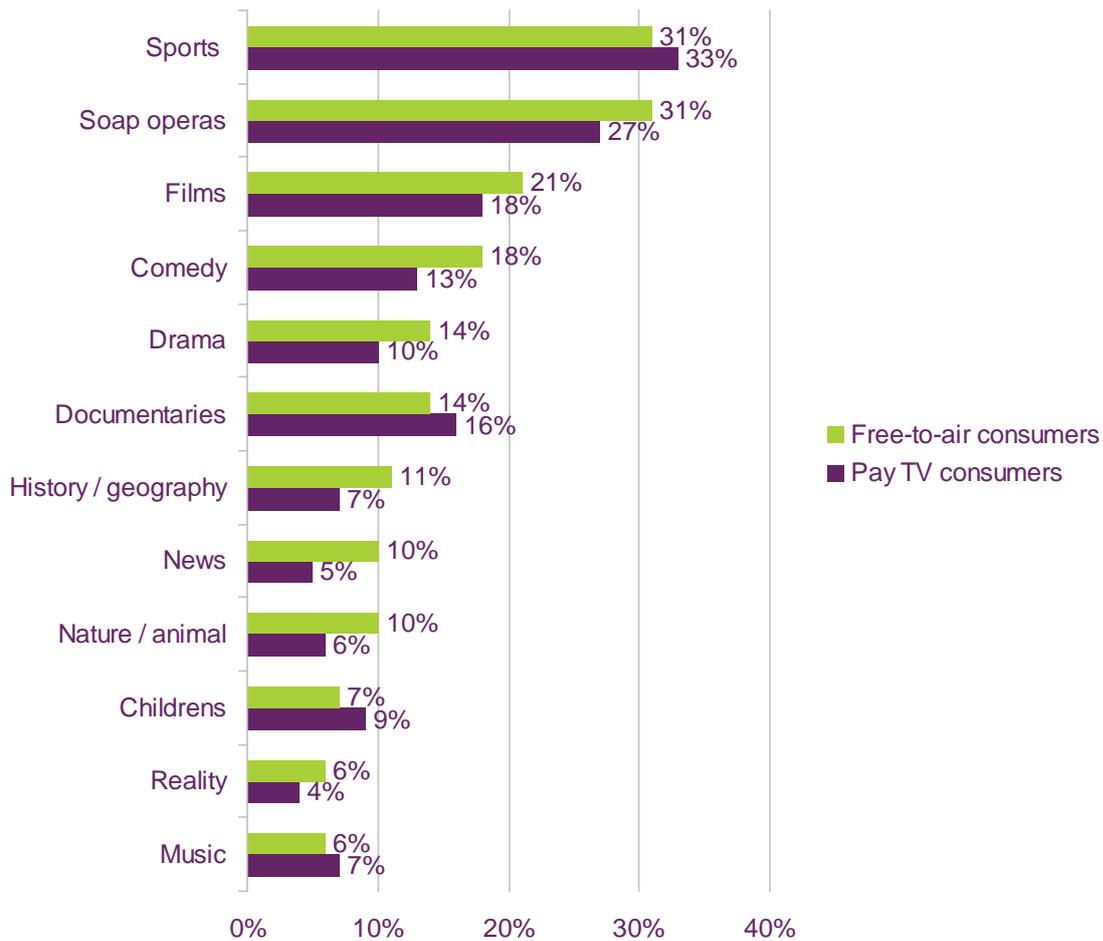
3.12 Content which has a broad appeal, but which is widely available free-to-air, such as some of the UK-originated content available via the public service broadcasters, is unlikely to drive pay TV subscriptions, since consumers are unlikely to pay a significant premium to watch programmes similar to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

- 3.13 The comment is frequently made in broadcasting that ‘content is king’. A number of consultation respondents agreed with the observation in our Second Pay TV Consultation that no amount of high-tech platform features could make up for an absence of attractive content, or “turn unattractive content into attractive content”. The ability to time-shift a programme, for example, is of value precisely because consumers want to watch a specific and valued piece of content in the first place.
- 3.14 This is not to say that platform features are unimportant – far from it. A movie buff, given the choice between a movies channel in SD and HD, may well value the enhanced definition afforded by HD sufficiently to pay extra for it; however, given the choice between that movies channel in SD and another channel which is in HD but does not contain interesting content, they are much more likely to follow the underlying content rather than the higher definition⁶⁹.
- 3.15 The characteristics which viewers look for when deciding what programme to watch are highly subjective – the level of interest in a particular genre or a particular storyline, the attractiveness of particular actors or actresses, the degree of support for a particular sporting event or for a particular team, and so on. In addition, consumers have very varied preferences for different types of content. This was illustrated by the consumer research which we have set out in our previous consultation documents⁷⁰.
- 3.16 Figure 2 shows the genres of content that are most attractive to consumers.

⁶⁹ Our 2009 Omnibus survey (see the Pay TV Statement, Annex6, Appendix 5) found that pay TV subscribers were much more likely to mention programmes and channels than platform characteristics as important characteristics of their pay TV service (e.g. 45% mentioned access to particular programmes, while 4% mentioned HD as a key characteristic – although this reflects the fact that HD has been recently introduced and does not yet have penetration of premium channels.).

⁷⁰ See in particular the charts set out in section 4 of Annex 14 to our First Pay TV Consultation – http://www.ofcom.org.uk/consult/condocs/market_invest_paytv/annex14.pdf.

Figure 2 Chart showing varied preferences (consumer research)



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

3.17 The three genres that are most valued by consumers are sports, soap operas and movies. Of these, soap operas are widely available on free-to-air television, and so are unlikely to be a primary driver of pay TV subscriptions. The same is true of other genres which are valued by consumers, such as comedy, drama and documentaries. Sports and movies stand out as being among the most valued genres by consumers, and also having a high degree of exclusivity to pay TV. On this basis alone we would expect them to be key drivers of pay TV subscriptions.

3.18 In Section 4 of our Pay TV Statement, we analyse the importance of movie content in more detail. We set out a summary of this analysis below, looking specifically at:

- Sums paid by channel providers for content rights.
- Statements made by market players.

Sums paid for content rights

3.19 The importance of first-run Hollywood movies in particular is revealed by evidence including the observed behaviour of firms which are active in the market. Movies programming represented 16% of Sky's programming costs in 2008/09, and 6% of

Sky's entire operating expenses. This is significantly lower than Sky's expenditure on sports programming, but is similar in magnitude to Sky's total expenditure on all third party channels (18% of programming costs) and higher than its total expenditure on its own news and entertainment channels (12% of programming costs). The cost of movie programming decreased by 1% year on year to £278m⁷¹.

Statements made by market players

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

- [X]⁷².

3.21 These are confirmed by many internal documents which we have obtained following various information requests to other pay TV providers:

- [X]⁷³. [X]⁷⁴. [X]⁷⁵.
- [X][X]⁷⁶[X].
- [X][X]⁷⁷. [X].
- [X]⁷⁸.

Movies sector overview

Viewing formats

3.22 Films can be viewed in a number of different formats, including traditional theatrical release in the cinema, DVDs, linear TV channels and on-demand viewings. To access a wide range of films without having to pay each time they view a film consumers may use subscription services, for example through TV packages or through online DVD rental. Some may use PPV and Over The Counter ('OTC') rental.

3.23 As shown by Figure 3, the most important means of watching movies (measured by revenue) are DVD retail, television (including FTA and pay TV channels) and in cinemas. In comparison, services such as VoD and rental (both OTC and online) are markedly smaller. It also summarises trends in revenues associated with different film formats and windows. Revenues have declined overall since 2004, though trends vary between the different formats. We observe:

- There has been a small decline in revenues associated with films on TV. According to Screen Digest the value of the FTA window appears to be broadly flat over the period⁷⁹.

⁷¹ Page 38,

<http://www.sec.gov/Archives/edgar/data/932789/000095012309028302/u06991e20vf.htm> page 31.

⁷² [X].

⁷³ [X].

⁷⁴ [X] Ibid.

⁷⁵ [X] Ibid.

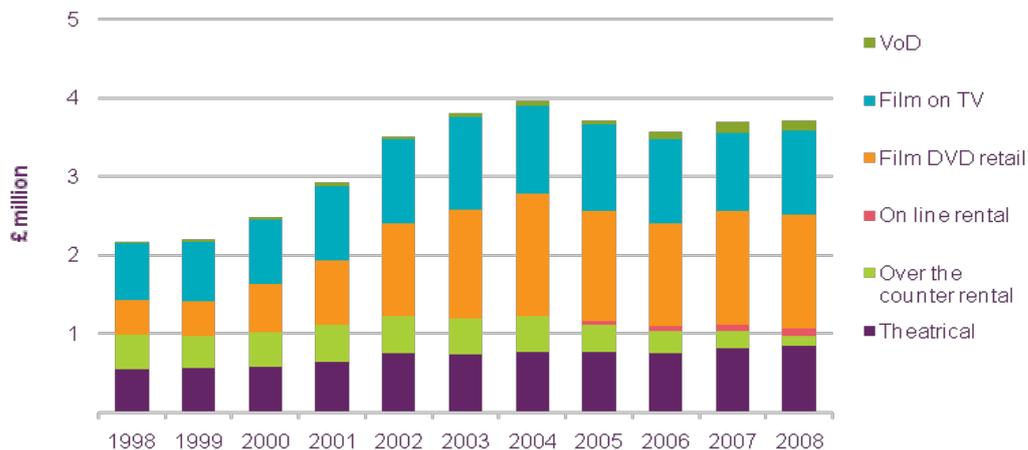
⁷⁶ [X] Ibid.

⁷⁷ [X] Ibid.

⁷⁸ [X] Ibid.

- SVoD services have been relatively unimportant to date. However, as we discuss further in this document our view is that there is considerable scope for these services to grow in popularity if they are able to provide sufficiently attractive content.
- Revenues from OTC DVD rentals are falling sharply, but this is partly offset by increases in PPV and online DVD rentals.

Figure 3 Value of films from different formats, nominal figures



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

Notes: 'Film on TV' covers terrestrial, subscription and free multi-channel. Pay-per-view is included within the VoD total. 'VoD' includes Near Video on Demand (nVoD) and true video on demand

Windowing structure

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

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

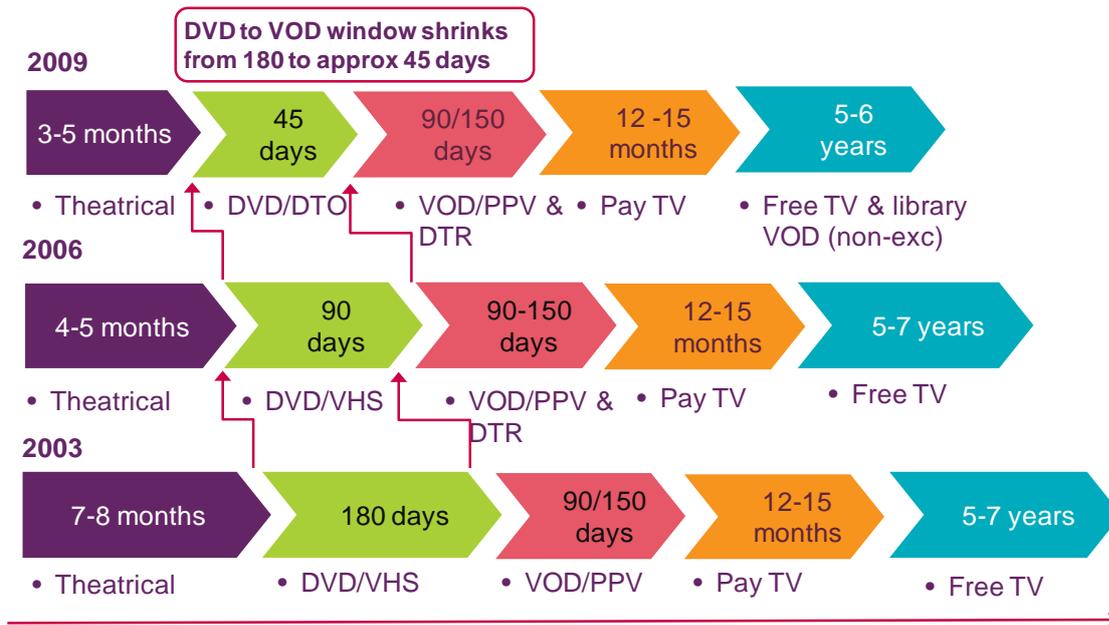
- While viewing of sports is largely limited to attendance at events, and live broadcast on linear channels and pay-per-view services, movies are available over a wider range of formats such as DVD retail and rental, and, increasingly, VoD.
- Linear movie channels regularly repeat movies, and in some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

⁷⁹ See figure 10 of Annex 11 to First Pay TV Consultation.

- While premium sports channels primarily comprise bundles of different live sports content, premium movies channels bundle newer movies with older movies.

3.26 Movie studios manage the timing of film release across different formats, as we explained in further detail in Annex 11 of our First Pay TV Consultation. The timed availability of films across different formats is a form of price discrimination. It enables studios to exploit consumers’ different willingness to pay for content in order to maximise the value of their movies and recover the fixed costs of production and marketing. The timing of the different windows and formats is set out in Figure 4 below, which also shows the way in which the windows have changed over the past few years.

Figure 4 Movie windows



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

Note: There are potential future changes in the movie windows. For example, Warner Bros is trialling the release of movies on PPV at the same time as DVDs.⁸⁰

3.27 As the figure shows, in recent years, some of the movie windows have been getting narrower. For example, since 2003 the DVD window has shifted from 7-8 months to 3-5 months after the theatrical release⁸¹. The delay between cinematic release and the first pay TV subscription window has also reduced:⁸²

- Sky told us that “Over the last few years, Sky has renegotiated its movie contracts so that it can show titles at an earlier date post cinematic release. In 2001 the pay TV subscription window ran from 18 to 33 months after cinematic release; by 2007 it had moved forward by six months, typically running from 12 to 27 months after cinematic release. Therefore any film can be shown six months

⁸⁰ See Matthew Garrahan (23 December 2009) “Warner launches on-demand push into Europe” at FT.com

⁸¹ The Odeon cinema group threatened not to show the film “Alice in Wonderland” in protest against Disney’s plan to shorten the theatrical run by bringing forward the DVD release date: see “Odeon ends Alice in Wonderland boycott”, guardian.co.uk, 25 February 2009.

⁸² Third Pay TV Consultation, paragraphs 4.295 to 4.296.

earlier than would have been possible in 2001, meaning that it is closer to the cinematic release and the accompanying publicity”⁸³.

- In addition, [X]⁸⁴.

- 3.28 **Cinematic release:** films are first released at the cinema often accompanied by very substantial and costly marketing and promotional campaigns. Average ticket prices were £5.20 in 2008⁸⁵. Screen Digest reported that the cinema release “is regarded as a marketing platform and most distributors will not make profit at this stage”⁸⁶. However, cinema release is important to consumers: research conducted by Sky reported that “films were most special at the cinema, closely followed by owning films on DVD”⁸⁷.
- 3.29 **DVD retail:** consumers purchase DVDs in order to obtain permanent access to a number of specific favourite films within a film library of their own. Sky’s consumer research⁸⁸ showed that DVD retail was perceived as offering very good value as it provides the benefits of permanent ownership of an extremely popular delivery mechanism. The average price of a DVD movie was about £7.36 in 2008,⁸⁹ although the range of prices is wide – particularly as prices typically fall by more than half after the initial release period (see Figure 90 of the Pay TV Statement). Just over a quarter of DVDs (27%) are bought as gifts rather than for personal or family use⁹⁰.
- 3.30 **DVD rental:** consumers can rent DVDs to access recently released films on a temporary basis. Sky’s research found that “renting films is still reasonably popular (even amongst Sky Subscribers) with renters welcoming variety, the mid week deals and improved window”⁹¹. Consumers can choose to rent from traditional over the counter stores or – increasingly – from online subscription services. The majority of rentals (by value) are still over the counter rentals but the quantity and value of online subscription rentals is growing rapidly. Typical prices to rent latest release films are around £3.75 over the counter (although there may be discounts to this headline price) and around £2.40 online⁹².
- 3.31 **PPV:** a number of TV retailers including Virgin Media, Sky, TalkTalk and BT Vision offer PPV movies, allowing consumers a convenient way to access new movies.
- 3.32 PPV services based on ‘Pull VoD’ or ‘True’ VoD⁹³ are possible on Virgin’s cable network and TalkTalk’s and BT’s IP networks. Sky’s satellite service provides both

⁸³ Sky response of 9 July 2008 to Ofcom’s information request of 29 May 2008 question 6 “Changes in the quantity and quality of services delivered to subscribers to Sky’s packages that include Sky’s sports channels, 2001/02 – 2006/07” section 4, paragraph 12.

⁸⁴ [X].

⁸⁵ See for example: <http://www.cinemauk.org.uk/ukcinemasector/ukcinema-industryeconomics/averageukticketprices/>.

⁸⁶ First Pay TV Consultation, Annex 11, page 21.

⁸⁷ Sky’s third response to Ofcom information request of 29 May 2008.

⁸⁸ Ibid.

⁸⁹ In the Third Pay TV Consultation we referred to an average DVD price of £8.97 (for example, in paragraph 4.265). That figure relates to the average price of all DVDs. It thus includes non-movie DVDs such as DVD box sets of television series. The £8.97 figure was taken from British Video Association Yearbook 2009, page 28.

⁹⁰ Source: British Video Association Yearbook 2009 page 73.

⁹¹ Sky’s third response to Ofcom information request of 29 May 2008.

⁹² Source: British Video Association Yearbook 2009 page 80.

⁹³ ‘Pull’ or ‘True’ VoD means consumers can get instant access to the film of their choice.

‘Push VoD’⁹⁴ and ‘Near’ VoD PPV services⁹⁵. These services differ in terms of both pricing and the number of films available:

- In 2008, Sky offered a total of around 400 films (including HD) priced at £3.99 per film on its PPV nVOD service⁹⁶. Only a small fraction of these films were available at any one time.
- In 2008, Virgin Media offered a catalogue of around 500 films on the FilmFlex PPV VOD service. New releases were priced between £2.50 and £3.50 and library titles were priced between 50p and £2⁹⁷. FilmFlex offers more films at any one time than Sky’s PPV nVOD service.

3.33 We estimate that Sky’s revenue from PPV nVOD services was [X] in 2008 and Virgin Media’s revenue from PPV VOD services was [X] in 2008⁹⁸. Taking into account the fact that there are markedly more subscribers to Sky’s satellite platform than to Virgin Media’s cable platform⁹⁹, these revenue figures suggest that cable subscribers are more likely to purchase PPV VOD services than satellite subscribers are likely to purchase PPV nVOD services.

3.34 **Internet Download:** Downloading content to watch from the internet offers consumers a wide range of content that can be accessed relatively easily and viewed at their convenience. Content can be downloaded legally from the internet either to watch on a one-off basis (also known as download to rent or rental VOD) or to retain permanently (also known as download to own). Suppliers include Apple (via its iTunes store) and Blinkbox. Movies can also be downloaded illegally using file sharing applications such as Bit Torrent.

3.35 **Pay TV Subscription Services:** Sky Movies and Disney Cinemagic show films in the first pay TV subscription window from the six Major Hollywood Studios. Sky also has contracts with several independent distributors and other movie studios (see paragraph 4.276 in the Third Pay TV Consultation). Consequently, Sky’s premium movie channels provide the first opportunity for viewers to watch the vast majority of the most popular films on a linear TV channel.

3.36 In addition, two types of SVoD service are also available. First, Sky’s SVoD service shows movies during the first pay TV subscription window. This is available via the Sky Player service and can be accessed via a subscriber’s PC, or on TV via an Xbox [X].

3.37 Second, there are various other SVoD services not owned by Sky that show films after the first pay TV subscription window. For example Picturebox offers a rolling catalogue of second pay TV and library titles over a number of UK platforms. The available titles from the non-exclusive second pay TV window are older than those

⁹⁴ ‘Push’ VoD refers to services where content is downloaded to the hard drive of the set-top box and made available to view on demand.

⁹⁵ ‘Near’ VoD (nVoD) refers to a multiple linear channels that broadcast the same content at staggered start times.

⁹⁶ Statistical Yearbook 2009, UK Film council, page 106.

⁹⁷ Ibid, page 106.

⁹⁸ Responses to Ofcom Information requests.

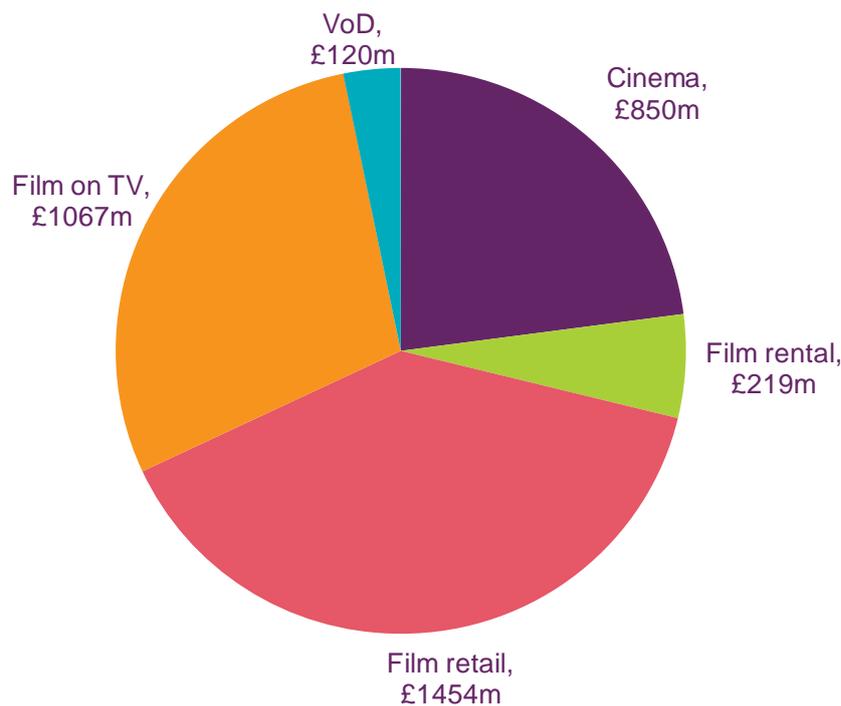
⁹⁹ In 2008, Virgin Media had approximately 3.6m subscribers and Sky had 8.8m satellite subscribers. Statistical Yearbook 2009, UK Film council, page 106.

featured in the exclusive first pay TV subscription window. They typically run from 27 to 36 months after cinematic release¹⁰⁰.

3.38 **FTA Channels:** FTA channels and other basic tier subscription channels show a wide variety of older films. In 2007 there were 2,182 film transmissions on the main terrestrial channels, 20,271 film transmissions on FTA multi-channels and 34,782 transmissions on subscription movie channels¹⁰¹.

3.39 The studios determine the order and length of the windows over which their movies are shown, to maximise profits. This structure enables studios to earn significant revenues from movies well after initial release, as shown in Figure 5.

Figure 5 UK revenue for different film windows in 2008, nominal figures



Source: Film Council 2009 Statistical Yearbook, based on data supplied by Nielsen, EDI, MRIB, BVA, Official Charts Company, DGA, Screen Digest and RSU Analysis.

Summary of available movie services

Wholesale premium movies channels

3.40 The main supplier of wholesale premium movies channels (i.e. those for which a subscription fee is charged) is Sky, though Disney also supplies one channel (Disney Cinemagic). Premium movies channels are retailed by Sky and the cable companies, primarily Virgin Media.

3.41 Sky's agreements with the Major Hollywood Studios cover movies from the first pay TV subscription window and older library titles, which are bundled together in wholesale premium movie channels. As noted above, the first pay TV subscription

¹⁰⁰ Virgin Media, supplementary submission dated 15 August 2008, page 15 - <http://www.ofcom.org.uk/tv/paytv/virginmedia.pdf>

¹⁰¹ UK Film Council Statistical Yearbook 2008 figure 11.6 p92, figure 11.7 page 95. PSB channels refer to BBC1, BBC2, ITV1, Channel 4 and Five.

window provides the first opportunity for viewers to watch the vast majority of the most popular films on a linear TV channel.

- 3.42 Subscriptions to these channels are driven by the titles which have been successful at the box office and are capable of generating strong audiences^{102 103}. For example, Sky describes Sky Premiere as “home of the biggest new movies”¹⁰⁴. This has by far the most views per film of any Sky Movies channel, which suggests the importance of big box office films.

Sky Movies

- 3.43 Sky offers 12 premium movies channels. Eight are, broadly speaking, genre-specific, while two (Sky Movies Screen 1 and Sky Movies Screen 2) put “the best of Sky Movies in one place”, and two (Sky Movies Premiere and Sky Movies Premiere+1) show a small number of major new releases (five per week). These channels, taken together, show all of the films from the six Major Hollywood Studios, among others, in the first pay TV subscription window.
- 3.44 All these channels are available in SD or HD except for Sky Movies Classics and Sky Premiere +1, which is only available in SD. They are aggregated into three packages¹⁰⁵:
- Sky Movies 1: Sky Movies Comedy, Sky Movies Family, Sky Movies Classics, Sky Movies Modern Greats, Sky Movies Screen 1.
 - Sky Movies 2: Sky Movies Action and Thriller, Sky Movies Sci-Fi and Horror, Sky Movies Indie, Sky Movies Drama, Sky Movies Screen 2.
 - Sky Movies Pack (Sky Dual Movies / Sky Movies Mix): Sky Movies 1 and Sky Movies 2, Sky Premiere and Sky Premiere +1.¹⁰⁶
- 3.45 Sky Movies channels are retailed by Sky and by cable companies, primarily Virgin Media. Sky retails directly on its satellite platform and TalkTalk’s IPTV platform. Virgin Media retails Sky Sports on its cable platform. Sky has a direct relationship with its retail subscribers. Subscribers pay Sky a monthly fee in exchange for access to packages of channels. In order to receive these channels satellite subscribers must install equipment to receive and decode a satellite signal, including a satellite dish and set-top box.
- 3.46 As shown in Figure 6 Sky retails Sky Movies 1, Sky Movies 2 and Sky Dual Movies in bundles with other basic packages (mixes) and Sky Sports packages. [X]¹⁰⁷.

¹⁰² First Pay TV Consultation, Annex 11, Screen Digest report ‘Movie markets in the UK’, page 93.

¹⁰³ In our Second Pay TV Consultation we also noted that Sky has exclusive agreements with the six Major Hollywood Studios to exploit their films in the pay TV window and that these films accounted for 80% of UK box office revenues (paragraph 5.155)

¹⁰⁴ <http://movies.sky.com/sky-movies-home> (as viewed on 15 February 2010).

¹⁰⁵ See <http://packages.sky.com/see/MoviesMix.aspx> (as viewed on 11 January 2010).

¹⁰⁶ Sky retails its 12 Sky Movies channels in this pack with Disney Cinemagic. But Disney Cinemagic is not included within its wholesale products.

¹⁰⁷ [X].

Figure 6 Sky premium movies subscribers

[X]

3.47 Virgin Media retails Sky Movies 1, Sky Movies 2, Sky Dual Movies, on its cable platform with other basic TV packages (“M”, “M+”, “L”, and “XL”) and Sky Sports channels¹⁰⁸. Virgin Media retails Sky Movies 1 or standalone Sky Movies 2 at between £16.50 per month (if they are taken with the ‘XL’ package) and £28 a month (if taken with the ‘M’ package)¹⁰⁹.

Disney Cinemagic

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

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

Other movie services in the UK

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

- Lovefilm – Lovefilm is a DVD rental and digital download service with over 1 million active DVD rental subscribers in the UK. It offers a range of subscription DVD rental packages, alongside its on-demand streaming service launched in May 2009. Lovefilm offers SVoD movies as part of its “Unlimited” online DVD rental plans. These plans cost from £9.99 per month (1 disc at a time) to £15.99 per month (3 discs at a time). In 2010, it had 1,024 films/features in its catalogue¹¹⁰. These films are streamed over the internet through a web browser. In March 2010 Lovefilm announced an agreement with Sony and Samsung to make their internet film library available through the manufacturers of TV sets¹¹¹. Although the exact nature of the service is unclear, it appears to showcase films from the FTA / library VoD window¹¹².
- Sky Player – Sky currently only exploits its SVoD rights through its PC-based Sky Player application transmitted over the internet. This is available on a standalone basis, enabling customers to subscribe to watch a package of channels from Sky on a PC, Mac or Xbox 360 without the need to install a set-top box. Sky offers SVoD films for free as part of a Sky Dual Movies subscription on Sky’s satellite platform. In 2008, Sky’s SVoD service had 400 films in its catalogue from all the Major Hollywood Studios¹¹³.

¹⁰⁸ Virgin Media has also recently added an “M+” basic package. This is not included in Figure 33 of the Pay TV Statement as it was not available in September 2008.

¹⁰⁹ See <http://allours.virginmedia.com/html/tv/sky-movies-channels.html> (as viewed on 12 January 2010). Note these prices are from a different time period to those used in Figure 33 of the Pay TV Statement.

¹¹⁰ Source: <http://www.lovefilm.com> (as viewed on 22 January 2010)

¹¹¹ <http://www.ft.com/cms/s/0/b6565eaa-32ea-11df-bf5f-00144feabdc0.html>

¹¹² See paragraph 5.33.

¹¹³ Source: Film Council 2009 Statistical Yearbook, page 106.

- PictureBox – NBC Universal’s branded SVoD service, which offers a rolling catalogue of second pay TV and library titles over a number of UK platforms. This gives subscribers the ability to watch movies over several sittings, freeing viewers from the constraints of rental. The available titles from the non-exclusive second pay TV window are older than those featured in the exclusive first pay TV subscription window. Subscription is monthly and can be purchased on a standalone basis or tied into a TV bundle. Subscribers are then able to choose from a rolling selection of 28 titles (or more depending on platform) available every month. PictureBox offers movies via ‘pull’ and ‘push’ VoD, depending on the capabilities of the platform on which the service is offered.
- FilmFlex – a VoD service offering PPV movies on Virgin Media TV. This was launched in January 2005, replacing ‘Front Row’, the previous nVoD service. FilmFlex is a joint venture between Walt Disney and Sony Pictures. In 2008 it had around 500 available films. New releases are priced between £3.50 and £4.50 and library titles are priced between 50p and £2. It has films from all major studios except Fox and is available to 3.7 million cable TV subscribers.
- Apple TV – Apple TV offers a range of movies and TV content that can be viewed on a TV using the Apple TV digital media adaptor (which first launched in the UK in December 2007)¹¹⁴.
- Blinkbox – Blinkbox is an online VoD service featuring movies to stream, download to rent and download to buy. Movie rentals are available from 99p and download to own movies from £3.99¹¹⁵.
- Games consoles (various) - These includes Sony’s PlayStation 3, which offers movies and TV programmes, and Microsoft’s Xbox Live service, which offers movies, Sky Player live and on-demand content.

3.51 In addition to these, on 30 July 2009, Sky confirmed the launch of a ‘pull’ VoD service in 2010¹¹⁶. The service, delivered by broadband internet, is expected to utilise the ethernet port of existing Sky+ HD boxes. No further details were given, and it is not yet known whether the service will be restricted to those who take Sky’s own broadband service. Sky has not announced further details on how the service will be priced or packaged or which consumers will be eligible for the service¹¹⁷. [X]¹¹⁸.

International examples

3.52 There are also various international examples of SVoD services:

- Netflix, which is the leading DVD rental service in the US¹¹⁹. Netflix offers an on-demand subscription service bundled with their traditional DVD rental service. [X]¹²⁰. [X]¹²¹.

¹¹⁴ <http://www.apple.com/uk/appletv/>

¹¹⁵ <http://www.blinkbox.com/>

¹¹⁶ http://corporate.sky.com/media/press_releases/2009/3d_tv.htm

¹¹⁷ Sky to launch 3D TV in 2010 following record Sky+HD growth, Sky press release dated 30 July 2009 available at: http://corporate.sky.com/media/press_releases/2009/3d_tv.htm

¹¹⁸ [X].

¹¹⁹ <http://www.netflix.com/>

¹²⁰ [X]

¹²¹ [X]

- In Italy there are various examples of SVoD services available over the internet and IPTV¹²². For instance, Telecom Italia's 'Alice Home TV' service, which offers SVoD films on IPTV through a partnership with Sky Italia. The 'Sky SVoD film pack' offers a choice of 140 films for a monthly subscription fee of €16.00 alongside a 'SVoD sport' pack which costs €15.00 per month¹²³.
- In December 2003, in France Orange TV launched the '24/24 video' service to its subscribers, an IPTV based VoD portal that combines instant and subscription payment methods¹²⁴. The SVoD service currently offers a set of genre based 'series packs', which cover music and children's programming at a fixed price of €4.99 per month, with plans to launch another series pack in the coming months¹²⁵.

Premium movie content

3.53 In Section 6 of our Pay TV Statement, we set out our view of the nature of demand for premium movies channels. Here, we summarise the main issues in respect to the characteristics of the channels. i.e. quantity, quality, format, timing and price, and subscribers' preferences for these characteristics;

Quality of films

- 3.54 In our Third Pay TV Consultation we said that Sky's premium movie channels also show a large quantity of films that are of particularly high quality (at least in terms of box office success). We also noted that Sky has exclusive agreements with the six Major Hollywood Studios to exploit their films in the pay TV subscription window and that these films accounted for 80% of UK box office revenues¹²⁶.
- 3.55 Sky argued in response to our Third Pay TV Consultation that we gave insufficient weight to the quality of films as distinct from timing¹²⁷. As we said, we agree that quality is important. Many of the films viewed on Sky Movies are those that had large box office revenues (Figure 7). Sky describes Sky Premiere as "home of the biggest new movies"¹²⁸ This channel has by far the most views per film than any other Sky Movies channel, which suggests the importance of big box office films¹²⁹. Using box office revenues as an indicator of quality, these facts suggest the importance of the quality of films to Sky Movies subscribers.
- 3.56 In contrast, Sky Indie has the fewest views per film. The differences in the viewing figures for the different Sky Movies channels emphasise the importance of films distributed by the Major Hollywood Studios. This is evidence that consumers regard the films distributed by these studios as relatively attractive (i.e. in some sense higher 'quality' from the perspective of the majority of consumers).

¹²² NPA Conseil, 'Video on demand in Europe', page 261 to 262.

¹²³ Ibid, page 261.

¹²⁴ <http://2424video.orange.fr/>

¹²⁵ NPA Conseil, 'Video on demand in Europe', page 209.

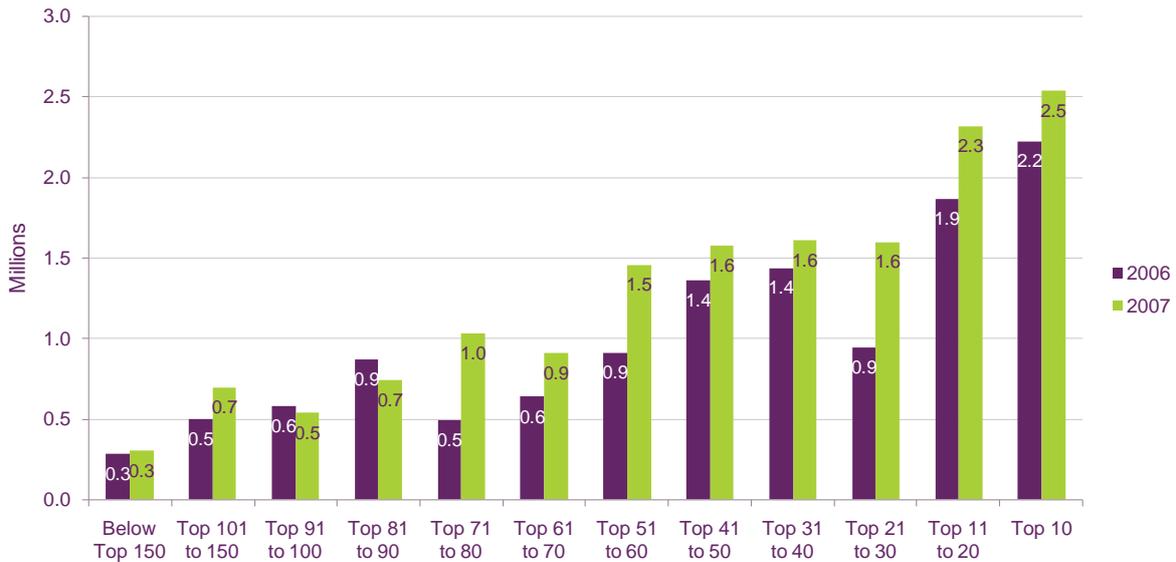
¹²⁶ Third Pay TV Consultation, Section 4, paragraphs 4.274 to 4.275.

¹²⁷ October 2009 Sky Submission, paragraph 95.

¹²⁸ <http://movies.sky.com/sky-movies-home> (as viewed on 15 February 2010)

¹²⁹ Pay TV Statement, Figure 77.

Figure 7 Average views per film by UK box office revenue rank*



Sources: BARB viewing data for 2008, <http://boxofficemojo.com/intl/uk/yearly>

Note: *E.g. “Top 10” refers to the top 10 films in the UK by box office revenue. Sky Movies may not have shown all of these films as not all films will have entered the pay TV window. Box Office revenues also include those from Ireland and (perhaps surprisingly) Malta.

Timing

3.57 Consumers typically value a given film more the closer it is to its release date. Sky accepted this¹³⁰, but also stated that an older movie may be valued more highly than another (different) film that is more recent for example because viewers consider the older film to be higher ‘quality’. Sky gave a number of examples in support of this proposition, including viewer data showing that a repeat on Channel 4 attracted a greater number of viewers (among households with Sky Movies) than the first showing of a more recent film on Sky Movies¹³¹.

3.58 While some older films may be more attractive than some newer films, most films are more attractive when they are closer to their release date. As we noted at paragraphs 4.282 to 4.285 of our Third Pay TV Consultation, all other things being equal, more recent movies are more attractive. As stated in paragraph 4.270 of the Third Pay TV consultation, this is in part because significant marketing occurs around the time of the initial cinema release which increases the awareness of a film¹³². The value of this marketing will diminish over time. Furthermore, once a consumer views a film in

¹³⁰ October 2009 Sky Submission, footnote 67 to paragraph 95.

¹³¹ Sky’s data related to the evening of 26 September 2009. The Lord of the Rings: The Two Towers was released in the cinema in 2002 and attracted an average audience amongst households that subscribe to Sky Movies of 162,000. Tropic Thunder was released in the cinema in 2008 and was broadcast on Sky Movies for the first time. It attracted an average audience of 100,000. 6 October 2009 Sky Submission, Table 3 and paragraph 95.

¹³² As noted in paragraph 4.295 of the Third Pay TV consultation, Sky referred to the pay TV window moving closer to the cinematic window “and the accompanying publicity”. Sky response of 9 July 2008 to Ofcom’s information request of 29 May 2008 question 6 “Changes in the quantity and quality of services delivered to subscribers to Sky’s packages that include Sky’s sports channels, 2001/02 – 2006/07” section 4 paragraph 12.

an earlier window its value to that consumer in later windows is likely to be diminished.

3.59 The attractiveness of recent movies is supported by a number of pieces of evidence:

- Internal research supplied to us by Sky¹³³, [X].
- A survey carried out for Virgin Media asked consumers for which genre of content they would consider paying more than their current subscription. This Virgin Media survey found that “new” movies was the most popular movie genre for both Virgin Media and Sky subscribers (cited by [X] % and [X] % of subscribers on each platform). This was significantly above “classic movies”, cited by only [X] of subscribers on both cable and Sky¹³⁴.
- [X]¹³⁵. [X]. This provides further evidence on the importance of newer films.
- In addition, in our survey 22% of price sensitive consumers responded that access to new films is a “must have” and 46% say it is “nice to have”¹³⁶.
- For consumers that are less price sensitive, the corresponding figures are 35% and 40% respectively.

Market players

Major Hollywood Studios

- 3.60 Sky currently holds exclusive rights to show films in the first pay TV subscription window from the six Major Hollywood Studios¹³⁷. This allows Sky’s premium movie channels to show a large quantity of films that are of particularly high quality (at least in terms of box office success). The Major Hollywood Studios are Disney, Fox, Paramount, Sony, Universal and Warner.
- 3.61 Sky has exclusive contracts with all six Major Hollywood Studios alongside a number of independent distributors to show films from the pay TV window¹³⁸, [X] Pathé. Sky has had exclusive agreements with the current six Major Hollywood Studios to exploit their films in the pay TV subscription window since [X]¹³⁹.
- 3.62 Figure 8 shows the overall output of studios, including Major Hollywood Studios. The movies licensed to Sky represent the vast majority of the Major Hollywood Studios’ output per year.
- 3.63 Screen Digest estimates that the films produced by the six Major Hollywood Studios typically account for around 35% of films released at UK cinemas but for 80% of UK box office revenues.

¹³³ Sky’s third response to Ofcom’s questions of 29 May 2008.[X].

¹³⁴ Virgin Media response to information request of 15 May 2007.[X].

¹³⁵ [X].

¹³⁶ See Figure 75 of the Pay TV Statement.

¹³⁷ For definition see footnote 1 and also <http://www.mpa.org/AboutUsMembers.asp>.

¹³⁸ [X].

¹³⁹ The year depends on the studio. Source: Sky response to information request of 20 December 2007. Note however that Disney premieres its animated films on its Disney Cinemagic channel, before they are shown on Sky Movies (see for example http://media247.co.uk/skydigital/newsarchive/2006/02/sky_launch_conf.php).

Figure 8 Number of film releases from the studios



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

Pay TV operators

3.64 Today, the main operators of satellite and cable services are:

- British Sky Broadcasting (Sky), which was created by the merger of Sky and BSB in 1990. It launched digital TV in 1998 and had 9.7 million subscribers at the end of 2009¹⁴⁰. Its Sky Digital service offers a range of free-to-air, basic and premium channels.
- Virgin Media, created by a consolidation over 13 years of the cable franchise areas created in 1984, culminating in the merger of NTL and Telewest in 2006, and the subsequent re-branding in 2007 to Virgin Media. Virgin Media had 3.7 million TV customers at the end of 2009¹⁴¹.

3.65 Other providers of residential pay TV services include:

- BT Vision, which offers paid-for content such as TV shows and movies on-demand via IPTV. It also offers the linear TV channels from Freeview and the ESPN subscription channel via DTT. BT Vision launched in December 2006 and had 451,000 customers at the end of 2009.
- Top Up TV, the pay DTT service, offers a selection of on-demand content, such as TV shows and films. Programmes are downloaded to the hard drives of its Top Up TV Freeview+ digital video recorders (DVR), so-called 'push' VoD. Top Up TV also offers the linear TV channels from Freeview, via DTT, and the ESPN subscription channel, also via DTT. Top Up TV launched in 2004.
- TalkTalk TV¹⁴² is the UK's only pay TV service to offer linear TV channels via IPTV (or television over DSL). Recent set-top boxes also include a DTT tuner. It also offers a wide range of on-demand content. TalkTalk TV was formerly HomeChoice, which launched in 1999 offering just VoD content. It launched linear TV channels in 2004. Internet service provider Tiscali announced plans to

¹⁴⁰ http://corporate.sky.com/documents/pdf/1ffb247d89b6490c9cd3dc7a4f24f4eb/2010/Interim_2010

¹⁴¹ <http://pressoffice.virginmedia.com/phoenix.zhtml?c=205406&p=irol-newsArticle&ID=1395258&highlight=>

¹⁴² TalkTalk TV was previously called Tiscali TV but was rebranded in January 2010 by its owner Carphone Warehouse.

acquire HomeChoice in August 2006 and rebranded the service to Tiscali TV in March 2007. Tiscali UK was acquired by Carphone Warehouse in 2009 and has around [X] subscribers.

Future Developments

3.66 In Section 4 of our Pay TV Statement, we also address the likely future developments in the pay TV market¹⁴³. This is relevant to our analysis as it indicates whether certain types of content are likely to continue to be as important for pay TV in the longer term as we believe them to be now:

- In terms of movie programming, blockbuster movies are likely to retain their appeal, but the ways in which consumers access movies are likely to evolve. The simultaneous broadcast of a small number of movies to a large number of viewers may not be the most effective means of distribution in the longer term. Increasing availability and adoption of on-demand technologies and services are likely to mean that distribution techniques change as consumers take greater control over how they watch movies.
- It is not difficult to imagine scenarios under which movies are generally accessed more directly by consumers, for example via various forms of internet download. Movie download services are already available, though they have yet to be taken up by large numbers of consumers.

Current trends

Pay TV sector

3.67 Our Pay TV Statement puts forward some current observations of the UK audiovisual sector that provide the background to our assessment of the future of the movies sector in the UK¹⁴⁴. While it is difficult to assess how a sector will develop over a longer time horizon, current trends can offer useful indicators to future behaviour and developments:

- There remains a strong appetite for watching TV and viewing levels on the whole are increasing¹⁴⁵.
- Consumers are demonstrating an appetite for enhanced viewing experiences. At the end of 2009, more than 3 million homes had the reception equipment – set-top boxes and integrated digital televisions – capable of accessing HDTV channels and on-demand content¹⁴⁶.
- Content consumption habits are changing as on-demand services become more widespread. Such services enable consumers to take increasing control of their viewing through applications like DVRs or VoD (more than half of Virgin Media digital TV customers - 58% - regularly used VoD, including catch-up TV, at Q4 2009, up from 47% at Q4 2008¹⁴⁷).

¹⁴³ Pay TV Statement, Section 4, paragraph 4.154.

¹⁴⁴ Ibid, paragraphs 4.161 to 4.162.

¹⁴⁵ <http://www.ipa.co.uk/content/IPA-publishes-Q4-2009-Trends-in-TV-Report>

¹⁴⁶ See Figure 13 of the Pay TV Statement, UK homes with linear HDTV channels.

¹⁴⁷ <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzMxMj8Q2hpbGRJRDR0tMXxUeXBIPTM=&t=1>

- New technologies are becoming more capable. For example, increased broadband speeds and availability, coupled with more advanced delivery techniques, are enabling consumers to watch high-quality video over the internet: 23% of adults with home internet watched online catch-up TV in 2009, up from 17% a year earlier (Ofcom Communications Market Report 2009¹⁴⁸).
- Portability and transferability are likely to become more important to consumers as they watch and listen to content on a greater range of devices. This is already being seen, in part helped by the take-up of devices such as Apple's iPod and iPhone.
- More consumers are buying pay TV services as part of bundles of communications services. In Q1 2009, 34% of UK adults that claimed to buy a bundle of services bought a three-product combination of TV, broadband and fixed-line telephone, up from 12% in 2005¹⁴⁹.
- 'Hybrid' models are becoming more common, whereby different technologies are combined to create more advanced products and services. For example, combining broadcast and broadband distribution technologies in one device to offer both linear and non-linear programming (BT Vision and TalkTalk TV offer such services).

3.68 Section 4 of our Pay TV Statement looks in greater detail at the changes in the pay TV and related audiovisual sectors that are already happening and those that are likely to take place given announcements by industry¹⁵⁰. This is relevant to our analysis in the Section below, as we turn to the particular importance of movies content for driving the development of VoD, and investment in new superfast broadband networks and IPTV in the UK.

Video on demand

3.69 Pay TV has historically provided a means of accessing a greater range of TV channels for a monthly subscription than is available on a free-to-air platform. 49% of UK homes subscribed to a pay TV service at the end of 2008¹⁵¹. Within the last decade, pay TV operators have also introduced a range of additional TV products, some of which have been enabled by developments in technology. An example of this has been the increasing prominence of VoD as a new method for consumers to access programming.

3.70 VoD services allow consumers to watch programmes in a non-linear fashion and organise their viewing outside of the restrictions of a TV schedule. Content is stored on the networks of operators ready for viewing or stored locally, on the hard drive on a set-top box in the home. When referring to VoD we exclude DVRs, which are discussed separately. VoD is broadly split up into three types:

- 'Pull' VoD, sometimes referred to as 'True VoD', where the content is delivered via a two-way network (commonly used by cable and IPTV). Operators of pull VoD typically offer thousands of hours of content on demand.

¹⁴⁸ <http://www.ofcom.org.uk/research/cm/cmr09/>

¹⁴⁹ <http://www.ofcom.org.uk/research/tce/ce09/research09.pdf>

¹⁵⁰ Pay TV Statement, paragraphs 4.154 to 4.182.

¹⁵¹ Ofcom International Communications Market Report 2009.

- ‘Push’ VoD, where content is downloaded to the hard drive of the set-top box and made available to view on demand. Push VoD services are limited by the capacity available to store programming on the set-top box, as well as by the need to predict what consumers will wish to watch, so offer a significantly reduced choice of programming as compared to pull VoD.
- ‘Near’ VoD (‘nVoD’), where multiple linear channels broadcast the same content at staggered start times.

3.71 As discussed in Section 4 of our Pay TV Statement, Superfast broadband, IPTV, and VoD are a set of closely linked technological innovations which have the potential to deliver significant benefits to consumers. VoD services provide convenient access to a wide range of content on-demand and can be delivered over either a closed IPTV platform or the ‘open’ internet. Both of these types of network are ideally suited to NGA, as they require a high bandwidth access network to enable the reliable and robust delivery of video services to consumers.

3.72 In the UK, VoD has become increasingly popular amongst consumers. BBC’s iPlayer catch-up TV service received 61.5 million requests to stream/download radio and TV programmes across all platforms in January 2009. This figure had nearly doubled to 114.8 million in December 2009¹⁵². At Q1 2009, 23% of UK adults (15 years and above) with internet access at home (or 16% of all adults) said that they watch online catch-up TV¹⁵³.

3.73 Figure 7 below provides a summary of selected VoD offers from key UK providers, covering the earliest VoD offerings to the latest services available today. In the UK, VoD providers such as Virgin Media, BT Vision and TalkTalk TV, which employ pull VoD, are now offering thousands of hours of on-demand programming.

¹⁵² http://www.bbc.co.uk/pressoffice/pressreleases/stories/2010/01_january/14/iplayer.shtml

¹⁵³ Ofcom Communications Market Report 2009, page 267.

Figure 7 Selected VoD offers from key providers

Provider	Distribution technology	VoD launch date	VoD content available	Number of VoD homes
Talk Talk TV	IPTV (pull VoD)	1999 (as HomeChoice)	Thousands of hours of VoD content. Free catch-up, SVoD films (Movies Now, Picture Box, Film4 On Demand), PPV VoD and SVoD TV packages.	<50,000
Virgin Media	Cable (pull VoD)	December 2005 (as Telewest's TV Drive)	Thousands of hours of VoD content. Free catch-up, SVoD films (Picture Box), PPV VoD and SVoD TV packages.	3.7 million
Top Up TV Anytime	DTT (push VoD)	November 2006	Over 700 shows a month available and SVoD films (Picture Box).	490,000 (Ofcom DTV Update, Q3 2009)
BT Vision	IPTV (pull VoD)	December 2005	Thousands of hours of VoD content. Free catch-up, SVoD films (Picture Box), PPV VoD and SVoD TV packages.	451,000
Sky	Satellite (nVoD & push VoD)	nVoD, March 1996; push VoD November 2007	Sky Box Office (nVoD) offers pay-per-view movies and some sport. Sky Anytime TV service offers up to 85 hours of different content.	9.4 million for nVoD; 5.3 million for push VoD*
BBC iPlayer	Online (pull VoD)	December 2007	Offers most programming from the previous seven days of the BBC schedule on demand (for streaming or download).	All homes with hardware and suitable internet connection
Sky Player	Online (pull VoD)	December 2008	Pay TV channels on demand. Premium option for Sky Sports and Movies. On demand movies also available.	All homes with hardware and suitable internet connection

Source: Operators, using latest available data.

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

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

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

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

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

3.75 Similar services include ITV Player, Demand Five and Blinkbox. The online TV market is likely to further develop as new providers enter the market, resulting in a greater range of programming available online to consumers. SeeSaw, owned by transmission company Arqiva, launched a catch-up TV service in February 2010 and Hulu, the US service backed by NBC Universal, News Corporation and Disney, has previously stated its ambitions to launch in the UK¹⁵⁴.

Movies content on VoD

3.76 Movies content is particularly important for the growth of VoD, as a VoD service which provided instant access to a wide range of recent movies would be highly valued by consumers. This view is supported by the views of UK pay TV operators, who have emphasised the potential of a SVoD service which exploited rights to movies in the first pay TV subscription window. For instance, in response to our Second Pay Consultation, Virgin Media stated:

“In particular, there is a strong demand for SVoD as customers in the UK show a clear preference for subscription services over PPV services. An SVoD movie service would be an extremely compelling proposition by enabling customers to watch a movie of their choice at their convenience and without paying an additional specific fee per movie¹⁵⁵.”

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

“BT has emphasised, in particular the importance of SVoD movie services, and would highlight the success of SVoD services in other markets (particularly the US) where competitive distortions in accessing SVoD rights - such as those that exist in the UK market – are not present. Accordingly, BT supports fully Ofcom’s analysis of the “high strategic importance” of VoD, including SVoD¹⁵⁶.”

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

“For movies, consumers’ habits are already changing. [X][X]¹⁵⁷.”

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

- [X] Sony¹⁵⁸.
- [X]¹⁵⁹. A content provider stated that, in its view, as on-demand services continue to proliferate and grow their customer bases, the pay TV window will

¹⁵⁴ <http://paidcontent.co.uk/article/419-hulu-talking-with-possible-partners-for-uk-launch/>

¹⁵⁵ Virgin Media response to Second Pay TV Consultation, paragraph 7.12.

¹⁵⁶ BT response to Third Pay TV Consultation, paragraph 6.1.

¹⁵⁷ [X] response to Second Pay TV Consultation, page 6.

¹⁵⁸ [X].

eventually be predominantly SVoD-based. However, given some viewers' preference for watching programming from a linear schedule it also expected that the pay TV window will continue to include a linear component for the foreseeable future¹⁶⁰.

- [X]¹⁶¹.

IPTV

- 3.80 In previous consultation documents, we have drawn on international examples to understand how different pay TV markets operate¹⁶². Looking beyond the UK market can also help in defining a forward-looking assessment of pay TV. Our analysis in Section 4 of the Pay TV Statement¹⁶³ shows that the most successful IPTV launches a round the world tend to share the common characteristic of having access to important premium content.
- 3.81 Despite significant differences in many cases, some international markets can offer indications of how particular technologies and sectors can develop. One of the more recent technologies to see notable take-up in some markets is IPTV, which enables the delivery of television channels and on-demand programming over a broadband network rather than traditional infrastructures such as terrestrial, satellite or cable.
- 3.82 We believe VoD services are also set to become particularly important in the context of IPTV. Within this trend, premium content (in particular premium movies) could be important in driving take-up of such services. This is different to premium sports content, which loses a significant proportion of its appeal once it ceases to be live and is likely to be less important.
- 3.83 In the UK, IPTV has seen limited take-up even though it was among the first countries in which such platforms were launched. There are currently around 50,000 subscribers to the TalkTalk TV¹⁶⁴ service, while 451,000 customers had BT Vision at the end of 2009, which offers VoD over the broadband network and live television channels through the DTT service Freeview.
- 3.84 While there appears to be a move towards two-way networks facilitated by the move towards IPTV and 'next generation access' technologies, broadcast networks are likely to continue to be utilised to deliver a volume of linear television. The combination of broadcast and unicast technologies is likely to offer attractive consumer propositions.
- 3.85 IPTV appears to have seen reasonable take-up in markets where it has had access to a wide range of content. While much of the growth of IPTV in France has been attributed to 'free' TV offered with a broadband subscription, Orange TV had attracted 663,000 subscribers to its premium sports and movie channels by Q4

¹⁵⁹ [X].

¹⁶⁰ [X].

¹⁶¹ [X].

¹⁶² First Pay TV Consultation, Annexes 9 and 16; Second Pay TV Consultation, paragraphs 3.62 to 3.86.

¹⁶³ Pay TV Statement, paragraph 4.166 to 4.176.

¹⁶⁴ <http://www.ft.com/cms/s/0/a76f1918-70ad-11de-9717-00144feabdc0,s01=1.html>

2009¹⁶⁵. Other IPTV providers offer the premium sports and movie channels of Canal Plus.

- 3.86 IPTV and fibre-based broadband TV services have also seen reasonable take-up in other regions. In the US, there were 5.5 million at the end of Q1 2009¹⁶⁶. Here some operators have adopted fibre technology (often referred to as FTTH, which stands for ‘fibre to the home’) to deliver a wide range of television services. Verizon’s Fios TV, for example, offers up to 125 HDTV channels, multiroom¹⁶⁷ DVR functions and premium channels¹⁶⁸. In June 2009, Verizon had 3.1 million FTTH subscribers, of which 80% had a TV subscription. At the same time, AT&T had 1.6 million subscribers on its fibre network, of which 99.5% were customers to its U-verse¹⁶⁹. AT&T had an initial target of 30 million homes passed by the end of 2010 (but this has now been pushed back a year)¹⁷⁰.

Movies sector trends

Changes to the window structure

- 3.87 As noted previously in this Section, a feature of the various release windows set by the studios is that they are not fixed structures; their position and boundaries change over time. In recent years the Major Hollywood Studios have shortened windows to maximise returns from the most profitable windows¹⁷¹:
- In 2002 the exclusive DVD rental window was dropped, with titles being released on DVD for retail and rental simultaneously.
 - The theatrical release window has narrowed significantly, from 31 weeks to 19.5 weeks on average between 2002 and 2005.
 - Some distributors are attempting to bring the DVD window forward even further.
 - Some of the Major Hollywood Studios have publicly supported the simultaneous release of titles across cinema, DVD and VoD platforms.
- 3.88 As Figure 4 illustrates, in recent years, some of the movie windows have been moving closer together¹⁷². For example, since 2003 the DVD window has shifted from being 7-8 months after the theatrical release to being 3-5 months. It has been suggested that the Major Hollywood Studios have actively shortened these windows

¹⁶⁵ http://www.orange.com/en_EN/finance/invest-analysts/cons-results/att00014504/FranceTelecom_FY09Results.pdf

¹⁶⁶ <http://www.screendigest.com/reports/10tvmarketmonitorq32009/pdf/RJAY-7ZPGPM/SD-2010-01-TVMarketMonitorIPTVQ32009.pdf>

¹⁶⁷ Multiroom enables customers to have multiple subscriptions in the home by installing additional set-top boxes.

¹⁶⁸ <http://www22.verizon.com/Residential/FiOSTV/Details/Details.htm>

¹⁶⁹ U-Verse uses fibre optic technology to bring to provide high speed internet, digital TV and a digital home phone service through the same connection.

¹⁷⁰ IDATE FTTH Watch Service 2009.

¹⁷¹ First Pay TV Consultation, Annex 11, Screen Digest report ‘Movie markets in the UK’, page 9.

¹⁷² The Odeon cinema group threatened not to show the film “Alice in Wonderland” in protest against Disney’s plan to shorten the theatrical run by bringing forward the DVD release date: see “Odeon ends Alice in Wonderland boycott”, guardian.co.uk, 25 February 2009.

because of the piracy that emerges in the ‘dead space’ between cinema and DVD releases¹⁷³.

Second pay TV window

- 3.89 As outlined above, a non-exclusive second pay TV window has developed (the 27-36 month release window) to offer titles available immediately after the exclusive 15 month first pay TV window has finished. Currently in the UK, the only service in the second pay TV window is NBC Universal’s PictureBox, which selection of titles is limited to the output of one studio. However, our discussions with Major Hollywood Studios [X]¹⁷⁴.

Simultaneous release

- 3.90 Alongside the trend towards shorter windows, it is also important to note that studios continue to experiment with the timing of movies release. One example is ‘day and date’ strategies, which involve concurrent PPV and DVD movie releases. One of the pioneers of this strategy internationally has been Warner Bros, which carried out early trials by allowing digital distribution before a DVD launch¹⁷⁵. In April 2008, Warner Bros UK brought the PPV/VoD release date to within 15 days of the DVD release of a number of films, such as *Beowulf* and *The Assassination of Jesse James by the Coward Robert Ford*¹⁷⁶.
- 3.91 Pay TV operators in the UK have also experimented with release timings¹⁷⁷. Sky has tested the ‘day and date’ release strategy with theatrical release and its PPV VoD service, Sky Box Office. It has conducted experiments with independent studios to make available the films *Edge of Heaven* and *Mum and Dad* on a PPV basis on the same day as their theatrical release¹⁷⁸.

¹⁷³ <http://www.guardian.co.uk/film/2010/feb/23/alice-wonderland-odeon-disney-row>

¹⁷⁴ [X].

¹⁷⁵ <http://paidcontent.org/article/419-warner-bros.-tests-vod-release-of-some-new-movies-before-dvd/>

¹⁷⁶ <http://metue.com/05-01-2008/itunes-warner-brothers-studios-dvd-day-and-date-releases/>

¹⁷⁷ <http://www.independent.co.uk/news/media/sky-movies-ian-lewis-we-have-to-get-films-to-fans-before-they-get-to-them-illegally-816403.html>

¹⁷⁸ Sky response to Second Pay TV Consultation, Annex 3, paragraph 2.6.

Section 4

Market definition

Summary

- 4.1 In this Section we present our preliminary findings on market definition in relation to:
- The upstream supply of movie rights from Major Hollywood Studios in the first pay TV subscription window in the UK. The purchaser of these rights is able to show movies on subscription linear channels as well as via SVoD services.
 - The wholesale supply of packages including Core Premium Movies channels. This market would include SVoD services, but few such services currently exist.

Introduction

- 4.2 In making a reference to the CC, the OFT's Guidance says that it is necessary to give 'some consideration to the definition of the relevant market', although noting that 'the effects on competition of some features may be clear enough that firm conclusions on the definition of the relevant market ... are unnecessary'¹⁷⁹.
- 4.3 The purpose of market definition in the context of a market reference is to help us assess competition concerns. As discussed in Section 6 of this document, we have concerns that features of the market for the sale of movie rights from Major Hollywood Studios in the first pay TV subscription window in the UK (the 'Movie Rights market') and the wholesale of packages including Core Premium Movies channels restrict, prevent and distort competition, resulting in adverse impacts on consumers. In order to consider the extent of this problem and to help scope possible remedies we consider the relevant markets in this Section.
- 4.4 The test for making market investigation references to the CC under s131 EA02 requires the consideration of reference markets for the goods or services involved. Market definition is an important means of identifying the competitive constraints that individual firms face and is an exercise which assists regulators and competition authorities in the assessment of the relative competitive positions of firms. In this case, we believe it is necessary for us not only to consider the definition of the upstream market for the relevant content rights, but also the related downstream wholesale market within which those rights are packaged into products suitable for distribution by pay TV retailers. We therefore look at the sale of movie rights in the first pay TV subscription window in the UK and also the supply of wholesale packages including Core Premium Movies channels for which these rights are an input.
- 4.5 We start by describing our approach to market definition before going on to consider the relevant upstream focal product. We then briefly set out the downstream markets which we have defined as part of the Pay TV Statement and how these relate to the upstream market.
- 4.6 We conclude with an assessment of the proposed reference markets for the purposes of this consultation on making a market investigation reference.

¹⁷⁹ OFT's Guidance, paragraph 4.8.

Our approach to market definition

- 4.7 Our approach to market definition is to consider whether any other products are close substitutes for the focal product, and may therefore be expected to exert a competitive constraint. The standard test for identifying close substitutes is the ‘hypothetical monopolist’ test (‘HMT’). The test seeks to establish the smallest product group such that a hypothetical monopoly provider of the products in that group could sustain prices above the competitive level.
- 4.8 As we note in the Pay TV Statement¹⁸⁰, market definition in a sector which is characterised by highly differentiated products may be difficult; having a differentiated product (i.e. one with unique characteristics which are important to consumers) generally allows providers to charge a higher price. The more differentiated a product is from its closest substitutes, the more scope its provider will have to set prices above competitive levels. With a limited degree of differentiation, prices may be close to their competitive levels. However, at the other end of the spectrum, the provider of a highly-differentiated product may be able to act as a monopolist¹⁸¹.
- 4.9 Assessing the impact of an increase in prices under an incorrect assumption that current prices are at competitive levels is known as the Cellophane Fallacy. We note in the Pay TV Statement that the scope to rely on an empirical application of the HMT may be compromised by this effect and that we believe that the cellophane effect compromises the application of the HMT in the case of movies market definition. As a result there is limited value in using empirical studies to assess switching responses to a price increase in order to define market boundaries. This is considered further in our Pay TV Statement¹⁸².

The relevant focal product

- 4.10 As market definition is essentially a tool for assessing competition concerns, it should be conducted in light of the specific competition concerns that we have identified. In our Pay TV Statement¹⁸³ we identify a concern that Sky, as a vertically integrated firm, with market power in a key upstream market, distributes its Core Premium Movies channels in a manner that favoured its own platform and its own retail business by denying these channels to other retailers / platforms, or by making them available on unfavourable terms.
- 4.11 Our concern about upstream rights is that the way in which these rights are sold may create a barrier to entry in the wholesale of packages including Core Premium Movies channels. As noted in Section 3, movies are an important content genre for consumers and availability of premium movies is a key driver of pay TV subscriptions. In particular, and as argued in our Pay TV Statement, consumers value access to (a) high-quality movies, (b) recent releases, (c) a large number of movies for a monthly subscription and (d) movies on TV. While movies are delivered in a number of different formats, Core Premium Movies channels are distinct in allowing subscribers to see a large number of recent high quality movies on TV for a monthly subscription, although an SVoD service with first-run Hollywood movies would also have these features. Sky is uniquely able to offer pay TV packages with this combination of features because it has exclusive rights to show movies from

¹⁸⁰ Pay TV Statement, Section 5, paragraphs 5.41 and 5.48.

¹⁸¹ This is distinct from cases where there are multiple providers of an undifferentiated product, and in which the current price can be taken to be competitive (e.g. in some merger cases).

¹⁸² Pay TV Statement, Section 5, paragraphs 5.46 to 5.53.

¹⁸³ Pay TV Statement, Section 7.

Major Hollywood Studios in the first pay TV subscription window, both on linear channels and SVoD.

- 4.12 As noted in Section 3, there is currently limited exploitation of SVoD rights; Sky has access to the rights as part of its exclusive contracts with Major Hollywood Studios but does not fully exploit these rights over its platform and does not supply SVoD to other wholesalers. However, since the SVoD rights are sold as part of the exclusive package of first window pay TV rights and the rights underpin services with very similar characteristics to linear movie channels, e.g. in terms of films available and payment methods, we include these rights in the focal products.
- 4.13 As a result, we believe the relevant focal product for us to consider in the upstream market is the sale of movie rights in the first pay TV subscription window in the UK from the Major Hollywood Studios. The next step is to consider whether this focal product forms a distinct economic market. We then consider downstream wholesale and retail market boundaries which have been reviewed as part of the pay TV investigation, in order to assess whether downstream switching in the event of a price increase by a hypothetical monopolist supplier would impose indirect constraints on the upstream supply of movie rights from Major Hollywood Studios and also to assess the extent to which market features combine to prevent, restrict or distort competition in these related markets.
- 4.14 In our Pay TV Statement¹⁸⁴, we note that premium SVoD services could provide a very similar experience to subscribing to a linear channel, but with added convenience, and are likely to be a close substitute, particularly given that the rights are supplied in the same window as linear channels. However, the content rights that would enable the delivery of such a service are currently held by Sky and as noted in Section 3, there is currently limited exploitation of SVoD rights; Sky does not fully exploit these rights over its platform and does not supply SVoD to other wholesalers. Since the SVoD rights are sold as part of an exclusive package of first window pay TV rights and the rights underpin services with very similar characteristics to linear movie channels, e.g. in terms of films available and payment methods, we include these rights in the focal products.

Upstream market definition

- 4.15 We start with the hypothesis that there is a distinct market for the sale of Movie Rights in the UK. The relevant question is then whether the market should be expanded to include other content rights (non-movies) and/or movies rights in other windows.
- 4.16 In order to assess this, we have regard to both the direct and indirect constraints if a hypothetical monopolist provider of Movie Rights (including linear and SVoD rights) raised the price of the rights.
- 4.17 Switching in response to a price rise may be affected by the cellophane effect¹⁸⁵. We note in the context of upstream rights that there are six movie studios. While we have not assessed the degree of competition (and product differentiation) between these studios, we have no basis for believing that their prices are above competitive levels. While we are concerned about cellophane effects in the wholesale market (in view of Sky's market power and profitability), we do not see the basis for such a concern in the upstream rights market. In addition, the fact that Sky has retained the rights for all

¹⁸⁴ Pay TV Statement, Section 6, paragraph 6.5.

¹⁸⁵ Pay TV Statement, Section 5, paragraphs 5.46 to 5.59.

six Major Hollywood Studios for almost 20 years, means that we have not observed any switching in response to price rises, so the cellophane effect does not arise as an empirical concern in our analysis.

- 4.18 **Direct constraints** on rights sellers would arise from pay TV wholesalers responding to an increase in upstream rights by choosing to purchase other rights (demand-side substitution), or by an alternative supplier (e.g. a movie studio other than one of the Major Hollywood Studios) responding to a price increase by entering the market and supplying equivalently attractive rights as the hypothetical monopolist (supply-side substitution). This is in contrast to **indirect constraints** which could arise if (a) upstream prices were passed on to wholesalers and in turn passed on in retail prices and (b) subscribers were to respond to these retail price increases by switching to other services. We first consider direct constraints and move on to reviewing downstream market definition in order to draw conclusions about the likely extent of indirect constraints.
- 4.19 In terms of direct constraints, in response to an increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window a wholesale channel provider has two options:
- Replace movie rights from Major Hollywood Studios in the first pay TV subscription window with movie rights from other windows; and/or
 - Replace movie rights from Major Hollywood Studios in the first pay TV subscription window with non-movies content or movies content from other studios.
- 4.20 Since consumers have strong preferences for a wide range of up-to-date quality movies on television, as discussed in the previous Section, there are likely to be few close substitutes for the content on Core Premium Movies channels for consumers¹⁸⁶. As a result it seems unlikely that a broadcaster could profitably switch from using movie rights from Major Hollywood Studios in the first pay TV subscription window to using rights to alternative, non-movies, content or less attractive movies which would hold similar appeal to consumers.
- 4.21 It is possible that the Movie Rights market should be broadened to include the supply of movie rights in other release windows. For example, movie rights in the second pay TV window or rights to DVD rentals could constrain pricing of movies in the first pay TV window. However, we note that the structure of the windows release system is designed to exploit different consumer preferences and is consistent with distinct narrow markets.¹⁸⁷ As a result, we think it unlikely that a wholesale provider of Core Premium Movies channels would be able to switch away from the first pay TV subscription window and provide a service which satisfies consumer preferences for premium movies on television.
- 4.22 In addition, we note that it is possible that Sky could continue to purchase premium movie rights in the event that a hypothetical monopolist tried to increase their price. As noted in the Pay TV Statement¹⁸⁸, we believe that prices for retail and wholesale packages including Core Premium Movies channels are above the competitive level. Given market structure and the existence of competing rights holders, it seems likely that upstream prices for rights will be relatively close to the competitive level. As a

¹⁸⁶ Pay TV Statement, Section 6.

¹⁸⁷ Pay TV Statement, Section 6, e.g. paragraph 6.30.

¹⁸⁸ Pay TV Statement, Section 6, paragraph 6.10.

result we believe that Sky could, in principle, absorb an increase in the price of premium movie rights, and that this may be more profitable than switching to rights to content which is perceived as being a poor substitute.

- 4.23 We do not consider, therefore, that there are likely to be strong direct constraints to a small but significant increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window.
- 4.24 We now consider whether it would be possible for supply-side substitution to undermine a price increase by a hypothetical monopolist. This would require another studio entering the sector, or an existing smaller player growing and being able to offer rights of equivalent appeal as recent releases from Major Hollywood Studios. This in turn would be dependent on another studio being able to make films of a comparable quality and quantity each year as the six Major Hollywood Studios, which is likely to be associated with substantial upfront costs and specialist knowledge of the sector. It would also require a new entrant to be able to supply a significant number of movies in order to make its product a viable alternative to the products available from existing studios and to encourage switching away from those products. This scale is only likely to be achievable over the long term and is likely to be associated with a high degree of risk. As a result we do not believe supply-side substitutability causes us to extend market boundaries beyond the focal product identified.
- 4.25 Hence, we do not believe there are substantial direct constraints on pricing in the upstream Movie Rights market.
- 4.26 We now consider wholesale and retail markets in order to assess whether there are indirect constraints on pricing in the upstream market.

Downstream markets

- 4.27 In assessing downstream markets, we adopt the conclusions of the market definition analysis outlined in the Pay TV Statement. In this, as part of the retail market definition exercise, we consider whether our candidate market – the supply of packages including Core Premium Movies channels - should be expanded to include Major Hollywood Studio movies delivered in different windows. We also consider whether the relevant market should also include, for example, theatrical releases, DVD rentals, FTA movies or alternative types of content (non-movies).
- 4.28 We conclude that there are narrow markets for the retail of packages including Core Premium Movies channels to UK residential customers. In coming to this view, we consider a range of evidence, including product characteristics, profitability analysis, consumer preferences and data on alternative means of watching movies, which suggests that demand-side substitution is unlikely in the event of a price rise¹⁸⁹.
- 4.29 This partly reflects our analysis that basic pay TV and FTA movies are inferior substitutes in terms of the number of hours of movie programming and the age of the movies. Similarly, characteristics of other movie formats are not sufficiently close to the first pay TV window movies to provide an adequate substitute such that switching to these products would constrain the pricing of a hypothetical monopolist supplier of packages including Core Premium Movies channels (even when we consider the aggregate constraint imposed by all potential substitutes).

¹⁸⁹ Pay TV Statement, Section 6.

- 4.30 In addition, we believe that entry by new suppliers is unlikely in the short term, because of the lack of availability of alternative relevant wholesale channels which would be of equivalent appeal to viewers.
- 4.31 In the Pay TV Statement, we also conclude that the scope of the relevant wholesale market is no wider than the relevant retail market and hence there is a narrow economic market for the wholesale supply of packages including Core Premium Movies channels.
- 4.32 In coming to this conclusion, we take the view that there are limited direct constraints associated with retailers switching away from purchasing Sky Movies in the event of a price rise. In addition, the narrow wholesale market definition derives from the limited indirect constraints imposed by consumer switching in the event of a price rise. As with retail market definition, this is based on a range of evidence, including product characteristics, consumer preferences, data on alternative means of watching movies, internal documents and pricing and profitability evidence¹⁹⁰.
- 4.33 For more details on downstream markets, please refer to our Section 6 of the Pay TV Statement.

Indirect constraints on the prices of upstream rights

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

Conclusion

- 4.36 To conclude, we believe there are distinct economic markets for:
- The upstream supply of movie rights from Major Hollywood Studios in the first pay TV subscription window in the UK.
 - The wholesale supply of wholesale packages containing Core Premium Movies channels.
 - The retail supply of packages containing Core Premium Movies channels.

¹⁹⁰ Pay TV Statement, Section 6, paragraphs 6.102 to 6.103.

Section 5

Features of the market

Summary

- 5.1 In this Section we identify a set of features of the markets for the upstream Movie Rights in the UK and wholesale supply of packages including Core Premium Movies channels relevant to our assessment of whether to make a market investigation reference to the CC. These features are:
- A limited pool of premium content from the Major Hollywood Studios.
 - The release windows structure.
 - The joint licensing of linear channel and SVoD rights by individual studios.
 - Exclusivity of rights licensing agreements between the individual studios and wholesale distributors.
 - Other restrictions in contracts for the rights in the first pay TV subscription window, such as the condition that [X].
 - Staggered availability of content rights and duration of contracts for premium movie rights.
 - Aggregation of substitutable premium movies into a single wholesale offering.
 - Sky's market power in the distribution of wholesale premium movies, which in turn gives Sky a high degree of negotiating power with the Hollywood Movie Studios in the upstream market.
 - Vertical integration of firms over the pay TV supply chain.
- 5.2 Each of these features can be regarded as relating to each of the two interdependent but related markets: the upstream market for the sale of movie rights in the first pay TV subscription window in the UK and the wholesale market for the supply of packages including Core Premium Movies channels in the UK. As we recognise above in paragraph 2.6, the term “feature” has a wide meaning within the context of EA02, and in the context of these particular markets it is therefore not possible to conclude that a particular feature is exclusive to only one of the markets.

Introduction

- 5.3 Following our overview of the characteristics of the pay TV sector and our proposed market definitions in Sections 3 and 4 of this document, here we set out a number of key features of the markets, the combination of which we suspect adversely affects competition. In Section 6, we explain how we consider these features prevent, restrict and distort competition.
- 5.4 For the purposes of a market investigation reference, a ‘feature’ of a market may be either structural or conduct-related, although in practice there may not be a clear

divide between these¹⁹¹. Features of a market may include conduct, either in the market referred or a related market, by persons active in the market concerned¹⁹². They may also include conduct relating to the market concerned, by customers of any person who supplies or acquires goods or services¹⁹³.

Limited pool of premium content

- 5.5 In Sections 3 and 4, we have noted the importance of premium movies for driving platform choice and hence entry into the market for the supply of packages including Core Premium Movies channels. We believe there are distinct markets for Movie Rights and the supply of wholesale packages including Core Premium Movies channels.
- 5.6 In the first pay TV subscription window, movies are typically licensed exclusively. Depending on its size, a single studio releases a limited number of movies per annum ('studios' output') – on average around 30. The average cost for making and marketing a single Hollywood film is about \$100m¹⁹⁴.
- 5.7 Currently, Sky has ongoing individual agreements with all six the Major Hollywood Studios¹⁹⁵, which generally require Sky to purchase a maximum number of around [X] releases from each studio per year¹⁹⁶. This means that the total number of first releases from the Major Hollywood Studios licensed to Sky is around [X] - less than 200 per year.
- 5.8 A potential entrant at the wholesale level would have to acquire a broad enough selection of the premium movie rights to assemble an appealing package for consumers. The ability to do so is constrained by this limited pool of rights for broadcasting movies produced by the Major Hollywood Studios which presumably results from the high costs of producing such content.
- 5.9 Paragraph 3.21 of Annex 7 of the Second Pay TV Consultation discussed the minimum volume of rights needed to viably launch a Core Premium Movies channel¹⁹⁷.
- [X]¹⁹⁸.
 - [X]¹⁹⁹. [X]²⁰⁰. [X]²⁰¹.

¹⁹¹ OFT's Guidance, paragraph 4.4.

¹⁹² S131(2)(b) Enterprise Act.

¹⁹³ S131(2)(c) Enterprise Act.

¹⁹⁴ The MPAA's Theatrical Market Statistics 2007 - <http://www.mpa.org/2007-US-Theatrical-Market-Statistics-Report.pdf>, page 7.

¹⁹⁵ Sky's response dated August 2007 to information request dated 18 July 2007 and Sky's response dated 8 May 2009 to information request dated 20 March 2009 question.

¹⁹⁶ Output deals are common in the Hollywood film industry where the studios typically agree to license to broadcasters their entire anticipated film production (subject to a maximum) for a given period of years. For details see Sky's output deals with the Major Hollywood Studios.

¹⁹⁷ See also paragraphs 2.263 to 2.266 of Annex 8 to Third Pay TV Consultation for our discussion on synergies that arise from having a large volume of movies.

¹⁹⁸ [X].

¹⁹⁹ [X].

²⁰⁰ [X].

²⁰¹ [X].

- 5.10 In its response to the Second Pay TV Consultation, Virgin Media argued that the rights of at least three Major Hollywood Studios would be required in order to assemble an appealing package which could then be marketed as a mid-priced alternative to Sky Movies²⁰².
- 5.11 The importance of being able to acquire movies from a number of Major Hollywood Studios was also confirmed by the studios. For example, [X] said that aggregation drives people to services and that it only produces [X] movies a year which is not enough, even with library content, to make a service²⁰³. Similarly, [X] was of the view that it is quite hard to launch a service with the content from one studio. [X] believed that in the UK a platform would probably need content from around three Major Hollywood Studios²⁰⁴.

The release windows structure

- 5.12 As previously described, in the UK films are released through a series of windows set by the Major Hollywood Studios. Different time windows mean that the movies can be watched in various ways, including on traditional linear TV channels such as Sky Movies channels and other basic or FTA channels. Alternatively, they can be downloaded via the open internet, bought or rented on DVD, or watched on an on-demand service.
- 5.13 Essentially, the **release windows structure** drives the timing of when movies over different formats become available for viewing and how consumers pay to view them (e.g. whether they pay on a one-off or a subscription basis). Potential substitutes to Core Premium Movies channels at the wholesale and retail levels are strongly differentiated in terms of format, timing, quality, quantity and price.
- 5.14 The **release windows structure** enables movie studios to price discriminate, i.e. set different prices for different windows, and studios determine the order and length of the windows in order to maximise their profits. As a result, the studios can earn significant revenues well after their initial release.
- 5.15 The traditional sequential windowing structure has persisted for a number of years, although durations of windows have changed. It is possible that the sequencing or structure of windows will change in the future. However, studios have not informed us of any firm plans in relation to [X]²⁰⁵, although [X].
- 5.16 [X]²⁰⁶. [X].
- 5.17 Given the duration of current contracts and the nature of many of the studios' comments, we do not expect significant changes in the way rights are sold in the first pay TV subscription window in the short to medium term. We note, however, that the studios may experiment with new methods of distribution that could initiate some significant changes to the release schedule in other windows.

²⁰² See Virgin Media's response to Second Pay TV Consultation, paragraph 4.7.

²⁰³ [X].

²⁰⁴ [X].

²⁰⁵ [X].

²⁰⁶ [X].

The joint sale of linear and SVoD rights

- 5.18 At present, the Major Hollywood Studios bundle SVoD rights with the rights to show movies on subscription linear channels, and these bundled rights are acquired on an exclusive basis by Sky. As a result, Sky holds the SVoD rights across multiple distribution technologies for all six studios. As noted above, the studios [X].
- 5.19 However, the joint sale of linear and SVoD rights creates a risk that only one set of rights is exploited effectively, because the purchaser does not have the platform capability to exploit the other set of rights. The result is that the other rights effectively become warehoused.
- 5.20 Sky in particular faces a technological restriction in the supply of SVoD services on its satellite platform²⁰⁷. In contrast, other operators have had the capability to deliver SVoD services for several years, and have unsuccessfully tried to obtain access to the SVoD rights.
- 5.21 We have analysed information on the negotiations between UK operators and the Major Hollywood Studios in relation to the acquisition of UK pay TV premium movie rights. [X].
- 5.22 In particular, on a number of occasions Virgin Media and [X] have discussed purchasing premium movie rights with the Major Hollywood Studios. However on each occasion Virgin Media decided that it was [X]. Virgin Media told us that “it has been unsuccessful due to the difficulties of countering Sky’s dominant position. [X]²⁰⁸.”
- 5.23 [X] studios, like [X] have explored alternative means of exploiting their rights, including unbundling the SVoD rights, [X]. [X].²⁰⁹[X]²¹⁰.
- For example during negotiations in [X]²¹¹. [X]²¹².
 - This is consistent with [X] discussions with [X] for premium SVoD rights. It appears that Sky’s offer, [X]²¹³.
 - Virgin Media also told us that it had [X] explored the potential to secure a deal for a non-exclusive SVoD movie package from [X]. However, such a move could have repercussions on the price that [X] receives from Sky for the package of linear rights. [X]²¹⁴. [X]²¹⁵.

²⁰⁷ Broadcast satellite is a one-to-many technology and is unable to offer true SVoD. It is important to note that DVR services such as Sky+ offer a somewhat similar experience to SVoD, but with a lower choice due to storage capacity, and also with the need to plan ahead. The same is true of push VoD. Push VoD services (such as Sky Anytime) are limited by the capacity available to store programming on the set-top box, as well as by the need to predict what consumers will wish to watch, so typically offer a significantly reduced choice of programming as compared to pull VOD.

²⁰⁸ [X].
²⁰⁹ [X].
²¹⁰ [X].
²¹¹ [X].
²¹² [X].
²¹³ [X].
²¹⁴ [X].
²¹⁵ [X].

Exclusivity

- 5.24 Rights to the first pay TV subscription windows are secured under exclusive contracts with individual studios. In the UK, Sky has exclusive agreements with all six Major Hollywood Studios²¹⁶, typically acquiring the rights to show a film a given number of times over the pay TV subscription window (a period of up to 15 months), approximately twelve months after theatrical release in the UK²¹⁷. This means that these rights are not available for that period to any competing wholesalers within the UK. [X].
- 5.25 Exclusivity enables wholesalers and pay TV retailers to differentiate their services and thereby attract and retain subscribers²¹⁸, and it generates revenue for studios. The exclusive licensing, however, limits availability of alternative products to Sky's Core Premium Movies channels in the wholesale and retail markets.
- 5.26 Exclusivity can also provide a mechanism for the studios to recover the fixed costs of content production without competitive pressures driving downstream prices close to zero. As we discussed in our First Pay TV Consultation, where content is sold on a fixed fee basis, content providers are likely to prefer to sell on an exclusive basis. Otherwise, the first purchaser of the content would face the risk of the content being sold to additional wholesalers and downstream competition would potentially drive prices down to a low level (particularly given zero marginal costs to wholesale channel providers). This would substantially reduce the amount purchasers would be prepared to pay. Thus, where content is sold on a fixed fee basis, exclusivity is generally a more profitable strategy for the content seller.
- 5.27 By contrast, where content is sold on a per subscriber basis, this rationale for exclusivity is likely to be much less important to rights holders. The threat of downstream competition driving prices to very low levels is much weaker because wholesale channel providers at least need to ensure that they recover their marginal costs in relation to upstream content, as reflected in the per subscriber charge. In principle, a studio could therefore charge the same (or similar) per subscriber fees to multiple wholesale channel providers without facing the risk of a collapse in downstream prices – although we recognise that this type of arrangement can lead to 'double marginalisation'²¹⁹.
- 5.28 [X]²²⁰.
- 5.29 In terms of the first pay TV subscription window itself, we have found that:

²¹⁶ Exclusive agreements between pay TV providers and the film studios are called 'output deals' and run for several years.

²¹⁷ See Annex 11 to First Pay TV Consultation, page 87 - http://www.ofcom.org.uk/consult/condocs/market_invest_paytv/annex11.pdf

²¹⁸ See the OFT's 2002 Decision - http://www.of.gov.uk/advice_and_resources/resource_base/ca98/decisions/bskyb2

²¹⁹ Double marginalisation is an efficiency loss that may arise when a retailer purchasing content from a third-party wholesale channel provider does not see the true marginal cost of supplying content to individual consumers, which is close to zero, but instead sees a per-subscriber wholesale subscription charge. Thus the retailer's incentive to make the content widely available is weakened. As a result, the retailer is likely to set higher retail prices and may be discouraged from promoting / advertising the channel. In contrast, a vertically integrated retailer sees the true marginal cost of content. See also the Pay TV Statement, Section 4, paragraph 4.89.

²²⁰ This is in contrast with DVD retail/rental release window in which we understand that wholesalers negotiate for access to content on non-exclusive basis.

- Paramount Pictures has not contemplated plans to alter the way the first pay TV linear and SVoD rights are distributed in the UK²²¹. [X]²²².
- [X]²²³.
- [X]²²⁴.
- [X]²²⁵.
- [X]²²⁶ [X]²²⁷.

Other contract restrictions

5.30 As discussed, Sky currently holds the SVoD and linear rights for the same movies in the first pay TV subscription window. There are a number of conditions attached to acquiring these rights.

- Firstly, [X]²²⁸.
- Secondly, [X]²²⁹.

5.31 In some cases broadcasting films from a particular studio on an SVoD basis is conditional [X]:

- [X]²³⁰. [X]²³¹.
- [X]²³² [X]²³³.
- [X]²³⁴.

5.32 [X]²³⁵.

5.33 The restrictions described may have a direct impact on the flexibility of wholesalers to develop premium movie packages. One stakeholder told us that it had problems in acquiring [X]. We note that in particular, the condition requiring [X] might be expected to affect competition in the retail market.

²²¹ See the non-confidential version of Viacom’s response to Ofcom’s Information Request dated 20 May 2009.

²²² [X].

²²³ [X].

²²⁴ [X].

²²⁵ [X].

²²⁶ [X].

²²⁷ [X].

²²⁸ [X].

²²⁹ [X].

²³⁰ [X].

²³¹ [X].

²³² [X].

²³³ [X].

²³⁴ [X].

²³⁵ Electronic sell-through allows users to keep a copy of the movie permanently on their computer hard drive and eventually to burn it to a DVD-R or transfer it to a portable device.

Staggered availability of content rights and duration of contracts

- 5.34 Sky has had contracts with the six Major Hollywood Studios for the subscription pay TV subscription window since [X]²³⁶. Contracts tend to cover a number of years, and we note that the rights award process is not particularly transparent as contracts are negotiated confidentially between a broadcaster and individual studios²³⁷. As a result, the precise duration of each contract is not widely known. We have reviewed Sky's contracts with the Major Hollywood Studios and found that duration ranges between [X].
- 5.35 Typically, the rights are agreed for varying durations and contracts do not run in parallel. As a result, rights become available on a staggered basis rather than all at once.
- 5.36 Figure 9 below shows the dates on which Sky's current contracts with the Major Hollywood Studios expire. The length of time between Sky's contracts with different Studios expiring ranges from [X] months to [X] months. Since there is no guarantee that a rival bidder would win the next set of available rights, in practice a new entrant could face a significant delay before it could acquire additional rights²³⁸. We also note that [X].

Figure 9 Expiry dates of Sky's current contracts with the Major Hollywood Studios [X]

- 5.37 A wholesaler wishing to launch a new service will typically need to acquire the movie output from more than one studio. Constructing an appealing film package is likely to require a large volume of movies, in order to be able to offer a critical mass of content to consumers²³⁹. Because of the staggered availability of rights, this cannot be achieved simultaneously. Virgin Media noted that assembling a portfolio of attractive movie content across the Major Hollywood Studios is essential to compete with Sky Movies²⁴⁰ which may take a few years to achieve. Additionally, Virgin Media pointed out the "movie rights from more than one studio [act] as a risk pooling measure because the success of studios in producing popular titles ... will vary from year to year"²⁴¹. This is likely to constitute a barrier to entry for a wholesaler.

Aggregation of substitutable content by one buyer

- 5.38 As we would expect, content aggregation is a particularly important characteristic of the way in which movie services are put together. Content aggregation is significant because consumers have widely differing content preferences. There is a limited

²³⁶ The year depends on the studio. Source: Sky response to information request of 20 December 2007. Note however that Disney premieres its animated films on its Disney Cinemagic channel, before they are shown on Sky Movies (see for example http://media247.co.uk/skydigital/newsarchive/2006/02/sky_launch_conf.php).

²³⁷ A more transparent alternative could be publishing calls for tenders, notifying contract awards and publishing award criteria.

²³⁸ The timing of negotiations between a Major Hollywood Studio and potential bidders is not fixed. For example, [X]. This was over [X] in advance of the expiry of Warner's then agreement with Sky (in [X]). [X].

²³⁹ See also our Section 6.

²⁴⁰ Virgin Media response to Second Pay TV Consultation, paragraph 4.15

²⁴¹ Ibid, paragraph 4.10

amount of content which is highly valued by large groups of consumers, plus a long tail of content that is attractive to some individual consumers, but not to others.

- 5.39 The content available from a single studio does not provide the volumes required to create an attractive package. As we have stressed above in paragraph 5.7, a single studio might release around 30 movies per year. Given this, content aggregation is necessary in order to assemble a credible pay TV proposition.
- 5.40 Sky currently purchases the rights to movies in the first pay TV subscription window from all six Major Hollywood Studios. At the wholesale level, Sky aggregates different movies into channels and bundles of channels. While we recognise that content aggregation is often good for consumers and necessary to create attractive retail propositions, it may also cause us concern, particularly where it contributes to market power²⁴².
- 5.41 Aggregation of a high proportion of available premium movie rights from Major Hollywood Studios may have significant implications for the market, especially since the content being bundled is substitutable. By doing this, a buyer may be able to dampen the competition that would otherwise exist between competing premium movie services. This would allow a wholesaler to extract greater rents from retailers and ultimately final consumers.

Sky's market power in the distribution of wholesale premium movies

- 5.42 The various features we have discussed above, in particular the joint sale of linear and SVoD rights on an exclusive basis, enable first movers in the sector to monopolise the acquisition of content. We consider that, as a result, Sky has an advantage in relation to the acquisition of premium SVoD rights.
- 5.43 Our view is strongly supported by the historical evidence. In the UK Sky has managed to maintain its position over a prolonged period of time; over a period of almost 20 years Sky has never lost any of the premium movie rights. We regard this as clear evidence, contrary to Sky's claims that these rights are "contestable", that in practice there are significant barriers to other parties winning sufficient rights away from Sky.
- 5.44 In Section 6 of the Pay TV Statement we have concluded that Sky has market power in the wholesale supply of packages including Core Premium Movies channels, and is likely to do so for the next three to four years. This is based on Sky's very high and sustained market shares, the existence of barriers to entry, a lack of countervailing buyer power, and evidence that current prices are above the competitive level.
- 5.45 We note that Sky has a 100% share in the market for the wholesale of packages including Core Premium Movies channels. However, we also acknowledge that this market share figure substantially overstates the degree of market power held by Sky. There are a variety of other ways of watching films, and the aggregate constraint from these may be significant. Retail DVDs and films on free-to-air channels are the two types of service that offer the strongest constraint, as they are the closest substitutes that are of significant scale.
- 5.46 We have assessed the strength of this aggregate constraint by calculating market shares under a variety of assumptions for the market boundary. Considering the

²⁴² Please also see our discussion on bundling as a price discrimination mechanism in the Pay TV Statement, paragraphs 4.78 to 4.86.

constraint to be as strong as it plausibly could be, Sky would have a market share of around [X] 30-40 to 40-50%. This figure understates the degree of market power held by Sky, since it treats moderate substitutes as if they were close substitutes. The balance of evidence leads us to take the view that Sky has market power.

5.47 In our Pay TV Statement, we have considered that Sky has considerable advantages in winning key premium movie rights in future, particularly due to²⁴³:

- The impact of the staggered expiry of Sky's contracts with the Major Hollywood Studios.
- Efficiency advantages (such as greater certainty about wholesale income) that flow from bidders such as Sky being vertically integrated with pay TV retailers with a significant premium movie subscriber base. Any competitor for the rights would face a delay in establishing such a subscriber base – or would have to negotiate access to Sky's subscriber base. This is similar to the effect described in Section 5 of the Pay TV Statement in the context of sports.

5.48 Our view on whether potential competition is sufficiently strong to undermine the market power suggested by Sky's market shares is as follows²⁴⁴:

- We consider that Sky is likely to maintain its wholesale position unless it loses the majority of premium movie rights.
- We consider that Sky is likely to win the majority of premium movie rights that become available. This reflects the advantages that Sky enjoys when bidding for these rights. These advantages constitute barriers to entry and expansion from the perspective of competitors seeking to enter the relevant market.
- Accordingly, we consider that the threat of entry is not strong enough to prevent Sky exercising its market power. The weakness of existing and potential competition is consistent with Sky possessing market power, and potentially a dominant position.

5.49 In addition, our view that Sky has market power is supported by evidence that Sky's returns from the wholesale of movies are above the competitive level. Sky's persistently high returns are directly indicative of market power²⁴⁵, and this is not dependent on the precise market definition or market shares. Under our central case we find that Sky makes a return on sales for wholesale movie channels of [X] %, and a margin over direct costs of [X] %²⁴⁶. These estimates are subject to some uncertainty, but are materially higher than would be expected in a competitive market.

5.50 In our Pay TV Statement, we have also projected future market shares, particularly for relatively new services like legal movie downloads and Sky's proposed SVoD service. The key implication that we have drawn is that Sky's market power is unlikely to materially decline in the next few years. In particular, [X]²⁴⁷.

²⁴³ Pay TV Statement, Section 6, paragraph 6.315.

²⁴⁴ Pay TV Statement, Section 6, paragraphs 6.300 to 6.319.

²⁴⁵ OFT's Guidance paragraph 6.6.

²⁴⁶ Pay TV Statement, Section 6, paragraph 6.334.

²⁴⁷ Pay TV Statement, Section 6, paragraphs 6.338 to 6.344.

Vertical integration

- 5.51 Closely related to Sky's market power is vertical integration across wholesale and retail activities, a common feature in the pay TV sector, as illustrated in Figure 20 of our Pay TV Statement.
- 5.52 Vertical integration can enable firms to exploit synergies between different layers of the value chain and contribute to consumer benefits²⁴⁸. On the other hand, vertical integration combined with market power can result in incentives to act in ways which limit competition²⁴⁹. This is because a vertically integrated firm will also take into account the impact of its actions at one level of the supply chain on other parts of its businesses.
- 5.53 For example, absent regulation, there may be an incentive for a vertically integrated firm to refuse to supply wholesale services to other retailers, or to supply them on less favourable terms than it supplies itself. A firm with market power at the wholesale level may also seek to restrict downstream competition if it considers that downstream competitors may ultimately challenge its upstream position.
- 5.54 As we set out in the Pay TV Statement²⁵⁰ Sky's market power in the wholesale supply of Core Premium channels combined with its vertical integration, gives it the ability and incentive to restrict wholesale supply of packages including Core Premium Movies channels. We discuss this and the impact of the other features on competition in the next section.

²⁴⁸ See Pay TV Statement, paragraph 4.89 for our discussion on efficiencies of vertical integration.

²⁴⁹ We recognise that vertical integration is commonplace and only problematic in certain circumstances. This poses the question whether those conditions apply in the present circumstances. We assess this question in detail in Section 7 of the Pay TV Statement.

²⁵⁰ Pay TV Statement, Section 7.

Section 6

Prevention, restriction and distortion of competition

Summary

- 6.1 We are consulting on the view that the features we have identified prevent, restrict or distort competition in relation to the upstream sale of movie rights from the Major Hollywood Studios in the first pay TV subscription window in the UK and the wholesale supply of packages including Core Premium Movies channels in the UK.
- 6.2 The competition concerns we have identified are manifested in three ways:
- Limited exploitation of premium SVoD movie services.
 - Restricted distribution of Sky’s Core Premium Movies channels.
 - High wholesale prices for Sky’s Core Premium Movies channels.
- 6.3 We therefore believe that the s131 EA02 test for a market reference to the CC is satisfied.
- 6.4 In this Section, we look at the effect that these features are likely to have on consumers in terms of choice, innovation and price.

Introduction

- 6.5 In the previous Section, we have identified a set of features of the supply of premium movie content. In this Section, we assess how these features prevent, restrict and distort competition at the upstream and wholesale levels. This takes into consideration the historical development of the pay TV sector and the impact that the features have had to date. We also consider the impact of the prevention, restriction and distortion of competition on consumers in the retail market for the supply of television bundles containing Core Premium Movies channels, particularly in terms of choice, innovation and price. Moreover, we also consider likely future developments, in order to provide context for our analysis of potential remedies in Section 7.
- 6.6 We interpret the phrase “prevent, restrict or distort” competition broadly, to encompass any reduction or dampening of actual or potential competition²⁵¹, noting that markets will operate effectively when firms engaged in the market are subject to competitive constraint from other firms already in the market and/or from firms that could readily enter it, and from their customers²⁵².
- 6.7 In considering whether the s131 EA02 test is met, we have borne in mind that we need only to establish “reasonable grounds to suspect” that one or more features of a relevant market prevents, restricts or distorts competition.

²⁵¹ See OFT’s Guidance, paragraph 4.2.

²⁵² See OFT’s Guidance, paragraph 4.1.

Features affecting competition

- 6.8 The features set out in Section 5 are inter-related²⁵³. We are concerned with the way the features work in combination, which we suspect tends to prevent, restrict and distort competition in the markets identified. The features affect the operation of the supply chain and have a direct impact on consumers in terms of choice, innovation and the price they pay. In particular, we believe that the features enable and incentivise one player to limit competition.
- 6.9 We have identified the **release windows structure** as a relevant feature of the markets, noting that it determines when films in different formats become available for viewing. Conceptually, while this structure may be economically efficient, we suspect it has also contributed to the position whereby there is a single wholesale supplier of services based on rights sold in the first pay TV subscription window. Our key concern arises from the fact that **the linear and SVoD rights within that window are sold jointly and exclusively** to one broadcaster. Indeed, we note that in the UK Sky aggregates all substitutable premium movie content from the Major Hollywood Studios within this window. Moreover, the joint licensing of rights and **other contractual restrictions limit** the possibility that the supply of SVoD services will constrain linear channel services and vice versa.
- 6.10 In addition, the **limited pool of premium content** from the Major Hollywood Studios is such that an entrant seeking to challenge Sky would have to acquire rights from a number of these studios, since the amount of content available from one studio is unlikely to be sufficient to undermine Sky's wholesale market power. A wholesaler that has managed to **aggregate** most or all available rights is in a strong position to build a subscriber base. This in turn delivers bidding advantages; a large base of subscribers may enable a wholesaler to pay more for the underlying rights because it can monetise them more effectively than could a new entrant.
- 6.11 As set out in the previous Section, we consider that Sky has considerable advantages in winning key premium movie rights in future, particularly due to:
- The impact of the staggered expiry of Sky's contracts with the Major Hollywood Studios.
 - The efficiency advantages (such as greater certainty about wholesale income) that flow from bidders such as Sky being vertically integrated with pay TV retailers with a significant premium movie subscriber base. Any competitor would face a delay in establishing such a subscriber base – or would have to negotiate access to Sky's subscriber base. The existence of the **limited set of key content rights**, which only become contestable on a **staggered basis** makes entry extremely difficult as the process of assembling a viable portfolio of rights may take months or years.
- 6.12 Indeed, we consider that Sky is likely to win the majority of the premium movie rights that become available²⁵⁴. This reflects a number of advantages that Sky is likely to enjoy when bidding for these rights. These advantages constitute **barriers to entry** and expansion from the perspective of competitors seeking to enter the wholesale

²⁵³ Given that these features are inter-related, and have developed over the course of a number of years, we consider that evaluating the effect of each on an individual basis would be an artificial exercise.

²⁵⁴ See Pay TV Statement Section 6, paragraphs 6.309 to 6.316 for detailed discussion.

market. As such we consider it unlikely that other wholesalers would be able to bid successfully for enough premium movie rights to erode Sky's position.

- 6.13 Furthermore, we suspect that **content aggregation** can contribute to the creation of **market power** which in conjunction with **vertical integration** then enables a wholesaler to act in a way that restricts competition²⁵⁵. In practice, by aggregating a significant volume of premium movie rights, a wholesaler is able to dampen the competition that would otherwise exist between competing premium movie services.
- 6.14 We suspect that the combination of identified features has resulted in a situation in which all movie rights in the first pay TV subscription window are controlled by one player, i.e. Sky. They effectively underpin Sky's market power at the wholesale and retail level, giving rise to various effects, which we discuss below in turn.
- 6.15 We identify below more specifically our grounds for suspecting that the features identified prevent, restrict or distort competition, before assessing the extent of the impact this has on consumers, by reference to the criteria we have set out in our Pay TV Statement for assessing the functioning of the sector, which are²⁵⁶:
- Choice of platform and content:
 - Choice for consumers of platform and of content once platform selection is made.
 - Switching between retailers and platforms should not be artificially difficult.
 - Generation and availability of a broad range of high-quality content: a variety of content should continue to be generated and made available to consumers on all platforms.
 - Innovation:
 - In platform services, for example in terms of interactivity, set-top box functionality such as DVR capabilities, or VoD options.
 - In retail service bundling, packaging and pricing.
 - Pay TV services priced competitively and efficiently:
 - Prices which give consumers good value and allow efficient producers to earn a reasonable return on their investment.
 - A sufficient variety of price points / bundles to allow consumers to tailor their purchases to meet their preferences.

Competition issues: limited exploitation of premium SVoD rights

- 6.16 We believe it is reasonable to suspect that the combination of market features has prevented, restricted and distorted competition in relation to premium SVoD services, and therefore in relation to the supply of wholesale packages containing Core Premium Movies channels. We also consider that competition for the purchase of

²⁵⁵ See Pay TV Statement, Section 7 for more details on incentives that vertical integration creates.

²⁵⁶ See paragraph 1.15 of our Pay TV Statement.

movie rights from Major Hollywood Studios in the first pay TV subscription window is prevented, restricted and distorted.

- 6.17 Not only are wholesalers unable to access SVoD rights from Sky, but Sky does not exploit them fully itself. As discussed earlier, Sky has exclusive access to the SVoD rights in the first pay TV subscription window as part of its contracts with Major Hollywood Studios. In this context, we note Sky's Board paper indicating that [X]²⁵⁷.
- 6.18 Additionally, [X] Sky offers its premium movie SVoD services (via Sky Player) only to consumers who subscribe to Sky Movies channels. This means that SVoD services are not available on a standalone basis. For example, other operators of cable and IPTV platforms have been capable of delivering true VoD services for several years. As discussed in Section 5, [X], and as a result [X] offering has been limited to PPV and PictureBox. [X]²⁵⁸.
- 6.19 We have a number of reasons for believing that the importance of SVoD to competition will increase in the future. Several stakeholders expressed the opinion that SVoD is likely to take over from linear channels as the main way of delivering movies. As we have noted in Section 4, SVoD services could provide a very similar experience to subscribing to a linear channel²⁵⁹, but with the added convenience of allowing consumers to view a wide range of content when they want to. As set out in Section 3, this view is also confirmed by the fact that the consumption of VoD services has significantly increased, suggesting that consumers want to have more control over watching programmes. For example, more than half of Virgin Media digital TV customers - 58% - regularly used VoD, including catch-up TV, at Q4 2009, up from 47% at Q4 2008²⁶⁰.
- 6.20 Additionally, wider availability of premium SVoD movie rights would give others the opportunity to develop an SVoD movie service which would compete effectively with Sky's linear subscription movie offering.
- 6.21 The fact that other competitors do not have access to premium SVoD content impacts on their ability to offer innovative SVoD movie services. SVoD is not only important to the development of platforms that are well suited to deliver it, such as those using IPTV, but also to investment in the underlying superfast broadband networks. Lack of access to SVoD content could affect IPTV's prospects in the UK in the future²⁶¹. In this context we note that in the UK IPTV penetration in 2008 was only 0.2%, compared with 13% in France and 10% in Sweden²⁶². IPTV is an example of an innovative way of supplying TV which has proved popular in other countries such as US, France and Germany.
- IPTV offers new means of accessing content, with significant potential consumer benefits in terms of greater choice of content and control over when and how to watch it.

²⁵⁷ [X].

²⁵⁸ [X].

²⁵⁹ They offer a payment mechanism that is likely to be particularly attractive to consumers.

²⁶⁰ Pay TV Statement, Section 4, paragraph 4.162

²⁶¹ See Pay TV Statement, Section 4 for more on IPTV prospects in the UK.

²⁶² World Television Markets – Idate (2008). As we set out in paragraph 8.221 of the Pay TV Statement we interpret international comparisons with care, as there can be a range of historical contextual reasons for differences in penetration.

- IPTV is enhanced by large-scale investments in superfast broadband. However, such investment can only make sense if it is possible to develop the sorts of services that can exploit IPTV's capabilities – most obviously true VoD – which satellite is unable to offer.
- Such services focus on content; movie content is important for VoD services generally, and the premium SVoD movie rights are among the most important sets of VoD rights.

6.22 We acknowledge that as Sky becomes able to find technical solutions to delivering an SVoD service, our concerns related to limited exploitation may be somewhat reduced. However, there is a risk that having exclusive access to two sets of rights (linear and SVoD), will allow Sky to maintain and/or extend its market power. In particular we note the concern that over time, as Sky is increasingly able to deliver a true SVoD service, its current market power could simply be transferred across to the new service, without other operators ever having had a meaningful opportunity to compete.

Competition issues: restricted availability of Sky's Core Premium Movies channels

6.23 We set out in detail our concerns in relation to restricted availability of Sky's Core Premium Channels in the Pay TV Statement²⁶³. We summarise these here.

6.24 We are concerned that Sky, as a vertically integrated firm, with market power in a key upstream market, distributes its Core Premium Movies channels in a manner that favours its own platform and its own retail business. Sky's behaviour demonstrates that it has the incentive to limit wholesale distribution of its premium channels, with the effect of restricting downstream competition. In this context, we have found that Sky:

- Has restricted wholesale supply of its Core Premium Movies channels to other retailers on the DTH, DTT or IPTV platforms.
- Has restricted wholesale supply of its interactive services and HD premium channels to Virgin Media.
- Supplies its premium channels to Virgin Media at prices which do not allow Virgin Media to compete effectively against Sky at the retail level, taking into consideration the fact that Virgin Media does not (and could not) have the same scale as Sky.

6.25 This evidence of restricted supply, together with Sky's market power (which is underpinned by many of the features we discussed above) and its vertical integration, suggests that Sky is acting on a strategic incentive to restrict supply, in order to favour its own satellite platform as well as protect its position when bidding for key content rights in the upstream Movie Rights market. Competition in the supply of wholesale packages containing Core Premium Movies channels is prevented, restricted or distorted on the basis of both the absence of wholesale supply to new competitors and the terms of supply to Virgin Media.

²⁶³ Note that in our Pay TV Statement we have assessed both Core Premium Sports and Movies channels - see Section 7. Here in this document, we specifically refer to Core Premium Movies channels.

Competition issues: high wholesale prices

- 6.26 In Section 5 and Annex 3 of the Pay TV Statement, we have set out the evidence from Oxera's analysis that Sky has achieved persistent and significant profits, based on the difference between its ex post returns (measured by the Internal Rate of Return -'IRR') and its ex ante cost of capital and we note that this is a strong indicator of the existence of barriers to entry. In a well-functioning competitive market, we would expect the entry of new firms to drive prices down and reduce returns. We also conclude on the basis of this evidence that the prices of packages including Sky's Core Premium Movies channels are above the competitive level. We therefore consider that competition in the supply of wholesale packages containing Core Premium Movies channels is prevented, restricted or distorted.
- 6.27 Oxera's analysis shows that Sky's overall returns are around nine percentage points above its cost of capital, and that these high returns are concentrated in wholesale rather than retail services, and in premium rather than basic channels. Further disaggregated analysis shows that margins are likely to be higher in movies than sports, although this is likely to reflect the flow of money upstream to sports rights holders compared to movie rights holders. Oxera's findings are supported by our own pricing analysis in Section 10 and Annex 7 of the Pay TV Statement.
- 6.28 We have also explained that while the riskiness of Sky's early investments will have demanded returns in excess of its cost of capital for a period, we do not believe that such returns would be required on an ongoing basis unless there was evidence of continued significant risk-taking. Oxera's analysis suggests that more recent investments and innovations have involved considerably less risk, yet Sky has continued to earn returns materially above its cost of capital and appears likely to do so over the next few years. Consequently, we consider that the more recent profitability gap between Sky's IRR and its cost of capital is likely to go beyond the necessary rewards for significant risk-taking.

Consumer effects

- 6.29 We believe that the restriction, distortion or prevention of competition that we identified above mean that consumers lose out in terms of choice, price and innovation.

Choice

Impact of limited exploitation of SVoD rights on consumer choice

- 6.30 UK consumers currently have very limited access to this content on a full SVoD service. Sky distributes SVoD content only to its Sky Player applications on PC and Xbox and its iPhone mobile TV service. The distribution of these services is fairly limited. For example, in October 2009, there were [X] Sky Player subscribers.
- 6.31 In 2009, Sky announced the launch of a 'pull' video-on-demand service in 2010, to provide Sky+ HD customers with additional choice. Sky indicated that this service will use the broadband capability of existing Sky+ HD boxes. Although this could be an attractive service, it will only be available to about 25 % of Sky's subscriber base²⁶⁴.

²⁶⁴ According to Sky, on Q4 2009 there were 2.1 million households that had Sky+ HD boxes. The total number of Sky subscribers on Sky's satellite platform in September was almost 9.7 million - http://corporate.sky.com/documents/pdf/press_releases/4ad9b907f137492d998022a042ac035b/280110_Interim_Results_Press_Release. [X].

In contrast, all cable subscribers or IPTV subscribers would be able to access such a service, if it was available on their providers' platforms. In this context we note in its press release on results for half year ended 31 December 2009, Sky announced that it switched to selling HD-enabled set-top boxes as standard²⁶⁵. [X]

- 6.32 Our concerns on choice relate not only to the current situation for consumers, but also in particular how the pay TV sector is likely to develop in future. Looking forward, we are at a point where the potential choice of platforms is increasing, and is set to increase further. In our view there is potential for increased choice and innovation through the further development of IPTV services, and that the extent of such development is constrained by the lack of access to premium movie content, including SVoD. Lack of access to premium SVoD content may prevent entry or expansion of new providers using IPTV or other technologies leading to restriction in consumer choice.

Impact of restricted availability of Sky's Core Premium Movies channels on consumer choice

- 6.33 In Section 8 of the Pay TV Statement, we have analysed the impact that the restricted supply of the Core Premium Movies channels has on consumer choice and concluded that this situation leads to the distortions of choice which cause consumer harm.
- 6.34 While there is a relatively wide range of options for basic-tier TV, consumers wanting Core Premium Movies channels have a choice of only two retailers – Sky or Virgin Media (and those outside cable areas do not have any choice of retailer). We have some concern about the terms on which these channels are supplied to Virgin Media, which create a situation in which consumer choice is likely to be distorted.
- 6.35 More fundamentally, consumers with a preference for other platforms, or who do not want a “big” pay TV package – such as the ten million households with DTT services – are currently unable to access Sky's premium channels. The development of new platform technologies should open up a wider choice of operators to consumers, but this will not happen if those operators are denied access to key content.
- 6.36 Although a substantial proportion of consumers still buy pay TV services on a standalone basis, bundles of pay TV and telecommunications services are becoming increasingly important. Particularly on a forward-looking basis, therefore, restricted distribution of Core Premium Movies channels limits choice of triple-play bundles.

Innovation

Impact of limited exploitation of SVoD rights on innovation

- 6.37 We note that Sky would tend to favour only those innovations – in platform enhancement, and in pricing and packaging – which do not cannibalise its existing customer base and which tend to support its incumbent advantages over potential entrants. This would tend to inhibit the development of other services and platforms which could otherwise use premium movie content to drive demand, such as next generation networks, and mobile TV services.

²⁶⁵ See

http://corporate.sky.com/documents/pdf/press_releases/4ad9b907f137492d998022a042ac035b/280110_Interim_Results_Press_Release

- 6.38 In the UK there is growing interest in superfast broadband²⁶⁶, which is likely to have a significant impact on content distribution, for example via IPTV and may deliver significant benefits to consumers.
- 6.39 We are concerned that the lack of access to premium movie content may have a negative impact on the investment necessary to deliver superfast broadband and new IPTV platforms. This investment will in part depend on the ability to attract a wide range of TV subscribers including subscribers to premium movie content. For example, in our statement on the provision of superfast broadband we observed that HDTV and IPTV services have played a role in driving demand for NGA services in Europe²⁶⁷. On this basis we consider that access to premium movie content, in particular SVoD services is likely to prove important, albeit as one of several potential drivers of demand.
- 6.40 Superfast broadband networks and IPTV are capable of delivering both linear channels and VoD. VoD services are of particular interest, since they potentially offer consumers greater choice of content, and control over when it is viewed, than is provided by traditional broadcast platforms. VoD is a particular example of a delivery mechanism that does not favour satellite. Instead, VoD plays to the strengths of the broadband networks operated by BT and Virgin Media. Therefore, Sky does not have an incentive to encourage the development of VoD services.
- 6.41 Limited exploitation of premium SVoD movie rights is likely to hold back innovation to the detriment of consumers. The premium SVoD movie service could have been an innovative new service introduced several years ago. However, this has been and continues to be held back by the way in which the rights are sold, in particular the joint sale of SVoD and linear rights within the first pay TV subscription window. Our concerns in relation to innovation are also forward-looking. We think that the lack of access to premium SVoD content could also diminish the scope for future innovation. [X]²⁶⁸. This means that consumers will be denied [X].
- 6.42 Section 4 of the Pay TV Statement, describes some of the potential innovations we may see in the near future. For example, we have identified the potential for greater portability of devices and transferability of content between devices. We have also identified a trend towards hybrid devices which combine traditional broadcasting platform with an IP platform such as the proposed Canvas. These types of technologies would be able to provide a more interactive and participatory viewing experience where viewers can talk, text, game or otherwise interact during broadcasts. Where supply of the most important content is restricted, then firms wishing to enter or expand will face a lower incentive to innovate on such devices or platforms.

Impact of restricted availability of Sky's Core Premium Movies channels on innovation

- 6.43 In Section 8 of our Pay TV Statement, we have set out the evidence on which we based our view that innovation will be harmed by the restricted supply of Core Premium Movies channels. We have also described how Sky's approach to

²⁶⁶ Superfast broadband networks ('Next Generation Access' or NGA) use various types of fibre network (FTTH or FTTC) to deliver greater bandwidth to consumers.

²⁶⁷ Delivering super-fast broadband in the UK, Promoting investment and competition, 3 March 2009, page 68. See for example:

http://www.ofcom.org.uk/consult/condocs/nga_future_broadband/statement/statement.pdf . Page 68.

²⁶⁸ [X].

supplying its content restricts the availability of retailers to price and package Core Premium Movies channels in innovative ways. We have concluded that this limits the range and variety of packages and price points that consumers would be able to access, compared with the case where Core Premium Movies channels were supplied to retailers on a wholesale basis on terms that enable them to compete at the retail level.

- 6.44 Access to the Core Premium Movies channels which Sky currently controls is highly important to new entrants or to other firms planning to expand (as, indeed, was the case when Sky entered the market). Without access to this content, the overall prospects for such a firm are likely to be greatly diminished, and so is the likelihood that it will be willing to take a risk on substantial innovation, and secure finance for the necessary investment.

Retail prices

- 6.45 In Section 5 of the Pay TV Statement, we have described the evidence used to assess whether prices for consumers are high. Our analysis has concluded that Sky is earning returns significantly above its cost of capital, and that these returns are concentrated in Sky's wholesale premium sports and movies channels.
- 6.46 High wholesale prices for Sky's Core Premium Movies channels go hand in hand with high retail prices. Sky sets its retail prices and wholesale prices simultaneously, and it appears to determine its wholesale prices with reference to its understanding of the OFT's margin squeeze test²⁶⁹. Our assessment of profitability²⁷⁰ indicates that consumers pay high prices for packages including Core Premium channels. High prices are detrimental both to subscribers who pay them, and households who do not currently subscribe to these channels, but who would do so at competitive prices.
- 6.47 One reason that high wholesale prices of linear channels have been able to persist is that no competitive constraint has developed from SVoD. By selling the two sets of rights jointly, the studios allow Sky to aggregate not just the content from several different substitutable studios, but also two different, probably substitutable delivery mechanisms. This is likely to lead to prices for both that are above the competitive level. We explain above our view that Sky's prices for its Core Premium Movies channels are above competitive levels. Aggregation of the linear channel rights with the SVoD rights is, therefore, likely to mean that the prices of SVoD services are also above competitive levels.
- 6.48 Our view is that premium SVoD movie services are a close substitute to Core Premium Movies channels²⁷¹. If premium SVoD rights were available independently of linear rights, we would expect competition between the two types of service to lead to lower prices. In our view, SVoD services could in theory provide a strong constraint on Sky's linear channels. This could potentially keep both wholesale and retail prices closer to the competitive level, which would be to the benefit of consumers.

Conclusion

- 6.49 In order to make a market investigation reference to the CC under s131 EA02, Ofcom must have reasonable grounds for suspecting that any feature, or

²⁶⁹ [X].

²⁷⁰ See Section 5 and Annex 3 of the Pay TV Statement.

²⁷¹ Pay TV Statement, Section 6, paragraph 6.2.

combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.

- 6.50 In the course of our analysis, we have assessed a wide range of evidence and considered the impact of the features identified. On this basis we are consulting on our view that we have reasonable grounds for suspecting that the nine features of the markets we have identified, prevent, restrict or distort competition in connection with the supply and acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels.
- 6.51 We are particularly concerned about the impact of these features on prices, choice and innovation. For example, in the case of innovation we have described how the lack of access to premium movie content may have a negative impact on the investment necessary to deliver superfast broadband and new IPTV platforms.

Section 7

Proposed decision on a reference

Summary

- 7.1 We are consulting on our proposed decision to exercise our discretion to refer two markets to the CC under s.131 EA02 for investigation, on the terms set out in Annex 1.
- 7.2 We believe that it would not be more appropriate to address identified concerns (particularly in relation to SVoD) through use of our sectoral or CA98 powers; nor do we expect that the problems could be addressed through undertakings in lieu of a reference. We consider the scale of the problems and their adverse effects on competition more than justify a reference, and we consider that there is a reasonable chance that the CC would have appropriate remedies available to it.

Introduction

- 7.3 In Section 6, we have demonstrated that there are features that prevent, restrict or distort competition in the markets we identified in Section 4. We now consider whether we ought to exercise our discretion to make a reference. In this Section, we present our view as to why a market investigation by the CC is the most appropriate way of examining the identified competition issues described in Section 6. We explain the criteria we have addressed in considering whether to exercise our discretion to make a market reference to the CC and describe why we believe that these criteria are met.
- 7.4 As part of this, we present our initial thinking on the scope of options which might remedy our competition concerns described in Section 6 and the potential impact of these remedies. Our key concern is the limited exploitation of SVoD rights, particularly given our belief that SVoD is key to the future development of the pay TV sector. As a result, the remedies we have considered focus on how SVoD rights might be made more widely available, and we present our view of how this might positively impact innovation, pricing of premium movies and consumer choice.
- 7.5 We conclude that whilst an SVoD-focused remedy is likely to be outside our powers, there is a reasonable prospect that there would be a number of appropriate remedies available to the CC, if it agrees with our analysis of the adverse effects of the features of the markets on competition. A market reference would allow the CC to investigate these competition issues and assess the extent to which they may lead to consumer detriment and develop appropriate remedies.

Criteria for making a reference

- 7.6 In Section 6, we explain why we believe we have met the threshold to make a market reference to the CC, giving Ofcom discretion to refer the premium movie markets identified. In order to assess whether it is appropriate to make such a reference, the OFT's Guidance outlines four criteria that we should consider before we decide to make a reference²⁷², namely:
- The suitability or otherwise of using our CA98 or other sectoral powers.

²⁷² The OFT's Guidance, paragraph 2.1.

- Whether the problem could be addressed through undertakings.
- Proportionality and whether the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response.
- Whether there is a reasonable chance that appropriate remedies will be available.

7.7 We review the criteria below and conclude that we consider that it is appropriate to make a reference to the CC. We believe that the s131 EA02 test for a market investigation reference has been satisfied, and there is reasonable scope for the CC to develop appropriate remedies.

1. Application of CA98 or Article 101/102 and alternative powers

7.8 According to the OFT's Guidance, we need to consider whether the competition problem we have identified may involve an infringement of CA98 and, if so, we should only consider a reference to the CC in one of two circumstances:

- When we have reasonable grounds for suspecting that there are market features which prevent, restrict or distort competition, but not a breach of the CA98 prohibitions; or
- When action under CA98 has been or is likely to be ineffective for dealing with the competition issue identified²⁷³.

7.9 We recognise that it may be possible to define some aspects of the concerns we have identified as potential infringements of CA98. However, we consider it doubtful that one or more CA98 investigations would be appropriate to address these as:

- A CA98 investigation is concerned with behaviour that has occurred in the past and would not address the specific competition concerns that we have identified as likely to develop in the future.
- In addition, as described in Section 6, we are concerned about the consequences of a combination of features, some of which may not raise competition concerns if considered in isolation and some of which are unrelated to the conduct of a particular person, but which are likely to have a significant detrimental impact on competition when considered together. A CA98 investigation which targeted one issue might therefore not be able to address an underlying cause of the competition concern.
- We have also identified a variety of effects on competition. A CA98 investigation is geared to address specific conduct or issues and any remedies aimed at addressing the infringement identified would be likely, in our view, to be inadequate to deal with the set of industry-wide competition issues we have provisionally identified.

7.10 In our Pay TV Statement, we explain why we do not believe it is appropriate to include Core Premium Movies channels in a wholesale must-offer remedy²⁷⁴. Our findings on restricted distribution extend to Sky Movies channels, but the importance

²⁷³ The OFT's Guidance, paragraph 2.3.

²⁷⁴ Pay TV Statement, Section 9.

of linear movies channels appears to be gradually declining over time. This was demonstrated by the limited demand for wholesale linear movie channels in responses to our Third Pay TV Consultation.

- 7.11 Subscription services offering recent movies on demand seem to present a more compelling long-term proposition and a stronger proposition for securing effective competition, particularly as IPTV and VoD services provided over the open internet come of age.
- 7.12 We therefore consider that a linear channel wholesale must-offer remedy on all platforms would not by itself be an effective forward-looking solution to our competition concerns. At the same time, our powers under s316 CA03 do not extend to SVoD services, whilst action under CA98 is unlikely to be effective as a means of addressing our concerns.
- 7.13 We have also considered whether to put in place a wholesale must-offer remedy now for the period until any reference to the CC reaches a conclusion. However, we have concluded that it would not be appropriate to put in place a wide-ranging interim wholesale must-offer remedy, because of the likely lack of demand for linear movies channels on existing platforms over the immediate time horizon.
- 7.14 We would have a specific concern if Sky were to launch a service on DTT during this interim period which contained Core Premium Movies channels as well as Core Premium Sports channels. We address this in our separate statement on Picnic, where we decide that a launch by Sky on DTT should be subject to any such channels being made available to other DTT retailers.
- 7.15 Overall, we conclude that it would not be more appropriate to address the concerns under either our CA98 or our sectoral powers.

2. Undertakings in lieu of a market reference

- 7.16 We also need to take account of possible undertakings that could be offered by the studios and / or Sky to address the concerns raised and so obviate the need for a market investigation reference.
- 7.17 Ofcom has power under s154 EA02 to accept undertakings instead of making a reference to the CC. However, we have shown that the adverse effects on competition arise from the complex interrelationship between several features of the market and involving unilateral conduct of several firms as well as industry structure. As a result, we are not currently in a position to judge with any certainty whether particular undertakings would effectively address the problems identified.
- 7.18 Moreover, trying to negotiate undertakings with several parties, in circumstances in which possible adverse effects on competition have not been fully analysed, is likely to pose serious practical difficulties. Also, there is a risk that by agreeing undertakings with Sky alone, it may not be possible comprehensively to solve the problems identified.
- 7.19 Nonetheless, we will consider any proposals for undertakings that are offered by parties in the course of this consultation.

3. Proportionality and scale of the suspected problem

- 7.20 According to OFT guidance, we should only make a reference where we have reasonable grounds to suspect that the adverse effects of the features on competition are significant. In order to assess this we consider whether the suspected adverse effects are likely to have a significant detrimental effect on customers through higher prices, lower quality, less choice or less innovation²⁷⁵.
- 7.21 We realise that a reference to the CC would involve considerable costs to the CC itself, and impose a substantial burden on the businesses affected. Where adverse effects are not likely to be significant, the OFT takes the view that the burden on business, particularly in terms of management time, and the public expenditure costs of an investigation by the CC are likely to be disproportionate in relation to any benefits that may be obtained from remedying the adverse effects. The OFT guidance notes three factors which are relevant to determine whether a market reference is proportionate:
- The size of the market.
 - The proportion of the market affected by the feature giving rise to adverse effects on competition.
 - The persistence of the feature giving rise to adverse effects on competition.
- 7.22 We consider these in turn below alongside the detrimental consumer effects that arise out of the market features we have identified²⁷⁶.

The size of the sector

- 7.23 The pay TV market in the UK is worth some £4.32 billion annually in subscription revenues²⁷⁷. In terms of premium movies, the amounts paid by Sky for exclusive rights to movies content are substantial²⁷⁸, indicating the importance of this content to its business. In addition, Sky's expenditure on premium movies content alone represents over [X] of the total expenditure on all TV movie programming in the UK²⁷⁹. Moreover, retail and wholesale revenues from Sky's premium movie channels [X] in 2008²⁸⁰ are worth more than half of the total revenue associated with retail DVDs, and are therefore highly significant in revenue terms.

The proportion of the market affected

- 7.24 We consider that a significant proportion of the markets we have identified is affected by the features that we believe prevent, restrict or distort competition.
- 7.25 As set out previously, our key concern is around premium SVoD services, which have not been fully exploited by Sky to date. We believe that the inability of retailers other than Sky to provide a competing premium SVoD service is likely to be of material detriment to consumers in the future. In addition, a significant number of

²⁷⁵ OFT's Guidance paragraph 2.27.

²⁷⁷ See for example paragraphs 2.1.2 and 2.2.2 in <http://www.ofcom.org.uk/research/cm/cmr09/cmr09.pdf>

²⁷⁸ £278 million in 2009 – see http://annualreview.sky.com/pdf-downloads/annualReview/sections/Sky_AnRev_ROT_Y.pdf.

²⁷⁹ Pay TV Statement, Figure 82.

²⁸⁰ Pay TV Statement, Figure 80.

people could already have benefited from SVoD services if they were more widely available²⁸¹. Furthermore, the lack of access to SVoD content means that retailers are less likely to develop innovative services that would particularly appeal to subscribers.

- 7.26 The second concern we have is that currently premium movie services (i.e. premium SVoD and Core Premium Movies channels) are not widely available on a wholesale basis, which is likely to distort choices for those consumers who have a strong interest in premium content. While there is a relatively wide range of options for basic-tier TV, consumers wanting Core Premium Movies channels have a choice of only two retailers – Sky or Virgin Media (and those outside cable areas do not have any choice of retailer)²⁸².
- 7.27 As we have explained in our Pay TV Statement, a lack of wholesale access to Sky's Core Premium channels inhibits the range and variety of packages on offer to consumers²⁸³. This means that some consumers chose a package that does not closely reflect their preferences, or that they choose not to consume.
- 7.28 We have a particular concern that this may result in limited availability of entry-level packages, which might provide a reduced range of channels, at a lower price than the large bundles which are purchased by most of Sky's existing customers. This means that some existing customers may be paying more than they would in a competitive market, because they would be better off purchasing smaller packages of channels. Consequently, there is likely to be a level of unmet demand among other potential consumers, in particular the 10 million households whose primary means of viewing TV is via free-to-air platforms such as Freeview.
- 7.29 Although a substantial proportion of consumers still buy pay TV services on a standalone basis, bundles of pay TV and telecommunications services are becoming increasingly important²⁸⁴. Particularly on a forward-looking basis, therefore, restricted distribution of Core Premium Movies channels also limits choice of triple-play bundles.
- 7.30 The restricted supply of Core Premium Movies channels diminishes the scope for other retailers to invest in innovative products or services to enter or expand in the market. IPTV, the proposed project Canvas and NGA are all examples of innovative ways of delivering TV services which could be constrained if retailers are unable to access potential consumers of Core Premium Movies channels²⁸⁵.
- 7.31 Also, the unavailability of Sky's channels to third parties at an appropriate wholesale price has the effect of keeping retail prices high for almost [X] million consumers who subscribe to packages containing Core Premium Movies channels²⁸⁶. High prices are detrimental not only to subscribers who pay them, but also to households

²⁸¹ We note that impacted directly around [X] million consumers who currently subscribe to packages containing Sky Movies 1, Sky Movies 2 or Sky Movies Pack.

²⁸² This could have impacted on over 10 million households, in particular around 9.7 million homes that rely on DTT as their primary means of TV reception; Virgin Media subscribers that are out of cable area; almost 0.5 million of BT Vision customers (based on Q4 2009 data – see <http://www.btplc.com/News/ResultsPDF/q310release.pdf>), 0.05 million TalkTalk TV subscribers (see <http://www.ft.com/cms/s/0/a76f1918-70ad-11de-9717-00144feabdc0,s01=1.html>), [X].

²⁸³ Pay TV Statement, Section 8, paragraph 8.151.

²⁸⁴ See pay TV Statement, Section 4, paragraphs 4.71 to 4.74.

²⁸⁵ See Section 8 of the Pay TV Statement for more details.

²⁸⁶ These subscriber numbers are correct as of June 2009: [X].

who do not currently subscribe to these channels, but who would do so at competitive prices²⁸⁷.

The persistence of features giving rise to adverse competition effects

- 7.32 The features set out in Section 5 are likely to persist. We have no reason to believe that, absent regulatory intervention, there will significant new entry of either sellers or purchasers of premium movie rights. In particular, in our Pay TV Statement we have concluded that Sky's market power is likely to continue for the next three to four years.
- 7.33 We consider it very unlikely that the pool of rights for broadcasting movies produced by the Major Hollywood Studios will increase, that contracts will cease to be exclusive or to contain restrictions, or that studios will cease to sell SVoD and linear rights jointly. There is little prospect that buyers in the rights market (who are sellers in the wholesale channels market) will cease to be vertically integrated or to aggregate rights. The end dates of contracts are likely to remain staggered.
- 7.34 Also, the costs and risks involved in producing mainstream films are such that there are likely to be economies of scale and scope associated with operating a film studio—especially one that is comparable to the Major Hollywood Studios. As such, upstream entry is unlikely to provide an opportunity for a downstream broadcaster to enter the market based on a new set of premium movie rights.
- 7.35 At the wholesale level, a number of players, including Virgin Media²⁸⁸ and BT, have sought to purchase the movie rights in the first pay TV subscription window. However, none of these have been successful. Moreover, we have identified a number of features, such as the nature and timing of contracts, which limit the ability of anyone entering the market in future.
- 7.36 As stressed in Section 5, there may be some changes to the way rights are sold in the future. However, we do not believe that these would involve changing the way the rights are sold in the first pay TV subscription window. It is unlikely, therefore, to have any significant impact on resolving the identified concerns (see Section 6 above). We will make a full evaluation of any planned changes and any other developments along with responses received during this consultation, in taking our decision whether or not to make a reference.

Detrimental effects on consumers

- 7.37 In Section 6, we have outlined the detrimental effects on consumers in relation to higher prices, lower quality, less choice and less innovation. We have also referred to direct evidence of consumer detriment, since Sky's margins appear higher in movies. In addition, we anticipate that consumer harm arising from lack of innovation may be even greater in the future.
- 7.38 We acknowledge that the pay TV sector has delivered substantial benefits to consumers, both through investment in high-quality content and through innovative services, many of which have been driven by Sky. There may be offsetting customer

²⁸⁷ This may have an impact on the wider market. In this context we note that at the end of 2009, Sky had 9.7 million subscribers, Virgin Media had 3.7 million subscribers, and TalkTalk TV had approximately 0.05 million subscribers. This contrasts with the [X] million who currently subscribe to packages containing Core Premium Movies channels.

²⁸⁸ See Virgin Media's response to Second Pay TV Consultation dated 18 December 2008, paragraph 4.6. - http://www.ofcom.org.uk/consult/condocs/second_paytv/responses/Virgin/VirginMedia.pdf

benefits, in that the Major Hollywood Studios may be better able to continue to produce high volumes of quality films for consumers. However, in a well-functioning market it is competition that drives consumer benefits. The current restricted distribution of key content and services prejudices fair and effective competition, reducing choice of platforms and retail packages and dampening innovation.

- Consumers with a preference for platforms other than satellite or cable – such as the ten million households with digital terrestrial television – are currently unable to access Sky’s premium channels at all.
- Consumers on cable can access Sky’s Core Premium channels, but in standard definition only, without the associated interactive services, and purchased from a retailer whose incentive is to use the channels solely as a retention tool, rather than as a source of added value.
- While there are a large number of package combinations in the market, consumers have less variety of price points available to them than we would expect to see in an effectively competitive market. In particular, consumers who want an entry-level pay TV package rather than a ‘big-mix’ are under-served by current offerings.
- Bundles of TV and telecommunications services are becoming increasingly important. This is partially because regulation has been successful in ensuring that retail telecommunications markets are competitive. However, if the same is not true in pay TV markets, there is a risk that the forms of reduced choice we set out above will extend into these wider bundles.
- Although there has been considerable innovation in the sector, much of it has historically been of a type that suits Sky’s satellite platform. Sky is unlikely to innovate in ways which are suited to platforms other than its own. This is a particular concern looking forward, given the significant benefits we see for consumers in the effective exploitation of new distribution technologies.
- In particular, new broadband networks could offer consumers an unprecedented choice of content, and the ability to access that content on demand. This is a significant driver for investment in superfast broadband, but new content distribution platforms will not develop if they are denied access to key content.

Conclusions on proportionality

- 7.39 In conclusion, we believe that a market reference is a proportionate response to the persistent nature of competition concerns and the scale of the sector impacted by these concerns.
- 7.40 As explained above, this is a substantial market both in terms of the sums paid for content rights and in terms of the revenues from pay TV premium services. We therefore believe that the benefits of remedying any adverse effects which might be found to exist should outweigh these costs. We disagree with Sky’s argument that the harm is small and limited to a single issue and therefore a market investigation is inappropriate²⁸⁹.

²⁸⁹ See Sky’s response to Ofcom’s Third Consultation, Annex 6, paragraph A6.21 – http://www.ofcom.org.uk/consult/condocs/third_paytv/responses/org/sky/Annex_6.pdf.

- 7.41 We believe that in seeking to address the conditions which currently allow Sky to control the premium movie rights and to sustain high prices to pay TV subscribers, we would be acting in the interests of consumers.

4. Availability of remedies

Introduction

- 7.42 In accordance with the OFT's Guidance²⁹⁰, Ofcom should take into account the likely availability of appropriate remedies in the event that the suspected adverse effects on competition were found by the CC to exist. Where Ofcom has a reasonably good understanding of a market, it may identify the possible remedies. In light of the pay TV market investigation, we believe this applies in this case. We believe that there will be sufficient evidence available to the CC to enable it to reach a conclusion.
- 7.43 In Section 6, we have discussed preventions, restrictions and distortions to competition that are caused by the set of features in the markets we have identified. Our main concerns relate to limited exploitation and distribution of SVoD premium rights. In addition, we believe that consumer detriment arises from restricted distribution of Sky's Core Premium Movies channels and high wholesale prices.
- 7.44 In this Section, we review the likely availability of appropriate remedies in the event that the suspected adverse effects on competition were found by the CC to exist. At this stage, we do not determine whether the remedies are appropriate – only that possible remedies exist.
- 7.45 We believe that the central objective of any remedy considered should be to promote long-term competition by reducing the ability of firms to benefit from market power in a way which is detrimental to consumers, for example by reducing barriers to entry for new firms.
- 7.46 However, we recognise that any regulatory intervention carries risks with it. The clearest one in this case is in the uncertainty of assessing the extent of a future impact on competition. Any intervention may have distorting effects on the market. We also note the risks associated with changing the nature of the product that is sold by the studios (i.e. modifying the windowing structure) in a manner that would constrain studios' ability to adapt to changing market conditions.
- 7.47 In discussing the potential remedies, we have taken into account the criteria for the assessment of outcomes for consumers in the pay TV industry as described in Section 8 of the Pay TV Statement and as summarised in Section 6 of this document.
- 7.48 In considering the possible types of remedies, we also recognise the benefits that the current market structure has delivered to consumers. We acknowledge the particular importance of acting in a proportionate manner, particularly recognising that Sky's current market position reflects its willingness to invest private capital in what was initially a highly risky business. At the same time Sky's success has been built on its access to premium content, and it has sustained a position of market power in that content. Our analysis of the possible remedies needs to take these factors into account.
- 7.49 Below we briefly outline, at a high level, the issues that arise in relation to the potential remedies. As noted, our key forward-looking concern is around availability

²⁹⁰ OFT's Guidance, paragraphs 2.30 to 2.32.

of premium SVoD movie rights and we will not be imposing a wholesale must-offer obligation on Sky Movies channels. However the CC, in taking a holistic look at the full range of options available, will assess whether there are competition issues around the supply of linear channels which require intervention. In addition, we do not set out a detailed analysis of the remedies, since that would be for the CC to assess once it has concluded its view of the competition concerns. Rather we have considered what types of remedies might address the competition concerns that we have provisionally identified. We identify two broad approaches:

- The CC could seek to address the identified concerns at source, by intervening to change the way in which key premium movie rights are bought and sold. Such intervention may involve restrictions on the ability of firms to aggregate different types of rights or the requirements to make the sale process more contestable. Depending on the precise form of a remedy, it could facilitate new players in entering the market, but also promote innovation around new platforms and / or increase competitive pressure on wholesale margins.
- The CC could intervene to reduce Sky's ability to act on incentives to exploit market power, by requiring it to provide wholesale access to linear and SVoD premium movie content on regulated terms that goes beyond linear channels and includes SVoD services. Such an obligation would enable other operators to develop pay TV offers which include premium content, thereby facilitating choice and innovation.

7.50 It is worth noting that The Four Parties²⁹¹ argued for a market reference to address the “structural” features of the market underlying the “vicious circle” through “operationally separating” Sky's channel and distribution businesses. Our view, which we first expressed in the Second Pay TV Consultation²⁹² and have confirmed in our Pay TV Statement²⁹³, is that this would be disproportionate compared to other remedies available, especially since operational separation is unlikely to change the incentives faced by Sky. Only structural separation – i.e. full divestment – could address the underlying issue of incentives. Structural separation is however a costly and highly interventionist form of remedy. While there may be circumstances where seeking an intervention of this type would be justified, we continue to believe it would be disproportionate in this case.

Intervene at the upstream level in the way premium movie rights are sold

7.51 The CC could attempt to remedy the competition concerns at source, by seeking to change the way in which premium movie rights are bought and sold. This may be appropriate where there is a serious foreclosure risk due to the presence of a dominant undertaking, which is likely to acquire all of the premium movie rights. The aim of such a remedy would be to ensure that content aggregation, together with the other identified features, does not result in the creation of market power. A remedy of this type could also increase contestability in the market.

²⁹¹ The Four Parties, Submission to Ofcom on “the need for a market investigation into the pay TV industry dated 3 July 2007 (the ‘July Submission’).

²⁹² Second Pay TV Consultation, Section 8, paragraphs 8.30 to 8.34.

²⁹³ Pay TV Statement, Section 9.

Exclusivity

- 7.52 First, it might be possible to ensure that no provider has market power by placing specific restrictions on the aggregation of content. This could create new wholesale markets and intensify downstream competition. The possible remedies could include:
- A behavioural rule which requires any one Major Hollywood Studio to sell its output in the first pay TV subscription window to more than one provider.
 - A behavioural rule which prevents any one wholesale provider from purchasing the rights to the output in the first pay TV subscription window from more than two or three of the Major Hollywood Studios.
 - A behavioural rule which prevents any one Major Hollywood Studio from selling the SVoD rights in the first pay TV subscription window on an exclusive basis.
 - A behavioural rule which prevents any one Major Hollywood Studio from joint selling the linear and SVoD rights in the first pay TV subscription window.
- 7.53 A requirement to sell the SVoD and linear rights separately could allow companies who are technically able to offer SVoD to enter the market. In this context, we note, however, that such a remedy may be insufficient to ensure effective competition since the same player could purchase both linear and SVoD rights. As such it might be sensible to complement this remedy with additional restrictions, such as a ‘no single buyer’ rule. If so, the remedies outlined could allow at least two different service providers to exert a constraint on one another, as they are likely to offer close substitutes.
- 7.54 In its response to our Third Pay TV Consultation, Virgin Media considered that, rather than prohibiting one entity from acquiring both linear and SVoD premium movie rights, a potentially more effective remedy may be to restrict the sale of SVoD rights on a territory-exclusive basis but allow sale on a platform-exclusive basis within a territory, so long as no retailer can purchase the SVoD rights for a platform on which it does not retail²⁹⁴. Our view is that this model could facilitate platform exclusivity, with a local monopoly for each platform which could have significant implications on rights holders by artificially depressing rights values.
- 7.55 Sky has argued that if separate SVoD rights were made available, the value to a broadcaster of linear premium movie channels would diminish because the broadcaster would not be in a position to offer both linear channel and VoD services²⁹⁵. Similarly, in its response to our Third Pay TV consultation, Paramount expressed the view that unbundling SVoD rights would lead to significant drop in the revenue that it receives from Sky for the first pay TV subscription window rights. Paramount argued that such intervention would “penalise content providers which are already impacted by the other effective competitors to BSkyB”²⁹⁶.
- 7.56 As we discussed in Section 5, content aggregation has positive effects. Any remedy which prevents or restricts aggregation to the extent that would be necessary to eliminate market power is also likely to risk sacrificing some of these benefits. This might result in some consumers paying higher prices, due to a reduction in the

²⁹⁵ Sky response to Third Pay TV Consultation, Annex 6, paragraph A6.17

²⁹⁶ Paramount response to Third Pay TV Consultation - http://www.ofcom.org.uk/consult/condocs/third_paytv/responses/org/Paramount_Pictures.pdf

efficiencies associated with content bundling. It may also result in reduced convenience for some consumers, who may have to take multiple subscriptions or purchase multiple set-top boxes to get the content they want. However, we believe that it is worth considering in more detail whether the benefits to consumers in terms of greater competition and a wider choice of innovative services may offset these potential costs.

Structure of the first pay TV subscription window

- 7.57 The CC could also consider intervening in the current structure of the first pay TV subscription window, for example by shortening the duration of the window in order to allow the creation of a second pay TV window. This could enable more effective competition as SVoD becomes an increasingly attractive proposition, coupled with IPTV becoming increasingly viable as a means of delivery. In this context it is worth noting that the shorter the first pay TV subscription window, the greater likelihood that the content in the second pay TV window will be attractive to wholesalers.

Contestability

- 7.58 Finally, it might be possible to reduce barriers to entry by placing specific restrictions on the sale of content rights to make them more contestable, for example by placing specific constraints on contract durations. For example, ensuring that the dates for renewal are more aligned or ensuring that there is an open bidding process for their renewal. The CC could address the risk of long-term market foreclosure by restricting the current roll-over process that in practice extends the duration of contracts to five years. In addition, the CC might consider a requirement that the rights award procedure is overseen by a trustee to ensure that a procedure is undertaken in a fair, reasonable and a non-discriminatory manner. Also, the CC could impose constraints on the use of restrictive provisions in relation to first pay TV subscription window contracts.
- 7.59 Our view is that there may be merit in reducing barriers to entry by ensuring that key content rights are more contestable. The risk of perverse consequences for consumers associated with this type of intervention appears to be relatively low. We note there is a risk that this may not be sufficient to eliminate market power associated with the distribution of premium movie content since a number of features contribute to market power. However, the risk of foreclosure may be reduced by the development of a competitive bidding process under non-discriminatory and transparent terms at regular and frequent intervals, which would give potential buyers an opportunity to compete for the rights.

Intervene to reduce the ability to act on the incentives to exploit market power

- 7.60 The specific aim of such an intervention would be to establish behavioural rules which prevent Sky from exploiting its ability to distort downstream competition. The typical approach to this is to place an obligation on vertically integrated firms to offer others the same product it supplies to itself, and to do so in a manner that does not unduly discriminate. This could address Sky's incentives to restrict the distribution of its premium content and facilitate new retailers and platforms to emerge.
- 7.61 The most targeted remedy would be to set a requirement for Sky to supply defined content to other retailers on a wholesale basis on regulated terms – referred to as a 'wholesale must-offer' obligation. This would address very directly concerns in relation to restricted availability of premium content and the limited exploitation of SVoD. Sky would be required to make available specific channels on a wholesale

basis to other retailers. However, this content would still be branded as Sky's. We note that there are a number of possible variations to this potential remedy, including:

- An obligation to provide premium SVoD services on fair, reasonable and non-discriminatory ('FRND') terms.
- An obligation to provide both premium SVoD services and Core Premium Movies Channels.
- These could be accompanied by regulated prices for wholesale access.

7.62 Since currently there is no standalone premium SVoD service it would be necessary to include the linear channels in the scope of this type of remedy; premium movie SVoD content is only available to those customers who also subscribe to the relevant linear movie channels.

7.63 A wholesale must-offer remedy could enable increased competition between retailers and between platforms. Being able to sell premium content, including SVoD services, would enable retailers to increase the attractiveness of their package to consumers and would increase consumer choice. This could also encourage the development of new platforms, which without access to premium content would struggle to develop sufficient scale. This could have a benefit in the future if it enabled firms other than Sky to win premium movie content rights.

7.64 Based on our analysis in Sections 9 and 10 of the Pay TV Statement, any wholesale must-offer remedy would probably need to include a number of detailed conditions governing the terms and conditions of wholesale supply. The most obvious of these conditions is some form of ex ante pricing rule. Without such a pricing rule, there would be a need to provide a mechanism for resolving disputes, in case the parties cannot agree commercial terms.

7.65 The pricing rules could vary from a very high-level statement of how prices should be derived (e.g. retail-minus, cost-plus²⁹⁷) to a much more detailed description of how this should be done. However, as we have set out in our Pay TV Statement, there is a potential concern with cost-plus pricing in the context of pay TV²⁹⁸; it risks artificially depressing rights values. Firms are unlikely to bid vigorously for content rights if the result of doing so is to push up the future wholesale price of the channels they purchase from Sky. We note that as a result of our analysis, we decided to set the prices for Core Premium Sports channels on a retail-minus basis²⁹⁹.

7.66 We note that in theory, the CC could apply an obligation on Sky to sublicense its content. This could enable new retailers to ensure that customers will transfer from the licensed Sky brand to its own (new) brand. However, we believe that this type of intervention may not be appropriate as it could undermine the basis on which Sky originally contracted for this content. In effect this could break up the process of Sky assembling movie channels from various content. We view this as disproportionate. Sky's brand is an integral part of its service proposition, even at the wholesale level.

²⁹⁷ Under retail-minus approach, the wholesale price for a particular piece of content is set equal to the retail price for that content minus an assessment of the costs incurred at the retail level, including an appropriate retail profit margin. Under cost-plus approach, the wholesale price for a particular piece of content is set equal to an assessment of the wholesale costs that should be attributed to that content, including an appropriate wholesale profit margin.

²⁹⁸ Pay TV Statement, Section 9.

²⁹⁹ Pay TV Statement, Sections 9 and 10.

Conclusion

- 7.67 On the basis of the potential remedies outlined, we consider there is a reasonable prospect that the CC would have appropriate remedies open to it to address competition concerns in these markets. Any remedy would be dependent on the CC's consideration of the costs and benefits to consumers of implementing any option in the light of the likely developments in the market.
- 7.68 We are therefore consulting on our proposed decision to exercise our discretion to refer two markets to the CC under s131 EA02 for investigation, on the terms set out in Annex 1. We believe that it would not be more appropriate to address our concerns (particularly in relation to SVoD) through use of our sectoral or CA98 powers; nor do we expect that the problems could be addressed through undertakings in lieu of a reference. We consider the scale of the problems and their adverse effects on competition more than justify a reference, and we consider that there is a reasonable chance that the CC would have appropriate remedies available to it.

Annex 1

Proposed terms of the market investigation reference

DRAFT FOR CONSULTATION

Movie Rights

- A1.1 Ofcom, in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act) hereby makes a reference to the Competition Commission for an investigation into the supply and acquisition of **Movie Rights** in the United Kingdom.
- A1.2 Ofcom has reasonable grounds for suspecting that a feature or a combination of features of the market or markets in which the **Movie Rights** are supplied and acquired prevents, restricts or distorts competition in connection with the supply of these rights and the supply of packages including Core Premium Movies channels in the UK.
- A1.3 [DATE OF REFERENCE]

Packages including Core Premium Movie Channels

- A1.4 Ofcom, in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act) hereby makes a reference to the Competition Commission for an investigation into the wholesale supply and acquisition of **packages including Core Premium Movies channels** in the United Kingdom.
- A1.5 Ofcom has reasonable grounds for suspecting that a feature or a combination of features of the wholesale market or markets in which **packages including Core Premium Movies channels** are supplied and acquired prevents, restricts or distorts competition in connection with the supply of Movie Rights and the supply of packages including Core Premium Movies channels in the UK.
- A1.6 [DATE OF REFERENCE]

Definitions

- A1.7 For the purposes of these references:
- A1.8 “**Core Premium Movie channels**” means Sky Movies channels
- A1.9 “**Major Hollywood Studios**” means the members of the Motion Picture Association of America and their wholly owned or controlled subsidiaries.
- A1.10 “**Movie Rights**” means the intellectual property rights licensed by the Major Hollywood Studios, which:
- i) permit the exhibition of movies on broadcasting channels and/or subscription video on demand services in the UK; and

- ii) relate to movies that have been licensed for exhibition in the first pay TV subscription window.

A1.11 “**Ofcom**” means The Office of Communications.

A1.12 “**Packages including Core Premium Movie channels**” are packages including at least one “Sky Movies channel” and which may include other products or services, including but not limited to subscription video on demand services. Currently, subscription video on demand services based on the rights in the first TV subscription window produced or licensed by the six Major Hollywood Studios (“premium SVoD services”) are not available except as part of a package including Core Premium Movies channels and there is no separate market for them. They are included in this reference by dint of their inclusion in the package. However, for the avoidance of doubt, they are conceptually capable of being considered as a separate product which is likely to be a substitute for Core Premium Movies Channels and we invite the CC to have regard to premium SVoD services in its consideration of the reference.

A1.13 “Sky Movies channels” means those television broadcasting channels offered by Sky for wholesale and retail, which wholly or mainly comprise movies, and for which a subscription fee is levied that is not associated with the provision of channels wholly or mainly comprising non-movies content.

Annex 2

Responding to this consultation

How to respond

- A2.1 Ofcom invites written views and comments on the issues raised in this document, to be made by 5pm on 15 May 2010.
- A2.2 This date allows for a six-week consultation period, plus an additional three days to allow for public holidays, including Easter. A six-week consultation period is appropriate in this case, taking account of our published guidance, because the issues we consider in this document have been consulted on previously, and there are a limited number of interested stakeholders, all of whom we have been in contact with in relation to our previous consultation.
- A2.3 Ofcom strongly prefers to receive responses using the online web form at http://www.ofcom.org.uk/consult/condocs/movies_reference/, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A2.4 For larger consultation responses – particularly those with supporting charts, tables or other data – please email monika.kochanowska@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A2.5 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Monika Kochanowska
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7783 4109
- A2.6 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A2.7 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 5. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A2.8 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Monika Kochanowska on 020 7783 4192.

Confidentiality

- A2.9 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.
- A2.10 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A2.11 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/account/disclaimer/>

Next steps

- A2.12 Following the end of the consultation period, Ofcom intends to publish a decision in summer 2010.
- A2.13 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

- A2.14 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 3.
- A2.15 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A2.16 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:
- A2.17 Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW
- Tel: 0141 229 7401
Fax: 0141 229 7433
- Email vicki.nash@ofcom.org.uk

Annex 3

Ofcom's consultation principles

A3.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A3.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A3.3 We will be clear about who we are consulting, why, on what questions and for how long.

A3.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A3.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A3.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A3.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

A3.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 4

Consultation response cover sheet

- A4.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A4.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A4.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A4.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the ‘Consultations’ section of our website at www.ofcom.org.uk/consult/.
- A4.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don’t have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

Annex 5

Consultation questions

1. *Do you agree with our analysis of the market for the sale of Movie Rights from Major Hollywood Studios in the first pay TV subscription window in the United Kingdom? Please provide any relevant evidence you have to support your view.*
2. *Do you agree with our analysis of the features of the markets identified?*
3. *Are there any other features that we are missing and might be relevant to this assessment of competition in the identified markets?*
4. *Do you agree with our analysis of the prevention, distortion and restriction of competition caused by the features we have described?*
5. *Do you agree with our analysis of the impact on consumers regarding choice, innovation and pricing?*
6. *Do you agree with our analysis of the likely effects of the limited exploitation of SVoD services on competition?*
7. *Do you consider that the threshold for making a market investigation reference to the Competition Commission is met?*
8. *Do you consider that we should exercise our discretion to make a market investigation reference to the Competition Commission?*
9. *Do you have any comments on the draft wording of the proposed terms of the market investigation reference as set out in Annex 1?*