



SKY'S COMMENTS ON RESPONSES TO OFCOM'S SECOND CONSULTATION ON REGULATION OF SKY'S PROVISION OF ACCESS CONTROL SERVICES

- 1.1 This note comments on the responses by third parties to Ofcom's consultation entitled 'Review of Sky's Access Control Services Regulation' published on 23 July 2014. These contain a significant number of erroneous or otherwise flawed points.
- 1.2 Section A of this note provides comments on issues that are common to a number of these responses. Section B comments specifically on BT's response.

A. Issues that are common to a number of the responses

(i) The shift in focus to regulation of set-top boxes that do not yet exist

- 1.3 The most notable feature of the responses to Ofcom's current consultation is the significant shift in arguments that new regulation should be imposed on Sky which derive from issues concerning Sky's existing population of set-top boxes, to a focus on set-top boxes that do not exist today, and therefore have yet to be deployed by Sky.
- 1.4 The basic premise of these submissions is that if and when Sky deploys new set-top boxes it may be possible (i) to deliver existing services in a better way than via Sky's current generation set-top boxes, and/or (ii) to deliver services that it is not possible to deliver via Sky's current generation set-top boxes today. Ergo, according to BT, the BBC, and Channel 4, Ofcom should regulate Sky's provision of access control services in relation to those set-top boxes.
- 1.5 This shift in focus is wholly inappropriate. In particular, it fails to have regard to the basic principles set out in paragraph 6.18 of the Consultation as follows:

"We note that in considering whether there is the need for regulation at a time of technological change and uncertainty, one option that is available to a regulator is to forbear from intervening to require third party access to new technologies or services and/or to regulate the price for those technologies or services. Instead the regulator could choose to monitor how the new technology develops and how competition actually plays out, in relation to the development of new services, and thus mitigate the risk of regulatory failure in relation to the development of those new services. Adopting such an approach would not prevent the regulator from using its formal powers to intervene if a competition concern did then emerge at a later date."

- 1.6 It is a well-established principle that regulators should forbear from imposing specific regulation on firms that deliver new and innovative products and services to consumers, particularly in the period after launch (let alone before launch), when the risks associated with their investments are greatest. This is both (i) so as not to discourage investment and innovation generally, which is a key source of consumer benefit, but also (ii) because normally the risks associated with anticompetitive behaviour that has significant adverse effects on competition or consumers are low.

- 1.7 Moreover, [§]. It would be both unreasonable and inequitable to impose access regulation on Sky before it had deployed a single set-top box [§], yet leave those other platforms entirely unregulated.
- 1.8 For these reasons, Sky considers that regulation of access control services in relation to its new set-top boxes is inappropriate. Notwithstanding this position, however, Sky has offered to guarantee third party access to those set-top boxes in order that they can continue to operate the types of interactive services they offer today over Sky's existing set-top boxes. Sky has done so on a pragmatic basis, in order to allay fears expressed by broadcasters that their customers on Sky's new set-top boxes may not be able to access the same types of services as their customers can use on Sky's existing set-top boxes.
- 1.9 Of course, this does not mean that Sky will limit third party broadcasters' ability to offer additional services, offer particular services itself while preventing others from doing so, or set high charges for access control services in relation to those services delivered via its new set-top boxes. Sky considers, however, that in relation to new, innovative set-top boxes [§], it should be permitted a degree of freedom to negotiate the provision of access control services for those set-top boxes on commercial terms (subject to the constraints imposed by the Commitments) - in exactly the same way that a myriad of competing providers [§] are able to do today.
- 1.10 Plainly aware of this issue, BT in particular attempts to conflate matters relating to Sky's existing population of set-top boxes, and those relating to set-top boxes that Sky may deploy in the future. In several places in its submission, BT switches seamlessly from discussion of issues concerning the scale of Sky's existing population of set-top boxes to potential issues that may arise in relation to set-top boxes that do not exist today. For example, under the heading of "*the competition problem derives from Sky's control of a scale bottleneck*", BT begins with a discussion of the importance of "*access to Sky's 10.7 million subscribers*"¹, but ends by asserting:

*"it is clear that Sky's gateway control applies to...the Sky base of subscribers **regardless of the nature or type of set-top box over which AC services are provided**".² (Emphasis added.)*

- 1.11 This conflation is illegitimate. The key purpose of regulation of Sky's access control services is to prevent Sky having a material adverse effect on competition among service providers or broadcasters, for example by, at the extreme, denying important inputs to rivals. Plainly, whether or not such an effect is possible depends on the scale of the population of set-top boxes to which access is denied. If there are no such set-top boxes today, [§], it is not possible for such a material adverse effect to arise.

Assertions about the rate of take-up of new set-top boxes

- 1.12 Without prejudice to the fundamental point that regulation of access control services in relation to Sky's new set-top boxes is inappropriate, we comment in this section on assertions that new Sky set-top boxes should be regulated because it will be straightforward for Sky to create a large population of such set-top boxes (presumably in a short period of time).
- 1.13 The launch of an entirely new type of set-top box, by Sky or any other platform operator, is a major undertaking, involving substantial amounts of investment, effort and risk. In addition, there is no guarantee that existing subscribers will value the additional functionality of the new box sufficiently to incur the cost of upgrading, and the benefits of

¹ Paragraph 3.3 of BT's response.

² Paragraph 3.6 of BT's response.

improved functionality may be difficult to convey to non-subscribers as a selling point for taking Sky.

- 1.14 It is inappropriate to refer to the launch of a new set-top box, and making it available to existing and new subscribers as a “roll-out”³, suggesting a relatively straightforward process akin, for example, to an update of iOS software. Use of such a term fails to have proper regard to the enormous level of effort involved in first creating and then encouraging consumers to buy a new set-top box.
- 1.15 It is also inappropriate to base projections of potential take-up of new Sky set-top boxes on the rapidity with which Sky has been able to develop a population of connected set-top boxes among existing subscribers.⁴ To do so would confuse two very different processes, namely:
- (i) encouraging existing subscribers to replace their existing set-top box by buying a new box, and encouraging new subscribers to opt for a more expensive set-top box than the Sky+ HD box (the process in relation to new set-top boxes); and
 - (ii) encouraging existing subscribers to connect their existing Sky+ HD set-top box to a broadband network (the process by which Sky has been able to establish a significant population of connected set-top boxes).

The latter is far more straightforward than the former.

- 1.16 Finally, the rate at which Sky needs to recruit new subscribers in order to maintain its existing subscriber base is not a reasonable basis for determining the likely future growth in the number of new set-top boxes that are likely to be deployed. BT asserts:

*“this material impediment to fair and effective competition will arise quickly. Notwithstanding Sky’s relatively low rate of subscriber churn, it still needs to sign up around 1 million new (or returning) customers each year just to maintain the existing level of its subscriber base. (In practice, Sky is continuing to grow its subscriber base and so is signing up more new or returning customers each year than this.) Thus it supplies many hundreds of thousands of new boxes each year (if not more than one million). Therefore, once Sky has a new box available, it will be deployed to a substantial number of subscribers very quickly.”*⁵

- 1.17 BT’s assertions here are based on a number of false assumptions. First, and most obviously, many new and/or returning subscribers will not wish to purchase the new type of set-top box. Second, it appears to assume that Sky will give away new set-top boxes to subscribers; that may not be the case. Third, it is plainly not necessary for a returning customer to purchase a set-top box at all. Accordingly, the assertion that, because Sky needs to acquire or re-acquire around 1 million subscribers each year in order to maintain the size of its existing subscriber base this means that “once Sky has a new box available, it will be deployed to a substantial number of subscribers very quickly” is ill-founded, and cannot be relied upon.

³ Paragraph 7.72 of Ofcom’s consultation.

⁴ BT refers to Sky’s success in this respect at paragraphs 2.45 and 5.28 of its response.

⁵ Paragraph 4.11 of BT’s response.

(ii) "Access to the Ethernet port"

- 1.18 The submissions by BT and others in relation to so-called "access to the Ethernet port" of Sky's current set-top boxes demonstrate a fundamental misunderstanding of issues concerning the technical capabilities of those boxes. In particular, BT appears to believe that if it gained "access to the Ethernet port" on Sky's current set-top boxes, this would enable the provision of "substantially more attractive"⁶ interactive services. BT states:

*"BT notes that over 50% of Sky's subscriber base have now connected their set-top boxes to broadband and Sky has an active programme in place to increase the overall number of broadband-connected set-top boxes (e.g. through the provision of wireless connectors, to allow subscribers to connect their set-top box to their broadband router easily). This development allows Sky subscribers to access Sky's (closed) retail VOD service which is delivered to the set-top box via the customer's broadband connection and the set-top box Ethernet port. However, the benefits of broadband connected boxes are not limited to the provision of such stand-alone VOD services: an ability to provide enhanced TV services in conjunction with access to the Ethernet port is likely to lead to an increase in demand for such services, both from the point of view of service provider and consumer."*⁷

- 1.19 BT's misunderstanding of this issue is encapsulated in the following:

*"As BT has previously highlighted, there are a number of additional enhancements to its channels that it (and other third parties) could offer in the event of regulatory certainty around FRND access to Sky's Ethernet ports in conjunction with a connected broadband return path. Such access would allow the provision of a substantially richer offering than can be provided using a dial up modem and narrowband return path, which is largely limited to text and static images. As such many of the services that are clunky and offer a poor consumer experience over narrowband dial up would become considerably more attractive if offered via Sky's Ethernet ports."*⁸

- 1.20 The nature of the types of interactive services that can be offered via Sky's set-top boxes has nothing to do with the connection of that box to a telecoms network; it is primarily the result of the middleware used in those set-top boxes. Interactive applications running on Sky's existing set-top boxes already make use of always-on high speed return paths (where available), whether that is via a fixed or wireless broadband connection. However, whilst this significantly improves the speed at which an interactive application can establish a return path connection and the rate at which data can then travel over that connection, such an ability has no significant impact on enabling "a substantially richer offering" in relation to the interactive applications that can be run on Sky set-top boxes today.

- 1.21 The capability for interactive applications to access an authenticated return path connection via broadband is, of course, available to third parties. Accordingly, despite its submissions to the contrary, BT already has the ability to access the Ethernet port on Sky HD and Sky+ HD set-top boxes today. However, since we notified holders of Application Signing Agreements and Authentication Services Agreements that this is the case in July 2013, with a further reminder in July 2014, no third party has elected to make use of the capability or has inquired about doing so.

⁶ Paragraph 2.9 of BT's response.

⁷ Paragraph 2.45 of BT's response.

⁸ Paragraph 2.43 of BT's response. BT repeats the erroneous assertion that the limited nature of the interactive services that can be offered via Sky set-top boxes is a result of the use of a narrowband dial-up return path at paragraphs 2.9, 2.47, 2.53 and footnote 67.

- 1.22 BT also believes that, if it had “access to the Ethernet port” on current Sky set-top boxes, this could be used to deliver “substantially richer” interactive services to those boxes. For example, BT states:

*“half of [Sky’s] TV customers (5.7 million subscribers) now have the necessary capabilities to use AC services [sic] **delivered via** the Ethernet port and a broadband line.”⁹ (Emphasis added.)*

This is incorrect. The middleware in Sky set-top boxes only supports delivery of interactive applications via satellite. It does not support the delivery of the interactive applications themselves via broadband.

Use of ‘the Ethernet port’ for IP delivery of video

- 1.23 BT’s submission confuses use of a broadband connection to deliver genuine interactive services – such as voting or betting – with the ability to use that connection to deliver video content to end-users. For example, BT states:

“access to the ‘always on’, high speed Ethernet ports in Sky’s more recent boxes (particularly where connected to superfast broadband) would allow for... the ability to include video and audio content around voting and gaming services related to the underlying broadcast channel.”¹⁰

- 1.24 This is incorrect. It is not technically possible for a third party to deliver streamed video content directly to end-users via the broadband connection of Sky set-top boxes. Accordingly, the largely implicit proposition running through BT’s submission that it should be entitled to deliver streamed video content via broadband connections to Sky’s current generation set-top boxes is misplaced.

Future set-top boxes

- 1.25 To a significant extent, BT’s desire to be granted regulated “access to the Ethernet port” on Sky’s set-top boxes in fact relates to future rather than current set-top boxes, [§<]. Even then, however, it is erroneous to describe what BT is in fact demanding as “access to the Ethernet port”. BT is in fact demanding a broad package of capabilities which includes the ability to utilise a two-way broadband connection to Sky’s future set-top boxes.
- 1.26 We have already commented above in greater detail on demands for full regulated access to set-top boxes that Sky intends to deploy in the future.

⁹ Paragraph 5.28 of BT’s response.

¹⁰ Paragraph 2.48 of BT’s response.

B. Issues specific to BT's submission

1.27 The remainder of this note comments on issues that are raised by BT's response to Ofcom's consultation.¹¹

1.28 Sky disagrees entirely with the points raised by BT in its response. The fact that Sky has not addressed each and every erroneous or misleading assertion in BT's response cannot be taken to indicate that Sky accepts or agrees with the allegations or statements contained therein.¹²

(i) BT's incentives to enhance its services on the Sky DTH satellite platform

1.29 BT's submissions to Ofcom are premised on an implicit assumption that it has strong incentives significantly to enhance the television services that it offers on Sky's DTH satellite platform. This cannot be assumed. As a vertically integrated pay TV broadcaster, retailer and platform operator BT also has 'mixed incentives': BT has a preference for subscribers to BT Sport to subscribe via its own YouView platform, given the opportunity to earn additional margin from such subscribers – for example by selling them basic pay TV services. Like Sky, however, BT also has an incentive to serve customers on other platforms if they have a preference for those platforms and (in BT's case) are unlikely to switch to BT's YouView platform.

1.30 BT, however, may not wish to create as compelling a proposition as possible on Sky's DTH satellite platform – for example, via investing significant amounts in developing and providing interactive services. Instead, BT may prefer to put such investment into improving its YouView service, doing the minimum necessary to attract as many subscribers as possible on Sky's DTH satellite platform.

1.31 [REDACTED].

(ii) BT's submission has no regard to the to the legal tests that Ofcom must meet in order to impose access-related conditions on Sky

1.32 BT's submission has no regard at all to the legal tests that Ofcom must meet in order to impose access-related conditions on Sky. Such an approach is untenable. Ofcom's ability to impose access-related conditions on Sky in relation to access control services is constrained by the powers given to it under the Communications Act, which must be interpreted consistently with the Framework Directive (see Annex 1 to Sky's response to Ofcom's 2014 Consultation).

¹¹ All subsequent references are to paragraphs in BT's response, unless otherwise stated.

¹² A significant portion of BT's submission consists of recycled material from its submission to Ofcom of September 2013, in a somewhat updated and expanded form. (See, in particular, the alleged dependence on use of access control services for (i) clash management (paragraphs 2.11 – 2.27), (ii) enforcement activities related to commercial subscriptions (paragraphs 2.28 – 2.35), and residential subscription upgrade activity (paragraphs 2.36 – 2.38)). Sky addressed BT's unsupported and flawed assertions on these issues fully in its response to Ofcom's consultation, to which Ofcom is referred.

(iii) BT's submission contains no evidence

1.33 BT's submission comprises a compendium of unsupported assertions. BT states that it has "explained"¹³ (or "explained in detail"¹⁴), "highlighted"¹⁵, "addressed"¹⁶, and "set out in detail"¹⁷ certain matters. In fact, on inspection these purported explanations comprise entirely of un-evidenced assertions.

1.34 As set out in Sky's response to Ofcom's consultation, if Ofcom chooses to proceed with proposals to impose new access-related conditions on Sky it must do so on the basis of cogent evidence capable of withstanding profound and rigorous scrutiny. Ofcom cannot rely on BT's assertions if there is no evidence to support them.

(iv) BT's assertions in relation to the dependence of the success of BT Sport on Sky's access control services are not credible

1.35 BT's latest submission repeats its assertions that a lack of access to Sky's access control services would jeopardise the future success of its BT Sport channels and/ or its pay TV retail business, and discourage ("if not preclude...altogether"¹⁸) BT from bidding for sports rights in future. BT's claims include the following:

- *"the ability to use Sky's AC services to ensure that BT can bid for and exploit important sports rights, as well as ensure the quality of its sports channels, is essential."*¹⁹
- *"unless BT is able to deliver equivalent enhanced TV services on its BT Sport channels to those offered by Sky on Sky Sports, there is a significant risk that BT would be placed at a (further) material competitive disadvantage compared to Sky - both in relation to being able to attract customers and when bidding for sports rights."*²⁰
- *If BT is unable to offer the same or similar functionality (or indeed potentially distinct functionality) and richness of consumer experience on its BT Sport channels as that offered by Sky on its sports channels, there is no doubt that BT's channels will be perceived as a lower quality service by potential subscribers, all other things being equal."*²¹
- *"This perception is likely to impact take up of BT Sport, further limiting BT's ability to build a retail subscriber base of premium sports subscribers with a strong willingness to pay for sports content. Any impact on BT's ability to build its subscriber base will further exacerbate the barriers to acquiring premium sports rights that Ofcom identified in its pay TV Statement in 2010."*²²
- *"if FRND access to Sky's 'red button' functionality is not assured BT will be placed at a direct disadvantage when bidding for sports rights."*²³
- *"without access to Sky's 'red button' functionality.... [BT] would be placed at a material bidding disadvantage compared to Sky (if not precluded from bidding altogether) when bidding for live sports rights"*²⁴

¹³ E.g. paragraphs 1.5, 1.7, 2.17.

¹⁴ Paragraph 2.11.

¹⁵ E.g., paragraphs 2.12, 2.21, 2.43 and 3.17.

¹⁶ Paragraph 2.24.

¹⁷ E.g. paragraphs 2.22, 2.28, Annex pages 1 and 2.

¹⁸ Paragraph 2.12.

¹⁹ Paragraph 1.3.

²⁰ Paragraph 2.2.

²¹ Paragraph 2.6.

²² Paragraph 2.7.

²³ Paragraph 2.8.

- *“it is clear that, if BT is unable to deliver enhanced TV services in conjunction with its BT Sport channels on Sky’s platform which are equivalent to those offered by Sky in conjunction with Sky Sports, it would be placed at a (further) material competitive disadvantage to Sky (in terms of attracting subscribers and therefore in bidding for sports rights)”.*²⁵
- *“Assured access to AC services (which enable the development and delivery of enhanced TV services) is a critical component of a successful premium sports service. BT’s incentives to invest in expensive sports rights, and its ability to recoup its investment will be negatively impacted if... the quality of the underlying viewer experience of the channel is limited, due to a lack of access to critical enhanced TV services that supplement and augment the viewer experience.”*²⁶
- *“the ability to use AC services to ensure that BT can bid for and exploit important sports rights, as well as ensure the quality of its sports channels, is essential.”*²⁷
- *“gateway control of access control services, in light of the scale bottleneck that is the Sky platform, gives Sky the ability to distort competition. By hindering BT’s ability to offer enhanced TV services (either by not providing access to AC services, limiting the scope of such services or simply delaying the provision of these services), Sky has the potential to (further) limit BT’s ability to create a compelling wholesale and retail sports proposition, as well as to make BT a less effective bidder for sports rights.”*²⁸

1.36 These assertions are specious. As set out in detail in Sky’s response to the consultation, even if BT today was unable to offer interactive services on Sky’s DTH satellite platform, [redacted], this would make no difference at all to BT’s ability to compete effectively for sports rights, or the continued success of BT Sport.

1.37 The extraordinary number of times that BT makes these assertions in its submission suggests that BT believes that constant repetition may give them a degree of plausibility; it does not.

(v) BT’s assertions about access to Sky subscribers are irrelevant

1.38 BT seeks to make much of access to Sky’s subscribers being integral to the success of BT Sport – indeed, the *“survival of BT Sport”*²⁹ – particularly in view of the fact that there is a significant number of subscribers to premium sports channels on Sky’s DTH satellite platform. BT states:

“Given both the absolute and relative scale of the Sky platform, access to these subscribers is critical for any pay TV provider seeking to build scale to recover the fixed costs associated with investment in pay TV channels....Sky’s platform is in particular a critical gateway to accessing premium pay TV subscribers, since it has the highest concentration of both premium sports and premium movies subscribers.... since the highest concentration of subscribers with the highest propensity to pay for premium sports channels is present on the Sky platform, launching a successful premium sports channel in practice requires access to Sky’s subscriber base. Indeed, [redacted] of BT’s BT Sport customers access the channels via the Sky platform. Without access to these

²⁴ Paragraph 2.12.

²⁵ Paragraph 2.56, repeated at Annex 1 to BT’s submission.

²⁶ Paragraph 3.2, repeated at Annex 1 to BT’s submission.

²⁷ Paragraph 3.3.

²⁸ Paragraph 3.3, repeated at Annex 1 to BT’s submission.

²⁹ Paragraph 3.1.

subscribers, the underlying channel economics for the BT Sport business would be materially undermined.”³⁰

“Sky’s digital satellite platform remains a key means of delivering pay TV services given the absolute and relative scale of the Sky platform, and launching a successful premium sports channel requires access to Sky’s subscriber base via its set-top boxes.”³¹

“access to Sky’s 10.7 million subscribers via the Sky platform is critical for the further development and, ultimately, for the survival of BT Sport”³²

1.39 These points have nothing to do with the current consultation and should be disregarded. As Ofcom and BT are fully aware, access to Sky customers for the provision of pay TV services is guaranteed to BT by the regulation of Sky’s provision of conditional access services.

(vi) Assertions in relation to the TPS regime and charges for TPS services

1.40 BT makes a series of assertions about charges for AC services under Sky’s proposed Commitments. BT’s submissions on this issue are both difficult to follow and, to the extent that their meaning can be discerned, without merit.

1.41 First, BT makes a number of assertions about the proposed cap on the fixed charge to ASA holders of £100,000 per annum.³³ BT is an organisation with an annual turnover of around £20 billion. In the year ended March 2013 BT Retail had costs of over £5 billion. In this context, for BT to argue that regulation is required based on a fear that this fee might be higher than appropriate is patently absurd.

1.42 Second, BT makes a series of assertions associated with a potential effect of accepting the Commitments on charges for other TPS services (*i.e.*, CA and EPG charges). The meaning of these assertions is difficult to discern. Their apparent intention is to raise concerns in Ofcom’s mind when there is in fact no proper basis for such concerns.

1.43 For example, at paragraph 6.15 of its submission BT states:

“the commitments create the likelihood of either (i) Sky deriving an unwarranted windfall gain by over recovering its AC costs or (ii) a shortfall in common costs that would be made up by Sky in the charges for other TPS, creating unwarranted distortions across other products and operators.”

1.44 In the first instance these alternatives are inconsistent. BT assumes that charges for AC services are independent of those for EPG and CA services in the first part of its assertion, but assumes that they are linked in the second part of that assertion.

1.45 More generally, it is wrong to consider that charges for AC services provided by Sky can (a) have any significant effect on charges for other TPS services provided by Sky, or (b) create “unwarranted distortions across other products and operators”. This is for three key reasons: (i) the costs and revenues associated with access control services are small, and there is no sound reason to believe that this will change significantly in the future; (ii) TPS charges comprise a *de minimis* part of the costs of delivering services via Sky’s DTH satellite platform; and (iii) TPS charges for CA services and EPG listings are required to be not unduly discriminatory.

³⁰ Paragraphs 2.4 -2.5.

³¹ Paragraph 3.1.

³² Paragraph 3.3.

³³ See paragraph 4.37.

(vii) BT's assertions about past competition inquiries

- 1.46 BT makes a series of assertions in relation to findings about Sky and/or competition in pay TV services from past competition inquiries. BT's belief is that (a) any findings by competition authorities in the past were unquestionably true, and (b) (regardless of whether or not they were correct at the time) such findings cannot be (and have not been) undermined by subsequent developments. BT's approach is particularly stark in relation to the findings set out in Ofcom's 2010 pay TV Statement. Both beliefs are without merit.
- 1.47 In relation to the second belief, Ofcom's pay TV Statement was issued almost five years ago, and the analysis on which it was based was conducted over five years ago. As Ofcom recognised when announcing the review of the WMO, "*there have been a number of sector developments*"³⁴ since 2010. Above all, BT's entry as a scale player in both retail pay TV services and, in particular, as a broadcaster of premium sports channels since 2010, is sufficient to undermine many of the conclusions reached by Ofcom in its pay TV Statement.

BT's reliance on an economic paper produced by Compass Lexecon

- 1.48 The apparent cornerstone of BT's assertions that its success in building a highly successful premium sports channel business in under two years is an aberration, is an economic paper produced by Compass Lexecon.³⁵ Sky notes the following in relation to this paper.
- 1.49 During Ofcom's pay TV inquiry Lexecon (as it was then), produced a series of economic analyses that were submitted to Ofcom on behalf of the Complainants. Those economic analyses were shown to be highly partisan, and both factually and technically incorrect. In the CAT proceedings, Dr Jorge Padilla, a principal at Compass Lexecon, and one of the authors of the current paper, produced an economic model that purported to support Ofcom's conclusions about Sky's incentives to withhold its sports channels from third party pay TV retailers. Under cross examination, Dr Padilla conceded that when populated with data that reflected real-world numbers (e.g., subscriber numbers on different platforms) his model in fact showed the opposite. Accordingly, Sky considers that Ofcom should exercise extreme caution in attributing weight to the Compass Lexecon paper.

(viii) Assertions about the future importance of betting, gaming and voting services provided in conjunction with TV channels

- 1.50 In several places BT's submission asserts that future Sky set-top boxes are likely to be able to provide far superior betting, gaming and voting services, than those available via its current generation set-top boxes and that these will be an important source of revenue for broadcasters in future. For example, BT states:

*"many of the services that offer the possibility of **additional revenue streams** that are clunky and offer a poor consumer experience over narrowband dial up today, would become **considerably more attractive** if offered via Sky's Ethernet ports. **Betting, gaming and voting services, in particular, may become substantially more attractive, with increased demand and associated revenue streams.**"³⁶*
(Emphasis added.)

³⁴ 'Pay TV - Ofcom begins review of the wholesale must-offer', Ofcom, April 2014. <http://stakeholders.ofcom.org.uk/broadcasting/reviews-investigations/pay-tv/pay-tv-wholesale/>.

³⁵ Sky has now been provided with the technical annexes to this paper, although has not yet reviewed them.

³⁶ Paragraph 2.9.

“voting, betting and gaming services are services where growth in demand may be expected in the future.”³⁷

- 1.51 BT provides no evidence in support of these assertions. They are not credible.
- 1.52 In relation to voting, it is difficult to understand how BT considers the act of interactively selecting an option from a range of alternatives might be substantially enhanced in future compared with the types of applications available today – via Sky’s platform and a myriad of other platforms.
- 1.53 It is also not credible that there will be significant growth in demand for set-top box based voting linked to television channels in future. If this were the case, it might be expected that BT (and other broadcasters – particularly those for whom voting is likely to be more significant, such as ITV) would be putting significant efforts into developing voting services for its own Youview platform, the Virgin Media TiVo platform, Freesat and Freeview and to be expecting significant growth in revenues from such applications. We see no evidence of such development, nor of increased expectations of significant new revenues from voting in future.
- 1.54 In relation to ‘gaming’³⁸, again there is no evidence that there is substantial untapped consumer demand to ‘play along’ with television programmes that (a) cannot be met using internet-based applications today (accessed, for example, via tablets and mobile phones), and that (b) would only be able to be met via Sky’s new set-top boxes.
- 1.55 As in relation to betting services, discussed below, if there were merit in BT’s assertions it would be expected that significant growth in such services would already be being observed on platforms such as YouView, and TiVo.

The unimportance of “continuous betting” services

- 1.56 It is evident that BT has sought to persuade Ofcom that provision of new types of betting in conjunction with its sports channels is a significant part of the future success of its premium sports channel business. BT’s current submission states:

“For the reasons highlighted in paragraphs 2.9 and 2.43 – 2.49 above, voting, betting and gaming services are services where growth in demand may be expected in the future.”³⁹

“As such, many of the services that offer the possibility of additional revenue streams that are clunky and offer a poor consumer experience over narrowband dial up today, would become considerably more attractive if offered via Sky’s Ethernet ports. Betting, gaming and voting services, in particular, may become substantially more attractive, with increased demand and associated revenue streams.”⁴⁰

- 1.57 While BT’s submission in response to Ofcom’s first consultation stated:

“many of the services that are clunky and offer a poor consumer experience over narrowband dial up would become considerably more attractive if offered via Sky’s Ethernet ports. These include:

³⁷ Paragraph 4.33.

³⁸ We assume that BT is referring to applications that enable viewers to play along with TV programmes, such as quiz shows, rather than gaming in its usual sense (i.e., the provision of games of chance, such as roulette).

³⁹ Paragraph 4.33. As far as Sky can determine, only paragraph 2.48 provides reasons for this assertion.

⁴⁰ Paragraph 2.9.

- *Betting services: more contextual content could be provided around a betting service via broadband, and access to Sky's Ethernet port could allow real time bet and play functionality.*⁴¹

1.58 Apparently reflecting these submissions, Ofcom's consultation referred specifically to betting and gaming services in a discussion of 'enhanced television services', as follows:

*"Betting and interactive games linked to the content on the main channel may enhance the content by allowing viewers to interact with the content to play along or to place bets on various outcomes based on the content on the main channel."*⁴²

1.59 Sky is surprised at the emphasis placed on betting services in Ofcom's consultation and BT's submissions.

1.60 There was a period during the heyday of optimism about the future of interactive TV services in the early 2000s when the ability for television viewers to bet continuously during sports events (for example on the next goal-scorer, or which team would win the next corner in football matches) via their set-top box was envisaged as one of the 'killer applications' of interactive TV. Many presentations were given predicting significant consumer demand for such services. Such predictions have proven to be misplaced. Far from being the bonanza envisaged in the early 2000s this type of betting proved to be a damp squib.

1.61 This is not due to the capabilities of set-top box delivered interactive applications. It is, instead, a basic matter of lack of consumer demand. Consumers have little appetite for interacting continuously during sports events; they prefer to watch such events, rather than to fiddle about with betting applications during them. Even on platforms which could support continuous betting during viewing – such as internet-based services accessed via mobile phones, tablets and laptops, for example – this type of betting has not emerged. Accordingly, there is no good reason to believe that there would be a viable business case for offering this type of betting even in the event that Sky's set-top boxes include middleware with greater capabilities than that available today.

1.62 BT has an unfettered ability to develop these types of betting services via IP-connected platforms for its sports channels today on the BT YouView platform, and presumably a significant ability to do so on Virgin Media's TiVo platform. The scale of those platforms is significantly greater than that associated with Sky's yet-to-be-launched new set-top boxes, and will remain so for the foreseeable future. Given the emphasis that BT appears to place on continuous betting services, Sky would suggest that Ofcom ask BT for evidence as to (a) when it intends to begin offering this type of betting on those platforms, and (b) how much revenue it expects to earn from them.

1.63 The type of continuous betting envisaged by BT and Ofcom must be distinguished from "real time" betting, *i.e.*, relatively standard bets (such as the winner of a football match) where punters can place a bet on the outcome at any point in time until the result is known.

1.64 Such betting is commonplace today. Online betting services are updated in real time. Viewers can make, and update, such bets via a wide range of devices, including mobile phones, laptops and tablets. Such services do not need to be delivered via a set-top box to enable viewers to *"interact with the content.... to place bets on various outcomes based on*

⁴¹ Paragraph 59.

⁴² Paragraph 3.6.3.

the content on the main channel”⁴³ The opportunity to offer such services is fully open to BT today. It is improbable that the functionality of any new set-top boxes deployed by Sky would offer BT any significant new ability to capitalise on real time betting opportunities.

1.65 More generally, net income from betting is unlikely ever to be a significant source of revenue for television broadcasters, acting in their capacity as television broadcasters – whether they offer such bets via set-top boxes, other devices or a combination of platforms. This is because anyone is able to take bets on events shown on television. Television broadcasters do not have any unique ability to capitalise on the opportunity to offer bets on events being shown on television. BT’s apparent submissions that net income from bets placed on events being shown on BT Sport might in future make a significant contribution to the recovery of the costs of that business are fanciful.

1.66 Of course, BT, or any other broadcaster, could diversify their business and, as Sky has done, become a bookmaker. Such a diversification, however, does not depend in any way on the ability to procure AC services from Sky, and it would be erroneous to view such a diversification as a means of funding television channel production.

(ix) BT’s (and Ofcom’s) criticisms of ‘second screen’ applications and smart TV functionality

1.67 BT makes various criticisms of ‘second screen’ applications and smart TV functionality as substitutes for an interactive service offered via a set-top box. We have addressed these criticisms in a separate note, provided with this response.

(x) BT’s allegation that Sky’s submissions show that “Sky intends to act on its incentives to limit competition if regulation is removed”

1.68 BT’s latest submission to Ofcom repeats erroneous and unjustified assertions that Sky’s own submissions “*demonstrate the hollowness of its claims that it would wish to continue to offer [sic] third party interactive/ enhanced TV services on its platform absent an on-going, enforceable, obligation to do so*”⁴⁴. Sky rejects this assertion entirely.

1.69 In particular, BT alights on statements by Sky that it has either been reluctant to, or considered very carefully whether to, introduce new services or functionality if those services or functionality would be required to be offered immediately to third parties.⁴⁵ BT asserts that these statements “*clearly prove that even under the current regime where AC regulation exists, Sky’s incentives as a platform operator are outweighed by its incentives to limit the emergence of downstream competition from third parties.*”⁴⁶

1.70 BT’s interpretation of Sky’s statements is absurd. The choice being considered by Sky is not, as BT would have it, whether or not Sky should make a new service available, but not enable other platform users to do so (which might, in theory distort downstream competition). Instead, it is a choice about whether or not to introduce new services or functionality that all platform users – including Sky – would then be able to use.

1.71 Furthermore, contrary to BT’s assertions, the fundamental reason that Sky has had to consider such issues carefully is in the context of Sky’s role as a platform operator. Sky’s firm belief is that one of the virtues of its platform – and one of the key reasons that Sky

⁴³ At least one bookmaker already offers an app that enables users to link it directly to events being broadcast on television. See: <http://www.theappside.com/2012/09/19/paddy-power-releases-second-screen-app-for-premier-league-football/>. Such apps use Automatic Content Recognition technology, which is also used by other broadcasters to synchronise online apps with TV programmes. See further the papers by Civolution and Answers included at Annex 1.

⁴⁴ Paragraph 3.15.

⁴⁵ See paragraphs 3.19 -3.20, and paragraph 4.25.

⁴⁶ Paragraph 3.20.

has been so successful - is that it is straightforward to use and navigate, and that by and large it is not cluttered with a plethora of services that detract significantly from the platform. Accordingly, Sky has been highly concerned when introducing new services or functionality in the past to preserve those attributes.

1.72 [REDACTED].

(xi) BT's allegations about how Sky would behave under the Commitments

1.73 BT also seeks to make much of the risk associated with the lack of direct enforceability of the Commitments by Ofcom. BT alleges that there is a risk that Sky would engage in "*very carefully orchestrated, deliberate action*"⁴⁷ to breach the Commitments. Sky considers this allegation to be discreditable to BT. We repeat again that Sky would not behave in this way, and there is no good reason to believe that it would.

1.74 In principle, the same could have been said about BT when it gave commitments to Ofcom in 2004 when continuation notices that applied to its business were removed. In practice, however, it was (quite reasonably) expected that BT would abide by those commitments and, as far as Sky is aware, it did so. The same expectation should be afforded to Sky.

Sky

October 2014

⁴⁷ Paragraph 4.65.

Annex 1

Papers about Automated Content Recognition