



# Proposed BSkyB Digital Terrestrial Television Services

Statement on Sky's "Picnic" proposal

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Statement

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## Section 1

# Summary

- 1.1 This Statement concludes Ofcom's consideration of Sky and Arqiva's "Picnic" proposition for a pay television service on digital terrestrial television (DTT). This involves Sky replacing its existing free to air (FTA) channels on DTT with pay TV channels, including *Sky Sports 1* and *Sky Movies Screen 1*<sup>1</sup>.
- 1.2 While Sky put its plans on hold in September 2008, Sky has confirmed that its regulatory application remains in place. It is therefore appropriate for us to bring this process to a conclusion.
- 1.3 Sky plays a significant role in the provision of pay TV services, particularly with respect to premium sports and movies channels. The strength of Sky's position is such that the Picnic proposal raises competition issues. These issues are particularly relevant for DTT, where development is at a critical stage with digital switchover in progress and HD services now available in parts of the country.
- 1.4 We want consumers on DTT to have access to premium sports and movies content. However, there are greater benefits if this happens in a way that ensures fair and effective competition, so that consumers have more choice in the TV packages they subscribe to, including lower-priced entry-level bundles, and with greater prospects for innovation in the longer term.
- 1.5 Having considered the responses to consultation, we have decided to consent to the proposal, subject to the wholesale must-offer remedy set out in our Pay TV Statement being in place, and evidence that it has been implemented effectively. Under this remedy, Sky is required to offer the sports channel it proposes to retail on DTT – *Sky Sports 1* – to other retailers of pay TV services.
- 1.6 In terms of timing, Sky may have a decisive competitive advantage if it is able to launch its service before competitors. This is even more likely to be the case if it can also offer movies, in addition to sports, given that those competitors would not have access to Sky's movies channels.
- 1.7 While we do have concerns over restricted distribution of movies channels, our main forward looking concern relates to the sale of video-on-demand rights. We cannot adequately address this concern by imposing a wholesale must-offer remedy, or under our sectoral powers more generally. We are therefore consulting on a proposed decision to make a reference to the Competition Commission.
- 1.8 In the meantime, we have decided that Sky should be permitted to launch Picnic only once it has concluded a wholesale agreement with at least one third party retailer. The wholesale agreement would be for the premium sports and movies channels that Sky wishes to retail on DTT – *Sky Sports 1* and *Sky Movies Screen 1*. We would expect other retailers to be able to quickly enter into similar agreements. If Sky was permitted to launch Picnic first, it would have an incentive to delay providing

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<sup>1</sup> Sky replaced *Sky Movies Screen 1* with *Sky Movies Showcase* on 26 March 2010. However, Sky and Arqiva have not sought to vary the licence variation requests they have submitted to us for consideration.

wholesale access to these channels. This requirement is therefore designed to address this risk and ensure that the wholesale must-offer remedy is effective.

- 1.9 Our decision in this Statement is confined to the specific licence variation requests submitted to us by Sky and Arqiva in 2007. However, our current view is that we would be unlikely to have competition concerns in respect of a future proposal from Sky and Arqiva containing premium content, provided that similar steps have been taken to those described above in relation to Picnic.

## Background

- 1.10 Arqiva (previously National Grid Wireless Ltd) and Sky (British Sky Broadcasting Ltd) have applied to remove the three FTA channels that Sky currently provides on DTT. These would be replaced with five pay TV channels (four of which would only be available for part of the day) as part of Sky's Picnic service<sup>2</sup>.
- 1.11 DTT, primarily driven by the popularity of Freeview, is widely regarded as a success story. By the end of 2009, DTT was the most common means of receiving television with around 10 million households relying solely on DTT for multichannel viewing; more homes than those viewing television via satellite or cable<sup>3</sup>.
- 1.12 However, in comparison to satellite and cable, pay TV services on DTT are still emerging and are yet to mature. The development of these services is uncertain, especially at a time of significant technical evolution and service innovation. These changes include digital switchover and the use of the released spectrum, high definition services, a move to different technical transmission standards and the introduction of hybrid DTT / IPTV services offering on-demand services over broadband. The evolution of DTT is therefore at a critical transition point and presents a significant opportunity for pay TV services.
- 1.13 We published our second consultation on Sky's Picnic proposal on 30 September 2008. In parallel, we have carried out a wider investigation into the pay TV sector. We published a second consultation document as part of that investigation at the same time, given that the issues raised by this proposal, such as access to premium content, informed our wider pay TV market investigation and vice versa.
- 1.14 We published a third consultation document on our wider investigation on 26 June 2009, which set out details of a proposed 'wholesale must-offer' remedy, including issues related to pricing. It was necessary to consider these issues before concluding our assessment of Sky's Picnic proposal.
- 1.15 In September 2008 Sky put its plans for Picnic on hold, though it has confirmed that its regulatory application remains in place. Given the time that has passed since

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<sup>2</sup> Sky currently provides *Sky News*, *Sky Sports News* and *Sky Three* on a FTA basis. These would be replaced by *Sky Sports 1*, *Sky Movies Screen 1* (in the evening) and *Sky One* (in the evening, including an hour of *Sky News* content). In addition, the remainder of Sky's capacity would be used by Sky to retail two further pay TV channels in the daytime: *Discovery Channel* and *Disney Channel*. The proposed Picnic service would not be compatible with any existing set-top boxes. Consumers would therefore need a new set-top box to receive these pay TV channels.

<sup>3</sup> The number of homes relying on DTT as their sole means of digital TV reception was around 9.7 million in Q3 2009. Separately, Freeview reported in December 2009 that the platform was now the main-set TV service in 10 million homes. Source: The Communications Market: Digital Progress Report Digital TV, Q3 2009, Ofcom, 21 December 2009, paragraph 1.4.

Sky's initial Picnic announcement, we anticipate that Sky and Arqiva may wish to modify the channel line-up if they were still to proceed with a pay TV service on DTT. This may particularly be the case since Sky replaced *Sky Movies Screen 1* with *Sky Movies Showcase* on 26 March<sup>4</sup>.

- 1.16 In concluding our assessment of the Picnic proposal we have therefore set out our views on the broader principles of whether we should consent to Sky retailing premium sports and movies channels on DTT, in the interests of providing greater clarity and certainty to the industry.

### Issues and concerns raised by the Picnic proposal

- 1.17 We noted in our Second Picnic Consultation that a Sky pay TV service on DTT, offering premium sports and movies, would have an immediate, positive effect on the choice and availability of retail pay TV services on DTT. However, we also expressed some concerns. As a result of Sky's position in the wholesale provision of sports and movies channels, we considered that it was highly unlikely that any retailer of pay TV services on DTT would be able to compete effectively with Picnic in the absence of wholesale access to Picnic's premium channels (*Sky Sports 1* and *Sky Movies Screen 1*). In turn, we considered this was likely to cause significant concern and potential consumer detriment in the long term.
- 1.18 More specifically, the issues and concerns raised were in the following four areas:
- **Access to content:** almost all of the respondents to our consultation agreed with our competition concerns that the proposal would be likely to result in Sky becoming the sole or main provider of pay TV services on DTT, to the potential detriment of consumers in the long term. The majority also considered that the consequent adverse effects on competition could occur within a short timeframe. Sky was the only organisation to disagree, stating that our competition concerns had not been sufficiently demonstrated.
  - **Sky as a retailer of pay TV services:** a number of organisations, including Sky's pay TV competitors, expressed concerns that Sky has unassailable advantages as a retailer, which could not be addressed by ensuring wholesale access to content, or any other regulatory conditions. These stakeholders argued that Sky should not be permitted to retail pay TV services on DTT at all. In contrast, Sky, Arqiva and the BBC agreed with our view that given the availability of our ex post competition powers, there is a lack of sufficient evidence to justify ex ante intervention to prohibit Sky retailing pay TV services on DTT.
  - **Technical platform services:** we raised a concern that Sky might leverage its market power in the wholesale provision of premium content to gain control over technical platform services on DTT. However, we considered that wholesale access to Sky's premium sports and movies channels would address this concern since it would then be possible to watch these channels on a competitor's DTT platform, and not only on Sky's DTT platform. Respondents to our second consultation agreed with our view, with the exception of Sky and Virgin Media: Sky stated that our approach would be overly interventionist, while Virgin Media stated it would not go far enough.

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<sup>4</sup> As reported, for example, at <http://www.digitalspy.co.uk/digitaltv/news/a203956/sky-movies-screen-1-to-become-showcase.html>.

- **Other policy considerations:** we considered that while there may be issues about the plurality of news provision, the proposal would be unlikely to have a significant adverse effect on digital switchover or the popularity of Freeview. We recognised that the proposal would bring greater choice, and therefore potentially greater complexity in consumers' purchasing decisions, which may be an inevitable and acceptable consequence of increased competition and innovation. The majority of respondents agreed with our view. Finally, respondents were concerned over Sky's position on the board which manages Freeview, given that its interests may be increasingly misaligned with those of Freeview. However, we expressed caution over pursuing regulatory action without allowing the opportunity for a commercial resolution to be agreed.
- 1.19 Given the concerns raised, the uncertainty over the development of DTT and the impact of the proposal, we identified three broad options in our first Picnic consultation:
- Option 1 – consent to the proposal on an unconditional basis;
  - Option 2 – consent to the proposal subject to imposing additional conditions;
  - Option 3 – not to consent to the proposal.
- 1.20 Our provisional conclusion, in our second Picnic consultation, was that we should consent to the proposal but only subject to effective fulfilment of additional conditions (Option 2). We therefore consulted on the potential use of a number of conditions, in particular a requirement for Sky to supply its premium channels on DTT on a suitable wholesale basis.

## Conclusions and summary of decision

- 1.21 We have concluded in our Statement on our pay TV market investigation, which we are also publishing today, that Sky has market power in separate wholesale markets for "Core Premium Sports" and "Core Premium Movies" channels. In sports this is unlikely to change in the next few years. In movies, the position is more complex; while the importance of linear channels is starting to fade, we expect video-on-demand to become increasingly important, and Sky controls the rights required to develop a subscription video-on-demand service. Our primary competition concern is that Sky is restricting distribution of premium services, with effects on competition, particularly from newer platforms and retailers on DTT or IPTV.
- 1.22 As a conclusion to our pay TV market investigation, we have decided to put in place an obligation on Sky to offer to wholesale *Sky Sports 1* and *2*, at regulated prices. In contrast we have not included movies channels in this remedy. Instead we are consulting on referring the movies sector to the Competition Commission for investigation.
- 1.23 We have considered the responses to our second Picnic consultation in the light of our regulatory duties. Our conclusion is that implementation of the Picnic proposal would be likely to be prejudicial to fair and effective competition and to consumers. This is because it is highly unlikely that any competing retailer on DTT would be able to compete effectively with Picnic in the absence of the wholesale supply of Sky's Core Premium Sports channels – *Sky Sports 1* in the case of Picnic. Furthermore, we do not believe that it is appropriate to rely on our ex post powers to address these competition concerns. We therefore consider that if Picnic were to proceed, this

would entail a breach of the conditions in Arqiva's and Sky's licences requiring them not to enter into arrangements which would prejudice fair and effective competition.

- 1.24 The wholesale must-offer remedy set out in our Pay TV Statement addresses the primary competition problem we have identified with the Picnic proposal with respect to sports channels. Consenting to the proposal, subject to the wholesale must-offer remedy being implemented effectively, seeks to gain the benefits of greater choice in premium content on DTT, whilst ensuring fair and effective competition. We have therefore considered whether this is sufficient to address our competition concerns without requiring any further, Picnic specific, conditions.
- 1.25 As raised in our second consultation, a key outstanding issue is the question of timing. Even with the wholesale must-offer remedy, we consider Sky would have an incentive to delay making its sports channels available to its competitors if it had already launched Picnic, in order to gain a significant first mover advantage in offering premium pay TV services on DTT.
- 1.26 Without certainty that the wholesale must-offer remedy had been implemented effectively, this would be prejudicial to fair and effective competition. We consider that the signing of a wholesale supply agreement is the only practical and sufficiently certain way of determining that competing retailers can take advantage of the wholesale must-offer remedy in practice.
- 1.27 A further consideration is the inclusion of Core Premium Movies channels in the proposal, in addition to sports. In the short term, DTT provides the best opportunity for scale entry into the retailing of pay TV services, given the large installed base of TV aerials and homes relying solely on DTT for multichannel viewing. Absent Picnic, we believe that the main entry strategy for most players will be to base their offerings on a limited number of premium sports channels using the DTT capacity which is available.
- 1.28 A movies offering is less attractive to an entrant on DTT, since there is insufficient capacity to carry a full set of movies channels. In the longer term, the appropriate solution to our competition concerns on movies content may not be a wholesale must-offer remedy on movies channels, which is why we are consulting on a reference to the Competition Commission. In the meantime, if Picnic launches including a movies channel, this would be a material change to the current market conditions that form the basis of our competition assessment set out in our Pay TV Statement. This would provide Picnic with a decisive competitive advantage over other retailers on DTT (who would only have access to sports channels), because of the incremental appeal to consumers of being able to watch movies in addition to sports.
- 1.29 Leaving this advantage unaddressed would not ensure fair and effective competition between platforms and retailers on DTT, and hence would jeopardise the benefits to consumers of competition, innovation and choice, in a way that could be difficult to unwind. For the reasons related to the timing of Picnic's launch described above, we consider that Sky should first sign a wholesale supply agreement for any Core Premium Movies channels to be retailed on DTT incrementally to sports channels, with terms including pricing to be agreed commercially.
- 1.30 We have therefore decided that Sky should be permitted to launch Picnic once it has concluded one or more wholesale agreements such that:

- the Core Premium Sports channel it wishes to retail on DTT – *Sky Sports 1* – could be sold to consumers by at least one third party retailer not affiliated with Sky, on a DTT platform other than Sky's DTT platform; and
  - the Core Premium Movies channel it wishes to retail on DTT – *Sky Movies Screen 1* – could be sold to consumers by a retailer of pay TV services on DTT that had already entered into an agreement for the wholesale supply of *Sky Sports 1*.
- 1.31 Once the first such wholesale agreement(s) has been entered into, the non-discrimination obligations to which Sky is subject will mean that other retailers can quickly enter into similar agreements / arrangements.
- 1.32 In our second consultation we considered including certain conditions in relation to simulcrypt. We observe that since our last consultation additional DTT capacity has become available. In principle, it is not appropriate to create an asymmetry where Sky has an obligation to supply the channels on a simulcrypt basis but its retail competitors do not have to reciprocate.
- 1.33 We have therefore decided that it should be for Sky and relevant third party retailers to agree commercially whether the wholesale channels should be supplied on a simulcrypt basis and on what terms. However, we continue to see simulcrypt as an important way of making efficient use of limited DTT capacity and would expect it to be the efficient outcome under normal market conditions. Accordingly, we would be keen to understand the reasons behind any failure to reach such a solution.
- 1.34 With respect to the other concerns raised, we have not received any new evidence in response to our second consultation and have concluded that it is not appropriate to impose further regulatory conditions. In particular, we see significant benefits for consumers from Sky retailing pay TV services on DTT, given its impressive track record in serving retail customers on its satellite platform. While we recognise the concerns about Sky retailing on DTT, we remain of the view that the available evidence does not justify ex-ante regulation, which in some cases would effectively be a blanket prohibition on Sky retailing on DTT.

### Next steps

- 1.35 If Sky and Arqiva wish to proceed with the Picnic proposal, or a different pay TV proposition on DTT that includes Core Premium channels, a number of steps must be taken.
- First, Sky will need to enter into appropriate wholesale supply arrangements, as described above. We would need to be satisfied that the requirements we have set out had been met.
  - Second, we must be satisfied, before consenting to a variation to the core proposals, that the capacity of the programmes broadcast by Arqiva to appeal to a variety of "tastes and interests" is not unacceptably diminished.
  - Third, Arqiva must obtain our consent to changes to its carriage agreement with Sky that are required to implement the proposal or any other pay DTT proposition from Sky.
- 1.36 It should be noted that we may not need to consult publicly on any of these steps.

- 1.37 Subject to these steps, we would vary the description of the “core proposals” in Arqiva’s multiplex C licence to reflect the change in the identity of the Sky channels that will be broadcast and we would amend Sky’s DTPS licence accordingly.

## Section 2

# Introduction

## Background

- 2.1 On 4 October 2007, we published a consultation (the "**First Picnic Consultation**") entitled "*Proposed BSkyB digital terrestrial television services*" on a proposal (the "**Proposal**") by British Sky Broadcasting Ltd ("**Sky**") and National Grid Wireless Limited, now known as Arqiva<sup>5</sup> ("**Arqiva**"), to replace Sky's existing free-to-air ("**FTA**") channels with pay television services over digital terrestrial television ("**DTT**")<sup>6</sup>. Sky announced that the Proposal would be launched under the "**Picnic**" brand name.
- 2.2 In the First Picnic Consultation we set out our initial views on the impact of the Proposal on competition in the pay TV sector and in relation to the development of DTT. While recognising that the Proposal has some consumer benefits, we also considered that it raises competition concerns. We therefore sought comments on these views and on whether the Proposal should be approved unconditionally, approved with conditions or rejected.
- 2.3 On 30 September, we published a further consultation (the "**Second Picnic Consultation**"), in which we consulted on our view that consent should be given to Picnic, but only subject to certain conditions.
- 2.4 This Statement sets out Ofcom's conclusion and explains the rationale for Ofcom's decision, reached after taking account of all the responses to our First Picnic Consultation and our Second Picnic Consultation and in the light of the relevant considerations. It further summarises the responses to the Second Picnic Consultation and responds to relevant matters raised by respondents.
- 2.5 We are also publishing today a statement on our pay TV market investigation (the "**Pay TV Statement**") in which we have decided to require that *Sky Sports 1* and *Sky Sports 2* are made available to retailers on platforms other than Sky's, and to consult on referring the sale of premium movies rights and premium movies channels to the Competition Commission ("**CC**"), raising the concern that this content should also be made more widely available.

## Our assessment of the Proposal to date

- 2.6 In order to provide maximum clarity to readers, we describe in chronological order below the key documents relating to our assessment of the Proposal.

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<sup>5</sup> At the beginning of September 2008, Arqiva received approval from the Competition Commission for its merger with National Grid Wireless Limited. From 22 September 2008 National Grid Wireless Limited and its group companies traded under Arqiva brand names.

<sup>6</sup> [http://www.ofcom.org.uk/consult/condocs/dtv/condoc\\_dtv.pdf](http://www.ofcom.org.uk/consult/condocs/dtv/condoc_dtv.pdf).

- On 8 February 2007, Sky issued a press statement (the "**February 2007 announcement**") announcing its intention to replace its three FTA DTT channels with subscription channels<sup>7</sup>.
- On 16 February 2007, we issued a press statement regarding the February 2007 announcement, noting that we would consult on the Proposal when we received a request for approval from Sky and Arqiva<sup>8</sup>.
- On 17 April 2007, Sky submitted an application (the "**Sky Application**") to us to vary its Digital Television Programme Service ("**DTPS**") licence.
- On 30 April 2007, Arqiva submitted an application (the "**Arqiva Application**") to us to vary its multiplex C licence (we refer to the Sky Application and the Arqiva Application together as the "**Applications**").
- On 26 June 2007, following requests for further information, we announced that we had been provided with sufficient information from Sky and Arqiva to commence our assessment of the Proposal and that we intended to consult on the competition issues raised by the Applications<sup>9</sup>.
- On 4 October 2007 we published our First Picnic Consultation. The consultation period closed on 14 December 2007<sup>10</sup>.
- Between October 2007 and February 2008 we received 450 responses to our First Picnic Consultation<sup>11</sup>.
- On 18 December 2007, we published a first consultation (the "**First Pay TV Consultation**") on our wider pay TV market investigation.
- On 13 May 2008, we announced that as there were issues raised by the Proposal that inform our wider pay TV market investigation and vice versa, we would publish a further consultation document on each subject simultaneously by the end of summer 2008<sup>12</sup>.
- On 30 September 2008, we published the Second Picnic Consultation and a further consultation on our Pay TV Market Investigation (the "**Second Pay TV Consultation**").
- At the end of January 2009, we received the last response to our Second Picnic Consultation.

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<sup>7</sup> <http://phx.corporate-ir.net/phoenix.zhtml?c=104016&p=irol-newsArticle&ID=960773&highlight>.

<sup>8</sup> [http://www.ofcom.org.uk/media/news/2007/02/nr\\_20070216](http://www.ofcom.org.uk/media/news/2007/02/nr_20070216).

<sup>9</sup> Ofcom made an initial announcement on 16 February 2007 which, amongst other things, envisaged that competition issues raised by an application from Sky would be subject to consultation.

<sup>10</sup> <http://www.ofcom.org.uk/consult/condocs/dtv/>.

<sup>11</sup> All non-confidential responses to our First Picnic Consultation can be found on our website at <http://www.ofcom.org.uk/consult/condocs/dtv/responses/>.

<sup>12</sup> <http://www.londonstockexchange.com/exchange/prices-and-news/news/market-news/market-news-detail.html?announcementId=1838680>.

- On 26 June 2009, we published our **Third Pay TV Consultation**, which considered proposed remedies. We noted that the majority of respondents to our Second Picnic Consultation had indicated they agree our consent to the proposal would need to be subject to regulated wholesale prices for Sky's Core Premium channels<sup>13</sup>. Accordingly, we decided to consult on a range of wholesale prices in our Third Pay TV Consultation, in order to consider the relevant factors, before concluding on our assessment of the Picnic proposal.
- Today we are publishing this Statement on our decision in respect of the Proposal together with our Pay TV Statement.

## The Proposal

- 2.7 In recognition of the fact that Sky's plans for Picnic are no longer under active consideration and the possibility that Sky and Arqiva might submit new licence variation applications, this Statement considers the broader principles of whether we should consent to Sky retailing Core Premium channels on DTT and, if so, whether such consent should be subject to any conditions<sup>14</sup>. We apply those principles to our assessment of the Proposal, which we are required to bring to a conclusion.
- 2.8 Sky currently broadcasts three channels on multiplex C on DTT: *Sky News*; *Sky Sports News* and *Sky Three*. Under the Proposal, part of Sky's "Picnic" entertainment and communications service (announced on 1 October 2007), these three channels would be replaced with five channels as follows:
- *Sky Sports 1*: the same channel broadcast as *Sky Sports 1* on satellite including live coverage of Football Association Premier League ("**Premier League**") football matches, broadcast 24 hours a day, seven days a week.
  - *Sky Movies Screen 1*: the same content as *Sky Movies Screen 1* on satellite comprising a selection of recent movies covering different genres, broadcast between 6.00pm and 6.00am<sup>15</sup>.
  - *Sky One*: a simulcast of the general entertainment *Sky One* channel which is already available on satellite broadcast from 7.00pm to 6.00am, together with one hour of *Sky News* content scheduled between the hours of 6.00pm to 7.00pm daily, up to seven days a week.
  - *Discovery Channel*<sup>16</sup>, broadcast between the hours of 6.00am and 6.00pm, seven days a week.
  - *Disney Channel*, broadcast between the hours of 6.00am and 6.00pm, seven days a week<sup>17</sup>.

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<sup>13</sup> Paragraph 2.60 of our Third Pay TV Consultation.

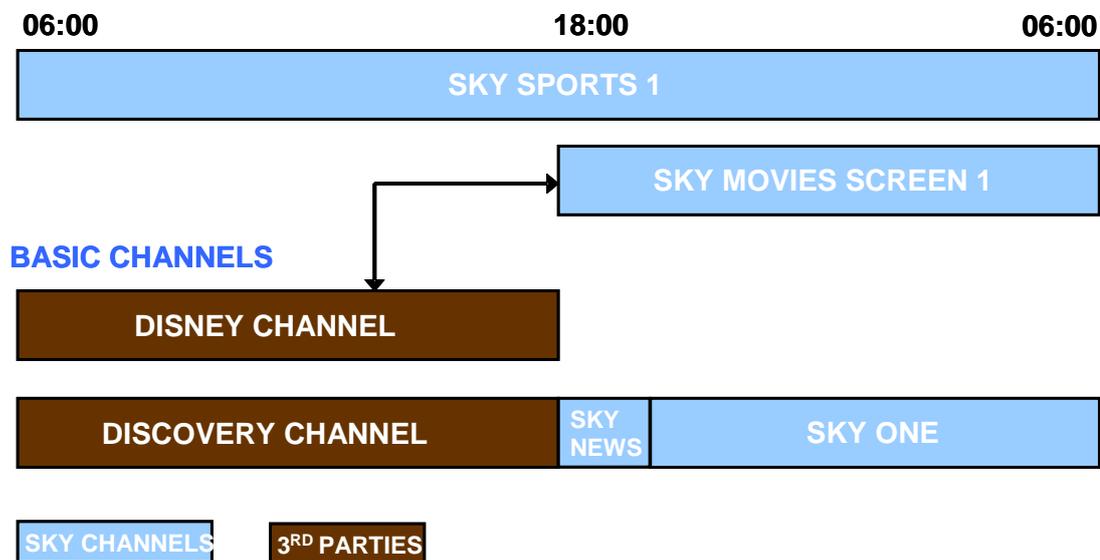
<sup>14</sup> See <http://www.guardian.co.uk/media/2008/sep/12/bskyb.television>.

<sup>15</sup> Sky replaced *Sky Movies Screen 1* with *Sky Movies Showcase* on 26 March 2010. However, Sky has not sought to vary the proposal it has submitted to us for consideration.

<sup>16</sup> Sky did not announce the inclusion of *Discovery Channel* and *Disney Channel* until after the publication of our First Picnic Consultation.

2.9 The Proposal is illustrated in the diagram below (which is based on a similar diagram provided to us by Sky).

**PREMIUM CHANNELS**



2.10 [X]<sup>18</sup>

2.11 Under the Proposal, only those viewers that had been appropriately authorised would be able to access the Picnic channels. To prevent unauthorised viewing, the channels would be protected using conditional access (“CA”) technology. This comprises scrambling and encryption technologies that allow a broadcaster to restrict reception of its digital channels to consumers who have been authorised to view them. Typically it is used by pay TV operators to protect subscription and pay per view revenues. Consumers would need a set-top box that supported the relevant CA technology in order to gain access to the channels. Choice of CA technology is therefore an important component of the Proposal.

2.12 Sky is proposing to use CA technology supplied by NDS Group plc (“NDS”)<sup>19</sup>, which is used by broadcasters around the world to encrypt pay TV services, including Sky for its satellite service in the UK. NDS is different from the CA technology used by existing pay TV services on DTT in the UK, who all use CA technology supplied by Nagra France (“Nagra”), a company which is part of the Kudelski Group<sup>20</sup>. Launching

<sup>17</sup> Sky announced in its press release of 1 October 2007 that it initially expects the children’s channel to commence broadcasts daily at 6.00am, but will have the flexibility to commence its DTT broadcasts as early as 3.00am, when the *Sky Movies Screen 1* service usually ends its daily schedule.

<sup>18</sup> [X]

<sup>19</sup> A company headquartered in the UK which develops and supplies digital rights management and CA products. Its shareholders are Permira with a 51 per cent stake and News Corporation with a 49 per cent stake.

<sup>20</sup> A Swiss corporation which operates in the business areas of digital TV, public access and audio products.

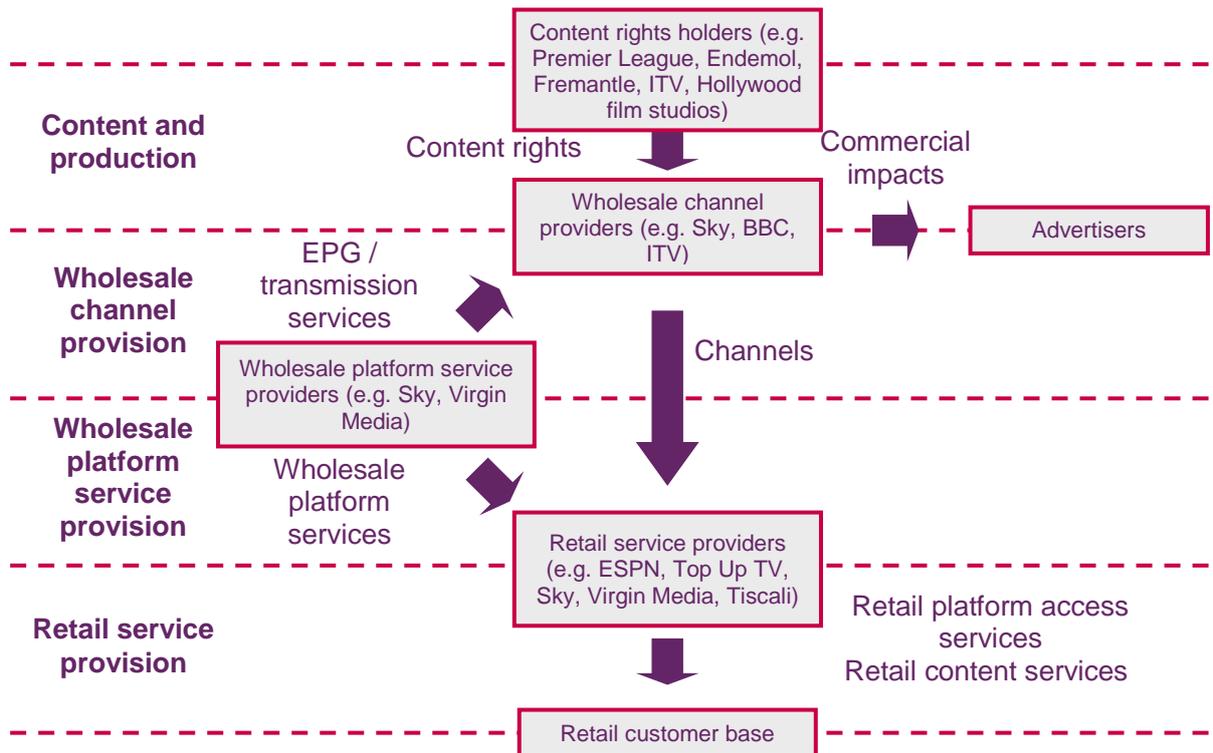
a new platform on DTT, using NDS CA technology, means that consumers would be required to buy a new set-top box in order to access Picnic TV channels.

2.13 Sky and Arqiva require consent from us before they are able to implement the Proposal.

**Market structure**

2.14 In our Second Picnic Consultation we laid out our view of the structure of the pay TV value chain. We suggested a model, illustrated in the diagram 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 commissioning content, acquiring rights to broadcast content or licensing content from other providers.
- Wholesale platform service provision, provides services to enable retailers to restrict the supply of content to consumers, or provides Electronic Programme Guide (“EPG”) services to broadcasters.
- Retail service provision, includes the bundling of channels into packages to retail to consumers.



2.15 We recognise that the TV sector is complex, and that there are therefore challenges in characterising all the activities involved in a single diagram. We also accept that it is somewhat simplistic to characterise a linear value chain in an environment as complex as TV broadcasting. However, in our view the above market structure continues to be a useful overall analytical framework. The structure and

characteristics of the UK pay TV sector are set out in Section 4 of our Pay TV Statement.

## Key developments

- 2.16 We summarise here some of the key developments since the publication of the Second Picnic Consultation, which are relevant to our assessment of the Proposal. These developments relate to the product offerings of service providers and the development of new technologies.

## Premier League rights

- 2.17 One important event since publication of our Second Picnic Consultation is that the Premier League held the auction for the live rights to that competition for the 2010/11 to 2012/13 seasons. The outcome of this was a material change relative to the previous auction in 2006, both in terms of the outcome of the auction, and the subsequent impact on the market.
- 2.18 The outcome of the February 2009 auction was that Sky won the rights to five of the six available packages, which is the maximum available to a single bidder under the Premier League's commitments to the European Commission. Setanta won the rights to the remaining package, generally recognised to be the least attractive, with the largest number of fourth pick matches.
- 2.19 Following the February 2009 auction, Setanta's future became increasingly uncertain, culminating in it losing its Premier League rights and going into administration.
- On 19 June 2009 the Premier League announced that Setanta had been unable to meet its financial obligations, and that the existing licence agreement between Premier League and Setanta had therefore been terminated, with immediate effect.
  - The Premier League further announced its intention to auction the live rights which had been held by Setanta to show the 46 UK live matches for the 2009/10 season. Of these, Sky is precluded by the Premier League's commitments to the European Commission from winning both packs of 23 matches.
  - On 22 June the Premier League announced that ESPN Ltd had won the rights to both packs of matches that Setanta had previously licensed for the 2009/10 season, and the one pack that Setanta had licensed for the 2010/11 to 2012/13 seasons<sup>21</sup>. At the same time ESPN Ltd announced that it had agreed a wholesale deal with Sky for distribution on Sky's satellite platform. It also has distribution agreements with Virgin Media, Top Up TV, BT Vision and TalkTalk TV.
  - Following this, it was announced on 23 June that Setanta had gone into administration<sup>22</sup>.

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<sup>21</sup> <http://www.guardian.co.uk/media/2009/jun/22/espn-wins-premier-league-rights>.

<sup>22</sup> <http://www.guardian.co.uk/media/2009/jun/23/setanta-goes-into-administration>.

## Digital Switchover

- 2.20 Between now and 2012, analogue channels and the existing digital terrestrial multiplexes will be switched off, transmitter group by transmitter group, and replaced with new switchover multiplexes. Turning off the analogue signals will make it possible to boost the strength and coverage of digital terrestrial services, increasing coverage from 73% of UK households before digital switchover ("**DSO**") to 98.5% after DSO.
- 2.21 Since publication of our Second Picnic Consultation, switchover has been successfully completed in the Border, West Country and Granada TV regions with the final switchover in Wales now in progress and due to be completed on 31 March. This will equate to 5.5 million households having completed the switchover process.

## HD on DTT

- 2.22 In July 2008, we published the first Notice of Invitation to Apply for DTT multiplex B capacity. Two tranches of capacity, each sufficient for the broadcasting of one HD service, were made available in addition to a third tranche of capacity to which the BBC is guaranteed access. We decided to award capacity to each of the applicants (the Channel 3 licence holders and Channel 4/S4C).
- 2.23 It is anticipated that advances in technology will permit further HD services to be carried on multiplex B: a fourth service in 2010 and a fifth from 2012 onwards. On 11 December 2008, we published a second Invitation to Apply for the fourth slot. In March 2010, we determined that we would not reserve capacity for either of the applicants (Five and Channel 4/S4C) and the fourth slot capacity is therefore available for the BBC to use. We intend to issue a further invitation to apply for capacity for the anticipated fifth slot, probably in 2011.
- 2.24 The BBC and ITV launched their terrestrial HD services in December 2009, initially in the London and Granada regions. These will soon be joined by HD services from Channel 4 and S4C. By summer 2010, around 50% of UK households are expected to be able to receive the new transmissions. Consumers will need to purchase a new set-top box and connect it to an HD enabled television to view the services. The first products started to become available for purchase from retailers early in 2010.

## Project Canvas

- 2.25 Project Canvas is a proposed joint venture between the BBC and six other partners to develop and promote a platform, based on common standards and a consistent user experience. Viewers with a broadband connection would be able to watch on their television sets on-demand services, such as the BBC iPlayer or the ITV Player, and other internet content and applications, as well as ordinary linear television channels. This would be via a set-top box or potentially integrated digital TVs, connected to the internet. Viewers would need to have a broadband subscription but would not need to pay an additional subscription for access to the platform and its content. However, the intention would be for the platform to be sufficiently flexible to support pay TV models for additional content in the future.
- 2.26 The BBC Trust initiated an assessment of the proposal as a "non-service" application in February 2009. Following consultation and an assessment of public value and market impact, the BBC Trust gave provisional approval to the BBC's involvement in Project Canvas in December 2009. The BBC Trust's final decision is expected in spring 2010.

## The First Picnic Consultation

- 2.27 We first consulted on the Proposal because it raised a number of potentially significant competition issues. We also consulted on the impact of the Proposal on DSO, Freeview and consumer confusion.
- 2.28 Our First Picnic Consultation outlined three approaches in response to the Proposal:
- Consent to the Proposal unconditionally, relying on our ex post competition powers ("**Option 1**").
  - Consent to the Proposal subject to additional ex ante conditions, such as requiring Sky to make its channels available to other retailers on a wholesale basis ("**Option 2**").
  - Not to consent to the Proposal under any conditions ("**Option 3**").
- 2.29 In total, we received 450 responses to our First Picnic Consultation: 426 responses from members of the public (of which 142 are confidential) and 24 responses from organisations (of which 5 are confidential). By way of brief overview:
- About 87 per cent of the 426 individuals that responded to the First Picnic Consultation said that we should not consent to the Proposal.
  - Sky was the only organisation which said explicitly that we should consent to the Proposal unconditionally.
  - The majority of the other organisations that responded (including all of Sky's retail competitors) said that we should not consent to the Proposal or consent to it only if appropriate ex ante conditions are imposed on Sky.
  - Most organisations said that we needed to consider the Proposal alongside our Pay TV Market Investigation.

## The Second Picnic Consultation

- 2.30 Our provisional conclusion in our Second Picnic Consultation was that we are most likely to fulfil our regulatory duties by consenting to the Proposal but only subject to effective fulfilment of certain conditions. This approach would seek to gain the benefits of greater choice in premium sports and movies on DTT, whilst ensuring fair and effective competition in pay TV. We therefore also consulted on the potential use of the following conditions:
- A **wholesale must-offer remedy**, under which Sky would be required to supply its premium sports and movies channels on a suitable wholesale basis which is commercially viable, in particular, subject to certain conditions in relation to wholesale pricing.
  - The **use of simulcrypt**, under which other retailers of pay TV services on DTT, using different CA systems, could access Sky's premium sports and movies channels without needing to transmit the same channels more than once, subject to suitable security requirements.
  - **Ancillary conditions**, which would focus on our intended outcome for competition and consumers by ensuring that a wholesale must-offer remedy is

not easily manipulated to be ineffective, but commercially and technically workable.

- 2.31 We received 24 responses to our Second Picnic Consultation, of which 6 are confidential in their entirety. We received 4 responses which contained some confidential material, but where a non-confidential version was also provided, whilst 14 responses contained no confidential material. By way of brief overview:
- We received responses from ten members of the public, two of which are confidential in their entirety. Five individuals said we should not consent to Picnic, four said we should consent subject to conditions including a wholesale supply arrangement and one said that we should consent to Picnic unconditionally.
  - Of the 15 organisations which responded to our Second Picnic Consultation, Sky was the only one which said that we should consent to the Proposal unconditionally.
  - The majority of the other organisations that responded said that we should not consent to the Proposal or consent to it only if appropriate ex ante conditions are imposed on Sky.

## The legal framework

- 2.32 We explained in the First Picnic Consultation<sup>23</sup> and in the Second Picnic Consultation<sup>24</sup> our process and the legal framework for assessing the Proposal. We have explained that the Proposal raises significant competition issues relating both to competition on the DTT distribution technology and across a broader set of digital television platforms<sup>25</sup>.
- 2.33 There is a sectoral competition regime which applies to the consideration of competition issues in the broadcasting sector. This is set out at sections 316 to 318 of the Communications Act 2003 ("**CA03**"). In particular section 316 provides that:

"(1) The regulatory regime for every licensed service includes the conditions (if any) that OFCOM consider appropriate for ensuring fair and effective competition in the provision of licensed services or of connected services.

(2) Those conditions must include the conditions (if any) that OFCOM consider appropriate for securing that the provider of the service does not—

(a) enter into or maintain any arrangements, or

(b) engage in any practice,

which OFCOM consider, or would consider, to be prejudicial to fair and effective competition in the provision of licensed services or of connected services.

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<sup>23</sup> Paragraphs 2.9 to 2.15 and 3.2 to 3.12.

<sup>24</sup> Paragraphs 2.15 to 2.24 and Annex 5.

<sup>25</sup> The terms "platform" and "distribution technology" are discussed in detail at paragraph 9.173 of our Pay TV Statement.

(3) A condition imposed under this section may require a licence holder to comply with one or both of the following—

(a) a code for the time being approved by OFCOM for the purposes of the conditions; and

(b) directions given to him by OFCOM for those purposes.

(4) In this section –

“connected services”, in relation to licensed services, means the provision of programmes for inclusion in licensed services and any other services provided for purposes connected with, or with the provision of, licensed services; and

“licensed service” means a service licensed by a Broadcasting Act licence.

2.34 Pursuant to this provision all Broadcasting Act licences include standard conditions concerning fair and effective competition. The relevant conditions in the licences held by Arqiva and Sky are as follows:

- Condition 11(1) of the multiplex C licence requires that Arqiva shall:

“(a) not enter into or maintain any arrangement, or engage in any practice, which is prejudicial to fair and effective competition in the provision of licensed services or of connected services; and

(b) comply with any code or guidance for the time being approved by Ofcom for the purpose of ensuring fair and effective competition in the provision of licensed services or of connected services; and

(c) comply with any direction given by Ofcom to the Licensee for that purpose.”

- Similarly, condition 14(1) of Sky's DTSPS licence provides that Sky shall:

“(a) not enter into or maintain any arrangement, or engage in any practice, which is prejudicial to fair and effective competition in the provision of licensed services or of connected services; and

(b) comply with any code or guidance for the time being approved by Ofcom for the purpose of ensuring fair and effective competition in the provision of licensed services or of connected services; and

(c) comply with any direction given by Ofcom to the Licensee for that purpose.”

2.35 The issues raised by the Proposal give rise to concerns as to whether, in the relevant markets identified, the interests of consumers are being, or will be, well served by the operation of competition. We have therefore considered whether it would be prejudicial to fair and effective competition if the Proposal were to proceed. In Sections 3 and 7 we explain the markets which we consider to be relevant to our analysis of the Proposal and our concerns relating to fair and effective competition.

- 2.36 In the Second Picnic Consultation we set out the sectoral duties which are applicable to our assessment of the effect the Proposal would be likely to have on fair and effective competition and on consumers<sup>26</sup>.
- 2.37 We also have powers to apply and enforce competition law in relation to the prohibitions under the Competition Act 1998 ("CA98") and Articles 101 and 102 of the EC Treaty (together our "competition powers"). Under section 317 CA03, where we are considering competition issues we must, before proceeding under section 316, consider whether a more appropriate way of proceeding in relation to some or all of the matters in question would be under CA98.
- 2.38 The operation of section 316 CA03 and its relationship to CA98 under section 317 CA03 are discussed in detail in Section 3 of our Pay TV Statement.

### Impact assessment

- 2.39 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 CA03, which means that generally we have to carry out impact assessments where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in our activities. However, as a matter of policy we are committed to carrying out and publishing impact assessments in relation to the great majority of our policy decisions.
- 2.40 The analysis presented at Section 7, when read in conjunction with the rest of this Statement, represents an impact assessment, as defined in section 7 CA03.
- 2.41 For further information about our approach to impact assessments, see the guidelines, "*Better Policy Making: Ofcom's approach to Impact Assessment*"<sup>27</sup>.

### How this consultation relates to our pay TV market investigation

- 2.42 Our assessment of the Proposal has been closely linked to our pay TV market investigation. In particular, they have both considered the issue of access to premium content.
- 2.43 The majority of respondents to our Second Picnic Consultation indicated that they agree our consent to the Proposal would need to be subject to regulated wholesale prices for Sky's Core Premium channels.
- 2.44 Given the overlap between the two matters, and in light of consultation responses, we were not able to conclude our assessment of the Proposal ahead of the conclusion of our pay TV market investigation.

### Structure of this document

- 2.45 The remainder of this Statement is structured as follows. In Sections 3 to 6, we summarise the responses to our Second Picnic Consultation on the relevant issue(s),

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<sup>26</sup> See Annex 5 to our Second Picnic Consultation.

<sup>27</sup> [http://www.ofcom.org.uk/consult/policy\\_making/guidelines.pdf](http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf)

and set out our conclusions on those issues. In Section 7 we set out our decision in respect of the Applications.

- Section 3 sets out our conclusions on the competition concerns regarding access to premium content.
- Section 4 sets out our conclusions on whether Sky should be permitted to retail pay TV services on DTT.
- Section 5 sets out our conclusions on issues regarding technical platform services.
- Section 6 sets out our conclusions on the non-competition issues.
- Section 7 sets out our decision on the options available to us and on how we should proceed with the Proposal.
- Annex 1: Glossary.

## Section 3

# Access to content

## Purpose of this Section

3.1 This Section summarises the responses which we received to our Second Picnic Consultation on our competition concerns regarding access to premium content in connection with the Proposal, and sets out our conclusions on this issue in light of the conclusions in our Pay TV Statement.

## Our views in the Second Picnic Consultation

3.2 In our Second Picnic Consultation we explained why, in our view, the Proposal would be likely to result in Sky becoming the sole or main retailer of pay TV services on DTT. Notwithstanding the more immediate benefits of greater choice and availability of pay TV services on DTT, this in turn might be the source of significant concern and potential consumer detriment in the long term. We considered that the reasons for this were as follows.

- There are two types of content which have a significant appeal and a high degree of exclusivity to pay TV: live top-flight sports and first-run Hollywood movies. It is these types of content which are the primary drivers of pay TV take-up<sup>28</sup>.
- There is a market for the wholesale supply of certain sports channels, specifically those premium channels or packages of premium channels which contain live Premier League matches: ("**Core Premium Sports channels**"), and a market for the wholesale supply of channels which include movies from the six "**Major Hollywood Studios**"<sup>29</sup>, shown in the first pay TV window ("**Core Premium Movies channels**" together with Core Premium sports channels, "**Core Premium channels**")<sup>30</sup>.
- Sky has market power in the wholesale supply of Core Premium Sports and Movies channels<sup>31</sup>.
- Sky has various incentives to withhold its Core Premium Sports and Movies channels from other retailers of pay TV services in a way which may weaken the longer term competitive landscape<sup>32</sup>.
- It is therefore highly unlikely any competing retailer of pay TV services would be able to compete effectively with Picnic in the absence of the wholesale supply of Sky's Core Premium Sports and Movies channels<sup>33</sup>.

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<sup>28</sup> Paragraphs 3.32 to 3.34 of our Second Picnic Consultation.

<sup>29</sup> 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.

<sup>30</sup> Paragraphs 3.35 to 3.46 of our Second Picnic Consultation.

<sup>31</sup> Paragraphs 3.47 to 3.49 of our Second Picnic Consultation.

<sup>32</sup> Paragraphs 3.56 to 3.59 of our Second Picnic Consultation.

<sup>33</sup> Paragraphs 3.50 to 3.53 of our Second Picnic Consultation.

3.3 We said in our Second Picnic Consultation that the Proposal, unchanged, would be likely to result in Sky becoming the sole or main retailer of pay TV services on DTT as a result of its market power in the wholesale markets for Core Premium channels. In particular, we considered that:

- Picnic's content offering particularly of Core Premium Sports and Movies channels would be very popular, and would not be available from any other pay TV retailer on DTT<sup>34</sup>. We recognised that a Core Premium channel in the form of *Setanta Sports 1* would be available on DTT from BT Vision, Setanta and Top Up TV. However, this would only account for a minority of Core Premium sports content available on DTT<sup>35</sup>.
- A significant number of subscribers to BT Vision, Setanta and Top Up TV would switch away from those services to Picnic<sup>36</sup>. The costs of switching from one pay TV retailer to another were unlikely to deter switching<sup>37</sup>.
- Sky's retail competitors on DTT would be less likely to attract new subscribers to their services than in a scenario where Picnic was not available to consumers<sup>38</sup>.
- Potentially high rates of subscribers switching away to Picnic combined with lower levels of new subscribers were likely to threaten the economic viability of Sky's competitors on DTT. [ X ].
- Sky becoming the sole or main retailer of pay TV services on DTT as a result of its market power in the wholesale markets for Core Premium channels would diminish significantly the number of addressable consumers on the platform for other retailers, thereby restricting or preventing the growth or entry of efficient competitors at the retail level<sup>39</sup>.
- This in turn would be likely to lead to consumer detriment in the form of reduced choice of pay TV provider, higher prices, or poorer quality of service. We also considered that this might further reduce the incentive for other pay TV providers to compete for key sports and movies rights, because they would be faced with a significantly reduced number of subscribers from which to recover the cost of acquiring such rights<sup>40</sup>.

3.4 We believed that, were Picnic to launch unconditionally, this outcome would materialise sufficiently quickly that *ex post* intervention would not be effective<sup>41</sup>.

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<sup>34</sup> Furthermore, consumers would have access to *Sky One*, which also would not be available from any other pay TV retailer on DTT, as well as *Discovery Channel* and *Disney Channel*.

<sup>35</sup> Paragraph 3.62 of our Second Picnic Consultation.

<sup>36</sup> Paragraph 3.63 of our Second Picnic Consultation.

<sup>37</sup> Paragraphs 6.57 to 6.66 of our Second Pay TV Consultation.

<sup>38</sup> Paragraph 3.64 of our Second Picnic Consultation.

<sup>39</sup> Paragraph 3.50 of our Second Picnic Consultation.

<sup>40</sup> Paragraph 3.52 of our Second Picnic Consultation.

<sup>41</sup> Paragraphs 3.61 and 4.16 of our Second Picnic Consultation.

## Respondents' views

### Sky<sup>42</sup>

- 3.5 Sky was the only respondent to our Second Picnic Consultation that provided detailed comments on our competition assessment of the Proposal.
- 3.6 It said that its views on our position regarding (i) the role of premium content, (ii) Sky's alleged market power in wholesale markets and (iii) its alleged incentives to withhold supply of premium channels from other retailers, were contained within its response to our Second Pay TV Consultation<sup>43</sup>.
- 3.7 Sky argued that the competition issues which we raised specific to the Proposal, have not been demonstrated to the requisite standards of proof or materiality. Sky therefore remained of the view that the only option was for us to consent to the Proposal on an unconditional basis (Option 1)<sup>44</sup>.
- 3.8 Sky considered that there were deficiencies in our evidence base which meant we had not demonstrated that consumers' interests would necessarily be damaged without the promotion of competitors' interests in "*the intrusive manner proposed*"<sup>45</sup>.
- 3.9 Sky considered that our competition analysis was flawed in the absence of a thorough assessment of competition at the retail level<sup>46</sup>. For example, it said that our Second Picnic Consultation did not address satisfactorily what would happen to existing pay TV retailers on DTT if Picnic launched unconditionally, and that the document contained no explanation of how DTT viewers are currently underserved by pay TV services<sup>47</sup>.
- 3.10 Sky also told us that we had not adequately explained why the launch of Picnic, without the restrictions advocated by us, would lead to any competition concerns materialising so quickly that any future recourse to *ex post* enforcement powers would necessarily be ineffective<sup>48</sup>.

### Other organisations

- 3.11 All other organisations which responded broadly agreed with our competition concerns regarding access to content. The majority considered that the consequent adverse effects on competition could or would be likely to occur within a short timeframe.

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<sup>42</sup> Sky's response to our Second Picnic Consultation also relies on its response to our second Pay TV consultation.

<sup>43</sup> Paragraphs 5.4 to 5.5 of Sky's response.

<sup>44</sup> See, for example, paragraph 5.6 of Sky's response.

<sup>45</sup> Paragraph 1.8 of Sky's response.

<sup>46</sup> See, for example, paragraph 5.13 of Sky's response.

<sup>47</sup> See paragraphs 5.25 and 5.22 of Sky's response.

<sup>48</sup> Paragraph 1.10 of Sky's response.

## Individual respondents

3.12 Of the nine individuals who responded on these issues, eight agreed that the launch of Picnic as proposed would be likely to have adverse effects on competition and seven agreed that such effects would be likely to materialise in a relatively short timeframe.

## Our conclusions

3.13 In accordance with section 316 and the associated licence conditions in Arqiva's multiplex C licence, and Sky's DTPS licence, we are considering whether in the absence of the wholesale supply of Sky's Core Premium channels as defined in our Pay TV Statement, the Proposal would be consistent with fair and effective competition.

3.14 In summary, we conclude in this Section that the Proposal would be prejudicial to fair and effective competition, in the absence of wholesale supply of Core Premium channels, given the following.

- Core Premium channels are key drivers of pay TV take-up, and Sky is proposing to retail two of these channels on DTT under the Proposal – *Sky Sports 1* and *Sky Movies Screen 1*.
- Sky has market power in the market for the wholesale supply of Core Premium Sports channels and in the market for the wholesale supply of Core Premium Movies channels. Furthermore, Sky has market power in the retail market for the supply of retail television bundles containing Core Premium Sports channels and in the retail market for the supply of retail television bundles containing Core Premium Movies channels.
- Sky's market power linked to its vertical integration provides it with an incentive to restrict supply of Core Premium Sports and Movies channels. In practice we observe that these channels have not been, and are not being, made available on a wholesale basis to its retail competitors on DTT.
- DTT provides the best opportunity for scale entry into retailing of pay TV services in the short term.
- If Picnic were to launch in the absence of the wholesale supply of its Core Premium Sports and Movies channels, no other retailer of pay TV services on DTT would be able to compete effectively with Sky at the retail level.
- This would result in a significant prejudice to fair and effective competition at the retail level.

3.15 As reflected in Sky's response to our Second Picnic Consultation, in those areas where our analysis and consideration of the issues have followed our views in our Second Pay TV Consultation, we have effectively conducted that analysis in the Pay TV market investigation process. Accordingly, with regard to the areas of overlap, we set out below the relevant conclusions from our Pay TV Statement.

## The importance of premium content

3.16 We referred in our Second Picnic Consultation to arguments in our Second Pay TV Consultation that:

- Choice of content is the key driver of pay TV take-up<sup>49</sup>.
- The primary drivers of pay TV take-up are live top-flight sports (international, or from top national sports leagues) and first-run (i.e. new to TV) Hollywood movies<sup>50</sup>.

3.17 We remain of this view. At paragraphs 4.104 to 4.156 of our Pay TV Statement, we observe that access to premium sports and movies, key drivers of take-up of pay TV, remains of vital importance to the competitive effectiveness of a pay TV business. In spite of future developments, we do not see that the appeal of premium sports and movies programming will diminish in the future. Indeed, such premium programming is expected to have enduring appeal across a range of platforms and devices. We believe that premium programming is likely to form an important part of the service proposition of a new entrant.

### **Sky's market power in the wholesale supply of premium sports channels**

3.18 In our Second Pay TV Consultation, we consulted on our view that there is a narrow economic market for the wholesale of Core Premium Sports channels<sup>51</sup>. We considered that *Sky Sports 1* fell within the market for the wholesale supply of Core Premium Sports channels.

3.19 In Section 5 of our Pay TV Statement, we have reached the conclusion, consistent with our Second Pay TV Consultation and our Third Pay TV Consultation, that Sky has market power in the wholesale market for packages including Core Premium Sports channels – now comprising *Sky Sports 1* and *2* and *ESPN*. These channels contain a distinctively large amount of the most attractive live sports, shown regularly through the year. The most significant of these is live coverage of Premier League football, but a number of other important events are also shown on these channels.

3.20 We consider whether there are substitutes for these channels, mainly by comparing the channels' characteristics with the characteristics of potential substitutes, but noting that the extent of substitutability is affected by the fact that prices for *Sky Sports 1* and *2* appear to be above competitive levels.

3.21 The closest substitute is sports on free-to-air channels, but the most attractive events shown on these channels are either infrequent or offer lower volumes of content. Our conclusion on market power is in any case largely independent of where the market boundary is drawn. Even if we were to include sports broadcasting on free-to-air as well as pay TV, Sky's market share would still be above 60%.

3.22 In order to conclude that Sky did not have market power, it would be necessary to believe either that at competitive prices general entertainment programming would be a close substitute to sports, or that Sky was unlikely to retain control of a material proportion of the sports rights it currently purchases. Both are highly improbable.

3.23 We have also concluded in Section 5 of our Pay TV Statement that there is a market for the retail supply of packages including Core Premium Sports channels and remain of the view that Sky has retail market power.

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<sup>49</sup> Paragraph 3.32 of our Second Picnic Consultation.

<sup>50</sup> Paragraphs 3.33 and 3.34 of our Second Picnic Consultation.

<sup>51</sup> Paragraph 4.145 of our Second Pay TV Consultation.

## Sky's market power in the wholesale supply of premium movies channels

- 3.24 In our Second Picnic Consultation, we reported that in our Second Pay TV Consultation, we were consulting on our view that there is a narrow economic market for the wholesale of Core Premium Movies channels<sup>52</sup>. We considered that *Sky Movies Screen 1* fell within the market for the wholesale supply of Core Premium Movies channels.
- 3.25 In Section 6 of our Pay TV Statement, we have reached the conclusion, consistent with our Second Pay TV Consultation and our Third Pay TV Consultation, that Sky also has market power in the wholesale market for packages including Core Premium Movies channels, including *Sky Movies Screen 1*. These channels contain a wide range of recent popular movies, including all of the films from the six Major Hollywood Studios shown in the first pay TV window.
- 3.26 We consider whether there are substitutes for these channels, mainly by comparing their characteristics with the characteristics of potential substitutes. We conclude that there are no close substitutes, implying that that Sky has a market share of 100%.
- 3.27 However, 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.
- 3.28 We have assessed the strength of this aggregate constraint by calculating market shares under a variety of assumptions for the market boundary. Considering the constraint to be as strong as it plausibly could be, Sky would have a market share of around [ X ] [30 to 50]%. However this figure understates the degree of market power held by Sky, since it treats moderate substitutes as if they were close substitutes.
- 3.29 Our view that Sky has market power is directly supported by evidence that Sky's wholesale prices for movies channels are above the competitive level. This evidence is independent of the precise market definition or market shares.
- 3.30 Sky also purchases exclusive subscription video-on-demand rights for movies in the pay TV window from all of the Major Hollywood Studios. A subscription video-on-demand service showing the same movies in the same window would appear to be the closest substitute for Sky's Core Premium Movies channels. If, as expected, subscription video-on-demand services increasingly replace linear channels, Sky's position is likely either to be maintained or to become more powerful, particularly due to the advantages of subscription video-on-demand over linear channels.
- 3.31 We have also concluded in Section 6 of our Pay TV Statement that there is a market for the retail supply of packages including Core Premium Movies channels and remain of the view that Sky has retail market power.

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<sup>52</sup> Paragraph 4.235 of our Second Pay TV Consultation.

## Conclusions in our Pay TV Statement on competition issues and consumer harm

- 3.32 In Section 8 of our Pay TV Statement, we have concluded that Sky restricts distribution of its Core Premium channels to potential new retailers in a way which is prejudicial to fair and effective competition. A number of companies have tried and failed, over an extended period of time, to negotiate terms with Sky which would allow them to retail premium channels to their customers.
- 3.33 Our review of these negotiations reveals lengthy and ultimately fruitless discussions over a number of years between Sky and other pay TV operators over possible wholesale of Sky's premium channels. This impasse has remained despite, as Sky agrees, there being an immediate financial benefit to Sky from wholesale supply. We believe this is because Sky is acting on two strategic incentives – to protect its retail business on its own satellite platform, and to reduce the risk of stronger competition for content rights.
- 3.34 Sky's behaviour in negotiation has been to respond to requests for wholesale supply with counter-offers to retail its channels on behalf of other retailers. Sky's position has been that it would be unwilling to enter into a wholesale deal unless it could be shown that it would be better off than under a retail arrangement. We accept that other parties' preference for supply should not automatically take precedence over Sky's preferences. There are however legitimate reasons for the reluctance of third parties to enter into retail deals with Sky, and where it has been evident that no retail deal would be reached, Sky appears to have preferred to be absent from the relevant platform rather than to pursue wholesale supply.
- 3.35 An outcome where Sky was the dominant retailer of premium content across all platforms would not in any event ensure fair and effective competition, as Sky would still have the incentive and ability to manage competition in favour of its own platform(s). Practical examples such as Sky By Wire on Tiscali / TalkTalk's TV platform bear out this concern, where Sky's prices are high compared to those on satellite, and premium take-up is low as a result.
- 3.36 To the limited extent that Sky enters into any discussions about wholesale pricing with any other retailer, these discussions centre on the prices which Sky currently sets to Virgin Media via the rate-card. We do not believe it to be a reasonable expectation for retailers other than Sky to be prepared to pay the rate-card price for Sky's Core Premium channels, as these prices would not allow them to compete effectively. The rate-card prices are set so as to allow a retailer with Sky's scale to compete effectively, and there is only room in the market for one such retailer.
- 3.37 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. However, in a well-functioning market it is fair and effective competition that drives consumer benefits. The current restricted distribution of key content 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 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 pay TV markets are not effectively competitive, 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 will have the ability to offer consumers an unprecedented choice of content, and access to 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 'must-have' content.

### **The impact of the Proposal on competition**

3.38 Sky noted that the main reasons we provided for our views in our Second Picnic Consultation (as set out in paragraph 3.2 above) were: (a) the role of certain premium content in the take-up of pay TV services, (b) Sky's alleged market power in wholesale markets for the supply of premium content, (c) Sky's alleged incentives to withhold supply of its premium channels from other retailers, and (d) an expectation that Sky would continue to win the majority of live Premier League and movies rights for at least the next few years, so maintaining its alleged upstream market power<sup>53</sup>. In response to these arguments, Sky referred us to its response to the Second Pay TV Consultation, where, it said, these allegations had been fully addressed.

3.39 We note that, notwithstanding Sky's responses to the Second and Third Pay TV Consultations, and its other submissions in relation to our Pay TV market investigation, we are of the view that:

- Premium sports and movies channels are a key driver of demand for pay TV services.
- Sky has market power in the wholesale and retail of pay TV packages including Core Premium Sports and Movies channels.

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<sup>53</sup> Sky response, paragraphs 5.4 to 5.5.

- Sky as a vertically integrated firm with market power at the wholesale level is acting on an incentive to withhold supply of its premium channels from other retailers.
- Sky is likely to continue to win the majority of live Premier League and key movies rights for at least the next few years, so maintaining its upstream market power.

3.40 Sky noted that we had identified three concerns specific to the launch of Picnic:

- Sky emerging as the sole or main pay TV retailer on DTT.
- Consequent adverse effects on competition.
- Any such adverse effects being likely to materialise quickly.

3.41 Sky criticised our arguments on each of these points, which we address in turn below.

#### Sky emerging as the sole or main pay TV retailer on DTT

3.42 For the reasons given in our Second Picnic Consultation, we consulted on the view that in the absence of the wholesale supply of Sky's Core Premium channels, the Proposal would be likely to result in Sky emerging as the sole or main retailer of pay TV services on DTT.

3.43 Sky argued that we had not distinguished between the effect of Sky becoming the sole pay TV retailer on DTT, and the effect of Sky becoming the main pay TV retailer on DTT. It said we had failed to explore whether either or both states were more likely to have an effect on competition, quoting us as saying that "Sky would, under current market conditions, be the exclusive retailer of the majority of the Core Premium channels on DTT"<sup>54</sup> which, in Sky's view, might have different connotations.

3.44 While there are some switching costs, our view is that these would not be enough to deter new subscribers, or customers of existing pay DTT and FTA DTT content from switching to a significantly more compelling offer (i.e. one with Sky Core Premium content). That Sky expected to win a substantial customer base for Picnic is evidence of this. However, having taken up a pay TV service on DTT, subscribers are likely to be reluctant to switch again unless the alternative is significantly better than their current provider. So the strongest competition is likely to take place at the point before the consumer has taken up a pay DTT service, and is deciding which one to choose.

3.45 As such, any provider who is first to market with a compelling product – in particular a DTT based offering with Sky's Core Premium channels – and wins a large share of potential DTT based pay TV customers, is likely to be at a considerable advantage to a later entrant.

3.46 Any retailer of pay DTT services would face a tougher competitive environment if Sky were also present on the same platform. Existing retailers are relatively small scale, and the only alternative Core Premium channel to which they have access is ESPN, which is somewhat less attractive than Sky's channels (as reflected in its lower price

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<sup>54</sup> Our Second Picnic Consultation, paragraph 3.55.

and take-up than Sky Sports channels). As such we consider that unless existing pay TV retailers are able to match Sky's Picnic offer, there is a risk that they will no longer be viable.

- 3.47 We remain of the view that certain Sky Sports and Sky Movies channels are key drivers of demand for pay TV services. While Sky Movies channels may become less important with the development of SVoD services, there is a risk that, in the short term, DTT is key and a DTT retailer competing against a DTT offer from Sky would be at a disadvantage if it could not offer Sky Sports *and* Sky Movies channels.
- 3.48 In particular, in comparing sports packages, the option also to take a movies package for a relatively small additional price will make a bundled package more attractive than a standalone package to many consumers – [ X ].
- 3.49 Sky did not advance any views as to why the effect on competition would be different depending on whether Sky were the sole, or just the main, pay TV retailer on DTT. Nor did it set out its views as to the different connotations of the term "exclusive retailer". Our view is that the effect on competition would be qualitatively the same if Sky was the sole pay TV retailer on DTT, or if it was the main pay TV retailer on DTT. Based on our view of the importance of Core Premium channels and consistent with our assessment of Sky's market power with respect to those channels, we consider that a smaller pay TV retailer on DTT would have at best only a marginal effect in ameliorating the impact of Sky's presence on DTT.

### Consequent adverse effects on competition

- 3.50 Sky argued that we had failed to undertake a thorough analysis of competition at the retail level, instead focusing on market definition at the wholesale level.
- 3.51 It said that, notwithstanding our view that competition between pay TV retailers takes place on a cross-platform basis, our concerns appeared to be based on a desire to promote competition specifically on DTT and that we had not discussed whether it was appropriate to adopt a non-platform-neutral approach<sup>55</sup>.
- 3.52 Sky made further arguments regarding the following issues:
- 3.53 Content availability: Sky said that we considered that the Core Premium channels provided Sky with market power and that without them a retailer could not compete effectively. It said that we did not substantiate this concern in the Second Picnic Consultation, or explain how its purported concern would materialise<sup>56</sup>.
- 3.54 Sky further argued that our:
- "...assertions [in our Second Picnic Consultation] about market power are in stark contrast to previous statements it has made when considering the removal of the FTA only restrictions on Multiplexes B, C and D, where it considered that Sky's premium channels were not sufficiently attractive to persuade significant numbers of DTT homes to replace their set-top boxes with ones from Sky. Nor is any attempt made to reconcile these different positions, or explain what,

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<sup>55</sup> Paragraphs 5.14 and 5.15 of Sky's response.

<sup>56</sup> Paragraph 5.17 of Sky's response.

in Ofcom's view, has changed over the last 3 years to merit such a shift in position"<sup>57</sup>.

- 3.55 Sky said that we had not considered whether the restricted line-up of Core Premium channels on DTT affected our analysis<sup>58</sup>.
- 3.56 It also said that no consideration had been given to the availability of *Setanta Sports 1* to BT Vision and Top Up TV subscribers, even though this channel falls in the same relevant market as *Sky Sports 1* and *Sky Sports 2*<sup>59</sup>.
- 3.57 Consumer demand: Sky said that we had taken limited account of its projected subscriber numbers for Picnic, and how this fits with the requirements of materiality, although it did not elaborate further on this point<sup>60</sup>. It also said that we had not generally considered the likely demand for pay TV services via DTT, or considered whether they are already well serviced by existing TV services (and hence whether the promotion of pay TV on DTT is appropriate)<sup>61</sup>.
- 3.58 Sky further noted some specific circumstances of DTT, including that its viewing was primarily driven by the popularity of Freeview and PSB cross-promotion; that restrictions on pay TV services until 2006, and that the context of the platform's development were relevant to the fact that pay TV subscriber numbers on DTT were relatively low. It also noted that we had taken little if any account of likely prices for reception equipment, content packages, contractual terms and the impact on consumer demand of differences between providers<sup>62</sup>.
- 3.59 Switching from existing providers: Sky noted our acknowledgement that the absence of actual information on consumer switching behaviour in response to the launch of Picnic means that it is difficult to attempt any quantification of the scale of any detriment to competitors<sup>63</sup>. Sky argued that as the churn analysis we set out is based on assumptions rather than evidence, it does not provide adequate support for our concerns about impact on existing pay TV retailers on DTT<sup>64</sup>.
- 3.60 Sky further noted that subscribers to existing pay DTT services have chosen these services over alternative pay TV offers, so it cannot be assumed that they are inherently likely to switch. Sky quoted a newspaper report that Dan Marks, Chief Executive of BT Vision, who was "adamant that pay TV does not begin and end with football"<sup>65</sup> as confirming its view that DTT subscribers cannot be assumed to be inherently likely to switch.
- 3.61 Entry deterrence: Sky argued that we appeared to consider further new entry as important, but that we did not explain whether such entry would be likely, or why any

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<sup>57</sup> Paragraph 5.18 of Sky's response.

<sup>58</sup> Paragraph 5.19 of Sky's response.

<sup>59</sup> Paragraph 5.20 of Sky's response.

<sup>60</sup> Paragraph 5.21 of Sky's response.

<sup>61</sup> Paragraphs 5.22 and 5.23 of Sky's response.

<sup>62</sup> Paragraph 5.23 of Sky's response.

<sup>63</sup> Paragraph 5.25 of Sky's response.

<sup>64</sup> Paragraph 5.26 of Sky's response.

<sup>65</sup> Daily Telegraph, 6 January 2009. See paragraph 5.28 of Sky's response.

new entry would be “sufficiently material to competition overall such that the consumer interest is best served by Ofcom intervening to promote such platform entry”<sup>66</sup>.

- 3.62 Addressable consumers: Sky argued that the addressable base of consumers would remain constant. It said that we had not explained the view that this addressable base of consumers would diminish, or why, in a cross-platform retail market, the protection of fair and effective competition would require the promotion of intra-platform competition<sup>67</sup>.
- 3.63 In response to these issues raised by Sky, we note that Sky's response referred to the Second Pay TV Consultation, which did not define retail markets. However, we considered retail substitution in considerable detail in assessing indirect constraints on Sky at the wholesale level (from retail-level switching). Furthermore, we defined and analysed retail markets in our Third Pay TV Consultation and have now set out our conclusions in Sections 5 and 6 of our Pay TV Statement.
- 3.64 While DTT provides the best opportunity for scale entry into retailing of pay TV services, given the large installed base of TV aerials and homes relying solely on DTT for multichannel viewing, our concern is not specifically about competition on DTT.
- 3.65 Rather, our concern relates to Sky's market power in the supply of Core Premium channels, and the presence of barriers to market entry or expansion. The critical stage in the development of pay TV on DTT provides an opportunity for a new retailer to enter the market, or an existing one to improve its service. This is therefore an opportunity to challenge Sky's market power at the retail level. Stronger retailers could also – in the longer term – be in a position to compete against Sky in bidding for key rights, and, as a result, also challenge Sky at the wholesale level.
- 3.66 Our interest is in allowing potential entrants to take advantage of this opportunity. We would expect to take a similar approach if an opportunity for entry had arisen using a different distribution technology, and in that respect our approach is platform-neutral, while responding to the current commercial reality.
- 3.67 We address each of Sky's more specific issues below.

#### *Content availability*

- 3.68 The licences for television multiplexes B, C and D formerly contained a general requirement that any services carried on the multiplex “shall be provided on a free to air basis save with the prior consent of Ofcom”. In October 2005 we consulted on whether this blanket FTA requirement should be removed<sup>68</sup>. This is the document to which Sky referred in its response.
- 3.69 In the April 2006 Statement we concluded that we would be prepared to remove the FTA requirement in response to requests from the Licensees. It was considered that a general restriction on pay services was no longer required as this form of

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<sup>66</sup> Paragraph 5.29 of Sky's response.

<sup>67</sup> Paragraph 5.31 of Sky's response.

<sup>68</sup> <http://www.ofcom.org.uk/consult/condocs/paytv/>

intervention could unnecessarily inhibit the development of pay services by the market.

- 3.70 However, as we explained at paragraphs 3.10 and 3.11 of our First Picnic Consultation, the April 2006 Statement concerned the removal by Ofcom of a general restriction on the provision of pay TV services on multiplexes B, C and D. It did not deal with any specific applications, which remained to be determined on an individual basis dependent on the issues (including competition issues) raised in each case.
- 3.71 The analysis which we have carried out during our assessment of the Proposal, and which has been considerably more detailed and specific than the analysis that was carried out at in 2005, shows that our October 2005 consultation underestimated the likely demand for Sky's Core Premium channels on DTT.
- 3.72 We accept that having far fewer channels relative to satellite would be likely to make a DTT offer less attractive to current subscribers to retail bundles. However, to the extent that ([ X ]) this reduced offering would be reflected in a lower price (i.e. below satellite prices), it could well prove to be more effective than a hypothetical service offering the full range of Core Premium channels at satellite retail prices, in attracting households with a moderate interest in Core Premium channels.
- 3.73 Our view that Sky has market power in the respective markets for the wholesale supply of packages including Core Premium Sports channels and Core Premium Movies channels is set out in our Pay TV Statement.
- 3.74 With regard to the Proposal, we have concluded that inclusion of Core Premium channels in a DTT package would greatly increase the consumer demand for that package, thereby giving the provider a significant advantage over competitors who could not offer such channels.
- 3.75 While *Setanta Sports 1* no longer exists, a similar argument applies to *ESPN*. Even though we have concluded that *ESPN* is in the same relevant wholesale and retail market as *Sky Sports 1* and *Sky Sports 2*, we do not consider that it competes with them on equal terms for the following reasons:
- First, we do not conclude in our Pay TV Statement that ESPN Ltd has market power in the wholesale supply of Core Premium Sports channels.
  - Second, ESPN wholesales its channel widely<sup>69</sup> so we do not have the same concerns about restriction of supply.
  - Third, as we note in our Pay TV Statement, a substantial majority of Sky Sports subscribers see football, in particular live Premier League matches, as a very important part of their sports subscription and live Premier League content is concentrated on Sky Sports channels<sup>70</sup>. Looking forward, from the 2010/11 to the 2012/13 football seasons, *ESPN* will show only 23 live Premier League matches per year, compared to the 115 live Premier League matches which will be shown by Sky.

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<sup>69</sup> See paragraph 2.19 above.

<sup>70</sup> Paragraph 5.7 of our Pay TV Statement.

### *Consumer demand*

- 3.76 We consider that we have taken account of the relevant issues in reaching our current view on the likely impact of the Proposal on competition, having carefully reviewed the available evidence from both our consideration of the Proposal, and from our Pay TV market investigation. This evidence has included third party analyst demand forecasts and business plan information from Sky and its competitors.
- 3.77 We recognise that we are not able to determine the nature of the commercial offerings that may come to market or the identity of the ones which will succeed. Except where there are specific potential market failures arising from market power – these are issues for the market.
- 3.78 While there is inherent uncertainty in forecasting the take-up of pay TV services on DTT, Sky's predicted take-up of Picnic would represent a substantial customer base to a prospective entrant. We also consider that there is scope for a greater take-up of services including Core Premium channels than Sky forecast for Picnic, if such services are offered by more than one provider, and differentiated by bundling with other services – particularly if one or more provider is independent of Sky and seeks to compete aggressively for Sky's satellite customers.
- 3.79 In the quantitative aspect of our impact assessment in our Pay TV Statement, we estimate that by the end of the fifth year of our proposed wholesale must-offer remedy, DTT/IPTV retailers would serve 1.8 million customers taking Core Premium channels. Of these, we estimate that Picnic would serve around [ X ] customers. We estimate that Sky would serve around 0.6 million fewer customers taking Core Premium channels on satellite. If Picnic alone was to retail on DTT/IPTV, we would expect fewer subscribers to Core Premium channels on the platforms, with Picnic serving [ X ] households<sup>71</sup>.
- 3.80 Given that we consider DTT provides the best opportunity for scale entry into retailing of pay TV services in the short term, we consider if Picnic were permitted to launch as proposed in the absence of any conditions to address access to content, it would significantly prejudice fair and effective competition.
- 3.81 We remain of the view that there is scope for an entrant to use Sky's Core Premium channels to gain a substantial customer base, and hence significantly to affect the nature of competition at the retail level.

### *Switching from existing providers*

- 3.82 The purpose of the option evaluation analysis referred to by Sky (set out in Annex 6 to our Second Picnic Consultation) was to estimate the scale of the likely competition effects. We recognised that these estimates were subject to uncertainty. Our view that Picnic would be likely to have a negative impact on competitors was based on evidence set out in our Second Pay TV Consultation that Core Premium channels are the key driver of demand for pay TV<sup>72</sup>.

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<sup>71</sup> See paragraphs 8.67 to 8.68 of our Pay TV Statement.

<sup>72</sup> Paragraphs 3.32 to 3.34 of our Second Picnic Consultation.

- 3.83 Sky's comments regarding churn figures are discussed in our revised impact assessment<sup>73</sup>. We note that, if Picnic had been launched in 2007 and achieved the take-up originally expected by Sky, of [ X ] subscribers, and given that at the time there were around 400,000 pay TV subscribers on DTT<sup>74</sup>, then Picnic would have accounted for [ X ] of pay DTT subscribers, even in the absence of any switching by existing subscribers. Given DTT provides the best opportunity for scale entry into retailing of pay TV services in the short term, this would have a significant adverse effect on the opportunity for expansion or entry by other retailers.
- 3.84 We consider that viewers who have shown both a preference for DTT and a willingness to pay for TV, are somewhat more likely than average to subscribe to a pay DTT service which offers the most popular pay TV channels.
- 3.85 We do not consider that the reported views of Dan Marks are conclusive on this subject. With regard to the quote by the Chief Executive of BT Vision, which may have been published with a number of objectives in mind, we do not consider that this is sufficient to counter the relevant evidence which we have considered in our pay TV market investigation.
- 3.86 First, BT has made statements to Ofcom which counteract this quote. For example, it told us in response to our Third Pay TV Consultation that "BT's own experience is that it is essential to offer must have premium content, such as sport, to attract pay TV subscribers"<sup>75</sup>. [ X ].

#### *Entry deterrence*

- 3.87 Our position with regard to the Proposal is not only based on an expectation of new entry from organisations that are new to retailing pay TV services. In our Second Picnic Consultation, we said that "the critical stage in the development of pay TV on DTT provides an opportunity for a pay TV provider on DTT to emerge to compete with existing providers on satellite and cable"<sup>76</sup>. Our view does not depend on whether the providers who seek to take this opportunity are new entrants, firms who already operate a pay DTT service, or a combination of the two.
- 3.88 Our view, that entry or expansion is likely, is supported by representations we have received from third-party retailers<sup>77</sup>. We consider that there is scope for entry or expansion to be material in the short term because of the potential demand for a DTT package of premium content, as reflected in Sky's projected subscriber numbers for Picnic. In addition, the ongoing development of DTT/IPTV hybrid services could have a considerable impact on the pay TV market, if packaged with sufficiently attractive content.

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<sup>73</sup> In the impact assessment model for our Pay TV Statement, we assume that DTT retailers have the same price and cost structure as Sky. This is in the absence of more reliable evidence to the contrary. As a result we also assume the same rate as Sky.

<sup>74</sup> Paragraph A6.46 of our Second Picnic Consultation.

<sup>75</sup> Paragraph 2.18 of BT's response to our Third Pay TV Consultation.

<sup>76</sup> Paragraph 1.8 of our Second Picnic Consultation.

<sup>77</sup> See for example paragraphs 7.57 to 7.63 of our Pay TV Statement in which we summarise attempts in the past by Sky's retail competitors to secure wholesale access to its Core Premium channels.

### *Addressable consumers*

- 3.89 We accept that in principle the addressable base of consumers would not diminish. However, we consider that in practice the availability of the most popular pay TV channels on DTT would be a sufficiently compelling offer that a considerable proportion of pay DTT subscribers would choose to subscribe to Picnic rather than to other pay DTT services which did not offer Core Premium Channels. As a result, the providers of these alternative offers would not be able to compete effectively.
- 3.90 As described in paragraphs 3.57 to 3.59 above, our focus is not on the promotion of intra-platform competition. We consider that entry or expansion in pay DTT services has scope to increase retail competition across all platforms. Our concern is to ensure that all new or existing pay DTT service providers are subject to fair and effective competition, and that their ability to compete on equal terms is not compromised by restricted access to key content.

### Adverse effects on competition likely to materialise quickly

- 3.91 In our Second Picnic Consultation, we considered that the emergence of Sky as the sole or main retailer of pay TV services on DTT and the consequent adverse effects on competition described above would be likely to occur in a relatively short timeframe.
- 3.92 Sky argued that we had not adequately assessed the speed of take-up of Picnic or switching away from other pay TV retailers, adding that:
- No consideration has been given of the demands of DTT viewers, availability of Setanta content from existing retailers, and “the very high levels of” viewing of PSB/sister channels on DTT.
  - No assessment has been made of the impact that Picnic’s comparatively limited offering will have on the speed of take-up of Picnic and churn.
  - No argument has been made that market power can be attributed to basic channels included in Picnic<sup>78</sup>.
- 3.93 Sky further argued that even based on our definition of a cross-platform retail market for pay TV alone, in light of Sky’s subscriber projections for Picnic (which are low relative to the total number of pay TV subscribers) its launch could not be considered to have a material impact on competition<sup>79</sup>.
- 3.94 As discussed in 3.75, we consider that Setanta (and now ESPN) is relatively weak in comparison to Sky’s Core Premium channels that would be made available from Picnic. Sky did not elaborate its views in relation to PSB/sister channels on DTT. It is unsurprising that households which have a free DTT service watch more PSB/sister channels than those with a wider choice of channels through a pay TV service. However, this is not necessarily informative of their willingness to take up a pay TV offer on DTT.

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<sup>78</sup> Paragraph 3.56 of Sky’s response.

<sup>79</sup> Paragraph 3.57 of Sky’s response.

- 3.95 While we cannot have direct evidence as to the speed of take-up of Picnic, there is some evidence that attractive new services can be adopted rapidly in this sector. For example:
- Within five months of its launch in 1998, ONdigital (which offered premium Sky channels on DTT) announced that it had won 110,000 subscribers, and was gaining 30,000 new subscribers per month<sup>80</sup>.
  - More recently, UK homes with subscriptions to linear HDTV channels tripled in around one year, from around half a million in Q2 2008 to 1.6 million in Q2 2009<sup>81</sup>.
- 3.96 Of course, adoption of a service depends on a range of factors, including the price, the intensity of marketing, and the strength of consumer demand, which, until the service is launched, can only be estimated.
- 3.97 While Sky has argued that Picnic was a “comparatively limited” service<sup>82</sup>, [ X ].
- 3.98 Crucially, Sky itself would be able to control the speed of adoption, by determining the intensity of marketing, and changing the price if necessary. If Sky were concerned about a competitive threat from an alternative provider, it would have the scope to cut the price of Picnic and market the service more intensively (for example through time-limited introductory offers) in order to attract customers who would otherwise have considered subscribing to the alternative DTT provider. In particular, this could well be the rational response from Sky if a third party sought regulated access to Sky's Core Premium channels for inclusion in a DTT package.
- 3.99 We note that in general switching costs on DTT are relatively low – given the large installed base of aerials, switching in this case does not involve the more complex installation of a satellite dish or extensive cabling as in the case of satellite or cable. As such, if Sky had first mover advantage with a compelling product offer that was substantially better than existing DTT services, it could quickly migrate subscribers away from existing retailers such as TUTV and BT Vision.
- 3.100 Meanwhile, a competitor seeking to negotiate and arrange access to Sky's premium content could potentially face delays in, for example, gaining DTT capacity and satisfying Sky as to the security of its technology.
- 3.101 We consider that, once Sky establishes a customer base on DTT, if there is a significant delay before a competitor with access to Sky's Core Premium channels comes to the market, such a competitor will face considerably greater difficulty in attracting those customers away from Sky than if both launched at the same time. While barriers to switching are generally low, it is likely that there will be some resistance to switching due to customer inertia, and the need for a new set-top box. Because of this, we consider that customers would be unlikely to switch to an entrant other than for a substantial discount. Sky would therefore be at a substantial advantage over any such competitor.

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<sup>80</sup> Source: BBC News, 8 April 1999; PRS Newswire Europe (<http://www.prnewswire.co.uk/cgi/news/release?id=44791>).

<sup>81</sup> Ofcom Digital Television Update – 2008 Q3 and 2009 Q3, paragraph 3.9 (in each document): <http://www.ofcom.org.uk/research/tv/reports/dtv>.

<sup>82</sup> Paragraph 5.36 of Sky's response to our Second Picnic Consultation.

3.102 As regards Sky's assertion that the launch of Picnic will not have a material impact on competition, given its size in relation to pay TV, our view is that competition is already adversely affected by Sky's market power in the supply of Core Premium channels, and that the impact of Picnic will be to lose, or at least greatly diminish, an opportunity for an independent retailer to emerge as a challenger to Sky.

## Section 4

# Sky as a retailer of pay TV services on DTT

### Purpose of this Section

- 4.1 This Section summarises the responses which we have received to our Second Picnic Consultation on the potential impact on competition of Sky retailing on DTT, and sets out our conclusions on whether Sky should be permitted to retail pay TV services on DTT.

### Our views in the Second Picnic Consultation

- 4.2 In response to our First Picnic Consultation, [ X ] and Virgin Media expressed concerns regarding various advantages which they believe Sky has as a retailer, which could not fully be addressed by a wholesale must-offer remedy, or by any other regulatory conditions. These stakeholders argued that Sky should not be permitted to retail pay TV services on DTT, even after the introduction of an effective wholesale must-offer remedy including related conditions.
- 4.3 In summary, we were told that Sky has a unique ability to become the sole provider on DTT given its financial resources, relationships with set-top box manufacturers, exclusive relationships with content providers and access to scarce DTT capacity.
- 4.4 Stakeholders said that, in practice, Sky could influence in many different ways the types of DTT boxes that are manufactured and thereby impede the take up of competing pay TV services on DTT, e.g. by underwriting manufacturing R&D costs, providing "sale or return" support for manufacturers and linking Picnic box prices to satellite box orders<sup>83</sup>.
- 4.5 They also said that there are many different ways in which Sky could influence high street retailers so as to restrict the take up of competing pay TV services on DTT. These include (but are not limited to) the following:
- subsidising DTT boxes;
  - providing marketing support for retailers;
  - paying significant retail commissions;
  - linking the price of Picnic boxes to subscriptions;
  - providing "above the line" advertising support for retailers;
  - providing "sale or return" support for retailers;
  - making payments for listing and store refits etc.;

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<sup>83</sup> See, for example, paragraphs 3.12 to 3.17 of Virgin Media's response to our First Picnic Consultation.

- providing “below the line” support (such as point of sale materials, staff training etc.); and
  - providing increased financial support for Sky Digital (Sky's satellite pay TV service) to retailers who promote Picnic.
- 4.6 Virgin Media said that Sky can leverage existing relationships with third party content providers to secure exclusivity of supply<sup>84</sup>.
- 4.7 We explained that in our view the majority of the activities which Sky might engage in to gain competitive advantage are not unique to Sky. We also explained that it is not clear that any of these activities are in themselves necessarily undesirable, and in some cases they may be efficient in promoting and enabling the take-up of services to the benefit of consumers (for example, investment in marketing and developing a brand is likely to promote consumer choice). We therefore did not consider that it would be appropriate to prohibit Sky from retailing pay TV services on DTT simply on the basis that it would be likely to engage in these types of activities.
- 4.8 We also expressed our view that a suitable wholesale must-offer remedy could, in principle, address some of the objections to Sky retailing on DTT. Access to premium content is likely to enhance the attractiveness of the retail offerings of Sky's competitors, providing them with greater opportunity to develop their brands and encourage the take-up of set-top boxes compatible with their retail services.
- 4.9 We said that we have concerns about the issues which could arise from Sky's position as a major purchaser of set-top boxes and its relationship with retailers. However, in September 2008, we had not been presented with evidence to support the proposition that any anti-competitive activities would be likely to occur or would deny Sky's retail competitors access to potential subscribers.
- 4.10 Given the availability of our ex post competition powers, we considered that there was insufficient evidence to justify ex ante intervention to prohibit Sky from retailing pay TV services on DTT<sup>85</sup>.

## Respondents' views

### Arqiva

- 4.11 Arqiva told us that Sky should be permitted to retail pay TV services on DTT, provided that Ofcom's consent is subject to an effective wholesale must-offer remedy being put in place. Arqiva told us that:

“The proposal to require Sky to make its content available via a wholesale must-offer arrangement would appear to address the majority of competition issues. The limitations of the installed receiver base will have to be overcome by pay TV providers and this

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<sup>84</sup> Paragraphs 3.18 and 3.19 of Virgin Media's response to our First Picnic Consultation.

<sup>85</sup> For our views on whether Sky should be permitted to retail pay TV services on DTT, see paragraphs 3.82 to 3.114 of our Second Picnic Consultation.

should be facilitated by the must-offer arrangement encouraging a plurality of pay TV viewer propositions."<sup>86</sup>

## Sky

- 4.12 Sky agreed with our approach regarding the concerns over Sky retailing pay TV services on DTT<sup>87</sup>. However, Sky did not address any of the specific concerns raised by other stakeholders in its response.

## Other organisations

- 4.13 Of the nine organisations which responded on this issue, [ X ] and the Four Parties<sup>88</sup> considered that we failed (i) to have due regard to Sky's incentives and (ii) to address its unmatched retail advantages as a retailer of pay TV services. The Four Parties said that this failure is inconsistent with our principal duty to further the interests of consumers in relevant markets, where appropriate by promoting competition<sup>89</sup>.
- 4.14 Virgin Media added that we addressed Sky's advantages as a retailer of pay TV services by evaluating those advantages within the context of a number of artificial separate categorisations, and that we therefore materially underestimated the adverse impact on competition arising from the aggregate effect of Sky's advantages<sup>90</sup>.
- 4.15 [ X ] both raised the specific point that we failed properly to address Sky's exclusive ability to leverage the popular influence and cross promotional power of such newspapers as *The Sun* and *The News of the World*, which [ X ] described as "simply unreplicable"<sup>91</sup>.
- 4.16 With regard to our view that ex post powers would be sufficient to address any competition concerns arising from Sky's abilities and incentives as a retailer of pay TV services, [ X ] and Sky considered that there is inconsistency between this position and our position on access to content, where we said that ex ante conditions are required<sup>92</sup>.
- 4.17 [ X ] considered that our arguments around Sky's ability to influence retailers and manufacturers are unconvincing. In [ X ]'s view, the circumstances that might prompt anti-competitive behaviour by Sky – namely the existence of alternative retailers who are selling Sky's premium channels to DTT or satellite customers – have never existed in the past and do not exist today. [ X ] said that it is therefore

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<sup>86</sup> See the response to question 8 in Arqiva's response to our Second Picnic Consultation.

<sup>87</sup> Paragraph 6.1 of Sky's response to our Second Picnic Consultation.

<sup>88</sup> The Four Parties are BT Vision, Setanta, Top Up TV and Virgin Media. Setanta Sports GB went into administration in June 2009. Setanta continues to operate in Ireland and other countries outside Europe.

<sup>89</sup> See for example paragraph 11 of Annex 2 to the Four Parties' response to the Second Picnic Consultation.

<sup>90</sup> See paragraph 3.4 of Virgin Media's response to our Second Picnic Consultation.

<sup>91</sup> [ X ]

<sup>92</sup> [ X ] and paragraph 6.2 of Sky's response to our Second Picnic Consultation.

unsurprising that there may not be clear historic evidence of anti-competitive behaviour – but this does not make a compelling case that there will not be any such anti-competitive behaviour in future.

- 4.18 On this same point, we were told by [ X ] that Freesat is no threat to Sky's core pay TV business. They appeared to make the point that the ability of Freesat to engage major manufacturers to produce its reception equipment, is not relevant in determining whether Sky would be able to inhibit the launch of competing pay TV services on DTT.
- 4.19 Virgin Media considered that Sky's access to scarce DTT capacity is a material advantage to Sky which cannot be legitimately considered as a reward for risk taking in committing to DTT at the launch of Freeview. Further, it was not obvious to Virgin Media that any other organisation likely to launch a pay service on DTT currently benefits from a similar advantage<sup>93</sup>.
- 4.20 In contrast to the views summarised above, the BBC, like Arqiva, told us that Sky should be permitted to retail pay TV services on DTT, provided that Ofcom's consent is subject to an effective wholesale must-offer remedy being put in place<sup>94</sup>.

## Individuals

- 4.21 Five individuals agreed with our view that Sky should not be prohibited from retailing pay TV services on DTT provided that its Core Premium channels on DTT are made available to its retail competitors on a suitable wholesale basis. Four individuals disagreed with our view, while one individual said that Sky should be permitted to retail pay TV services on DTT and should not be required to make its Core Premium channels available to competing retailers on a wholesale basis.

## Conclusions

### Summary

- 4.22 Provided our concerns regarding access to content are met, our starting position is that there are significant benefits for consumers from Sky retailing pay TV services on DTT, given its impressive track record in serving retail customers on its satellite platform. Therefore any regulatory constraint on Sky's ability to retail needs to be justified by compelling evidence to show that such an intervention would be appropriate in order to ensure fair and effective competition.
- 4.23 It is not appropriate for us to address potential behaviour by Sky where there is insufficient evidence that it would be likely to occur. It is also not appropriate for us to intervene in respect of behaviour which is broadly positive for consumers; we believe that many of the concerns put to us by stakeholders are simply a reflection of Sky's competence as a retailer.
- 4.24 We do have a concern, separate from access to content issues, over the impact that Sky retailing on DTT might potentially have on fair and effective competition. However, we have concluded that it would not be appropriate to use section 316 CA03 to address that concern through an ex ante prohibition, given the uncertainty

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<sup>93</sup> Paragraph 3.14 to 3.16 of Virgin Media's response.

<sup>94</sup> See the BBC's response to question 3 in our Second Picnic Consultation.

over the evidence of particular types of conduct occurring and our ability to rely on CA98 to address many of the concerns raised.

### **Sky's incentives and potential advantages as a retailer**

- 4.25 As noted above, respondents to our Second Picnic Consultation said that we had failed to recognise (i) Sky's unique incentives to engage in certain practices at the retail level of the supply chain and (ii) the cumulative effect of the types of practice which Sky might engage in.
- 4.26 On the first point, the Four Parties told us in their response to our Second Picnic Consultation that:
- “...Sky has a specific long-term strategic incentive to keep rival retailers suppressed. It is that unique long-term strategic incentive which will ensure that, irrespective of the financial resources of Sky's competitors, Sky will always be willing to outspend them in respect of these activities listed in paragraph 2 above and thereby limit their ability to compete at the retail and content acquisition levels...”<sup>95</sup>.
- 4.27 We accept that if we consented to Picnic as proposed, Sky may have an incentive – as well as the ability – to engage in the practices outlined at paragraph 4.5 to ensure that other retailers of pay TV services do not develop into more effective competitors to Sky. Furthermore, there is a possibility that if Sky acted on this incentive by engaging in certain activities, this might increase the likelihood of it emerging as the sole or main retailer of pay TV services on DTT and such an outcome materialising more quickly.
- 4.28 However, we also consider that if third party retailers of pay TV services had wholesale access to Sky's Core Premium channels on DTT, any third party retailer which launched a competing pay TV service on DTT that included one or more of those channels, would inherently be provided with an incentive to engage in such practices as well, as part of the competitive process.
- 4.29 Moreover, as we explained in our Second Picnic Consultation, some of Sky's retail competitors also have the ability, in principle, to engage in these practices. If they did engage in them, this may be efficient in promoting and enabling the take-up of services to the benefit of consumers. For example, investment in marketing and developing a brand is likely to promote consumer choice.
- 4.30 The second general point, articulated by Virgin Media, for example<sup>96</sup>, is that we evaluated the arguments regarding Sky's advantages as a retailer of pay TV services within the context of a number of artificial categorisations, and that in doing so we underestimated the full extent of Sky's influence and the way in which this would operate to its advantage. We were told that, in consequence, we materially underestimated the adverse impact on competition that would arise from the activities identified at paragraph 4.5.

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<sup>95</sup> Paragraph 5 of Annex 2 to the Four Parties' response.

<sup>96</sup> See for example paragraphs 3.3 and 3.4 of Virgin Media's response.

- 4.31 As noted in our Second Picnic Consultation, we accept in theory that cumulative effects may well be material<sup>97</sup>. However, that does not translate to meriting intervention in the absence of evidence to demonstrate that Sky/Picnic retailing on DTT would be an outcome that was prejudicial to fair and effective competition.

### Sky's cross-promotion advantages

- 4.32 On the specific point raised by [ X ] that Sky has an exclusive ability to leverage the cross promotional power of popular newspapers owned by related News Corporation companies, even if it is the case that Sky is able to obtain advertising space as a result of the News Corporation shareholding in Sky (we were not provided with any evidence on this), we do not consider that this is a ground for prohibiting Sky from retailing pay TV services on DTT.
- 4.33 First, Sky is not alone in having such marketing advantages. BT Vision, for example, could target BT's 13.7 million<sup>98</sup> domestic customers by including advertising flyers for the service with BT telephone and broadband bills.
- 4.34 Second, the extent to which Sky would benefit from wide scale advertising in News Corporation-owned newspapers is debatable. This is because in dedicating advertising space to Picnic, those newspapers would face the opportunity cost of foregone advertising revenues from advertisers not connected with News International.

### **Sky's potential influence over set-top box manufacturers and retailers**

- 4.35 In our Second Picnic Consultation, we said that we have concerns about the issues which could arise from Sky's position as a major purchaser of satellite set-top boxes and its relationship with retailers<sup>99</sup>. However, at that stage we had not been presented with evidence to support the proposition that any anti-competitive activities would be likely to occur or would deny Sky's retail competitors access to potential subscribers.
- 4.36 We understood that some organisations which responded to our First Picnic Consultation had serious concerns that Sky would have a unique incentive and ability to prevent the manufacture of set-top boxes for competing retailers of pay TV services on DTT.
- 4.37 However, responses to information requests, which we sent to manufacturers of set-top boxes in 2007, did not give us clear grounds to suspect that Sky had been attempting to prevent the manufacture of set-top boxes for its retail competitors, such that it would be appropriate to open a CA98 investigation at that point.
- 4.38 We were also told by some organisations that if we consented to the Proposal, Sky and/or News Corporation would be likely to promote Picnic set-top boxes by influencing high street retailers in many different ways to restrict the take up of competing pay TV services on DTT.

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<sup>97</sup> See paragraph 3.112 of our Second Picnic Consultation.

<sup>98</sup> Number of BT residential exchange lines at end of Q3 2009. Source: Ofcom, Telecommunications market data tables Q3 2009, Table 7.

<sup>99</sup> Paragraphs 3.94 to 3.114 of our Second Picnic Consultation.

- 4.39 We recognised there is a possibility that Sky may seek to influence the retail supply of set-top boxes to the detriment of competing pay TV retailers on DTT, and ultimately to the detriment of consumers. However, we took the view that the proposition that Sky's behaviour would deny Sky's retail competitors access to potential subscribers was no more than speculative given the lack of supporting evidence.
- 4.40 We do not consider that any of the responses to our Second Picnic Consultation provided us with additional evidence or analysis to alter our views on this matter. On the contrary, we observe that the launch and growth of Freesat has not been prevented by the lack of compatible reception equipment available in retail outlets.
- 4.41 We also note that BT Vision, which had 451,000 customers at the end of December 2009<sup>100</sup>, has not approached us during the course of our assessment of the Proposal regarding any inability to source manufacture of its hybrid DTT/IPTV set-top box, known as the "Vision+ Box".

### Freesat

- 4.42 As we explained in our Second Picnic Consultation, the BBC and ITV launched its joint venture "Freesat" service in May 2008, and consumers have been able to access the service via Freesat-compatible set-top boxes and integrated digital TVs<sup>101</sup>. We noted in our Second Picnic Consultation that, in practice, the launch of Freesat had not been prevented by an absence or lack of compatible reception equipment available in retail outlets<sup>102</sup>.
- 4.43 [X], in their responses to our Second Picnic Consultation, appeared to argue that the ability of Freesat to engage major manufacturers to produce its reception equipment, is not relevant in determining whether Sky would be able to inhibit the launch of competing pay TV services on DTT. We disagree with this view. Freesat is widely regarded to be a rival to Sky's satellite business yet Sky does not appear to have attempted and/or been able to inhibit the manufacture or retail of Freesat reception equipment.
- 4.44 That Sky is likely to consider Freesat a competitive threat to its business is evidenced by:
- the fact that Freesat, like Sky, is a satellite service carrying a large number digital channels and services, but unlike Sky Digital, is contract and subscription free; and that
  - consumers can access Freesat by a variety of different set-top boxes, PVRs and IDTVs, and the service can potentially be accessed using an existing Sky Digital dish.
- 4.45 We consider that Sky is likely to feel a degree of competition from Freesat in a number of ways. Firstly, there is the risk that existing subscribers to Sky Digital, particularly those who do not wish to subscribe to any Core Premium channels, will switch to Freesat. Secondly, a number of consumers who would otherwise have

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<sup>100</sup> Paragraph 4.39 of our Pay TV Statement.

<sup>101</sup> See e.g. the penultimate bullet point of paragraph 3.9 of our Second Picnic Consultation.

<sup>102</sup> See paragraph 3.110 of our Second Picnic Consultation.

taken up a subscription with Sky may opt for Freesat instead. Thirdly, the presence of Freesat is also likely to result in fewer consumers paying for access to "Freesat from Sky"<sup>103</sup>. This, in turn, means that there are fewer Freesat from Sky viewers who can potentially be upgraded to Sky Digital.

4.46 [X]<sup>104</sup>

4.47 We consider that the availability of free HD services on Freesat are likely to pose a particular competitive threat to Sky, given that HD is clearly of fundamental importance to Sky's satellite business. Sky's 2009 Annual Review, for example, states that:

".....we made an early commitment to high definition (HD) television that helped us to achieve a clear leadership position from which we have gone on this year to put HD at the centre of our strategy."<sup>105</sup>

4.48 In this context, we note that Freesat had around 750,000 customers at the end of September 2009<sup>106</sup> and more than three quarters (79%) of Freesat decoders sold supported HD services by the third quarter of 2009<sup>107</sup>. Furthermore, Sky's own promotional material on its website in March 2010 compared Sky+HD with other HD providers, listing Virgin Media (V+ HD) and Freesat HD, and contrasting its offer of a free Sky+HD set-top box when subscribing for a year, with the price of a Freesat set-top box stated to be "Around £219"<sup>108</sup>.

4.49 With regard to our observation that Sky does not appear to have attempted and/or been able to inhibit the manufacture or retail of Freesat reception equipment, we are aware that there are currently eleven brands of approved Freesat products: Bush, Ferguson, Goodmans, Grundig, Humax, Metronic, Panasonic, Sony, LG, Sagem and Technisat. Furthermore, the Freesat-compatible products supplied by these companies are available from major high street and online retailers such as Amazon, Argos, Comet, Currys and John Lewis.

### Adequacy of ex post powers

4.50 To the extent that Sky's conduct in relation to the manufacture and retail supply of DTT set-top boxes might lead to competition concerns in the future, we remain of the view that we can investigate such issues under our ex post competition powers<sup>109</sup>. We consider that this is consistent with the use of our ex ante powers to address our competition concerns regarding access to content.

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<sup>103</sup> Freesat from Sky is a satellite television service from BSkyB which gives viewers access to over 200 FTA channels: some free-to-view encrypted channels, an EPG and Sky Active interactive data services.

<sup>104</sup> [X]

<sup>105</sup> Page 4 of Sky's 2009 Annual Review: [http://annualreview.sky.com/pdf-downloads/annualReview/full/Sky\\_Annual\\_Review\\_2009.pdf](http://annualreview.sky.com/pdf-downloads/annualReview/full/Sky_Annual_Review_2009.pdf).

<sup>106</sup> Paragraph 4.42 of our Pay TV Statement.

<sup>107</sup> Digital Progress Report, Digital TV, Q3 2009: [http://www.ofcom.org.uk/research/tv/reports/dtv/dtv\\_2009\\_q3/dtv\\_2009\\_q3.pdf](http://www.ofcom.org.uk/research/tv/reports/dtv/dtv_2009_q3/dtv_2009_q3.pdf).

<sup>108</sup> <http://www.sky.com/shop/supertelly/home/why-choose-supertelly/>

<sup>109</sup> See paragraph 3.113 of our Second Picnic Consultation in which we expressed this view.

- 4.51 With regard to the latter, we have assembled a body of evidence which shows that Picnic, as proposed, would be likely to be prejudicial to fair and effective competition and consumers (see Section 3 which also refers to Sections 5, 6 and 7 of our Pay TV Statement).
- 4.52 In contrast, we have not been presented with sufficient evidence to support the proposition that Sky has both the ability and the incentive to be able to influence manufacturers and/or retailers of set-top boxes in such a way as to foreclose the market to its retail competitors, thus denying them access to potential subscribers. We therefore consider that any such activities, to the extent that they amounted to anti-competitive conduct, would be more appropriately addressed through reliance on our ex post powers under CA98.

## Section 5

# Technical platform services

### Purpose of this Section

5.1 This Section summarises the responses which we have received to our Second Picnic Consultation on concerns that the Proposal would enable Sky to control access to technical platform services on DTT, and sets out our conclusions on whether it is appropriate to impose any conditions to ensure fair and effective competition in this respect.

### Our views in the Second Picnic Consultation

5.2 In our Second Picnic Consultation, we said that we would be concerned if Sky leveraged its market power in the wholesale provision of premium content in order to gain control over TPS on DTT<sup>110</sup>. We considered that while an issue such as Sky's influence in the provision of satellite set-top boxes may afford Sky a unique advantage in the provision of DTT set-top boxes, Sky would start from a position of zero set-top boxes which are compatible with its proposed DTT service, in contrast to the significant installed base of DTT set-top boxes which are compatible with existing pay TV services and not capable of receiving Sky's proposed service.

5.3 Furthermore, we considered that a suitable arrangement where competitors could gain access to Sky's premium channels would address this concern since it would then be possible to watch these sports and movies channels on a competitor's DTT platform, and not only on Sky's DTT platform.

5.4 Even if Sky's market position developed in such a way that it gained market power in relation to the provision of TPS on DTT, our view was that it would be subject to existing regulations regarding the provision of TPS<sup>111</sup>. We considered that the appropriate vehicle for deciding whether any competitor might have market power in the wholesale provision of TPS is our market review of wholesale digital television broadcasting platforms, which is currently on hold until the completion of our pay TV market investigation.

### Respondents' views

#### Arqiva

5.5 In its response, Arqiva stated "We agree that it is not necessary to impose additional conditions addressing the provision of TPS by Sky."<sup>112</sup>

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<sup>110</sup> For our views on TPS see paragraphs 3.123 to 3.127 of our Second Picnic Consultation.

<sup>111</sup> Although we recognise that the guidelines which set out how the TPS regulations apply to Sky's satellite platform do not apply to a Sky DTT platform.

<sup>112</sup> Arqiva's response to question 4 in our Second Picnic Consultation.

## Sky

- 5.6 In response to our view that to address the provision of TPS by Sky it would not be necessary to impose conditions in addition to a wholesale supply arrangement, Sky considered that it represents:

“.....another instance of Ofcom’s analysis being predicated on the imposition of compulsory licensing obligations on Sky, rather than considering whether an alternate, less interventionist approach would be more proportionate to the identified concern (which again has not been demonstrated to the required standards).”<sup>113</sup>

## Other organisations

- 5.7 Of the three other respondents which addressed this issue, Freeview and the BBC agreed with our view<sup>114</sup>.

- 5.8 Virgin Media, on the other hand, told us that it:

“.....does not consider that it would be appropriate for Ofcom to rely on existing regulations regarding the provision of TPS in those circumstances. This is because it would first be necessary for Ofcom to carry out a review to determine whether Sky had market power in relation to the provision of TPS on DTT. This would be a time consuming exercise and by the time Ofcom had reached a determination, it would be effectively too late to prevent Sky becoming the sole provider of TPS on DTT. This would in turn strengthen the ability of Sky to become the sole supplier of pay TV services on the DTT platform.”<sup>115</sup>

- 5.9 Virgin Media also told us that it has material reservations about how effective the existing TPS regime has been in practice.

## Conclusion

- 5.10 We have reached the decision that if we were to consent to the Proposal subject to Sky’s Core Premium channels being available on a wholesale basis to competing retailers, it would not be necessary to impose additional conditions addressing the provision of TPS by Sky.
- 5.11 We might be concerned if Sky had the opportunity to gain control over DTT in respect of the wholesale provision of TPS simply as a result of its unique market position in other parts of the supply chain, rather than on the merits of its TPS in comparison to competing TPS.
- 5.12 Sky’s market power in the wholesale provision of Core Premium channels is likely to provide it with such an opportunity. However, if Sky’s Core Premium channels were to become available to third party retailers using their own or other non-Sky DTT

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<sup>113</sup> Paragraphs 7.1 to 7.4 of Sky’s response to the Second Picnic Consultation.

<sup>114</sup> See the BBC’s and Freeview’s responses to question 4 in our Second Picnic Consultation.

<sup>115</sup> For Virgin Media’s comments on the issue of TPS, see paragraphs 4.1 to 4.7 of its response to our Second Picnic Consultation.

platforms on terms which enabled them to compete with Picnic effectively, it is far from clear that Sky would inevitably become the sole provider of TPS on DTT<sup>116</sup>.

- 5.13 With regard to Sky's comment above, we consider that our decision represents the least interventionist regulatory approach. If our concerns were only in respect of the provision of TPS by Sky, then the imposition of a wholesale supply obligation may well be a disproportionate measure.
- 5.14 However, it is important to understand that in Section 7 we identify the wholesale must-offer as a remedy to address our competition concerns regarding access to Sky's Core Premium channels. Having established the need for the remedy on that basis, we consider it would have the added benefit of meeting our concerns for competition in respect of the provision of TPS on DTT, as Sky would not become the sole or main provider of TPS simply as a consequence of its market power in the wholesale of Core Premium channels.
- 5.15 In due course, if Sky's market position developed in such a way that it gained market power in relation to the provision of TPS on DTT, it would be subject to existing regulations regarding the provision of TPS<sup>117</sup>. As we explained in our Second Picnic Consultation, the appropriate vehicle for deciding whether any competitor might have market power in the wholesale provision of TPS is our market review of wholesale digital television broadcasting platforms, which is currently on hold.
- 5.16 For these reasons, we do not consider any additional conditions are required and hence this is the least interventionist approach we can adopt in relation to TPS.

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<sup>116</sup> See paragraphs 7.107 to 7.119 on our conclusion that the inclusion of *Sky Movies Screen 1* in the Proposal, incremental to *Sky Sports 1*, would be prejudicial to fair and effective competition if Sky's retail competitors could not gain wholesale access to *Sky Movies Screen 1* in addition to *Sky Sports 1* and *Sky Sports 2* under our wholesale must-offer remedy.

<sup>117</sup> Although we recognise that the guidelines which set out how the TPS regulations apply to Sky's satellite platform do not apply to a Sky DTT platform.

## Section 6

# Other policy considerations

### Purpose of this Section

6.1 This Section summarises the responses which we have received to our Second Picnic Consultation on concerns that the Proposal may have a detrimental effect on the appeal of Freeview, or the take up of digital television during the DSO process, and sets out our conclusions on whether it is appropriate for us to take any action.

### Our views in the Second Picnic Consultation

6.2 In our Second Picnic Consultation, we expressed our view that while there may be issues about the plurality of news provision, the Proposal would be unlikely to have a significant adverse impact on DSO or the popularity of Freeview with consumers<sup>118</sup>.

6.3 We also considered that while the Proposal would lead to greater choice, and potentially complexity, for consumers when they decide what set-top boxes and TVs to buy, a degree of greater complexity may be an inevitable and acceptable consequence of increased competition and innovation<sup>119</sup>.

6.4 We did have a concern over Sky's position on the board of DTVSL, the company which manages Freeview, given that Sky's interests may be increasingly misaligned with those of Freeview. However, we said we would be cautious about pursuing a regulatory remedy without allowing the opportunity for a commercial resolution to be agreed<sup>120</sup>.

### Respondents' views

#### Arqiva

6.5 Arqiva stated:

"We support Ofcom's position that the Proposal is unlikely to have a significant adverse effect on the DSO process or the appeal of Freeview to consumers."<sup>121</sup>

6.6 With respect to the question of Sky's position on the board of DTVSL, Arqiva considered that this is a matter for the shareholders of DTVSL to resolve<sup>122</sup>.

#### Sky

6.7 Sky told us that it:

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<sup>118</sup> Paragraphs 3.146 to 3.149 and 3.159 of our Second Picnic Consultation.

<sup>119</sup> Paragraphs 3.154 to 3.158 of our Second Picnic Consultation.

<sup>120</sup> Paragraphs 3.150 to 3.153 of our Second Picnic Consultation.

<sup>121</sup> Arqiva's response to question 5 in our Second Picnic Consultation.

<sup>122</sup> Arqiva's response to question 7 in our Second Picnic Consultation.

"...considers that the approach that Ofcom has taken in this section is appropriate, the restraint that it exercises (for example, in paragraph 3.152, concerning DTVSL) admirable, and agrees with Ofcom's conclusions that no specific regulation is required to address any of the concerns raised."<sup>123</sup>

## Other stakeholders

6.8 Of the individual respondents and other organisations (Freeview, the BBC, Information TV and Virgin Media) which addressed the issue of DSO and the appeal of Freeview, the majority agreed with our view.

6.9 Freeview told us that:

"..... Whilst we accept that overall viewing share of these channels is very limited at around 2%, we do however contend that viewers' perception of the platform is diminished by removal of content and the faith they have in the Freeview brand is adversely affected to some degree. People invest in Freeview equipment to access particular free content, and the value of the investment is reduced when that free content is reduced."

6.10 However, with regard to the impact on DSO, it said that:

".....we do not feel the proposal will impact negatively on the DSO process, so long as the marketing from any pay provider on DTT is clear and their claims and propositions do not mislead consumers in any way. Equipment should be sold with no obligation to take out a long term or open-ended subscription and that should be made clear."<sup>124</sup>

6.11 On the issue of consumer confusion, only Virgin Media and four individuals disagreed with our position. Virgin Media said that:

"If, contrary to Virgin Media's view, Ofcom considers it appropriate to permit the Proposal to proceed subject to some form of wholesale must-offer regime, it will be necessary to impose additional conditions on Sky to address the increased complexity in the decision making process for consumers wishing to buy DTT reception equipment. The reason for this is that the greater the complexity of the decision making process, the more important will be the advisory role of retailers. In other words, the more complex the options, the more consumers will rely on the advice of retailers. In this regard, Ofcom has already recognised that (i) Sky has a unique ability to influence retailers (in particular, to provide additional support to retailers if Picnic is stocked or to engage in punishment mechanisms if Picnic is not stocked or rival DTT retailers are promoted), (ii) Sky will have an incentive to act in such ways, and (iii)

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<sup>123</sup> See paragraph 8.1 of Sky's response to the Second Picnic Consultation.

<sup>124</sup> See the response to question 5 in Freeview's response to our Second Picnic Consultation.

if Sky were to influence retailers in such ways, this would act to the detriment of consumers.”<sup>125</sup>

- 6.12 Seven organisations in addition to Arqiva and Sky addressed the issue of Sky's continued involvement in DTVSL following the launch of Picnic, of which Freeview and Virgin Media were fairly neutral. [ X ]<sup>126</sup>.

## Conclusion

### Impact on DSO and Freeview

- 6.13 We consider that the dissenting views to our position on this issue do not provide any new evidence to support a change in our position. We have therefore reached the decision that the Proposal would be unlikely to have a significant adverse effect on DSO or the appeal of Freeview with viewers.
- 6.14 As we explained in our Second Picnic Consultation, we recognise that while there may be issues about the plurality of news provision<sup>127</sup>, we do not consider that the Proposal would have a material impact on the overall popularity of Freeview. This is because Sky's existing channels on DTT, taken together, have a small audience share of not more than two per cent and the PSB channels will remain on DTT on a FTA basis<sup>128</sup>. While the PSB channels have continued to lose audience share on DTT over the past few years, the combined audience share of the PSB channels taken together with their spin-off channels has significantly increased. In December 2009 they accounted for almost 90 per cent of overall viewing on DTT<sup>129</sup>.
- 6.15 We are aware that in 2009 there were reports that ITV and Five might switch their advertiser-funded FTA digital channels to subscription<sup>130</sup>. However, the PSBs would still have a large majority viewing share in DTT-only homes<sup>131</sup>. Moreover, it is not clear that a move of Sky's existing DTT channels to pay would have an impact on the decision of a PSB whether to do the same, as industry reports suggest that ITV and Five are considering a move to offset declining advertising revenues – an entirely separate issue.
- 6.16 To the extent that the removal of Sky's FTA channels has an impact on the appeal of content available on Freeview, this will be considered under the applicable statutory

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<sup>125</sup> See paragraphs 6.1 to 6.2 of Virgin Media's response to the Second Picnic Consultation.

<sup>126</sup> [ X ]

<sup>127</sup> The removal of Sky News would leave BBC News as the only 24 hours news channel on Freeview. We note that since we published our Second Picnic Consultation in September 2008, CNN International has become available on Freeview for the limited hours of between 7pm and 12am.

<sup>128</sup> BARB data.

<sup>129</sup> BARB data.

<sup>130</sup> See for example: <http://www.guardian.co.uk/business/2009/jun/01/itv-bskyb-pay-tv> and <http://www.mediaweek.co.uk/news/942682/Five-studies-move-pay-TV-main-channel/>.

<sup>131</sup> If ITV2, ITV3, ITV4, Fiver and Five USA were to switch to subscription, the remaining PSB channels would account for about 81 per cent of overall viewing in DTT-only households (December 2009 BARB data).

test relating to the variety of tastes and interest served by the programmes broadcast<sup>132</sup>.

- 6.17 We have not reached a conclusion in this Statement on whether the Proposal would be likely to raise issues about the plurality of news provision. We will consider this issue if and when Sky confirms with us that it wishes to proceed with the Proposal or any other proposition which concerns the removal of *Sky News* on DTT.

### **Consumer confusion**

- 6.18 We do not agree with Virgin Media that any consent to the Proposal should be subject to conditions imposed on Sky to address the increased complexity in the decision making process for consumers wishing to buy DTT reception equipment. This is because:

- We have not been provided with sufficient evidence to justify ex ante intervention to prohibit Sky from retailing pay TV services on DTT (see Section 4).
- While the proposal might lead potentially to increased complexity for consumers when they decide what set-top boxes and TVs to buy, we consider that this would be an acceptable consequence of greater choice and innovation.
- We consider that retailers of set-top boxes would inherently seek to minimise any scope for confusion through clear marketing, as otherwise they would face the risk of dealing with a large number of returns at significant cost.

- 6.19 If we did reach the conclusion that we should address this issue, in particular to avoid consumers requiring different set-top boxes for different pay TV services, it seems that the only practicable remedy would be to require Sky/Picnic to use CA standards compatible with those already in use on DTT. While this may provide some benefits in terms of interoperability and economies of scale it would reduce competition in the provision of CA services and, as a consequence, could reduce innovation in the development of CA services. This would therefore conflict with our duties under sections 3(2)(b), 3(4)(b) and 3(4)(d) CA03.

### **Sky's membership of DTVSL**

- 6.20 We have reached the decision that if we were to consent to the Proposal, such consent should not be subject to any conditions addressing Sky's membership of DTVSL. Notwithstanding the views of [ X ] we consider that while a commercial resolution to Sky's membership of DTVSL may not be achievable, intervening to remove Sky as a member of DTVSL would prejudice the outcome of that commercial process and is an issue that goes beyond the scope of assessing the impact of the Proposal.

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<sup>132</sup> See further paragraphs 7.145 to 7.151 on the process for next steps following our decision contained in this Statement.

## Section 7

# Consent to Sky retailing on DTT

7.1 This Section summarises the responses which we received to our Second Picnic Consultation on the options available to us and presents our decision on our review of the Proposal.

### Our views in our First Picnic Consultation

7.2 In our First Picnic Consultation, we said that given the consumer benefits of the Proposal, but the concerns about the longer term consequences for competition and the development of pay TV, we had identified three options for consultation:

- **Option 1: consent to the Proposal on an unconditional basis.**
- **Option 2: consent to the Proposal subject to imposing additional conditions.**
- **Option 3: not consent to the Proposal.**<sup>133</sup>

7.3 At that stage in our assessment of the Proposal, we were keen to receive comments from stakeholders on the options available to us, but were not making a recommendation on a preferred course of action.

### Our views in our Second Picnic Consultation

7.4 In our Second Picnic Consultation, we reached the preliminary conclusion that we are most likely to fulfil our regulatory duties by consenting to the Proposal subject to appropriate ex ante conditions including a wholesale must-offer remedy for premium content (Option 2) in order to (i) gain the benefit of bringing new programming content to DTT, providing consumers with greater choice in premium sports and movies, but also (ii) ensure the conditions for fair and effective competition in pay TV, both on DTT and more widely, to the benefit of consumers in the longer term. We therefore consulted on the potential use of the following conditions<sup>134</sup>.

- A **wholesale must-offer remedy**, under which Sky would be obliged to supply its Core Premium channels on a suitable wholesale basis which is commercially viable, in particular, subject to certain conditions in relation to wholesale pricing.
- The use of **simulcrypt**, under which other retailers of pay TV services on DTT, using different CA systems, could make use of the Core Premium channels without needing to transmit the same channels more than once, subject to suitable security requirements.
- **Ancillary conditions**, which focused on our intended outcome for competition and consumers by ensuring that the wholesale must-offer remedy is not easily manipulated to be ineffective, but commercially and technically workable. For

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<sup>133</sup> See Section 5 of our First Picnic Consultation.

<sup>134</sup> See paragraph 4.80 of our Second Picnic Consultation.

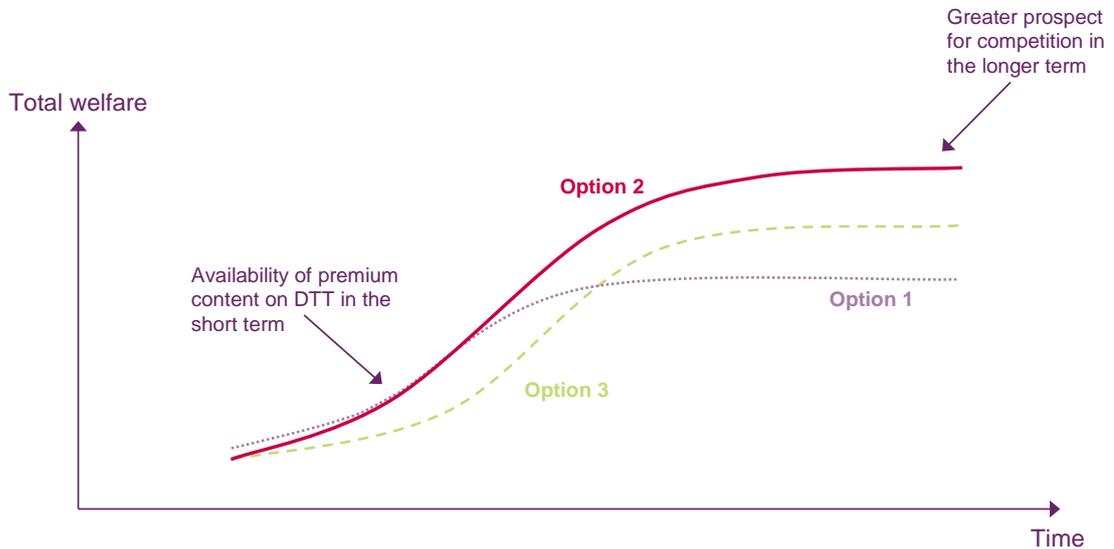
example, we consulted on whether it might be appropriate to require that Picnic may not launch until at least one third party retailer is able to start retailing the wholesale must-offer channels effectively.

### **Impact assessment: option evaluation**

- 7.5 In order to inform our overall analysis, we carried out an indicative analysis to compare the likely impact of the different approaches, Options 1, 2 and 3, set out in the First Picnic Consultation. Given the uncertainty about the future development of pay TV services on DTT, the analysis was inevitably stylised and was aimed at facilitating comparisons between the different approaches rather than representing projections or forecasts of what we thought would actually happen.
- 7.6 Firstly, we considered a comparison between an Option 1 approach (i.e. giving consent to the Proposal unconditionally) and an Option 3 approach (not giving consent to the Proposal). Unsurprisingly, our analysis suggested that in terms of availability of content an Option 1 approach would be likely to deliver a higher level of benefit, largely as a result of the view that the Proposal is likely to expand the addressable market for pay TV services on DTT.
- 7.7 However, we also noted the risk to competition and of longer term consumer detriment if an Option 1 approach resulted in Sky becoming the largest single provider on DTT and reduced the competitive pressure at the retail level in pay TV more generally.
- 7.8 We adopted a simple approach to representing this longer term effect on consumers by modelling it as if prices were higher in the long term than would otherwise have been the case. This was not intended to imply that any detrimental impact on competition would automatically take the form of higher prices – for instance, this approach could equally represent a reduction in quality (e.g. lower customer service or innovation).
- 7.9 Our indicative analysis suggested that a relatively modest one-off future increase in monthly package prices of around 3 per cent could be sufficient to negate the benefits of an Option 1 approach over an Option 3 approach. It was therefore possible to envisage situations where there is greater net benefit from not giving consent to the Proposal, and other situations where there is greater net benefit from giving consent to the Proposal unconditionally. The question of which situations are more likely depends on the likelihood and magnitude of higher prices for consumers in the future due to reduced competitive pressure. It was therefore difficult, on this basis alone, to determine definitively whether an Option 1 approach or Option 3 approach ultimately leads to greater benefits for consumers.
- 7.10 Secondly, we considered a comparison between Options 1 and 3 and Option 2 (i.e. giving consent to the Proposal subject to appropriate ex ante conditions including a wholesale must-offer remedy for premium content). Our analysis suggested that an Option 2 approach could give rise to a higher level of benefit than Options 1 and 3. This is because Option 2 would promote a wider availability of content and provide more scope for competitors to Picnic to develop alternative packages of services, providing greater choice for consumers. Coupled with ameliorating the risk of reduced competitive pressure at the retail level in the longer term, our analysis indicated that an Option 2 approach was most likely to generate the greatest level of benefits to consumers.

- 7.11 The diagram below presents a highly simplified and stylised representation of the consumer benefit that we considered Options 1, 2 and 3 are likely to deliver over time.

### Stylised comparison of Options 1, 2 and 3



- 7.12 The qualitative and quantitative analysis set out in Annex 6 of our Second Picnic Consultation helped to inform our analysis although it could not be determinative on its own, given the inherent uncertainty in forecasts. Taking into account the impact assessment analysis and comments in response to the consultation process, we considered that consenting to the Proposal subject to appropriate conditions including a wholesale must-offer remedy for premium content (Option 2) appeared to be more likely to deliver benefits to consumers than either an Option 1 or Option 3 approach. We therefore considered that of the three options available to us, Option 2 is most likely to satisfy our regulatory duties, in particular our duties to have regard to the desirability of promoting competition and encouraging investment and innovation to the benefit of consumers.

### Potential conditions of consent

- 7.13 Given our view that an Option 2 approach would deliver the greatest consumer benefit, and our view that the use of ex ante conditions through our sectoral competition powers under section 316 CA03 would be more appropriate than relying on our ex post powers under CA98 to address the competition concerns identified<sup>135</sup>, we consulted on the potential use of a wholesale must-offer remedy to ensure wholesale access to Sky's Core Premium channels and ancillary conditions which would be intended to ensure the effective implementation of these wholesale arrangements<sup>136</sup>.
- 7.14 Specifically, we considered that Sky should be required to supply *Sky Sports 1* and *Sky Movies Screen 1* on a wholesale basis to its retail competitors on DTT before it could launch Picnic.

<sup>135</sup> See paragraphs 4.14 to 4.21 of our Second Picnic Consultation.

<sup>136</sup> See paragraphs 4.22 to 4.64 of our Second Picnic Consultation.

- 7.15 Given that we were not contemplating a scenario in which third party retailers would simply be re-selling *Sky Sports 1* and *Sky Movies Screen 1* over Sky's pay TV platform on DTT, we needed to consider what would be the most appropriate means of those channels being supplied to Sky's competitors. Our view in the Second Picnic Consultation was that simulcrypt<sup>137</sup> would be the most appropriate solution to allow multiple retailers of those channels without needing to transmit the videostreams more than once, and ensuring that competition in the provision of CA services is not distorted by effectively pre-selecting a "winner"<sup>138</sup>.
- 7.16 Lastly, we recognised that Sky and third parties may have incentives to reduce the effectiveness of any wholesale must-offer remedy. We therefore asked whether stakeholders considered that any ancillary conditions would be required to ensure that any wholesale supply arrangement was effective from a commercial and technical perspective. At paragraph 4.50 of our Second Picnic Consultation, we listed the following possible examples<sup>139</sup>:
- i) A local simulcrypting trial involving Sky, Arqiva and one or more prospective third party retailers is carried out to the satisfaction of Ofcom, Sky and Arqiva.
  - ii) At least one third party retailer is in a position to start retailing the wholesale must-offer channels.
  - iii) A defined time period has elapsed following (i) the launch of a competing pay DTT service that includes at least one of the wholesale must-offer channels or (ii) the satisfactory completion of a local simulcrypting trial (referred to in the first bullet point above).
  - iv) Sky has achieved a specified number of wholesale DTT subscribers, defined to be subscribers of retail competitors on DTT who include at least one wholesale must-offer channel as part of their subscription.
- 7.17 As we explained in our Third Pay TV Consultation<sup>140</sup>, our assessment of the Proposal needed to be put on hold pending the conclusion of our pay TV market investigation.

## Respondents' views

- 7.18 We summarise below the responses to our Second Picnic Consultation on whether we should consent to the Proposal given the requirement to ensure fair and effective competition and if so what, if any conditions, that consent should be subject to. The responses to our Second and Third Pay TV Consultations on the need for a wholesale must-offer remedy are addressed in our Pay TV Statement.

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<sup>137</sup> As we explained in the First Picnic Consultation, "simulcrypt" is a technical solution which allows a single broadcast channel to be used with two or more CA systems, in the context of TPS.

<sup>138</sup> See paragraph 4.37 of our Second Picnic Consultation.

<sup>139</sup> For clarification, the potential conditions we listed in the Second Picnic Consultation were only examples. We had not in September 2008 reached a view on the full range of conditions that might be required, nor did we suggest that all the potential conditions listed would be appropriate.

<sup>140</sup> Paragraphs 2.58 to 2.60 of our Third Pay TV Consultation.

## Arqiva

7.19 Arqiva, which is a joint applicant in respect of the Proposal, was "broadly in agreement with Ofcom's analysis and proposed approach to facilitate Sky's premium content onto the Digital Terrestrial Television platform", adding that:

"The proposal to require Sky to make its content available via a wholesale-must offer arrangement would appear to address the majority of competition issues. The limitations of the installed receiver base will have to be overcome by pay TV providers and this should be facilitated by the must offer arrangement encouraging a plurality of pay TV viewer propositions."<sup>141</sup>

"The analysis [our indicative analysis] would appear to support Option 2, however, we have concerns that the notional benefit ascribed to Option 2 may be lost if the timescales for introduction are too protracted, i.e. the welfare profiles are coincident for Options 1 and 2 at the start but there is likely to be a lag between the welfare value of option 2 over option 1 as option 2 is an inherently more complex situation to engineer."<sup>142</sup>

7.20 Arqiva told us that Sky and third party retailers must have entered into wholesale agreements in respect of *Sky Sports 1* and *Sky Movies Screen 1* before Sky is permitted to launch Picnic. It also said that agreements need to be reached between content owners and multiplex operators as a precondition of launch<sup>143</sup>.

7.21 With regard to potential simulcrypt conditions, it said that technical operating conditions need to have been demonstrated to not compromise existing free to air DTT reception equipment. With respect to the cost of simulcrypt trials, Arqiva told us that this should be borne by pay TV operators.

## Sky

7.22 Sky understood from our Second Picnic Consultation, that we were proposing only to allow the launch of Picnic subject to various conditions once new compulsory regulation on Sky, as proposed in our Second Pay TV Consultation, had been put in place<sup>144</sup>.

7.23 Procedurally, it argued that the Picnic application is capable of being decided separately from our Pay TV market investigation and that our concerns regarding wholesale supply of premium content should be dealt with under that process rather than delaying the Picnic decision<sup>145</sup>.

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<sup>141</sup> Arqiva's response to question 8 in our Second Picnic Consultation.

<sup>142</sup> Arqiva's response to question 12 in our Second Picnic Consultation.

<sup>143</sup> Arqiva's response to question 11 in our Second Picnic Consultation.

<sup>144</sup> See, for example, paragraph 1.4 of Sky's response to our Second Picnic Consultation.

<sup>145</sup> Paragraph 4.2 of Sky's response.

- 7.24 Sky said that our impact assessment, which included our indicative analysis, was subject to a number of significant flaws which undermined our conclusions<sup>146</sup>. Further details are set out in our decision which starts at paragraph 7.47.
- 7.25 With regard to our provisional conclusions, Sky told us that it did not consider that we built a sufficient evidence base to justify doing anything other than approving the Proposal without condition (Option 1)<sup>147</sup>. Given Sky's view that our analysis was speculative and flawed, it considered that we have no basis for concluding that Option 2 would deliver superior market outcomes to Option 1<sup>148</sup>.
- 7.26 With regard to the imposition of possible ancillary conditions, Sky told us that it did not propose to comment on these conditions in detail, given that, in its view, the analysis that underpinned them falls far short of that required to justify their introduction<sup>149</sup>. Sky did consider, however, that the ancillary conditions contemplated are "Draconian", and that they would cause delay to Sky's channels being as widely available as possible on DTT.

### Other organisations

- 7.27 [ X ], Freeview, the BBC, Tiscali, and The UK Film Council agreed that our consent to the Proposal should be subject to a workable wholesale arrangement and a requirement to use simulcrypt.
- 7.28 The Four Parties, as well as [ X ] and Information TV said that we should not consent to the Proposal (Option 3) given Sky's unique retail advantages and incentives. However, the majority said that if Ofcom is minded to consent to the Proposal, such consent must be subject to conditions on the strictest possible terms (and more onerous than raised by Ofcom in the Second Picnic Consultation). [ X ] provided additional submissions in March this year arguing that any further conditions of consent should be subject to further consultation, in the light of market developments<sup>150</sup>.
- 7.29 All organisations that responded on the issue agreed that simulcrypt would appear to be the most appropriate means of allowing multiple retailers to have access to Sky's Core Premium Channels.
- 7.30 All organisations except Information TV and Tiscali commented on possible ancillary conditions to our proposed wholesale requirement. We summarise below by theme the ancillary conditions which stakeholders told us should be met before Picnic is permitted to launch.

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<sup>146</sup> Paragraphs 3.4 to 3.12 of Sky's response.

<sup>147</sup> Paragraph 9.3 of Sky's response.

<sup>148</sup> Paragraph 3.12 of Sky's response.

<sup>149</sup> Paragraph 9.2 of Sky's response.

<sup>150</sup> [ X ]

### *Signing of commercial agreements*

- 7.31 The BBC told us that Sky and third party retailers must have entered into wholesale agreements in respect of *Sky Sports 1* and *Sky Movies Screen 1* before Sky is permitted to launch Picnic<sup>151</sup>.

### *Simulcrypt*

- 7.32 There was a general consensus between organisations other than Sky that if we are to consent to Picnic, then one of the conditions of launch needs to be that simulcrypt trials have been successfully completed and a commercially and technically workable simulcrypt arrangement is put in place.
- 7.33 The Four Parties added that simulcrypt trials must demonstrate conclusively that simulcrypt is capable of being successfully implemented nationwide<sup>152</sup>.

### *Transmission costs*

- 7.34 We were told by the Four Parties that the transmission costs for *Sky Sports 1* and *Sky Movies Screen 1* must be shared between Sky and third parties on a Fair, Reasonable and Non-Discriminatory ("**FRND**") basis, and that the apportionment should be calculated on the basis of subscriber numbers<sup>153</sup>.

### *Readiness of third party retailers*

- 7.35 The BBC told us that Sky should be permitted to launch Picnic when at least one third party retailer is ready to launch a competing service on DTT containing *Sky Sports 1* and *Sky Movies Screen 1*<sup>154</sup>.
- 7.36 Most other respondents said that the launch condition should be more onerous. For example, [ X ] said that Picnic should not be permitted to launch until a competitor has started retailing the wholesale must-offer channels and/or that competitor has been retailing for a defined period<sup>155</sup>, while [ X ] suggested a ban on Picnic launching until a specified level of penetration has been achieved by competing retailers<sup>156</sup>.
- 7.37 The Four Parties considered that there must be a ban on Sky launching Picnic until the later of (i) not less than six months following the launch of a competing pay DTT service including at least one of the wholesale must-offer channels (with this period to include the key pay TV selling season of July to December) or (ii) the point of reaching at least 50,000 wholesale DTT subscribers (i.e. subscribers of third party pay TV retailers on DTT who include at least one of Sky's wholesale must-offer channels as part of their subscription)<sup>157</sup>.

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<sup>151</sup> Page 3 of the BBC's response.

<sup>152</sup> Paragraph 8.4 of the Four Parties' response.

<sup>153</sup> Paragraph 5.2 of the Four Parties' response. [ X ]

<sup>154</sup> Page 3 of the BBC's response.

<sup>155</sup> [ X ]

<sup>156</sup> [ X ]

<sup>157</sup> Paragraph 11.5 of the Four Parties' response.

### *Anti-gaming measures*

- 7.38 The BBC suggested that to address potential incentives to stall discussions and hence avoid meeting the conditions, we could take further action to assess the reasons for delay if after six months of the publication of our final Statement, a wholesale supply agreement had not been concluded between Sky and a third party retailer<sup>158</sup>.
- 7.39 The Four Parties said that we should impose conditions to guard against the deterioration in quality of *Sky Sports 1* and *Sky Movies Screen 1*. Specifically, they said that there should be conditions in place to prevent the migration of content away from these channels<sup>159</sup>. Virgin Media said there should also be conditions prohibiting cross-promotion by requiring that *Sky Sports 1* and *Sky Movies Screen 1* to be provided on a "clean feed" basis (i.e. they should not include any Sky marketing or promotional material)<sup>160</sup>.

### *Conditions to address Sky's retail advantages*

- 7.40 The Four Parties, [ X ] told us that if we are minded to consent to the Proposal, then such consent must be subject to additional conditions addressing the retail concerns raised by those respondents. For example, there was broad agreement between those respondents that there must be conditions to preclude the subsidisation of DTT boxes by either Sky or Picnic without Ofcom's prior written approval and to prevent Sky from linking the promotion and marketing of its retail satellite business with Picnic.
- 7.41 The Four Parties also said that we would need to prescribe the degree to which Sky could invest capital in Picnic and the period within which Picnic must be profitable<sup>161</sup>. In addition, [ X ] said that there must be tight controls on the level of investment and thus losses that Picnic can make, given Sky's financial strength and that its satellite business could benefit from rival DTT pay offerings being rendered unsuccessful, even if Picnic never breaks even<sup>162</sup>.
- 7.42 We were told by the Four Parties that in order to maximise transparency, Sky/Picnic must be required to disclose all of its contractual arrangements with manufacturers, high street retailers and any other participants in the retail supply chain in respect of DTT reception equipment<sup>163</sup>. Virgin Media added that there must be legal or operational separation between Sky and Picnic, subject to independent audit<sup>164</sup>.
- 7.43 Top Up TV and BT Vision told us in their recent January 2010 submission entitled, "*Ancillary condition in respect of Picnic's SAC*" that any consent to Picnic should be subject to a condition requiring accounting separation. They said that this would allow us to assess whether Picnic is a viable and profitable stand-alone venture on the

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<sup>158</sup> Page 10 of the BBC's response.

<sup>159</sup> Paragraphs 6.2 to 6.3 of the Four Parties' response.

<sup>160</sup> Paragraphs 11.16 and 11.17 of Virgin Media's response.

<sup>161</sup> Paragraph 1.10 of the Joint Parties' response.

<sup>162</sup> [ X ]

<sup>163</sup> Paragraph 7.2 of the Joint Parties' response.

<sup>164</sup> Paragraphs 11.18 to 11.20 of Virgin Media's response,

basis of the wholesale prices paid by its DTT retail competitors (i.e. a margin squeeze test), rather than as a result of cross-subsidy from Sky's larger business.

#### *Other ancillary conditions*

- 7.44 In addition to *Sky Sports 1* and *Sky Movies Screen 1*, [X] told us that third party retailers should be permitted to access the Sky feed of Disney and Discovery on DTT via simulcrypt<sup>165</sup>. [X] also said that Sky should be prohibited from securing exclusivity in the carriage of these channels on DTT.
- 7.45 [X] consider that after the launch of Picnic, there should be an ongoing restriction on Sky securing more than a specified percentage of the total DTT pay market as a retailer.

#### **Individual respondents**

- 7.46 Of the ten individuals who responded to our Second Picnic Consultation, five said that we should not consent to the Proposal (Option 3), four said we should consent subject to a wholesale must-offer remedy, under which Sky must provide wholesale access to its proposed sports and movies channels on DTT (Option 2) and one said that we should consent unconditionally (Option 1).

#### **Decision**

##### **Summary**

- 7.47 Given the consumer benefits of Sky's Core Premium channels becoming available on DTT, but also our competition concerns regarding access to content, we have decided to consent to the Proposal, subject to the effective fulfilment of certain conditions (Option 2). This is consistent with the preliminary conclusion we reached in our Second Picnic Consultation<sup>166</sup>.
- 7.48 Our decision is predicated on the wholesale must-offer remedy set out in our Pay TV Statement being in effect<sup>167</sup>.
- 7.49 We have decided that if the Proposal were to proceed, this would be consistent with the "fair and effective competition" conditions in Sky and Arqiva's licences, provided Sky had entered into:
- a prior wholesale supply agreement such that the Core Premium Sports channel it wishes to retail on DTT – *Sky Sports 1* – could be sold to consumers by at least one third party retailer not affiliated with Sky, on a DTT platform other than Sky's DTT platform; and

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<sup>165</sup> [X]

<sup>166</sup> See paragraph 4.80 of our Second Picnic Consultation.

<sup>167</sup> In our Pay TV Statement, as well as rejecting the Four Parties' suggestion for structural separation of Sky, we have also at this point set aside the possibility of a substantial intervention in the way sports rights are sold, which would have the intention of completely eliminating market power (see paragraph 9.2 of our Pay TV Statement).

- a prior wholesale supply agreement such that the Core Premium Movies channel it wishes to retail on DTT – *Sky Movies Screen 1* – could be sold to consumers by a retailer of pay TV services on DTT that had already entered into an agreement for the wholesale supply of *Sky Sports 1*<sup>168</sup>.
- 7.50 Once the first such wholesale agreement(s) has been entered into, the non-discrimination obligations to which Sky is subject will mean that other retailers can quickly enter into similar agreements / arrangements.
- 7.51 We recognise that Sky may have a decisive competitive advantage if it is able to launch its service before competitors. This is even more likely to be the case if it can also offer movies, in addition to sports, given that those competitors would not have access to Sky's movies channels. While we do have concerns over restricted distribution of movies channels, our main forward looking concern relates to the sale of video-on-demand rights. We cannot adequately address this concern by imposing a wholesale must-offer remedy, or under our sectoral powers more generally. We are therefore consulting on a proposed decision to make a reference to the CC. In the meantime, we have decided that our consent to the Proposal must be subject to Sky entering into a prior wholesale agreement in respect of both *Sky Sports 1* and *Sky Movies Screen 1*.
- 7.52 If Sky entered into a wholesale agreement in respect of *Sky Sports 1* only, we consider it would not be prejudicial to fair and effective competition if Sky proceeded to launch Picnic, retailing all of the channels under the Proposal except *Sky Movies Screen 1*. However, as we note at paragraph 2.10, [ X ].
- 7.53 The provisions relating to the wholesale supply of *Sky Sports 1* would be subject to the terms of our wholesale must-offer remedy in respect of Core Premium Sports channels. We have decided that the provisions relating to the wholesale supply of *Sky Movies Screen 1* should not be subject to any additional requirements to those summarised in paragraph 7.49.
- 7.54 We continue to consider the use of simulcrypt is important in making efficient use of limited DTT capacity. However, we have reached the decision that with regard to the above conditions, it should be for Sky and the relevant proposed third party retailer to agree commercially whether the wholesale channels should be supplied on a simulcrypt basis and on what terms.
- 7.55 To provide certainty and clarity for Sky, Arqiva and other stakeholders, and in recognition of the possibility that Sky and Arqiva may wish to launch a pay TV service which differs from the Proposal, this Section also considers the broader principles relevant to assessing whether Sky retailing Core Premium channels on DTT would be prejudicial to fair and effective competition (see for example paragraphs 7.133 to 7.135 below).

### **Ensuring compliance with Sky's and Arqiva's "fair and effective competition" obligations**

- 7.56 As we explain at paragraphs 3.6 and 3.7 of our First Picnic Consultation, paragraphs 2.21 and 2.22 of our Second Picnic Consultation and above at Section 2, there is a

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<sup>168</sup> For clarification, these two requirements could be met in the form of a single agreement between Sky and one third party retailer of pay TV services on DTT, not affiliated with Sky.

general "fair and effective competition" condition in Arqiva's multiplex C licence and Sky's DTPS licence.

7.57 Condition 11(1) of the multiplex C licence requires that Arqiva shall:

- "(a) not enter into or maintain any arrangement, or engage in any practice, which is prejudicial to fair and effective competition in the provision of licensed services or of connected services; and
- (b) comply with any code or guidance for the time being approved by Ofcom for the purpose of ensuring fair and effective competition in the provision of licensed services or of connected services; and
- (c) comply with any direction given by Ofcom to the Licensee for that purpose."

7.58 Similarly, Condition 14(1) of Sky's DTPS licence requires that Sky shall:

- "(a) not enter into or maintain any arrangement, or engage in any practice, which is prejudicial to fair and effective competition in the provision of licensed services or of connected services; and
- (b) comply with any code or guidance for the time being approved by Ofcom for the purpose of ensuring fair and effective competition in the provision of licensed services or of connected services; and
- (c) comply with any direction given by Ofcom to the Licensee for that purpose."

7.59 Given the conclusions which we reached in Section 3, we consider that implementation of the Proposal, absent wholesale supply of Core Premium channels, would involve a practice that would be prejudicial to fair and effective competition. It follows that if we: consented to the Proposal unconditionally; amended Arqiva's multiplex C licence and Sky's DTPS licence as requested by the parties; and Sky and Arqiva launched Picnic as proposed, this would result in a breach by Arqiva of the standard fair and effective competition condition in its multiplex C licence and result in a breach by Sky of the standard fair and effective condition in its DTPS licence. We note that this conclusion is consistent with the concerns expressed above by Arqiva.

7.60 In the light of this, we need to decide:

- i) whether it would be more appropriate to proceed under CA98 to address the competition concerns identified than to proceed under our sectoral competition powers; and
- ii) whether, in the light of this assessment, it is consistent with our regulatory duties for us nonetheless to consent to the Proposal unconditionally (Option 1), or consent to the Proposal subject to the imposition of additional conditions (Option 2) or not consent to the Proposal (Option 3).

## Regulatory options – section 317 CA03

- 7.61 As explained above at paragraph 2.37 and in our Second Picnic Consultation<sup>169</sup>, section 317 CA03 requires that before proceeding under our sectoral competition powers under section 316, it is necessary for us to determine whether it would be more appropriate to proceed under CA98 to address the competition concerns identified.
- 7.62 The reasons why we consider it is more appropriate to proceed under section 316 and impose a wholesale must-offer remedy in relation to Sky's Core Premium Sports channels than to proceed under CA98 are explained in our Pay TV Statement (see paragraphs 9.110 to 9.121 of that document).
- 7.63 Given that the wholesale must-offer remedy is now in place, there are two particular concerns which require additional consideration in relation to Picnic: the timing of the launch by Sky and Arqiva of any service; and the inclusion of *Sky Movies Screen 1* in the Proposal.
- 7.64 We explained in Section 3 the concerns which arise in the event that Sky launches a retail offer including *Sky Sports 1* and *Sky Movies Screen 1* significantly in advance of any competitors gaining access to those channels. The concerns specifically relate to the speed with which competition between pay TV retailers could be prejudiced in the absence of wholesale access to those channels.
- 7.65 Although *Sky Sports 1* is the subject of the wholesale must-offer remedy, we recognise that commercial agreement pursuant to that offer involves resolution of a number of different issues.
- 7.66 We also consider, given the conclusions we reach in section 7 of the Pay TV Statement that it is unlikely that an agreement for the supply of *Sky Movies Screen 1* is likely to be reached in the short term in the absence of any regulatory intervention. In those circumstances it is unlikely that action under CA98 to secure wholesale access to these channels could be taken quickly enough to remedy the prejudice to fair and effective competition that would be likely to result from an advance launch by Sky of Picnic. We therefore consider it is likely to be more appropriate to proceed under section 316.
- 7.67 Sky argued that our approach to the evaluation under s317 is undermined by our misinterpretation of the scope of section 316 – in particular because section 316 cannot be used to promote competition. These issues are addressed in Section 3 of the Pay TV Statement.

## Use of section 316 to address our competition concerns

- 7.68 In deciding whether we should address our competition concerns using our sectoral competition powers under section 316 CA03, we take into account our sectoral duties, and in particular the duty under section 3(3) CA03 to have regard to the need to act in a manner which is proportionate and targeted only at cases in which action is needed.
- 7.69 We have a bias against intervention, but this does not mean that we will fail to intervene where necessary, and in particular it may in some circumstances be

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<sup>169</sup> See paragraphs 4.14 to 4.17 of our Second Picnic Consultation.

necessary to intervene in areas where regulation does not exist. Interventions proposed must be proportionate to the problem identified. We have therefore considered the options we consulted on – notably whether it would be proportionate:

- not to use our sectoral competition powers and consent to the Proposal unconditionally (Option 1);
- to consent to the Proposal, subject to appropriate conditions concerning wholesale access to the Core Premium channels which Sky proposes to retail on DTT – *Sky Sports 1* and *Sky Movies Screen 1* (Option 2); or
- to use our sectoral competition powers not to consent to the Proposal (Option 3).

7.70 Even though we have concluded in Section 3 that implementation of the Proposal would be likely to result in harm to competition and consumers, we need to consider whether Option 1 is nevertheless the most proportionate regulatory approach because Options 2 and 3 would result in even greater harm to competition and consumers.

### Quantitative and qualitative analysis of Options 1, 2 and 3

7.71 Our conclusions draw on the quantitative analysis which forms a part of the impact assessment in our Pay TV Statement (see Section 11 and Annex 8 of that document). This quantitative analysis assesses the static effects of the wider availability of Core Premium Sports channels as a result of the wholesale must-offer remedy, taking account of the specific prices we have set. In particular, by modelling subscriber numbers for different packages with different operators, our quantitative analysis calculates:

- benefits to consumers based on retail prices and estimated willingness to pay; and
- benefits to producers based on retail prices and operators' costs.

7.72 Our analysis compares the static benefits to consumers and producers of a wholesale must-offer remedy alongside Picnic (Option 2) against the status quo of no Core Premium channels on DTT. We also compare these effects with a scenario where Sky/Picnic is the only retailer of Core Premium channels that launches on DTT (Option 1).

7.73 In our Second Picnic Consultation, we recognised that while an Option 1 approach would deliver a higher level of benefit compared to an Option 3 approach as a result of expanding the availability of Core Premium channels, this would be offset by the detrimental effect to competition in the longer term.

7.74 We adopted a simple modelling approach to represent this longer term effect on consumers. However, given the uncertainty associated with consumer outcomes in the longer term, we recognised that it is difficult, on the basis of this analysis alone, to determine definitely which of these two approaches ultimately leads to greater benefits for consumers (see paragraph 7.9 above). Given the lack of responses to this specific piece of analysis and the impossibility of quantifying longer term dynamic effects of increased innovation with any precision, we have decided not to attempt to update this analysis. Rather, we remain of the view expressed in our Second Picnic

Consultation, on the basis of the qualitative analysis of these issues set out in that document<sup>170</sup>.

- 7.75 In the following paragraphs, we first consider the impact of Option 1, then Option 3, before concluding that we should adopt Option 2, as proposed in our Second Picnic Consultation.
- 7.76 We consider that Option 1 would not be a proportionate approach and in particular that it would not be consistent with our principal duty under section 3(1)(b) CA03 to further the interests of consumers in relevant markets, where appropriate by promoting competition. This is because:
- first, we have concluded that implementation of the Proposal would be prejudicial to fair and effective competition and lead to resultant harm to consumers in the form of reduced choice of pay TV provider, higher prices or poorer quality of service, such that we cannot allow Picnic to proceed in the absence of any intervention by us;
  - second, our static quantitative analysis suggests that Option 1 would be likely to result in less consumer benefit than Option 2 because it would entail less competition<sup>171</sup>.
- 7.77 In particular, we have considered the impact on consumer benefits of Option 1 in paragraphs 11.70 to 11.72 of our Pay TV Statement. While recognising the material benefit to consumers of access to Sky's Core Premium channels on DTT, under this option, consumer choice for these channels would continue to be restricted to the two existing retailers - Sky and Virgin Media. Sky would be better able to manage competition at the retail level by ensuring that Picnic did not compete head-to-head with its own satellite offering, again restricting consumer choice with the effect of limiting potential market expansion. Finally, alternative platform owners would be restricted in their ability to offer innovative services by the lack of access to Core Premium channels.
- 7.78 While not consenting to the Proposal (Option 3) would clearly address our competition concerns highlighted at the first point in paragraph 7.76 above, we consider that it would not be a proportionate approach or consistent with our principal duty to further the interests consumers (section 3(1)(b) CA03). This is because there are immediate benefits to be had from consumers having access to Sky's Core Premium channels on DTT, including from Sky itself.
- 7.79 It would not be proportionate to ban Sky from retailing Core Premium Sports channels on DTT, and deprive consumers from receiving services from an effective retailer, when that retailer's competitors will be able to retail under our wholesale must-offer remedy. We would expect Sky/Picnic, alongside other retailers of Core Premium channels, to bring greater market expansion than those other retailers alone. A greater variety of products is likely to bring more consumers into the market, particularly if offerings from competing retailers are differentiated in some way.
- 7.80 We consider that consenting to the Proposal, subject to appropriate conditions to facilitate wholesale access to the Core Premium channels which Sky proposes to

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<sup>170</sup> See for example paragraphs 3.52 and 4.9 of our Second Picnic Consultation.

<sup>171</sup> See paragraph 11.107 of our Pay TV Statement.

retail on DTT (Option 2), effectively gains the best of both the options above for consumers: it gains the benefits of Sky retailing its Core Premium channels on DTT (inherent in Option 1), whilst addressing our competition concerns and hence ensuring fair and effective competition (which Option 3 seeks to safeguard). This is because:

- A wholesale must-offer remedy is a proportionate intervention to address our competition concerns, for the reasons set out in Section 9 of our Pay TV Statement. Those concerns are that it is unlikely any competing retailer on DTT would be able to compete effectively with Picnic, in the absence of the wholesale supply of Sky Core Premium Sports channels;
- consenting to the Proposal, subject to this condition, delivers greater benefits to consumers than consenting to the Proposal unconditionally. As noted above, we have quantified the effects of Option 2 compared to the status quo and Option 1. We believe that the market expansion effect would be substantially greater with a wholesale must-offer remedy, with 1.8 million subscribers to Sky's Core Premium channels under Option 2 versus [ X ] under Option 1<sup>172</sup>. As a result, we would expect consumer surplus to be £170 million greater over five years under Option 2 than under Option 1. Furthermore, this quantitative analysis does not take account of longer-term benefits to consumers from greater competition, such as wider choice and greater innovation.

7.81 Sky told us in its response to our Second Picnic Consultation that extreme caution must be attached to consideration of the "long term" in this sector – given the rapidly changing market circumstances, an analysis that relies heavily on calculations of future static gains and losses to consumers should be treated with extreme caution<sup>173</sup>. It also said that our reasons for preferring Option 2 to Option 1 are not well founded, as we did not undertake sufficient analysis to support our view that market outcomes would be better under Option 2 as a result of greater competition<sup>174</sup>.

7.82 We consider that these points have been addressed in our analysis in Section 11 of our Pay TV Statement, on which our comparison of Options 1 and 2 is based.

7.83 Additionally, with regard to the costs of regulation, we consider that the costs associated with the conditions of consent to the Proposal are likely to be confined to concluding wholesale arrangements with competing retailers and those costs are unlikely to be material, especially when compared with the likely consumer benefits<sup>175</sup>.

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<sup>172</sup> Our subscriber estimates combine the DTT and IPTV platforms. In early years we would expect the large majority of new customers to come through DTT, given the large installed base of Freeview households.

<sup>173</sup> Paragraphs 3.10 and 3.11 of Sky's response.

<sup>174</sup> Paragraph 3.12 of Sky's response. Sky said this observation was reinforced by the fact that in its view we had no regard to the costs associated with the regulation we proposed, and that our assessment of what would be likely to happen to existing pay TV retailers was based on assumption rather than evidence. However, Sky did not articulate what those costs might be nor their magnitude.

<sup>175</sup> See paragraphs 11.131 to 11.133 and 11.40 to 11.107 of our Pay TV Statement on the likely costs and effects on consumers of our wholesale must-offer remedy.

- 7.84 Sky also said that we failed to recognise that in practice the outcomes under Option 2 and 3 are likely to be the same, as under the conditions proposed by Ofcom, Picnic would become an unattractive investment for Sky<sup>176</sup>. Our obligation is to assess whether our consent to the Proposal would be consistent with fair and effective competition. On the basis of our impact assessment analysis, we consider that there is a significant opportunity for pay TV services on DTT in the short term, and continue to believe this is the case under conditions designed to ensure fair and effective competition<sup>177</sup>. However, it is Sky's commercial choice whether it chooses to proceed with a commercial proposition after we have given any such consent.
- 7.85 With regard to Arqiva's point that the benefit ascribed to Option 2 may be lost if the timescales for introduction are too protracted (see paragraph 7.19), the relevant periods to compare are from the date of this decision until services are launched under Option 1 or launched under Option 2. From this starting point we do not consider that there would be likely to be material delay in the delivery of the consumer benefits under Option 2 (in comparison to Option 1), given that our wholesale must-offer remedy is now in force as a result of the publication of our Pay TV Statement. Even if there was a delay of a year, the analysis which we have carried out in our Pay TV Statement indicates that Option 2 would, at the end of a five-year period, generate greater benefits than Option 1<sup>178</sup>.

#### Wholesale must-offer remedy

- 7.86 As we explain in Section 9 of our Pay TV Statement, absent Picnic, we believe that the main entry strategy for most players will be to base their offerings on a limited number of premium sports channels using the DTT capacity which is available<sup>179</sup>. A movies offering is less attractive to an entrant, since there is insufficient capacity to carry a full set of movies channels.
- 7.87 Accordingly, we have decided that our consent to the Proposal must be conditional on the implementation of the wholesale must-offer remedy set out in our Pay TV Statement, under which Core Premium Sports channels which form part of the Proposal – *Sky Sports 1* – would be made available on regulated wholesale terms to existing and prospective third party retailers of pay TV services on DTT.
- 7.88 However, that does not mean that we consider there to be an absence of competition concerns regarding premium movies content. To the contrary, we have set out such concerns in our Pay TV Statement but concluded that, in the longer term, the

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<sup>176</sup> Paragraphs 3.8 and 3.9 of Sky's response.

<sup>177</sup> Our impact assessment indicates there is a significant market opportunity on DTT: we forecast that there will be around 1.8 million premium households on DTT after five years. This is significantly larger than Picnic's subscriber target of around [ X ] million premium households. This suggests that the available market is sufficient to support more than one DTT retailer, including Sky.

<sup>178</sup> For our quantitative analysis of static effects, our modelling forecasts that there would be 1.6 million subscribers to pay TV services on DTT incorporating Sky's Core Premium channels after four years, if we consented to the Proposal subject to an effective wholesale must-offer remedy. In contrast, our modelling forecasts that if we consented to the Proposal unconditionally, Picnic would be the only retailer of Core Premium channels and would have [ X ] premium subscribers after five years. Furthermore, this analysis excludes the longer-term dynamic benefits to consumers from greater competition, such as wider choice and greater innovation.

<sup>179</sup> For this reason, the quantitative analysis in our Pay TV Statement referred to above assumes that pay TV retailers on DTT are offering premium sports bundles.

appropriate solution to our competition concerns on movies content may not be a wholesale must-offer remedy on movies channels, which is why we are consulting on a reference to the CC.

- 7.89 In the meantime, if Picnic launched, including a Core Premium Movies channel, this would be a material change to the current market conditions that form the basis of our competition assessment set out in our Pay TV Statement. This would provide Picnic with a decisive competitive advantage over other retailers on DTT (who would only have access to sports channels), because of the incremental appeal to consumers of being able to watch movies in addition to sports. We consider this issue in the remainder of this Section, together with our decision on the ancillary conditions which are required to ensure that the wholesale must-offer remedy is workable from a commercial and technical perspective.

### Potential new applications from Sky and Arqiva

- 7.90 While our decision in this Statement is confined to the Applications, our current view is that we would be unlikely to have competition concerns in respect of any future proposal from Sky and Arqiva containing Core Premium channels, provided substantively similar conditions had been brought into effect.

### **Ancillary conditions**

- 7.91 We consulted in our Second Picnic Consultation on the potential use of ancillary conditions, which focus on our intended outcome for competition and consumers by ensuring that the wholesale must-offer remedy is not easily manipulated to be ineffective, but is commercially and technically workable<sup>180</sup>. We said that such conditions may include a requirement that Picnic may not commence service until:
- i) A local simulcrypting trial involving Sky, Arqiva and one or more prospective third party retailers is carried out to the satisfaction of Ofcom, Sky and Arqiva.
  - ii) At least one third party retailer is in a position to start retailing the wholesale must-offer channels.
  - iii) A defined time period has elapsed following (i) the launch of a competing pay DTT service that includes at least one of the wholesale must-offer channels or (ii) the satisfactory completion of a local simulcrypting trial (referred to in the first bullet point above).
  - iv) Sky has achieved a specified number of wholesale DTT subscribers, defined to be subscribers of retail competitors on DTT who include at least one wholesale must-offer channel as part of their subscription<sup>181</sup>.
- 7.92 We have reached the decision that our consent to the Proposal must be subject to ancillary condition (ii) in the paragraph above, but not (i), (iii), (iv) or any other ancillary condition which further restricts Sky's ability to retail pay TV services on

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<sup>180</sup> For clarification, the potential conditions we listed in the Second Picnic Consultation were only examples. We had not in September 2008 reached a view on the full range of conditions that might be required, nor did we suggest that all the potential conditions listed would be appropriate.

<sup>181</sup> See paragraph 4.50 of our Second Picnic Consultation.

DTT. Given that we consulted on that specific proposal, we do not consider any further consultation is required before reaching our decision<sup>182</sup>.

- 7.93 A key issue for us to determine is the point at which Picnic should be permitted to launch. The least interventionist approach would be for us to permit the launch of Picnic with no conditions being required, relying entirely on the wholesale must-offer remedy set out in our Pay TV Statement to address our concerns for fair and effective competition. We do not consider that this would be an effective approach, given:
- i) that Sky may have an incentive to delay making *Sky Sports 1* available to its competitors on DTT;
  - ii) our conclusion in paragraphs 3.94 to 3.102 that if Picnic was permitted to launch without the wholesale must-offer remedy set out in our Pay TV Statement being implemented effectively, this would be likely to lead to the prejudice to fair and effective competition occurring within a relatively short timeframe;
  - iii) our conclusion in paragraphs 7.113 to 7.119 that the inclusion of *Sky Movies Screen 1* in the Proposal, incremental to *Sky Sports 1*, would be prejudicial to fair and effective competition if Sky's retail competitors could not gain wholesale access to *Sky Movies Screen 1*; and
  - iv) our conclusion in paragraphs 9.110 to 9.121 of our Pay TV Statement that it would not be appropriate to rely on our ex post powers to address our competition concerns.
- 7.94 Our key objective is for consumers to have access to Sky's Core Premium channels on DTT as soon as possible, including from Sky/Picnic, while ensuring our wholesale must-offer remedy is genuinely effective so as to promote fair and effective competition.
- 7.95 Given our competition concerns regarding the Proposal, and the likelihood that significant prejudice to fair and effective competition would be likely to materialise in a short timeframe, we consider that Picnic should only be permitted to launch when there is certainty that the wholesale must-offer remedy set out in our Pay TV Statement has been implemented effectively.
- 7.96 We consider that the signing of a wholesale supply agreement (or agreements) with at least one third party retailer of pay TV services on DTT is the only practical and sufficiently certain way of determining that competing retailers can take advantage of the wholesale must-offer remedy in practice.

#### Requirement for wholesale supply arrangements in respect of Sky's Core Premium Sports channels

- 7.97 In light of the above, we have decided that if Sky and Arqiva wish to proceed with the Proposal, Sky must already have entered into wholesale supply arrangements such

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<sup>182</sup> [ X ] told us in their letters of March this year that further consultation needs to be undertaken to fully consider all changes in the market since our Second Picnic Consultation. We consider that the market changes referred to in their letters are either outside the scope of our assessment of the Proposal, have not yet occurred and are therefore speculative, or have already been considered since September 2008 in our Third Pay TV Consultation.

that the Core Premium Sports channel it wishes to retail on DTT – *Sky Sports 1* – could be sold to consumers by at least one third party retailer of pay TV services on DTT.

- 7.98 We have decided that under these arrangements, the third party retailer must not be affiliated with Sky, otherwise the third party retailer would clearly not be incentivised to compete effectively with Sky/Picnic, and the agreement would therefore not meet our competition concerns.
- 7.99 Clearly, the wholesale supply arrangements will be made in the context of the availability of Sky's Core Premium Sports channels under our wholesale must-offer remedy and one of the terms of remedy is that the channels will only be available for retail on non-Sky platforms.
- 7.100 This addresses our requirement that the wholesale supply arrangements in respect of *Sky Sports 1* must be for retail on a DTT platform other than Sky's DTT platform.
- 7.101 The reason for this requirement is that if Picnic was permitted to launch following the conclusion of a wholesale supply agreement for retail on Sky's Picnic DTT platform, the competing retailer would be using Sky's DTT CA. In turn, this would raise concerns that Sky could become the sole provider of TPS on DTT simply as a result of its market power in the wholesale supply of Core Premium channels, given its incentive to delay access to its Core Premium channels to competing retailers using different TPS<sup>183</sup>.
- 7.102 Notwithstanding the above, if Sky concluded a wholesale agreement for the retail of a Core Premium channel (or channels) on its own DTT platform ahead of entering into a qualifying wholesale supply agreement, we would need to consider at that point the impact of the particular agreement on competition and the implications for our conditions of consent to the Proposal. This might require further public consultation.
- 7.103 We have also decided that the most proportionate approach is to leave Sky free to negotiate these wholesale supply arrangements in respect of *Sky Sports 1* with the relevant party/parties, subject only to the terms of the wholesale must-offer remedy set out in our Pay TV Statement and the requirement that the third party retailer is not affiliated with Sky<sup>184</sup>. This is because, in addition to this being the least intrusive approach, our objective is to secure the best outcome for competition and consumers by ensuring *Sky Sports 1* is available for retail on DTT by at least one competing retailer, rather than structuring commercial dealings.

#### *Possibility of a revised pay DTT proposal from Sky*

- 7.104 We recognise there is the possibility that instead of proceeding with the Proposal, Sky and Arqiva might submit new licence variation applications, with a view to Sky launching a pay TV service with a different channel line-up from Picnic.
- 7.105 If the new licence variation applications were submitted with a view to Sky retailing *Sky Sports 1* and/or *Sky Sports 2* on DTT, with or without any Core Premium Movies channels, our current view is that this would lead to prejudice to fair and effective

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<sup>183</sup> We address the issue of TPS in Section 5.

<sup>184</sup> It should be noted that a failure to agree terms could be brought to us as a complaint, as set out in Section 10 of our Pay TV Statement.

competition unless Sky had entered into wholesale arrangements such that *Sky Sports 1* and/or *Sky Sports 2* (as appropriate) could be sold to subscribers by at least one third party retailer of pay TV services on DTT not affiliated with Sky, on a DTT platform other than Sky's DTT platform. The reasons for this requirement are the same as those given above in respect of the Proposal.

7.106 Again, the parties would be free to negotiate the wholesale terms of supply, subject only to the terms of our wholesale must-offer remedy.

### Requirement for wholesale supply arrangements in respect of Sky's Core Premium Movies channels

#### *Our wholesale must-offer remedy*

7.107 In our Second Picnic Consultation and in our Second and Third Pay TV Consultations, we consulted on a wholesale must-offer remedy covering all of Sky's Core Premium channels.

7.108 In our Pay TV Statement, we have concluded that it is not appropriate to include Sky's Core Premium Movies channels in our wholesale must-offer remedy (paragraphs 9.153 to 9.172). Our concern about restricted distribution does extend to Sky's Core Premium Movies channels, but the importance of linear movies channels appears to be gradually declining over time, as illustrated by the apparent lack of demand for them in responses to our consultation.

7.109 Subscription video-on-demand services in the first pay TV window seem to present a more compelling long-term proposition, particularly as IPTV comes of age.

- 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.
- IPTV is reinforced by large-scale investments in superfast broadband. However, such investment only makes sense if it is possible to develop the sorts of services that can exploit IPTV's capabilities.
- Such services focus on content; movies content is important for VoD services generally, and the SVoD movies rights are among the most important sets of VoD rights.

7.110 A linear channel wholesale must-offer remedy would therefore be a solution to yesterday's problem. However, addressing tomorrow's problem by considering competition in SVoD services may require remedies that are beyond Ofcom's powers. Our proposition is therefore that we should make a market investigation reference to the CC for further consideration of the issue; this is set out in a separate document.

7.111 As we explain at paragraph 9.171 of our Pay TV Statement, it would still be a possibility to put in place a wholesale must-offer remedy in respect of Sky's Core Premium Movies channels now, until any reference to the CC played out. The CC's process could take some time to conclude, meaning that the situation would continue to be inconsistent with fair and effective competition in the meantime.

7.112 On balance we have come to the view that it would not be appropriate to put in place a transitional wholesale must-offer remedy across all platforms.

- On satellite Sky is already retailing all of its Core Premium Movies channels. Freesat is not currently in a position to offer a pay TV service, [ X ].
- On cable, Virgin Media already has wholesale access to Sky's movies channels.
- Over the likely timeline of a CC process, IPTV platforms appear to be less well suited to carrying a full suite of movies channels.
- DTT is the technology over which it is most likely that in the next two or so years retailers could take advantage of a wholesale must-offer remedy, given the large installed base of TV aerials and homes relying solely on DTT for multichannel viewing, and as demonstrated by the rapid take-up of Freeview and Sky and Arqiva's proposal to launch a pay TV service on DTT. However, we do not see substantial evidence of actual demand from operators for linear movies channels, particularly in the short term.

#### *Competition concerns in respect of Core Premium Movies channels*

- 7.113 We consider for the following reasons, that the launch of Picnic (or any other pay TV service under which Sky included its Core Premium Movies channels together with its Core Premium Sports channels), would provide it with a decisive competitive advantage over its retail competitors, and that this would constitute a material change to the current market conditions that form the basis of our competition assessment in our Pay TV Statement.
- 7.114 As explained at paragraph 3.40, it is DTT, in the short term, which provides the best opportunity for scale entry at the retail level. Looking at the example of BT Vision, even IPTV providers are likely to launch hybrid offerings (i.e. including DTT functionality) to facilitate migration from traditional broadcast to new technologies.
- 7.115 Of the roughly ten million DTT-only homes, there is a large base of potential pay TV subscribers who currently do not subscribe to any pay TV services<sup>185</sup>. It follows that there are potential first mover advantages to be had from signing up these consumers to pay TV services on DTT.
- 7.116 As we explained at paragraphs 3.48, we consider that Picnic would be likely to have greater appeal to consumers than a competing service which included *Sky Sports 1* but not *Sky Movies Screen 1*. In particular, the ability to offer both types of content in a bundle confers an additional advantage over standalone provision, and Sky's market power in the wholesale supply of Core Premium Movies channels means that competitors are unable to replicate these channels. This is particularly the case if standalone provision requires purchasing each type of content on different platforms which may require two different set-top boxes. Even if standalone provision is available on the same platform, bundling is advantageous because a consumer who would not be willing to pay the standalone price for one service may be willing to pay the bundled price<sup>186</sup>. In this context, Sky informed us that its reason for launching

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<sup>185</sup> In this context, we note that Freeview carried out a consumer survey in November 2007, in which it found that 22% of Freeview users would definitely or probably consider paying either a monthly or one-off fee to access more channels/programmes in addition to Freeview's channels.

<sup>186</sup> For example, suppose two providers on the same platform offered identical sports-only packages for £20, but one also offered a Sports and Movies package for £25. Consumers with no interest in movies would be indifferent between the two offers, and would buy one or other of the packages if they valued it at £20 or more. However, any consumers who valued the movies package at £5 or

Picnic with the proposed channel line-up was that a *Sky Sports 1* and *Sky Movies Screen 1* offering would have a broader appeal to consumers than a sports-only offering<sup>187</sup>.

7.117 Accordingly, consumers would be likely to choose the Sky offering over services from Sky's retail competitors if the latter did not have access to the Core Premium Movies channel(s) which Sky proposed to retail on DTT, given that [ X ]. Furthermore, as we note at paragraph 3.44, encouraging those consumers to switch to another pay TV service on DTT could be difficult after they have purchased a DTT set-top box that was compatible with Sky's service<sup>188</sup>.

7.118 In light of the above and our conclusions at Section 3, we conclude that the Proposal would be likely to lead to the foreclosure of Sky's retail competitors on DTT in a short timeframe even with our wholesale must-offer remedy in place.

7.119 Therefore, we conclude that consenting to the Proposal would result in a breach by Arqiva of the standard fair and effective competition condition in its multiplex C licence and result in a breach by Sky of the standard fair and effective condition in its DTSPS licence that could not be addressed by our wholesale must-offer remedy.

*Wholesale supply arrangements in respect of Sky Movies Screen 1 as a condition of consent to the Proposal*

7.120 Given that the wholesale must-offer remedy set out in our Pay TV Statement relates only to Core Premium Sports channels, we have therefore considered whether any further requirements are necessary in respect of *Sky Movies Screen 1* – the Core Premium Movies channel which Sky wishes to retail on DTT – as a condition of the launch of Picnic.

7.121 If we consented to the Proposal subject to wholesale supply arrangements being in place in respect of *Sky Sports 1* only, there would be a risk that Sky would have an incentive to delay wholesale access to *Sky Movies Screen 1*.

7.122 For this reason, we have reached the decision that if Sky wishes to proceed with the Proposal, it must already have entered into wholesale supply arrangements such that the Core Premium Movies channel it wishes to retail on DTT – *Sky Movies Screen 1* – could be sold to consumers by at least one third party retailer of pay TV services on DTT that has already entered into an agreement with Sky for the wholesale supply of *Sky Sports 1*.

7.123 The reason for requiring that Picnic may only launch when one and the same competing retailer is in a position to start retailing *Sky Sports 1* and *Sky Movies Screen 1* is because:

- As we explain in Section 7 of our Pay TV Statement, there is clear demand for wholesale access to Sky's Core Premium Sports channels on DTT from competing retailers of pay TV services.

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more would only consider the bundled package, and would buy it if their valuation of sports plus movies was higher than £25.

<sup>187</sup> Paragraph 9.165 of our Pay TV Statement.

<sup>188</sup> [ X ]

- Yet, Sky/Picnic would have a decisive competitive advantage that would be likely to lead to a material adverse effect on fair and effective competition if those competitors did not also have access to the Core Premium Movies channel(s) which Sky proposed to retail on DTT – *Sky Movies Screen 1* in the case of Picnic.

7.124 We are aware that our requirement for Sky to have entered into such wholesale supply arrangements might have an impact on Sky's incentive to launch a pay TV movies channel on DTT. However, we consider that any such impact would be outweighed by our need to ensure fair and effective competition.

7.125 We are also aware that in the future, Sky may increasingly look to offer movies content via SVoD. However, we note that consumer adoption of such services may take some time. Accordingly, in the short-term it is likely that a large proportion of pay TV consumers will continue to view movies content via linear television channels<sup>189</sup>.

#### *Wholesale pricing*

7.126 We have considered whether these wholesale supply arrangements in respect of *Sky Movies Screen 1* should be subject to any wholesale pricing conditions.

7.127 Our analysis of wholesale pricing, as set out in Section 10 of our Pay TV Statement, suggests that the current cable rate-card price would not be commercially viable for competing retailers of pay TV services, particularly those on DTT where channel packages are likely to be smaller and retail prices are likely to be lower.

7.128 However, given that we have decided that Picnic will only be permitted to launch when Sky has entered into wholesale supply arrangements in respect of *Sky Movies Screen 1*, if Sky wishes to launch Picnic, it will have commercial incentives to agree wholesale prices which are acceptable to the relevant third party retailer(s).

7.129 In light of the fact that Picnic would be markedly different from the current cable offerings in terms of range of movies channels and retail price<sup>190</sup>, we consider that a commercial approach to pricing, rather than a regulatory intervention, to be more appropriate as well as more proportionate, to the benefit of consumers.

#### *Ofcom review of reasons for failure to reach agreement on supply of Sky Movies Screen 1*

7.130 Notwithstanding our competition concerns in respect of *Sky Movies Screen 1*, we recognise that, given the evidence on demand among Sky's retail competitors for Sky's Core Premium Movies channels (which contrasts with our evidence on demand for Sky's Core Premium Sports channels) there is a possibility that no third party retailer of pay TV services on DTT will seek to obtain wholesale access to the channel.

7.131 Furthermore, even if certain retailers did have an interest in retailing the channel, they would have greater incentives not to seek wholesale access if the benefits of

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<sup>189</sup> We are consulting on whether we should make a reference to the Competition Commission under the Enterprise Act 2002 in respect of movies content provided via SVoD and linear movies channels.

<sup>190</sup> The current cable rate-card has 'Single Movies' and 'Dual Movies' wholesale products, but even in the case of 'Single Movies' this is a wholesale package of five channels. This contrasts with sports where the cable rate-card 'Single Sports' wholesale product is a single sports channel (Sky Sports 1 or Sky Sports 2).

preventing Picnic from launching as proposed outweighed the benefits of launching a competing pay TV service on DTT which incorporated *Sky Movies Screen 1*.

7.132 In the light of these risks and the consumer benefits of Sky's Core Premium channels becoming available on DTT as soon as possible, we would review our conclusions on the effect of a launch of *Sky Movies Screen 1* on fair and effective competition if:

- an agreement had not been entered into for the wholesale supply of *Sky Movies Screen 1*; but
- if Sky was able to provide clear evidence that (i) no prospective third party retailer of *Sky Movies Screen 1* had sought wholesale access to the channel or (ii) due to the actions or inactions of the relevant third party retailer, commercial negotiations had stalled and showed no reasonable prospect of leading to a signed commercial agreement.

#### *Possibility of a revised pay DTT proposal from Sky*

7.133 As we explain at paragraph 2.7, we recognise there is the possibility that instead of proceeding with the Proposal, Sky and Arqiva might submit new licence variation applications, with a view to Sky launching a pay TV service with a different channel line-up from Picnic.

7.134 If the new licence variation applications were submitted with a view to Sky retailing on DTT one or more Core Premium Movies channels together with *Sky Sports 1* and/or *Sky Sports 2*, our current view is that this would lead to prejudice to fair and effective competition unless Sky had entered into wholesale arrangements such that the relevant Core Premium Movies channel(s) and *Sky Sports 1* and/or *Sky Sports 2* (as appropriate) could be sold to subscribers by at least one third party retailer of pay TV services on DTT not affiliated with Sky, on a DTT platform other than Sky's DTT platform. The reasons for this requirement are the same as those given in this Section in respect of the Proposal.

7.135 As with regard to the Proposal, the parties would be free to negotiate the wholesale terms of supply, subject only to the terms of our wholesale must-offer remedy in respect of *Sky Sports 1* and/or *Sky Sports 2* (as appropriate).

#### Simulcrypt

7.136 In our Second Picnic Consultation, we consulted on the use of simulcrypt, under which other retailers of pay TV services on DTT, using different CA systems, could access Sky's premium sports and movies channels without needing to transmit the same channels more than once, subject to suitable security requirements.

7.137 It is important to understand that in that document we did not have concerns about access to DTT capacity *per se*. For example, we were not suggesting that any organisation may have market power in the supply of DTT capacity.

7.138 We have now decided that it is inappropriate to place a simulcrypt obligation on Sky but not on other retailers of pay TV services, given that under the wholesale must-offer remedy set out in our Pay TV Statement they can gain wholesale access to Sky's Core Premium Sports channels and secure separate access to DTT capacity, of which there is greater availability than in September 2008, when we published our Second Picnic Consultation.

- 7.139 We consider that reciprocity between Sky and other retailers of pay TV services is important for the promotion of fair and effective competition, meaning that it would be disproportionate to place an obligation only on Sky.
- 7.140 However, given that DTT is a limited resource, we would expect that the efficient outcome under normal market conditions would be a simulcrypt solution. In the light of our duty under section 3(2) CA03 to ensure optimal use of spectrum, we would be keen to understand the reasons behind any failure of the parties concerned to reach such a solution in the context of the standard conditions concerning fair and effective competition in the licences held by Arqiva and Sky.

#### Conditions to address Sky's advantages as a retailer

- 7.141 We have decided that our consent to the Proposal shall not be subject to any requirements which go beyond ensuring our wholesale must-offer remedy, as set out in our Pay TV Statement, is in place and with evidence that it has been implemented effectively. This is because, firstly, we are required to ensure that interventions proposed are proportionate to the competition problem we have identified regarding access to premium content. Secondly, we have decided that Sky's advantages as a retailer of pay TV services do not merit ex ante regulation. Accordingly, we have decided that Sky and Arqiva will not be subject to any conditions which seek to address Sky's advantages as a retailer of pay TV services.
- 7.142 Specifically, this means that of the potential ancillary conditions which we listed at paragraph 4.50 of our Second Picnic Consultation, we have decided that our consent to the Proposal, or any other Sky pay TV proposition on DTT including Core Premium channels, should not be subject to:
- example (iii) – a defined time period having elapsed following (i) the launch of a competing pay DTT service that includes at least one of the wholesale must-offer channels or (ii) the satisfactory completion of a local simulcrypting trial; or
  - example (iv) – Sky having achieved a specified number of wholesale DTT subscribers, defined to be subscribers of retail competitors on DTT who include at least one wholesale must-offer channel as part of their subscription.
- 7.143 With regard to the point made by Top Up TV and BT Vision that any consent to Picnic should be subject to a condition requiring accounting separation, we consider this would be a disproportionate and overly intrusive measure given the regulatory burden and financial cost this would impose on Sky. We would expect Sky to be able to demonstrate that Picnic was profitable on the basis of the relevant wholesale charges, without a requirement for accounting separation.

#### Other ancillary conditions

- 7.144 With regard to the specific point by [ X ] that Sky's competitors should be permitted to also have access to Disney and Discovery on DTT and that Sky should be prohibited from securing exclusivity in the carriage of these channels on DTT (paragraph 7.44), these are not conditions that would be proportionate or appropriate for us to require. This is because there is no suggestion that Sky has market power in the wholesale supply of these channels.

## Next steps following Ofcom's decision

- 7.145 If Sky and Arqiva wish to proceed with the Proposal, or a different pay TV proposition on DTT that includes Core Premium channels, a number of steps must be taken. We may not need to consult publicly on any of these steps.
- 7.146 First, Sky will need to enter into appropriate wholesale supply arrangements, as explained above. When the arrangements had been entered into, we would need to review them to assess whether they met our requirements set out at paragraphs 7.97 to 7.103 and 7.122.
- 7.147 Second, pursuant to Condition 17 of Arqiva's multiplex C licence, we must be satisfied, before consenting to a variation to the core proposals, that the capacity of the programmes broadcast by Arqiva to appeal to a variety of "tastes and interests" is not unacceptably diminished. Accordingly, at the same time as reviewing the relevant wholesale supply arrangements, we would assess the Arqiva Application, or any new licence variation request from Arqiva (as appropriate) to determine whether it satisfied the tastes and interests test.
- 7.148 Third, pursuant to Condition 11(8) of Arqiva's multiplex C licence, Arqiva must obtain our consent to changes to the carriage agreement between itself and Sky that are required to implement the Proposal or any other pay DTT proposition from Sky. If Sky and Arqiva wish to proceed with the Proposal or any other pay DTT proposition from Sky, Arqiva should revert to us with a draft of the carriage agreement for approval.
- 7.149 We would vary the description of the "core proposals" in Arqiva's multiplex C licence to reflect the change in the identity of the Sky channels that will be broadcast when these steps had been carried out, provided:
- the relevant wholesale supply arrangements met our requirements;
  - the Arqiva Application or any new Arqiva application (as appropriate) satisfied the tastes and interests test; and
  - we consented to the changes to the carriage agreement.
- 7.150 Additionally, as we noted at paragraph 3.9 of our First Picnic Consultation, Condition 11(11) of the multiplex C licence provides that Arqiva shall not, without our prior consent, enter into any agreements which would result in more than three digital television programme services being provided by Sky on multiplex C. If Sky wishes to proceed with the Proposal or a different pay TV proposition on DTT, we would ensure that the implementation of our decision in this Statement and our approach to Condition 11(11) were consistent. In certain circumstances this may mean that we would be willing, in principle, to consider relaxing the restriction to three digital television programmes. Whether we would do so in practice would depend on our assessment of the specific proposal we received.
- 7.151 Sky's DTSPS licence would then be amended to reflect these changes.

## Annex 1

## Glossary

<b>Arqiva</b> <sup>191</sup>	A company that operates the terrestrial TV transmission network in the UK and is licensed to operate two of the digital terrestrial multiplexes.
British Sky Broadcasting Group plc (" <b>Sky</b> ")	Operator of the primary digital satellite platform in the UK and retailer of the 'Sky' pay television service.
BT Vision	A video-on-demand service offered by BT to BT broadband customers. Services are delivered using both the digital terrestrial TV platform and BT telephone lines.
conditional access (" <b>CA</b> ")	Scrambling and encryption technologies that allow a broadcaster to restrict reception of its digital channels to consumers who have been authorised to view them. Typically used by pay TV operators to protect subscription and pay per view revenues.
digital cable (" <b>cable</b> ")	A television distribution network based on optical fibre and coaxial cable technology. The main provider in the UK is Virgin Media.
Communications Act 2003 (" <b>CA03</b> ")	The parliamentary act that sets out, amongst other things, Ofcom's duties and powers.
Competition Act 1998 (" <b>CA98</b> ")	The parliamentary act that provides an updated framework for identifying and dealing with restrictive business practices and abuse of a dominant market position.
conditional access module (" <b>CAM</b> ")	A device inserted into a set-top box or integrated digital TV which allows digital services protected with different conditional access technologies to be displayed.
digital switchover (" <b>DSO</b> ")	The process in the UK by which analogue terrestrial television services will cease on a region by region basis between 2008 and 2012.
Digital Television Programme Service (" <b>DTPS</b> ") Licence	A licence issued by Ofcom to all broadcasters of digital television channels on the UK digital terrestrial TV platform.
digital video recorder (" <b>DVR</b> ")	A device for recording digital television broadcasts, typically using a computer hard disk with a set-top box. Also known as a personal video recorder (PVR) and digital television recorder (DTR).
Digital Television Services Limited (" <b>DTVSL</b> ")	The consortium that owns and markets the Freeview brand on the digital terrestrial TV platform. Jointly owned by Arqiva, Sky, BBC, ITV and Channel 4.

<sup>191</sup> Defined terms used in this consultation are shown in bold type.

digital terrestrial television ("DTT")	The digital television distribution network based on terrestrial transmitter towers
Digital Video Broadcasting ("DVB")	The standards development body that has produced many of the specifications used on satellite, cable and terrestrial platforms, including transmission and conditional access technologies.
DVB-T	The DVB transmission technology standard that forms the basis of the digital terrestrial television platform. The DVB-T standard has been in use in the UK since 1997. An improved standard (DVB-T2) has also been developed.
electronic programme guide ("EPG")	An on-screen guide to scheduled broadcast television programmes, allowing a viewer to navigate and select content by time, title, channel and genre.
"FRND"	Fair, reasonable and non-discriminatory
Football Association Premier League (" <b>Premier League</b> ")	The body which is responsible for licensing the television rights for the English Premier Football league.
the " <b>Four Parties</b> "	Collectively, BT Vision, Setanta, Top Up TV and Virgin Media.
free to air (" <b>FTA</b> ")	The transmission of digital television (and radio) services without conditional access.
Freeview	The brand used to promote the free to air services available on the digital terrestrial television platform.
high definition (" <b>HD</b> ")	A television picture format that has higher picture resolution than standard definition (SD) services.
integrated digital television (" <b>IDTV</b> ")	A television set which has a built in digital tuner and receiver (typically for reception of digital terrestrial TV). IDTVs remove the need for an external set-top box.
internet protocol television (" <b>IPTV</b> ")	Delivery of television content using the internet protocol used for transferring data over the internet and private IT networks. IPTV is often used to refer to services delivered across the public internet as well as "walled garden" services provided over broadband connections, such as BT Vision.
MPEG-2	The digital technology used to compress the video component of the majority of digital television services in the UK. MPEG2 has been in use for over 10 years.
MPEG-4 H264/AVC (" <b>MPEG-4</b> ")	A relatively new digital compression technology which is more efficient than MPEG2.
multiplex	The combination of a number of digital television and radio

	services into a single datastream in order that they can be transmitted on a network. The DTT platform currently consists of 6 multiplexes.
Nagra France (" <b>Nagra</b> ")	A company which is part of the Kudelski group and operates in the business areas of digital TV, public access and audio products.
Nagra CA	The conditional access (CA) technology provided by Nagra and currently used in the UK by Top Up TV and BT Vision on the digital terrestrial television (DTT) platform.
NDS Group plc (" <b>NDS</b> ")	A technology company that provides the conditional access (CA) technology used by Sky on its satellite service.
public service broadcaster (" <b>PSB</b> ")	The four PSBs in the UK include: BBC, ITV, Channel 4 and Five.
satellite	The digital television distribution network based on satellite transmission.
Setanta Sport Holdings Limited (" <b>Setanta</b> ")	A former provider of pay TV sports channels on all the major digital TV platforms in the UK, which went into administration in June 2009.
set-top box	A digital television receiver that is connected to a television display. A set-top box may also include DVR capabilities.
simulcrypt	A technology that allows a single broadcast channel to be used with two or more conditional access systems.
technical platform services (" <b>TPS</b> ")	The provision by digital television platform operators of various technical services (including CA and EPG listing services) on a wholesale basis to broadcasters. Provision of some TPS may be regulated.
Tiscali / Talk Talk TV (" <b>Tiscali</b> ")	An IPTV provider which provides linear and on-demand TV services via BT telephone lines, now known as Talk Talk TV.
Top Up TV (" <b>Top Up TV</b> ")	A provider of pay TV services on the digital terrestrial TV platform.