



**Response of BT to
Ofcom's Review of Sky's Access Control Regulation**

19 September 2014

1. EXECUTIVE SUMMARY

- 1.1. British Telecommunications plc ("BT") agrees with Ofcom's conclusion that there is established demand for AC services to provide content linked to broadcast channels, particularly for enhanced TV services. There are no viable alternatives to allow broadcasters to provide these services if access to Sky's AC services is not available.
- 1.2. While BT accepts that demand today arises for a specific set of enhanced TV services, in light of Sky's development of new set-top boxes that will offer new functionality, it is to be expected that demand for additional/alternative enhanced TV services will grow (particularly in connection with the use of Sky's Ethernet ports for the delivery of enhanced TV content). Therefore, BT believes it is important that the regulatory regime for AC services is capable of taking account of and supporting such imminent future developments.
- 1.3. Given the absolute and relative scale of Sky's satellite platform, it remains the key means of delivering pay TV services in the UK. As such, access to Sky's 10.7 million satellite subscribers is critical for BT Sport. Therefore, the ability to use Sky's AC services to ensure that BT can bid for and exploit important sports rights, as well as ensure the quality of its sports channels, is essential.
- 1.4. In light of the scale bottleneck that is the Sky platform, Sky's gateway control of AC services gives Sky the ability to restrict and distort competition. Ofcom correctly identifies that Sky's vertical integration and market position in pay TV creates a concern about ensuring access to AC services, among other things.
- 1.5. As is explained in the body of this response, an accurate assessment of Sky's proposed commitments confirms that they would not prevent Sky from obtaining an unfair competitive advantage by restricting access to the functionality of its set-top boxes or by only providing such access on terms that are unfair, unreasonable and/or discriminatory.
- 1.6. One of the principal deficiencies with the commitments is that their scope is limited as they do not cover new enhanced TV services over Sky's future generation boxes. The commitments confirm that Sky's future generation boxes will have a different middleware – this will undoubtedly offer more advanced functionality which will be capable of supporting new enhanced TV services. Yet, under the commitments, Sky would be free itself to use this more advanced functionality to develop new enhanced TV services whilst foreclosing third parties from comparable development. As is noted in this response, Sky's own submissions to Ofcom confirm that it is reluctant to grant third parties access to its new functionality. The resulting disparity between Sky's retail services on its platform and those of its competitors would quickly give rise to a material impediment to fair and effective competition.
- 1.7. Ofcom claims that a benefit of Sky's proposed commitments is that, under them, Sky would fix certain AC charges. However, for the reasons explained below, this proposal is not beneficial to third parties and the net fixing of charges is likely to be illusory. This is because, among other things, this proposal would not prevent Sky from shifting fixed cost recovery from AC charges to other TPS charges – thereby ensuring that users of other TPS make up any potential shortfall.
- 1.8. In practice, the commitments would not provide certainty as to the terms (if any) on which broadcasters could gain access to Sky's AC services. Under the commitments, Sky would not only have substantial latitude as to the initial terms it specifies for its AC services, it would

also have significant scope to modify those terms in future. In addition, even though Sky commits to the introduction of 'reasonable' terms, it would be down to Sky itself (and not an independent, impartial regulator) to determine what is 'reasonable' in any situation under the commitments.

- 1.9. It is notable in this context that Ofcom acknowledges that (i) in the absence of regulation, Sky may vary its terms to reflect its own commercial incentives and (ii) Sky's incentives may lead to access not being available or only on disadvantageous terms. In the circumstances, it would not be appropriate for Ofcom to usher in a situation in which all decisions as to whether, and if so on what terms, Sky would give third parties access to its AC services were left to be determined by Sky. But that is precisely the situation that would arise if Ofcom were to accept Sky's proposed commitments in lieu of new access conditions.
- 1.10. Ofcom's assessment of Sky's proposed commitments also glosses over the fundamental shortcoming that the commitments are not actually enforceable. Ofcom's sole observation on this issue is that Sky claims that it would suffer reputational damage if it failed to comply with its commitments. Yet, if Sky were to adopt such a course, it would be a very carefully orchestrated action on Sky's part and Sky's rationale would be fully explained to its shareholders, potential investors and others. In such a situation, it would suffer no reputational damage as a result of departing from its commitments.
- 1.11. Furthermore, it is not correct to think of this issue in binary terms – i.e. that Sky either complies with its commitments or it doesn't. There are many 'grey areas' where the interpretation of the commitments would be down to Sky. Therefore, Sky would not have to renege on its commitments in order to impede fair and effective competition – it could achieve this end merely through the way it chooses to interpret its commitments. If Ofcom were to accept Sky's proposed commitments in lieu of new access conditions, Ofcom would have left itself impotent in such a situation.
- 1.12. These, and other, very material shortcomings with the commitments would not arise if Ofcom were to adopt new access conditions. For example, under the new access conditions Sky would be obliged to offer AC services on FRND terms for the development of new (and current) enhanced TV services over Sky's future generation (and current) set-top boxes.
- 1.13. Under the new access conditions, whilst Sky's charges for AC services would not be fixed, they would have to be FRND, hence reflecting the actual cost of providing these services. Thus, in circumstances where demand for AC services were to rise (which seems likely with the possibility of new services in future) or Sky's box costs were to fall (which should be the case at present in respect of Sky's current boxes), AC charges would also fall.
- 1.14. Self-evidently, a very material difference between Sky's proposed commitments and the new access conditions is that the former would not be legally binding whereas the latter could be enforced by Ofcom. In addition, the interpretation of the new access conditions in the event of a dispute between Sky and a third party would be a matter for Ofcom. For example, under the new access conditions, Sky's terms for AC services would have to be FRND and it would be for Ofcom, not Sky, to determine whether any particular terms complied with this requirement. Thus Sky could not interpret the new access conditions in a way that was intended to favour its own commercial incentives (identified by Ofcom in the Consultation Document) and thereby restrict or preclude access for third parties.

- 1.15. For the reasons outlined in the body of this response, BT agrees with Ofcom's statements that the new access conditions would not deter Sky from investing and innovating and would not produce adverse effects for Sky.
- 1.16. Ofcom suggests in the Consultation Document that the decision whether to accept Sky's proposed commitments or impose new access conditions is 'finely balanced'. This suggestion is based on an erroneous comparison between the commitments and the new access conditions. As is noted above (and in detail in the body of this response), Ofcom has overstated the benefits of the commitments whilst ignoring certain benefits of the new access conditions and understating the risks associated with the commitments. Once those errors are corrected, it is clear that there is an overwhelming case for imposing new access conditions.
- 1.17. For example, Ofcom's assessment does not have due regard to the fact that new enhanced TV services over Sky's future generation boxes would be covered by the new access conditions but would be excluded from Sky's proposed commitments. In addition, Ofcom does not have due regard to the fact that the terms, if any, on which Sky would provide access to AC services under the commitments are uncertain. Furthermore, as noted above, Ofcom has no basis for assuming that Sky will comply with its unenforceable commitments or that Sky will refrain from interpreting them in a way that is adverse to fair and effective competition.
- 1.18. In light of these issues, Ofcom is not correct when it suggests that the commitments seem to address the concerns of BT and other stakeholders. In practice, it is clear that the commitments would not prevent Sky from obtaining an unfair competitive advantage by restricting access to its AC services or by only providing such access on terms that are unfair, unreasonable and/or discriminatory. In the circumstances, the new access conditions are not only necessary to prevent such an adverse effect on competition and consumers, they are also manifestly proportionate.
- 1.19. There may be questions around the specific application of the new access conditions in the context of new enhanced TV services delivered over Sky's platform in the future since, by definition the nature and scope of such services are unknown today. However, any uncertainty over the application of the new access conditions to such developments would provide an opportunity for obfuscation and delay by Sky. It may also lead to significant involvement by Ofcom in helping resolve such issues if a broadcaster is left with no choice but to refer a dispute, or submit a compliance complaint, to Ofcom.
- 1.20. In order to streamline this process, BT believes that an appropriate and proportionate framework for requesting the provision of AC Services (as defined under the new access conditions) would provide an opportunity for questions relating to the scope and application of the new access conditions to be clarified and resolved more swiftly and efficiently. The objective of such a framework would be to avoid a situation in which the immediate recourse was to the dispute or complaints process and, as such, would be in the interests of all parties. BT sets out the key requirements of such a framework in this submission, consistent with the principles that apply to Openreach's network access requirements.

2. DEMAND FOR INTERACTIVE SERVICES

Overview

- 2.1. BT agrees with Ofcom's conclusion that there is proven demand for AC services to provide content linked to a broadcast channel, particularly for enhanced TV services.¹ There are no viable alternatives to allow broadcasters to provide these services if access to Sky's AC services is not available.
- 2.2. While BT accepts that demand today arises for a specific set of enhanced TV services (in BT's case alternative video streams for clash management, commercial watermarking [X]), in light of Sky's plans to develop new boxes that will offer new functionality it is to be expected that demand for additional/alternative enhanced TV services will grow, particularly when AC services (or their equivalent) enable enhanced TV content to be delivered via the Ethernet port. It is not possible today, given the asymmetry of information regarding Sky's set-top box development plans, for BT to determine exactly the kinds of new enhanced and interactive TV services that it would be able to, and therefore want to, develop and deliver in the future and what types of AC services would need to be accessed in order to undertake that development and delivery. However, it is clear that, unless BT is able to deliver equivalent enhanced TV services on its BT Sport channels to those offered by Sky on Sky Sports, there is a significant risk that BT would be placed at a (further) material competitive disadvantage compared to Sky - both in relation to being able to attract customers and when bidding for sports rights.
- 2.3. Therefore, BT believes it is important that the regulatory regime for AC services is capable of recognising this future demand for enhanced TV services that have not yet been developed, and the need for all enhanced TV services (both existing and new) to be delivered on future generations of Sky's set-top boxes.

Sky's platform remains critical for delivering access control services

The importance of the Sky platform

- 2.4. Sky's digital satellite platform remains an essential means of delivering multi-channel TV services and pay TV services given its overall scale. Sky now has 10.7 million subscribers,² which equates to two-thirds of total UK retail pay TV subscribers.³ Therefore, two-thirds of UK pay TV subscribers use Sky set-top boxes as their primary (and often only) means of accessing pay TV services. Given both the absolute and relative scale of the Sky platform, access to these subscribers is critical for any pay TV provider seeking to build scale to recover the fixed costs associated with investment in pay TV channels.
- 2.5. Sky's platform is in particular a critical gateway to accessing premium pay TV subscribers, since it has the highest concentration of both premium sports and premium movies

¹ AC Consultation Document, paragraph 3.80.

² Sky's Annual Report, 2013/14, includes subscribers in the UK and the Republic of Ireland.

³ AC Consultation Document, paragraph 2.7.

subscribers.⁴ It is notable that Sky has been able to launch a successful, profitable premium sports service without making its sports channels available across all pay TV platforms ie it clearly has not needed access to all third party platforms in order to profitably recover its fixed costs of channel investment. In contrast, all third party providers of premium sports channels (BT Sport, ESPN and before it Setanta) have used Sky's platform for delivery of their respective channels immediately from launch. This is unsurprising given the high fixed costs associated with the acquisition of premium sports rights – since the highest concentration of subscribers with the highest propensity to pay for premium sports channels is present on the Sky platform, launching a successful premium sports channel in practice requires access to Sky's subscriber base. Indeed, [3<] of BT's BT Sport customers access the channels via the Sky platform. Without access to these subscribers, the underlying channel economics for the BT Sport business would be materially undermined.

Access to AC services on the Sky platform is essential

- 2.6. BT agrees with Ofcom's assessment that enhanced TV services "*supplement and augment*"⁵ the underlying linear channel, that they "*could influence viewers' perceptions of the quality of a channel*" and that they form "*an integral part of the viewer experience*". If BT is unable to offer the same or similar functionality (or indeed potentially distinct functionality⁶) and richness of consumer experience on its BT Sport channels as that offered by Sky on its sports channels, there is no doubt that BT's channels will be perceived as a lower quality service by potential subscribers, all other things being equal.
- 2.7. This perception is likely to impact take up of BT Sport, further limiting BT's ability to build a retail subscriber base of premium sports subscribers with a strong willingness to pay for sports content. Any impact on BT's ability to build its subscriber base will further exacerbate the barriers to acquiring premium sports rights that Ofcom identified in its pay TV Statement in 2010.⁷
- 2.8. Moreover, as BT explained in its response to Ofcom's Review of Sky's Access Control Services Regulation dated 18 September 2013 (the "Response to the 2013 Consultation"), if FRND access to Sky's 'red button' functionality is not assured BT will be placed at a direct disadvantage when bidding for sports rights due to the fact that:
 - (i) certain sports such as golf, tennis and cricket tend to be extended events, which will tie up one or more channels for many hours, often over several days. As a result of their nature and scheduling such sports are likely to generate substantial fixture

⁴ BT estimates that approximately half of Sky's pay TV subscribers, i.e. approximately 5 million subscribers, take Sky's premium sports channels.

⁵ AC Consultation Document, paragraph 7.14.

⁶ BT may wish to offer AC services on its channels that Sky has not already developed.

⁷ See Appendix I and II to the Compass Lexecon paper titled "*Modelling dynamic competition in the retail CPSC market: indirect monetisation*" submitted to Ofcom on 27 December 2013 in Case CW/01106/05/13 - Complaint to Ofcom by BT regarding Sky's abuse of dominance.

clashes.⁸ If BT lacks the ability to broadcast these rights in full, or if broadcasting these rights displaces other rights already acquired, this effectively raises the cost to BT of bidding for these rights relative to an operator that would have the ability to broadcast these rights live in full behind a red button (such as Sky).

- (ii) many sports rights holders take into account multiple factors in deciding to whom to license their rights – and do not simply sell their rights to the highest bidder. Other factors are considered as part of the bid process such as programming plans, means of distribution and the level of exposure of their content in terms of likely audience/subscriber numbers. In the event of similarly sized financial bids, a pay TV broadcaster with the ability to offer wider exposure by broadcasting all of a rights holder's rights live across multiple platforms (for example through being vertically integrated with the dominant pay TV retailer) is likely to be favoured, *ceteris paribus*, over a pay TV broadcaster that was unable to guarantee broad distribution, and so equally as broad broadcast coverage, of all of the rights live across multiple pay TV platforms.

- 2.9. Enhanced and interactive TV services can also offer an additional source of revenue to channels seeking to defray the costs of channel provision. As BT has previously highlighted, services [X<] provide an expected incremental revenue stream for BT Sport.⁹ In addition, FRND access to Sky's Ethernet ports and broadband return path would allow for a substantially richer offering than can be provided using a dial up modem and narrowband return path. As such, many of the services that offer the possibility of additional revenue streams that are clunky and offer a poor consumer experience over narrowband dial up today, would become considerably more attractive if offered via Sky's Ethernet ports. Betting, gaming and voting services, in particular, may become substantially more attractive, with increased demand and associated revenue streams.

There are no alternatives for access to Sky's AC services for enhanced TV services

- 2.10. Before addressing the specific areas of BT's current demand for AC services, it is important to note that, in BT's view, there are no effective substitutes for access to Sky's AC services with respect to enhanced TV services generally. By their very definition, enhanced TV services are linked to the underlying linear channel broadcast, and, as Ofcom recognises, form "*an integral part of the viewer experience*".¹⁰ Given this, any alternative which takes the viewer away from the linear channel environment in order to access these enhancements, unless seamless and directly connected, will lead to a diminution in the viewer's experience. This leads (at best) to a risk of diminished quality perception of the channel and (at worst) the viewer not accessing the enhanced service at all. This includes:

⁸ For example, each PGA golf tournament is a 4 day event that would take up coverage on one channel for significant amounts of time, in particular during peak viewing times in evenings and weekends when other sporting events are also typically scheduled.

⁹ Response to the 2013 Consultation, paragraphs 52 to 57. These issues are also discussed at paragraphs 2.36 – 2.38 below.

¹⁰ AC Consultation Document, paragraph 7.14.

- (i) **Second screen devices:** Even if there were to be substantial increase in the take-up of second screen devices across the population as a whole and/or the technical restrictions identified by Ofcom could be overcome¹¹, accessing enhancements on a non-integrated basis would have a material bearing on the overall user experience. As Ofcom correctly identified *“the experience is likely to be different to that provided via the red button”* and *“would lead to discontinuity in viewing as the alternative videostream is selected, which would clearly impact on the viewer experience”*.¹²
- (ii) **Additional EPG listings:** Even if it were possible to obtain sufficient additional EPG listings on the Sky platform (which for the reasons set out in BT’s response to the consultations cannot be assumed)¹³, the process of exiting the linear channel being watched in order to find the enhanced service via an additional EPG listing would again undermine the integrated purpose of an enhanced service. As Ofcom recognises this *“would be disruptive to the viewing experience”*¹⁴ and would mean the enhanced service would be used less frequently.
- (iii) **APIs via smart TVs:** Again, even if take-up of smart TVs were to become universal, changing remote controls and exiting the Sky broadcast in order to access enhanced functionality via the smart TV would have a material bearing on the viewer experience. As Ofcom correctly recognises, users that subscribe to Sky will watch their subscription channels via the Sky set-top box.¹⁵ Requiring the viewer to use multiple devices to access enhanced TV services from third party providers, when Sky would provide a seamless service within its set-top box environment for its own channels, would materially impact both the perception and usage of these third party enhanced TV services.
- (iv) **Linear TV, newspapers, radio, the internet:** BT notes Ofcom’s suggestion that these sources may provide alternatives to Sky’s AC services for the supply of certain information services, even those that are linked to the content of the programme being broadcast.¹⁶ While the same information may be available from these sources, the reality is that for a fully integrated consumer experience, access to Sky’s AC services would be necessary. If Sky provides such services for its channels – allowing its consumers to access this information directly alongside the linear channel broadcast – but third parties have to direct their consumers to alternatives there will be a disparity in the quality of the services delivered, providing Sky with a substantial competitive benefit.

¹¹ AC Consultation Document, paragraph 3.21.

¹² AC Consultation Document, paragraph 3.21.1.

¹³ Response to the 2013 Consultation, paragraph 32.

¹⁴ AC Consultation Document, paragraph 3.22.

¹⁵ AC Consultation Document, paragraph 3.23.

¹⁶ AC Consultation Document, paragraph 3.28 – 3.30.

BT's demand for specific Access Control services

Demand for red button functionality for clash-management

BT's usage of Sky's AC services to provide alternative video streams for clash management

- 2.11. As BT explained in detail in its response to the 2013 Consultation, BT Sport's three linear channels do not provide sufficient scheduling capacity to allow BT to exploit fully the various sports rights that it has acquired to date and avoid the frequent fixture clashes that occur throughout the year.¹⁷ It is not surprising that, since BT's response to Ofcom's consultation in 2013, BT's acquisition of the live UEFA Champions League rights has increased the extent of fixture clashes that BT now needs to address. The previous fixture clashes which BT identified will be exacerbated by BT's obligation under its UEFA contract, [REDACTED]
- 2.12. BT highlighted in its response to the 2013 Consultation that without access to Sky's 'red button' functionality and hence the ability to broadcast more than three live sports events concurrently, it would be placed at a material bidding disadvantage compared to Sky (if not precluded from bidding altogether) when bidding for live sports rights, over and above the difficulties BT already faces in light of Sky's structural advantages in acquiring sports rights. BT explained why these issues are particularly acute when bidding for the UEFA Champions League rights, given (i) the number of games broadcast concurrently – up to eight matches on a single evening and (ii) where exposure of the rights as widely as possible is an important factor in determining the winning tender for the rights.¹⁸
- 2.13. As BT has now won these rights, guaranteed access to red button functionality to deliver additional alternative video streams on the Sky platform is critical for BT to be able to fully realise its investment in these rights, both in terms of being able to broadcast all available live matches as well as managing fixture clashes with existing rights acquired. More importantly, it is also essential to ensure that BT meets its contractual commitments to UEFA. Under the terms of its contract with UEFA, BT [REDACTED]
- 2.14. As the graphic below shows, this means for the six weeks of the Champions League group stages, BT must be capable of providing (at least) [REDACTED]
- 2.15. [REDACTED]
- 2.16. There is a phased roll out of red button videostreams on the Sky platform. The first of these services was launched recently on the 13th of September 2014 [REDACTED] Therefore, access to Sky's AC services has proven critical to BT's ability to exploit fully the UEFA rights it has acquired [REDACTED], and BT is already making use of Sky's AC services in order to deliver additional video streams.

There are no viable alternatives to access to Sky's AC services for clash management

- 2.17. As BT explained to Ofcom in its response to the 2013 Consultation, there are no viable alternatives to Sky's AC services for clash management.

¹⁷ Response to the 2013 Consultation, paragraphs 20 to 22.

¹⁸ Response to the 2013 Consultation, paragraphs 26 to 28.

- 2.18. As set out in its response to the 2013 Consultation¹⁹, BT considered the possibility of relying on a second screen application, with additional live rights, beyond those capable of being transmitted on its three channels, streamed online via a BT Sport application. However, due to the relatively low levels of usage of BT's online application for streaming live sports content²⁰, combined with customer preferences when watching live sporting events, BT concluded that a second screen is more suited to providing ancillary content rather than as a primary source for streaming live sports content. In this respect, BT believes that even if ownership of second screen devices materially increased from the 44% of tablet ownership identified by Ofcom²¹, it would still not be a viable alternative to access to Sky's AC services. As Ofcom correctly recognises:

*"Depending on the content of the alternative videostream, the size of the second screen (i.e. a smartphone or tablet) may also be an issue. For example, viewers may prefer watching sports events such as football matches on a larger screen."*²²

- 2.19. In particular, BT notes that ownership of second screen devices does not equate to usage of second screens. Simply because a proportion of viewers own a tablet does not mean that they would be willing to use that tablet for live TV viewing. It is usage that determines the viability of second screens as an alternative to access to Sky's AC services.
- 2.20. BT fully endorses Ofcom's view that the underlying user experience with a second screen is likely to be sub-optimal relative to that provided via the red button. BT also agrees with Ofcom's dismissal of Sky's suggestion that the second screen can be linked to the main screen.²³ As well as the specific technical difficulties highlighted by Ofcom, BT believes that many consumers would be put off by the need to adopt what would seem to be a complex technical work-around (regardless of how "easy" such a solution may be to implement in practice), thereby reducing usage of the enhanced TV service in practice.
- 2.21. In its response to the 2013 Consultation, BT also highlighted that usage of a second screen to stream an online application would not resolve the disadvantages that BT would face when bidding for rights.²⁴ BT highlighted in particular that key rights holders, such as UEFA, would not view such limited delivery as providing equivalent exposure to broadcasting additional matches directly to the satellite subscribers' main TV set. [3<]
- 2.22. Launching additional day-part channels – which would entail the acquisition of an additional EPG slot for each additional channel – would not be a suitable alternative to AC services as a means of resolving clash management.²⁵ BT set out in detail in its response to the 2013 Consultation why this would be more costly and difficult in terms of acquiring the necessary EPG listings (assuming any were available), would lead to diminished prominence which would materially affect the success of such services, and would be damaging to the

¹⁹ Response to the 2013 Consultation, paragraph 30.

²⁰ [3<]

²¹ AC Consultation Document, paragraph 3.21.1.

²² AC Consultation Document, paragraph 3.21.2.

²³ AC Consultation Document, paragraph 3.21.3.

²⁴ Response to the 2013 Consultation, paragraph 30.

²⁵ [3<]

consumer perception of the BT Sport brand.²⁶ BT also agrees with Ofcom's view that forcing consumers to navigate between different channel listings (which would almost certainly not be contiguous) would be disruptive to the viewing experience. BT also agrees that the red button effectively provides both the navigation and discovery functionality to alternative videostreams, which would be lost if this content was provided via additional day-part channels with their own EPG listing.²⁷

- 2.23. For the reasons set out above, BT believes that additional EPG listings are not a viable alternative to Sky's APIs.
- 2.24. BT addressed the issue of providing alternative videostreams using APIs on smart TV platforms in a previous submission and explained why this is not a viable alternative to access to Sky's AC services.²⁸ As BT explained and Ofcom accepts, there are material technical impediments to users implementing such a solution, and availability and use of smart functionality is still very limited. In addition, such a solution would impose material costs on third parties over access via Sky's AC services. In order to reach a similar number of customers as those available via Sky's set-top box, BT would be forced to develop different applications for multiple different APIs used by multiple different TV manufacturers in multiple different TV sets.
- 2.25. However, the impact on the viewer experience would remain a significant obstacle even if technical impediments, availability, usage and cost issues were capable of being addressed. As Ofcom correctly recognises, viewers that subscribe to Sky will watch their subscription channels via the Sky set-top box.²⁹ Requiring the viewer to use multiple devices (i.e. both the Sky set-top box and the separate API in the TV) to access enhanced TV services from third party providers, when Sky would provide a seamless service within its set-top box environment for its own channels, would materially impact both the perception and usage of these third party enhanced services.
- 2.26. Ofcom concludes that:
- "...we do not consider that second screens, additional EPG listing or smart TVs are likely to provide suitable alternatives to access to the Sky APIs for alternate videostreams."³⁰*
- 2.27. For the reasons set out above, BT believes it is clear that second screens, additional EPG listing or smart TVs do not provide suitable alternatives to access to the Sky AC services (including its APIs) for alternate videostreams.

Demand for commercial watermarking

- 2.28. BT set out in detail in its response to the 2013 Consultation why it uses Sky's AC services to provide a commercial watermark on its channels and why alternative solutions, such as dual

²⁶ Response to the 2013 Consultation, paragraphs 31 to 41.

²⁷ AC Consultation Document, paragraph 3.22.1.

²⁸ See BT's "Brief commentary on Sky's response to Ofcom's AC Review", dated 18 November 2013.

²⁹ AC Consultation Document, paragraph 3.23.

³⁰ AC Consultation Document, paragraph 3.24.

illumination, are not effective substitutes for BT Sport, particularly as a new entrant in the provision of sports channels. This continues to be the case.

2.29. Although originally redacted in the Consultation Document, BT was subsequently provided with text in which Sky suggested that [REDACTED]

2.30. [REDACTED]

2.31. [REDACTED]

2.32. Ofcom states that:

“Sky’s VCID functionality allows distributors to identify the viewing card being used in a commercial premise and can thereby check the authorisations present on the viewing card. As such, a distributor could identify whether a commercial premise had the correct authorisations and, if not, disable the card from showing their channels.”³¹

2.33. However, this misrepresents the process that is actually required for BT to receive a ‘translated’ customer account number from an onscreen VCID number. [REDACTED]

2.34. In contrast, in the event a FPO enters a commercial premise, sees BT Sport on the screen, and does not see the commercial watermark, they are immediately aware that there is an issue. [REDACTED]

2.35. As such, using VCID is not a substitute for the pint glass watermark, it is a complement that aids in the authentication process.

2.36. It is notable that despite the introduction of VCID, Sky still uses a commercial watermark, which is generated via access control services, to identify valid commercial subscribers. Until Sky ceases to use a commercial watermark and relies solely on VCID to identify commercial subscribers, any claim that VCID can be used for this purpose must be treated with the utmost scepticism.

Demand for red button functionality for subscriber [REDACTED] services

2.37. [REDACTED]

2.38. [REDACTED] BT observes that Sky itself makes extensive use of this functionality, including in relation to the launch of Sky Sports 5: viewers were able not only to upgrade their Sky TV subscription to include Sky Sports 5, but also to sign up to Sky’s related broadband offer via the same means.

2.39. These upgrade services fall within the definition of an enhanced TV service (“services that provide access to additional information and/or videostreams that complement the broadcast linear TV programme”) and also within the definition of contextual commercial services (“services developed to exploit the TV channel or programme”). BT discusses the issue of the overlap between enhanced TV services and contextual commercial services in further detail at paragraphs 2.40 to 2.42 below. However classified, it is clear under the new

³¹ AC Consultation Document, paragraph 3.52.

access conditions in Section 7 of the Consultation Document that upgrade services would fall within the definition of “*Pay TV Subscription Services*”.

Demand for other AC services

- 2.40. BT broadly agrees with Ofcom’s conclusions that current demand for AC services is primarily linked to the services that it has categorised as enhanced TV.³² However, BT makes the following comments about demand for the other categories of AC services identified by Ofcom.

Demand for other enhanced TV services and the overlap with contextual and commercial services

- 2.41. BT notes Ofcom’s comments regarding the likely overlap between certain enhanced TV services and contextual commercial services. BT notes Ofcom’s proposal that where an overlap exists, for analytical purposes, the service should be considered as an enhanced TV service.³³ BT believes that this approach is essential, and not just for analytical purposes but to ensure consistent, clear regulation going forward.
- 2.42. For the reasons discussed in paragraphs 2.4 to 2.10 above, BT believes that there are generally no suitable alternatives for access to Sky’s AC services for enhanced TV services. Any enhanced service that is linked to the underlying linear channel broadcast is unlikely to have a viable alternative that will not lead to a diminution in the viewer’s experience and hence quality perception of the channel. This is the case regardless of the underlying means of delivery of the data being broadcast/transmitted via the enhanced service. As Ofcom appears to recognise in its discussion of the potential for overlap with contextual and commercial services, enhanced TV services should not be limited to those services that are based around a return path with content/information going from the viewer to the broadcaster/service but must encompass two-way communications.³⁴
- 2.43. There would be a material risk of Sky undermining the efficacy of any AC regime going forward, if it was concluded that there was demand and no viable alternatives for enhanced TV services, but there was uncertainty as to whether this was also the case for contextual/commercial services. The risk would be that Sky could reject requests for AC services that could be considered to be either (or both) a contextual/commercial services and an enhanced TV service on the basis that they were contextual/commercial services. Therefore, it is important that if a service can be considered to be an enhanced TV service, even if it also has elements of being a contextual/commercial service, that it is treated as an enhanced TV service for the purposes of the AC regime going forward so as not to impose unnecessary restrictions and limitations on the development of new, competitive enhanced TV services.

³² AC Consultation Document, paragraph 3.80.

³³ AC Consultation Document, paragraph 3.5.

³⁴ For example, in the case of betting and gaming in the future the underlying data delivery may be broadcast/transmitted via the Ethernet port (rather than via satellite), but this does not change the fact that such services are enhancing a linear channel broadcast via the Sky digital satellite platform.

Demand for enhanced TV services with access to the Ethernet port

- 2.44. As BT has previously highlighted, there are a number of additional enhancements to its channels that it (and other third parties) could offer in the event of regulatory certainty around FRND access to Sky's Ethernet ports in conjunction with a connected broadband return path. Such access would allow the provision of a substantially richer offering than can be provided using a dial up modem and narrowband return path, which is largely limited to text and static images. As such many of the services that are clunky and offer a poor consumer experience over narrowband dial up would become considerably more attractive if offered via Sky's Ethernet ports.
- 2.45. In this regard it is worth noting that BT has developed a "Connected Red Button" service on its own YouView platform. [35]
- 2.46. BT notes that over 50% of Sky's subscriber base have now connected their set-top boxes to broadband³⁵ and Sky has an active programme in place to increase the overall number of broadband-connected set-top boxes (e.g. through the provision of wireless connectors, to allow subscribers to connect their set-top box to their broadband router easily). This development allows Sky subscribers to access Sky's (closed) retail VOD service which is delivered to the set-top box via the customer's broadband connection and the set-top box Ethernet port. However, the benefits of broadband connected boxes are not limited to the provision of such stand-alone VOD services: an ability to provide enhanced TV services in conjunction with access to the Ethernet port is likely to lead to an increase in demand for such services, both from the point of view of service provider and consumer.
- 2.47. It is important to consider demand for certain enhanced TV services on the Sky platform within this context. Ofcom's states that:

"Use of interactive TV as a means of remote gambling is low. However, this may be because alternatives exist... we consider that second screen apps may be able to gain sufficient visibility and sufficient synchronisation to the event in the main channel screen to provide a viable alternative to access via the red button.

In relation to gaming... alternatives have been used... However, there would be obvious advantages to red button access, particularly in terms of the 'call to action' to take part in the game. In addition, in some cases, such as play-along games on children's channels, the use of a second screen device may be less appropriate.

*Therefore, whilst it is not clear that access to Sky's APIs is necessarily essential to providing these services, such access may be materially advantageous."*³⁶

- 2.48. It is unsurprising that third parties have been forced into work-arounds in order to provide these kinds of services given the limitations inherent in using a dial-up modem and narrowband return path. However, this should not, per se, lead to a conclusion that demand for these services via the Sky set-top box is low, or that the alternatives currently being used

³⁵ corporate.sky.com/documents/pdf/latest_results/fy1314_press_release.pdf

³⁶ AC Consultation Document, paragraph 3.36 – 3.38.

by third parties are effective alternatives for access to Sky's AC services especially in the event access via the Ethernet port was available in order to deliver these kinds of services.

- 2.49. Two-way access to the 'always on', high speed Ethernet ports in Sky's more recent boxes (particularly where connected to superfast broadband) would allow for the provision of more contextual content and real time bet and play functionality, greater social media integration and the ability to include video and audio content around voting and gaming services related to the underlying broadcast channel. This richer, more attractive, interactive consumer environment has the scope to attract greater consumer participation and engagement with a broadcaster's service, with increased demand and associated revenue streams. In these circumstances, access to Sky's AC services would be essential in order to provide a seamless, integrated consumer experience.
- 2.50. BT notes that the proposed new access conditions have been drafted (appropriately) in a technology neutral way, so as not to refer to the nature of the connection of the return path (i.e. being limited to narrowband and not extending to broadband connections via the Ethernet port). BT agrees with this technology neutral approach, but has proposed a further minor amendment to the proposed new access conditions (in the definition of Authentication Services) to clarify that access to the return path is on a two-way basis, enabling transmission of components for enhanced TV services both from and to the set-top box. This is also consistent with the approach Sky has taken in its proposed commitments where (other than the specific exclusion set out in paragraph D(a)), it has not sought to limit third party access to, or use of, the Ethernet port, and does not distinguish between narrowband and broadband connections to Sky set-top boxes (whether current or future generation, as defined by Sky).

Navigation and discovery

- 2.51. BT agrees that any lack of demand currently for access to AC services to provide navigation and discovery services (other than those accessible via the red button to navigate between linear feeds) on Sky's platform, is likely due to the fact that such apps are in their infancy. Access to such services may become more important over time with greater integration of traditional pay TV content with wider forms of content (such as social media content etc). This is particularly likely to be the case as Sky moves towards greater usage of the Ethernet port and a broadband return path, facilitating improved, richer two-way interaction on its platform.
- 2.52. Therefore, in the future it appears likely that some navigation and discovery functions will be used to link wider media/information sources to broadcast content underlying linear channels (for example navigating to a Wikipedia-style information page to provide more information on a documentary being shown on the linear channel). To the extent that this is the case, BT would expect that such services would be treated as enhanced TV services for similar reasons to those set out above in respect of contextual and commercial services.
- 2.53. For "pure" navigation and discovery services (i.e. those that are not in any way linked to a linear channel broadcast and so clearly could not be classified as enhanced TV services), BT accepts that, for now, it is sufficient for Ofcom to keep this area under review.

Standalone services

- 2.54. As BT noted in its response to the 2013 Consultation, alternatives now exist for delivering the current range of existing standalone interactive services (such as e-mail or banking) – beyond Sky’s satellite platform.³⁷ Sky’s satellite platform, together with the historic limitations of its narrow-band dial-up return path, would not be regarded as an essential means of delivering such stand-alone interactive services.
- 2.55. However, in light of Sky’s active programme to increase the overall number of broadband-connected set-top boxes in its base and its future plans for the development of a new generation of boxes that will offer new functionality, future demand cannot be discounted for new stand-alone services that have yet to be developed, or are currently in their infancy. As BT set out in its response to the 2013 Consultation, and as Ofcom recognises, access to the Ethernet port, in particular could allow new services – including new stand-alone services – to be provided. In principle, concerns as to Sky’s control of a scale bottleneck may equally arise with such services.
- 2.56. It is important that Ofcom monitors this situation closely. Given the pace of technology change and in light of Sky’s incentives and ability to exercise gateway control over services provided via its set-top boxes (discussed in more detail in Section 3 below), it is vital that Ofcom acts swiftly as and when demand for a new standalone service is established, and potential competition concerns are identified.

New and future enhanced TV services

- 2.57. In light of Sky’s plans to develop a new generation of boxes that will offer new functionality it is to be expected that demand for enhanced TV services will grow, particularly for AC services (both new and existing) which support the delivery of services (such as social media content) via the Ethernet port. While BT has set out in paragraphs 2.43 to 2.45 some of the kinds of services it may wish to offer in the future with access to Sky’s Ethernet port and a broadband connection, given the asymmetry of information regarding Sky’s set-top box development plans, it is not possible today for BT to determine precisely the nature and scope of new enhanced TV services that it would want (and be able) to deliver in the future. However, it is clear that, if BT is unable to deliver enhanced TV services in conjunction with its BT Sport channels on Sky’s platform which are equivalent to those offered by Sky in conjunction with Sky Sports, it would be placed at a (further) material competitive disadvantage to Sky (in terms of attracting subscribers and therefore in bidding for sports rights).
- 2.58. In relation to such future developments, BT notes Ofcom’s observations that:

*“Interactive services provided via the Ethernet port, or via other technology changes on Sky’s platform (such as a new STB) could either be services that seek to provide the same user experience as available via existing services or could be entirely new types of services. **Where a service seeks to essentially replicate an existing service (e.g. red button functionality) but does via a different technical means (e.g. the***

³⁷ Response to the 2013 Consultation, paragraphs 1 and 69.

*Ethernet port) access using the new technology could be required to allow the service to be provided. For the viewer, the end result may be the same. In these cases it may be important that suitable access to the new technology is available to provide these services in the most effective and beneficial way for viewers.*³⁸

and

*“Access to the Ethernet port would allow further enhancement of the services discussed above. For example, additional alternative videostreams accessed via the red button could be made available (such as from VOD libraries). **It is not obvious that there would be alternative mechanisms to provide these services. Where alternative videostreams support or enhance the programme being viewed, similar concerns to those discussed above (in paragraphs 3.18 to 3.24) would still be relevant.**” (Emphasis added).*

- 2.59. BT believes that it is important to ensure that the development of new enhanced TV services is properly supported by the on-going AC regime, since for the reasons set out in paragraph 2.10 above, there are unlikely to be viable alternatives for future enhanced TV services given the nature of such services. BT acknowledges that, in particular in relation to the functionality that will be offered by Sky's next generation of set-top boxes, it is premature to seek to resolve the question as to the precise nature of potential new enhanced TV services today. However, the competition concerns expanded on in Section 3 of this response are likely to arise equally with new services, and the introduction of Sky's next generation set-top box is likely to reinforce, rather than reduce, Sky's gateway control of access control services.
- 2.60. It is therefore crucial that there is a clear, efficient process to ensure that third parties are provided with access to Sky's AC services in order to deliver new enhanced TV services via the Sky platform. It would risk leaving third parties at a material competitive disadvantage if there was undue uncertainty around Sky's obligations to provide such services, or if the only means of resolving questions of access and terms of access was through a prolonged reference of the matter to Ofcom. For these reasons BT believes it is important to have a clear process designed in such a way that it provides adequate certainty for both Sky and third parties as to their respective obligations and rights. BT outlines a proposal for such a process in Section 7 below.

³⁸ AC Consultation Document, paragraph 3.76.

3. THE COMPETITION PROBLEM

The competition problem derives from Sky's control of a scale bottleneck

- 3.1. As set out in Section 2 above Sky's digital satellite platform remains a key means of delivering pay TV services given the absolute and relative scale of the Sky platform, and launching a successful premium sports channel requires access to Sky's subscriber base via its set-top boxes.
- 3.2. Ofcom is correct that enhanced TV services form an integral part of the viewer experience, and that such services can have a material bearing on competition for pay TV service more generally.³⁹ Assured access to AC services (which enable the development and delivery of enhanced TV services) is a critical component of a successful premium sports service. BT's incentives to invest in expensive sports rights, and its ability to recoup its investment will be negatively impacted if (i) the ability to exploit those rights fully across all platforms is curtailed or (ii) the quality of the underlying viewer experience of the channel is limited, due to a lack of access to critical enhanced TV services that supplement and augment the viewer experience. In this regard, BT fully supports Ofcom's view that:

*"...if one sports channel is able to offer different camera angles, match statistics and the ability to bet on match outcomes as a result of access to red button services, while a rival channel is not able to offer the same functionality and richness of consumer experience, then (all other things being equal) our expectation is that the first channel would tend to be perceived as being a higher quality service by viewers."*⁴⁰

- 3.3. As such, access to Sky's 10.7 million subscribers via the Sky platform is critical for the further development and, ultimately, for the survival of BT Sport, and the ability to use AC services to ensure that BT can bid for and exploit important sports rights, as well as ensure the quality of its sports channels, is essential. As a result, gateway control of access control services, in light of the scale bottleneck that is the Sky platform, gives Sky the ability to distort competition. By hindering BT's ability to offer enhanced TV services (either by not providing access to AC services, limiting the scope of such services or simply delaying the provision of these services), Sky has the potential to (further) limit BT's ability to create a compelling wholesale and retail sports proposition, as well as to make BT a less effective bidder for sports rights (discussed in greater detail below).
- 3.4. Ofcom correctly identifies that it is Sky's vertical integration and market position in pay TV that creates a concern around ensuring access to AC services. Ofcom highlights that Sky is the only broadcaster with "sole control of a vertically integrated platform"⁴¹ and that other TV delivery platforms "are structured in such a way that they do not appear to face incentives that could lead to restricted access as can arise in the case of a single, vertically

³⁹ AC Consultation Document, paragraph 7.14.

⁴⁰ AC Consultation Document, paragraph 7.14.

⁴¹ AC Consultation Document, paragraph 7.9.

*integrated company such as Sky*⁴². This leads Ofcom to conclude that Sky is “*in a different position to other platform operators*”⁴³

- 3.5. While BT agrees that Sky is in a different position to other platform operators, it is important to recognise that the critical differentiating factor is not just Sky’s vertical integration and platform control, but rather Sky’s absolute and relative scale combined with its vertical integration (including its platform control). As set out above, access to the Sky platform is essential for any channel seeking to build scale and recover high fixed costs. This is due to the sheer number of subscribers accessible via the Sky platform: the scale bottleneck controlled by Sky provides access to more than three times the number of subscribers available via the next largest platform (Virgin Media – which is only present in around 50% of the UK) and [\gg]. Given their relative scale, platforms other than Sky’s are also in a fundamentally different bargaining position vis-a-vis channel access, which means they have fundamentally different incentives to Sky. As such, even if safeguards did not exist for other vertically integrated platforms, competition concerns are unlikely to arise given the more limited scale of these platforms and the incentives that they face.⁴⁴
- 3.6. In recognising the nature of Sky’s scale bottleneck, it is clear that Sky’s gateway control applies to its platform as a whole, i.e. access to the Sky base of subscribers regardless of the nature or type of set-top box over which AC services are provided. On this basis, access to all generations of Sky’s deployed set-top boxes (historic, current and future) must be assured, as any divergence in the treatment of future generations of set-top boxes risks materially weakening controls over the gateway as a whole. (This issue is considered further in Section 4 below.)

Sky has both the incentive and ability to limit competition

- 3.7. For the reasons discussed above, Sky’s control of a scale bottleneck means it has the ability to limit competition from third party broadcasters/pay TV retailers by affecting the quality of TV and TV-related services provided over its platform, including the “*look and feel*” of those services. As Ofcom recognises this:

“...enables the platform operator to influence the way in which competing channels/services delivered over that platform are perceived by viewers/subscribers. While not necessarily an issue in isolation, when combined with vertical integration this could have an impact on the incentives of the platform operator, in respect of

⁴² AC Consultation Document, paragraph 7.9.

⁴³ AC Consultation Document, paragraph 7.16.

⁴⁴ In this respect Ofcom’s reference to a single YouView “platform” (AC Consultation Document, paragraph 7.11) is not correct. There are multiple different YouView platforms (e.g. the BT YouView platform is distinct from the Talk Talk YouView platform), and considering them as a single entity overstates the scale of the individual platforms and risks over-estimating their individual bargaining position for channel access and misidentifying their incentives as a result. However, the general YouView safeguards that Ofcom refers to, particularly the fact that the YouView constitution requires access to all YouView platforms on FRND terms, is applicable to each YouView platform providing a further safety net.

providing enhanced interactive services to firms that compete (or that might compete) with its downstream operations.”⁴⁵

- 3.8. Ofcom states that, as a vertically integrated platform and pay TV channel provider, Sky has “mixed incentives”⁴⁶ when providing access to AC services to third party channel retailers. While BT accepts that, in principle, as a platform provider Sky may wish to provide the most attractive pay TV offering from third parties to its retail subscribers, in practice, its incentives as a channel provider to limit potential competition from emerging in the provision of premium sports channels across the value chain will outweigh this desire (for the reasons outlined below).
- 3.9. As Ofcom has previously recognised, Sky is dominant in the wholesaling and retailing of Core Premium Sports Channels (notably the Sky Sports 1 and 2 channels), and makes super-normal profits on the sale of these channels.⁴⁷ The upside to Sky from protecting this market position for the long term is likely to provide a vastly stronger imperative than any downside from subscribers to its platform receiving a lower quality version of BT Sport in the short term. [X] Creating significant bidding uncertainty for BT as to its ability to exploit rights fully, or achieve enhanced revenue streams, via the red button would ensure that Sky further limits the competition it faces from BT when bidding for these rights. In turn this would help preserve its structural bidding advantages and thereby protect Sky’s dominance at the wholesale and retail levels.
- 3.10. Ofcom is correct that, when bidding for sports rights “gaining a speedy resolution” of issues relating to access to Sky’s platform is a particular concern and “In the absence of the certainty provided by regulatory conditions, it may be more difficult to achieve such resolution.”⁴⁸ BT has previously provided Ofcom with a detailed economic model demonstrating that Sky will consistently be able to outbid BT for rights.⁴⁹ Any additional uncertainty that Sky can create around the bidding process further entrenches Sky’s bidding advantages and the structural barriers that BT faces in trying to create and further develop a premium sports channel. Even if Ofcom were to implement an effective WMO remedy to begin to unwind Sky’s systematic advantages in bidding for rights, a lack of certainty arising due to an ineffective access control regime would significantly undermine the effectiveness of that intervention. Therefore, BT strongly agrees with Ofcom’s statements that:

“In the absence of regulation, new entrants may not be able to secure contractual terms and would not have certainty about their ability to secure access prior to discussion with Sky. Where they are bidding for rights that also hold an interest for Sky, this could, in turn, dis-incentivise new entrants from bidding, if they consider they would only be able to offer a less feature-rich service than Sky itself provides... Taken together, these issues could reduce the extent of competition in the provision

⁴⁵ AC Consultation Document, paragraph 7.15.

⁴⁶ AC Consultation Document, paragraph 7.58.

⁴⁷ See Ofcom’s 2010 Pay TV Statement.

⁴⁸ AC Consultation Document, paragraph 7.66.

⁴⁹ See Appendix I and II to the Compass Lexecon paper titled “Modelling dynamic competition in the retail CPSC market: indirect monetisation” submitted to Ofcom on 27 December 2013 in CW/01106/05/13 - Complaint to Ofcom by BT regarding Sky’s abuse of dominance.

*of premium sports services. Given the important role that sports content plays in driving the take-up of pay TV, this could lead to a reduction in choice for consumers.*⁵⁰

3.11. BT notes Sky's statement that:

"...vertical integration was normally "benign" and would only result in distorted negotiations in certain circumstances which were not relevant for the provision of AC services, because of the intense competition at the retail level."

And that:

*"Sky has strong incentives to maximise the attractiveness of its platform to end-users. If third party interactive services (such as the BBC's red-button Wimbledon service) are likely to be of value to consumers, Sky has strong commercial incentives to facilitate their access to its satellite platform. These incentives are a reflection of strong downstream inter-platform competition"*⁵¹

- 3.12. BT strongly disagrees with Sky's assessment. Vertical integration is not generally assumed to be benign where the incumbent is dominant and has both the incentive and ability to limit the effectiveness of downstream competition from third parties, as is the case here with respect to AC services. In addition, Sky's suggestion that there is *"intense competition at the retail level"* and *"strong downstream inter-platform competition"* is simply untenable.
- 3.13. Multiple previous investigations into the pay TV sector have highlighted Sky's high and persistent retail market share, the difficulties associated with large-scale entry and expansion (including material structural barriers to entrants' ability to acquire premium sports rights), Sky's super-normal profits in downstream pay TV markets, Sky's incumbency advantages, and low levels of switching.⁵² None of these factors are consistent with Sky being subject to intense competition in retail pay TV markets or strong downstream inter-platform competition. Indeed in its August 2012 Report the Competition Commission very clearly stated that *"competition was not effective"* in the pay-TV retail market it defined.⁵³ The factors that led to this conclusion have not changed in the two years since the CC's Report.
- 3.14. BT believes that its substantial investment in BT Sport has the potential to be pro-competitive, particularly alongside an effective WMO remedy, and to deliver material benefits to consumers in terms of choice, innovation and lower prices. However, given Sky's significant market power, incumbency advantages and persistent super-normal profits across its pay TV business, BT does not underestimate the difficulties of building a sustainable sports channel. Given these difficulties, it is essential that, in circumstances where Sky has both the incentive and ability to weaken the constraint it might face from BT

⁵⁰ AC Consultation Document, paragraph 7.65.

⁵¹ AC Consultation Document, paragraph 4.27.

⁵² See Ofcom's 2010 Pay TV Statement; see also the Competition Commission's Report *"Movies on pay TV market investigation: A report on the supply and acquisition of subscription pay-TV movie rights and services"*, August 2012 (the "CC Movies report").

⁵³ CC Movies Report, paragraph 20.

Sport in the future by limiting access to AC services, Ofcom implements an appropriate regime to ensure Sky is unable to do so and to provide BT with the necessary certainty to underpin its on-going investment in sports rights.

Sky intends to act on its incentives to limit competition if regulation is removed

- 3.15. Based on the evidence that Sky has submitted to Ofcom, the likelihood that Sky would withhold AC services absent on-going regulation is not merely theoretical. Sky's own submissions demonstrate the hollowness of its claims that it would wish to continue to offer third party interactive/enhanced TV services on its platform absent an on-going, enforceable, obligation to do so.
- 3.16. Sky has put forward two reasons why it believes that regulation should be removed. It claims that (i) if it were required to give third party access to new AC functionality, it would incur material costs because of the need to test the security of third party applications to avoid those applications causing its set-top boxes to malfunction to the detriment of end-users and (ii) Sky considers the scope of its current AC obligations to be unclear and that this inhibits innovation, since Sky is concerned not to "*inadvertently*" extend its access obligation to any new functionality that it may develop in the future. Sky claims that as a result of these concerns the current access obligation under the Continuation Notice has a chilling effect on its willingness to innovate and invest.⁵⁴
- 3.17. As BT has previously highlighted, Sky also has to ensure that its own applications are developed appropriately and thoroughly tested so as not to cause set-top box malfunctions. Therefore, investment in "*relevant technical support and testing*"⁵⁵, the principle costs that Sky claims it is forced to incur, are not caused by assured third party access to AC services under the existing regulatory regime per se. Therefore BT agrees with Ofcom's conclusion in this regard that:
- "...we do not consider that Sky is exposed to significant upfront costs as regards third party access to Sky's existing AC services."*
- 3.18. More importantly, however, Sky is effectively arguing that it should not be required to incur these costs in respect of third party applications. Yet, it will not be possible for Sky to continue providing AC services to third parties without incurring these costs. Hence if the objective is to remove AC regulation in order to enable Sky to avoid these costs in respect of third party applications in future, then it must necessarily follow that Sky will not provide any AC services to third parties once the regulation of AC services is removed and existing contracts end. Therefore, any suggestion that on-going access to AC services could be achieved via commercial negotiation is clearly untenable.
- 3.19. The idea that Sky might "*inadvertently*" extend its access obligation also underlines the true trade-off between Sky's incentives as a platform operator (ie to allow third parties to access AC services in order that they may provide enhanced TV services which enhance Sky's platform) versus Sky's incentives as a channel provider (i.e. to limit third parties' ability to access these AC services). Sky's claims that "*Sky has strong incentives to maximise the*

⁵⁴ AC Consultation Document, paragraph 7.73.

⁵⁵ Paragraph 32 of Sky's submission.

attractiveness of its platform to end-users” is fundamentally at odds with its arguments in its own submissions that:

“Sky is, however, reluctant to develop and roll out new set top box functionality where it would be faced with the likelihood that Sky would be required by regulation to make that functionality available to third parties”.⁵⁶

“Such concerns have inhibited Sky from seeking to develop interactive services that use the Ethernet connection to link, for example, to internet-based help, shopping and social media services”.⁵⁷

“In some cases it prevents new services being made available at all. For example, Sky has not, to date, made use of the Ethernet connection included in recent set top boxes other than for the purpose of providing its Sky Anytime+ service”.⁵⁸

- 3.20. Sky appears to be suggesting that it has forborne from itself providing certain interactive/enhanced TV services specifically in order to prevent third parties from being able to offer corresponding services over its platform even though they would enhance the platform offering. This is a rather extraordinary admission from Sky, as, if it were true, it would clearly prove that even under the current regime where AC regulation exists, Sky’s incentives as a platform operator are outweighed by its incentives to limit the emergence of downstream competition from third parties. However, for the reasons discussed in paragraphs 5.23 to 5.32 below it seems somewhat implausible that AC regulation has had any impact in practice on Sky’s incentives to invest and innovate in new set-top box functionality or to make use of its Ethernet port.

⁵⁶ Paragraph 31 of Sky’s submission.

⁵⁷ Paragraph 39 of Sky’s submission.

⁵⁸ Paragraph 40 of Sky’s submission.

4. ISSUES WITH SKY'S COMMITMENTS

Overview

- 4.1. In broad summary, the principal objective of the application to Sky of AC regulation (and the TPS regulatory regime more generally) is to prevent Sky from obtaining an unfair competitive advantage by restricting access to the functionality of its set-top boxes or by only providing such access on terms which are unfair, unreasonable and/or discriminatory.
- 4.2. As is explained below, an assessment of Sky's proposed commitments confirms that they would fail to achieve this objective. In addition, it is clear that Ofcom's claim that "*Given the presence of Sky's proposed commitments ... the question of imposing [new access] conditions is finely balanced*"⁵⁹ is absolutely not supported by Ofcom's own assessment of the commitments in its Consultation Document.

Scope – new enhanced TV services over Sky's new boxes are not covered by Sky's commitments

- 4.3. A key point to note at the outset is that the scope of Sky's proposed commitments is limited. Even if Sky were to observe the terms of these commitments (which Ofcom cannot be sure will happen – see paragraphs 4.63 to 4.81 below), Sky would still be able to gain an unfair competitive advantage in particular as it launches new set-top boxes which support new enhanced TV services. This is because Sky's offer in its commitments to allow third parties to access the functionality of any new boxes does not extend to the development of any new enhanced or interactive TV services.
- 4.4. Ofcom has acknowledged that the responses to its July 2013 Consultation demonstrated that there is demand for access to Sky's AC services in order that third parties can provide enhanced TV services. For example, Ofcom states:

*"Our analysis indicates that there is in particular a demand for enhanced TV services from viewers on the Sky satellite platform and that access to functionality on Sky's platform is required to provide these services".*⁶⁰

- 4.5. Ofcom expressly acknowledged the critical role of enhanced TV services when it confirmed that they "*supplement and augment*"⁶¹ linear TV services and "*influence viewers' perceptions of the quality of a channel*".⁶² Ofcom went on to confirm that:

*"As a result, although enhanced TV services are ancillary to linear TV services, we regard them as forming an integral part of the viewer experience and we consider that they could have a bearing on how competition might operate in relation to television services in general".*⁶³

- 4.6. Ofcom also confirmed that:

⁵⁹ AC Consultation Document, paragraph 7.144.

⁶⁰ AC Consultation Document, paragraph 7.16. See also paragraph 3.18.

⁶¹ AC Consultation Document, paragraph 7.14.

⁶² Ibid.

⁶³ Ibid.

*“...the provision of red button services will have important implications for [BT’s] competitiveness ... Accordingly, we consider that continued access to Sky’s AC services for the provision of red button services and commercial watermarking will contribute to securing sustainable competition in the supply of retail pay TV services”.*⁶⁴

- 4.7. Whilst BT endorses this conclusion, it is important, particularly given the nature of the competition problem outlined in Section 3 above, that Ofcom does not limit itself to such a static view of the current range of enhanced TV services (i.e. just red button and commercial watermarking) and that it has due regard to the importance of future enhanced TV services.⁶⁵
- 4.8. The types of enhanced TV services that are currently run on Sky’s existing generations of set-top boxes were developed at a relatively early stage of Sky’s digital satellite platform. Red button services, for example, were introduced by Sky approximately 15 years ago. In addition, the OpenTV middleware in Sky’s set-top boxes was initially deployed by Sky at the launch of digital satellite services in the UK in 1998. It is, therefore, likely that any compelling enhanced TV services which are capable of running on the OpenTV middleware in Sky’s current set-top boxes have already been developed. Whilst it is still possible that new enhanced TV services may be developed to run on Sky’s current set-top boxes (and so Sky should be prohibited from preventing third parties from undertaking that development), in practice the development of new enhanced TV services using Sky’s current boxes seems rather unlikely.⁶⁶
- 4.9. This is a key reason for the introduction of new set-top boxes by Sky. In this regard, it is important to note that the definition of “Future Generations of Sky set top boxes” in Sky’s proposed commitments confirms that Sky’s new boxes will have a different middleware from Sky’s existing boxes – i.e. not OpenTV v1.2/v1.3. It is reasonable to assume that Sky is putting this different middleware in its new boxes precisely because it provides more advanced functionality which is capable of supporting, among other things, new enhanced and interactive TV services.
- 4.10. When Sky introduces new set-top boxes with new technology it will, itself, be able to make use of the new functionality to develop new types of enhanced and interactive TV services. Ofcom acknowledges that it “*expects*” this to happen.⁶⁷ Yet, Sky’s offer in its commitments to allow third parties to access the functionality of any new boxes does not extend to the development of any new enhanced or interactive TV services.⁶⁸ Furthermore, Ofcom has

⁶⁴ AC Consultation Document, paragraph 7.38.

⁶⁵ As noted in Section 3 above, Sky’s incentives and ability to restrict competition are not limited to these two current enhanced/interactive TV services but extend to any enhanced/interactive TV services which give Sky an advantage, including those that may be developed in the future.

⁶⁶ BT does, however, believe that existing enhanced TV services may still be further developed. For example, betting services could be improved as a result of access to the Ethernet ports included in Sky’s current range of set-top boxes (in lieu of the dial-up modems which Sky initially included in its set-top boxes). See Section 2 above for further detail.

⁶⁷ AC Consultation Document, paragraph 7.72.

⁶⁸ BT notes that Sky has indicated to Ofcom that it “*would be prepared to negotiate third party access for new services on commercial terms*” (paragraph 5.11.2). As outlined below at paragraph 4.20 *et seq.* below, given

expressly noted that, under the commitments, third parties would only be entitled to develop new enhanced TV services which rely on Sky's AC services "on the current generations of STBs".⁶⁹ As a result, Sky's introduction of new set-top boxes with new functionality is likely to lead directly to competition issues, since, for the reasons highlighted in Section 3 above, Sky will not be incentivised to offer access to this new functionality to third parties on a commercial basis⁷⁰ and, by withholding such access, will directly influence the way in which competing channels/services delivered over that platform are perceived by viewers/subscribers.

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

4.12. In the Consultation Document Ofcom seems to be unduly sanguine about the approach adopted in the commitments towards Sky's new boxes. For example, Ofcom states that:

"They [the proposed commitments] would also enable BT to provide new enhanced TV services on existing generations of STBs and to continue providing these enhanced TV services on any future generations of STBs that Sky might develop".⁷¹

4.13. In this statement, Ofcom is apparently suggesting that, under the commitments, BT could provide new enhanced TV services on Sky's new boxes. But such a suggestion would not be correct.

4.14. In practice, it seems likely that this statement is just poorly drafted and that Ofcom is seeking to suggest that, under the commitments, BT could adopt the strategy of developing and running new enhanced TV services on Sky's boxes which exist today (i.e. those which use the OpenTV v1.2/v1.3 middleware) whilst being forced to run only its old enhanced TV services on any new boxes which Sky deploys in future.⁷² Such a strategy would, to say the very least, be counter-intuitive as it would entail BT running new enhanced TV services on Sky's old boxes (which contain old, more limited, technology) whilst running old enhanced TV services on Sky's new boxes (which would contain new, more advanced, technology).

4.15. In addition if, over time, BT was able to develop new enhanced TV services and, under the commitments, only deployed them on Sky's older set-top boxes then, at that point, BT would have an extremely complex marketing message. It would have to explain that only some Sky

the nature of Sky's incentives not to supply such services to its downstream competitors, such as BT, there is no certainty that any such commercial negotiations would lead to acceptable (fair and reasonable) contractual terms.

⁶⁹ AC Consultation Document, paragraph 5.10.1.

⁷⁰ Sky has already confirmed that this is the case – see paragraphs 4.24 to 4.26 below.

⁷¹ AC Consultation Document, paragraph 7.126.

⁷² This is because new enhanced TV services over future generations of Sky boxes are outside the scope of Sky's proposed commitments.

households (those with older boxes) would be able to receive its new enhanced TV services. The likelihood is that this would also lead to a great deal of customer confusion and dissatisfaction, especially since potential customers are unlikely to be sufficiently aware of which version of the Sky set-top box they have in their homes, and this is not something that BT could check at the point of sale of its satellite pay TV services. In addition, as noted in paragraph 4.11 above, the number of satellite TV households which possessed the new, more advanced, boxes (and so would be prevented by Sky from receiving BT's new enhanced TV services) would be growing rapidly – and, in addition, customers are unlikely to wish to retain a legacy box where Sky is offering to upgrade it to a newer generation, with more functionality overall. At the same time, Sky would be able to develop comparable new enhanced TV services and deploy them across all of its boxes which were capable of supporting them without any arbitrary restrictions in respect of access to new, more advanced, boxes. That would clearly place BT at a significant competitive disadvantage, and render unusable Sky's commitment to allow new enhanced TV services on the current Sky boxes.

- 4.16. Ofcom seemed to suggest in the Consultation Document that such an outcome would not be acceptable when it confirmed that:

"Given the potential for new services and new functionality to develop in the future ... we would be concerned if access to other types of AC services that deliver benefits to consumers was not forthcoming".⁷³

- 4.17. Despite this 'concern', Ofcom acknowledged that Sky's proposed commitments would only cover the provision of AC services on new set-top boxes to support that current range of enhanced TV services and that the provision of new enhanced TV services on future boxes *"would not be covered by the proposed commitments"*.⁷⁴ In the circumstances, Ofcom's 'concern' about access for other types of AC services (cited in the preceding paragraph) will not be addressed in respect of Sky's future boxes if Ofcom accepts Sky's proposed commitments and forebears from introducing the new access conditions.

- 4.18. In this regard, Ofcom makes one further comment, which is that:

"On any new generations of STB however, except for the named [i.e. pre-existing enhanced TV] services, third parties would be required to negotiate with Sky commercially if they wished to launch a new type of interactive [or enhanced TV] service".⁷⁵

- 4.19. Ofcom suggests that:

"Sky has indicated that it would be prepared to negotiate third party access for new services on commercial terms".⁷⁶

⁷³ AC Consultation Document paragraph 7.4.

⁷⁴ AC Consultation Document paragraph 5.11.

⁷⁵ AC Consultation Document paragraph 7.138.

⁷⁶ AC Consultation Document paragraph 5.11.2.

4.20. But this ‘indication’ forms no part of the commitments. The commitments themselves are unenforceable and this indication has some lesser status even than that. In addition, this indication is not of a desire (or even just a willingness) on Sky’s part to achieve third party access. Instead, it is merely an indication of a preparedness to negotiate. In practice, this indication is worthless and hence no weight can be attached to it, especially in light of a proper assessment of Sky’s incentives to agree commercial terms absent regulation as set out in Section 3 above.

4.21. Furthermore, BT has previously explained to Ofcom that any commercial negotiations which do take place with Sky, in respect of services that Sky does not wish to provide and which are not regulated, do not lead to supply. But Ofcom erroneously dismissed this issue out of hand when it said:

*“While noting BT’s observations about its difficulty in securing wholesale access to Sky’s broadcast channels without regulatory intervention, we consider that it is in a different position as regards **access to Sky’s existing services**, given that it has an existing contract with Sky for access for AC services”.⁷⁷ (Emphasis added.)*

4.22. [X] Hence, in respect of new AC services over Sky’s new boxes and the issue of access to existing AC services on Sky’s current boxes after the expiry of BT’s current AC contract, all BT’s previously submitted evidence and concerns about the futility of trying to negotiate with Sky remain valid. Despite this, Ofcom has manifestly not had due regard to this evidence and these concerns.

The importance of new enhanced TV services

4.23. In order to obtain an indication of how important new enhanced and interactive TV services will be, Ofcom should ask itself why Sky is seeking to remove the AC regulation now. The Continuation Notice has been in place since 2003 and for more than a decade Ofcom has been under a statutory duty to remove it “as soon as is reasonably practicable”.⁷⁸ Despite this, it was only in late 2012/early 2013, when Sky was developing a new set-top box with new middleware (capable of supporting new enhanced and interactive TV services) that it approached Ofcom and argued that the AC regulatory regime should be revoked without new access conditions being imposed.

4.24. In this context, as noted in Section 3 above, Sky was surprisingly, and incautiously, candid in its initial submission to Ofcom. In paragraph ³¹ of that submission, Sky admitted that:

*“Sky constantly seeks to improve the functionality of its digital satellite platform – for example, via the introduction of new types of set top boxes, or the enhancement of the functionality of existing deployed set top boxes via changes to their software. **Sky is, however, reluctant** to develop and roll out new set top box functionality where it would be faced with the likelihood that Sky would be required by regulation to make that functionality available to third parties”. (Emphasis added.)*

4.25. In paragraph 39 of the same submission Sky claimed, after a redacted passage, that:

⁷⁷ AC Consultation Document paragraph 7.127.

⁷⁸ Paragraph 9(11) of Schedule 18 to the Communications Act 2003.

“Such concerns have inhibited Sky from seeking to develop interactive services that use the Ethernet connection to link, for example, to internet-based help, shopping and social media services”.

4.26. It is clear from this, and the fact that Sky is developing new set-top boxes which do not use OpenTV v1.2/v1.3 middleware, that if Ofcom removes the AC regime and accepts Sky’s commitments in lieu of new access conditions, then Sky will develop new enhanced and interactive TV services and deploy them over those new boxes whilst denying third parties the ability to do the same. (As noted in the preceding paragraph, Sky’s initial submission even hints at some types of new services, such as the integration of social media content delivered via the Ethernet port with TV channels delivered via satellite.) For the reasons explained above, the resulting disparity between the retail services available from Sky and its competitors on Sky’s platform will risk giving rise to a material impediment to fair and effective competition.

4.27. In this context, BT notes Ofcom’s statement that:

*“... at this stage, we do not propose to set access-related conditions under section 74 that would require Sky to give access to third parties to new functionality that it may deploy in the future in relation to services **other than enhanced TV services**”.*⁷⁹
(Emphasis added.)

4.28. That statement is a clear acknowledgment by Ofcom that the issue of access to new functionality in relation to enhanced TV services will need to be addressed in the future (see paragraphs 2.56 – 2.59 above). Yet the commitments only consider such access in respect of a static set of existing enhanced TV services which depend on existing technology and so make use of none of the additional capabilities of the new functionality that is being contemplated here. New enhanced TV services which make use of the new functionality are omitted from the scope of the commitments. This is a fundamental omission from the commitments and hence it would clearly not be reasonable for Ofcom to accept them.

4.29. Finally, on the issue of future services, Ofcom should note that Sky’s allegation that AC regulation adversely affects its incentives to develop and deploy set-top boxes with new, more advanced, functionality is not credible for the reasons explained in Section 5 below.

“Fixed” charges for (certain) AC services

4.30. Sky has said it will commit to:

“...a maximum charge of £100,000 p.a. for services which enable interactive applications to be authored and made available on future generations of STBs (and this charge would cover existing and new generations of STB so the maximum total charge would be £100,000 p.a.) and that there would be no additional charges for services specified in annex 2 of its commitments. For any services not listed (including gaming, betting and voting), it would agree charges with the broadcaster.”

⁷⁹ AC Consultation Document paragraph 7.77.

- 4.31. Throughout the Consultation Document, Ofcom highlights the purported benefits of Sky's proposed "fixed" charges, in particular:

*"The pricing commitment **would particularly benefit smaller interactive service providers whose AC services charges may represent a significant proportion of their budgets. It would allow S4C, for example, and other FTA broadcasters, to plan and manage their future budgets more effectively**"*⁸⁰

*"There may be some advantages to the proposed commitments compared to conditions, including greater certainty for third parties in relation to pricing. Under the proposed commitments, Sky has undertaken not to charge third parties more than a maximum charge of £100,000 p.a. for ASS and for authentication services charges to be based on a share of costs."*⁸¹ (Emphasis added)

- 4.32. In practice BT does not believe that Sky's proposals to fix some of its charges for AC services is beneficial for third parties.
- 4.33. Firstly, it is important to note the important exclusions with respect to the cap for ASS charges. For the reasons highlighted in paragraphs 2.9 and 2.43 – 2.49 above, voting, betting and gaming services are services where growth in demand may be expected in the future. Yet these are services that are expressly excluded from Sky's proposed cap. Sky does not set out any framework for how prices for these services will be determined.
- 4.34. Secondly, Sky states that authentication services charges would be based on a share of costs, yet under the AC regime that exists today, these services would also be charged on a share of costs basis but the third party would also have the protection that the share of costs it pays would be FRND. As Ofcom recognises:

"Whilst Sky has committed to a maximum charge reflecting shared costs for authentication services, how this share is calculated would be at Sky's discretion to determine (particularly without a reference to charges being FRND in the proposed commitments)." ⁸²

- 4.35. As such, far from providing certainty, Sky's proposals result in a diminution of the protections and certainties that exist today for authentication services charges.
- 4.36. Thirdly, and most importantly, Sky's proposal takes charging for AC services outside the existing Technical Platform Services (TPS) framework and pricing guidelines. Ofcom has not addressed in its consultation how this material change would affect issues around the recovery of common costs across TPS service more generally, and the potential for distortions in pricing of other TPS.
- 4.37. As Ofcom is aware, a large portion of TPS costs are common to all TPS services given the nature of set-top box and platform development and roll out.⁸³ Under the existing TPS

⁸⁰ AC Consultation Document, paragraph 7.121.

⁸¹ AC Consultation Document, paragraph 7.136.

⁸² AC Consultation Document, paragraph 5.10.4.

⁸³ For example, platform marketing and set-top box subsidies are large heads of common costs that Ofcom has permitted Sky to recover through TPS charges generally.

regime, Sky is obliged to offer all TPS on prices which are FRND, and ensure that it recovers its platform costs with a reasonable rate of return. Taking AC services outside this regime will lead to one of two possible outcomes:

- (i) The £100,000 cap leads to Sky over-recovering its common costs in the provision of AC services. In effect, this means that Sky has charged AC customers more than it would have done under the existing regime; i.e. costs to AC customers rise as a result of Sky's commitments, with Sky deriving a material windfall gain.
- (ii) The £100,000 cap leads to Sky under-recovering its common costs in the provision of AC services. This would lead to a shortfall in the recovery by Sky of its TPS common costs overall, unless Sky charges customers of other TPS (conditional access, regionalisation, etc) a higher price (reflecting a greater share of the common costs) in order to make up the shortfall.- This would create distortions in the pricing of other TPS.

4.38. Finally, it is not even clear that fixing the maximum price of AC services today would represent a good deal for AC customers. FRND pricing reflects the actual costs of providing a service given supply and demand conditions that exist at the time an AC customer signs its contract. As such, under an FRND pricing regime, AC customers have certainty that they are paying an appropriate price in line with the cost of providing the service required (and with recourse to Ofcom if they consider they are not).

4.39. In the event demand for AC services increases in the future (as seems likely to be the case for the reasons set out in Section 2 above), then under an FRND pricing regime, maximum charges should fall below the level of charges today (all else being equal). Similarly, if the costs of providing AC services fall AC customers should also reap the benefit.

Profound uncertainty under the commitments

4.40. In the Consultation Document, Ofcom makes a number of unjustified, positive statements about the situation that would prevail if it were to accept the commitments in lieu of new access conditions. For example, in two places Ofcom claims that the commitments would provide "*certainty*" as to the terms on which broadcasters would gain access to Sky's AC services.⁸⁴ But, as is explained below (and as Ofcom elsewhere concedes⁸⁵) this claim is not correct.

4.41. Ofcom refers to Sky's offer "*to incorporate into [existing AC] contracts, on request, a right of renewal on Sky's standard terms at the time of renewal*".⁸⁶ But that 'right' will only be inserted into existing contracts after the existing AC regulation is withdrawn. If, at that stage, Sky were to renege on this offer, Ofcom and existing customers of Sky's AC services would have no remedy.

4.42. Even if, following the withdrawal of the AC regulation, Sky were to insert this 'right' of renewal in existing AC contracts, the 'base line' to Sky's standard terms would not be known

⁸⁴ AC Consultation Document paragraphs 7.120 and 7.126.

⁸⁵ AC Consultation Document paragraph 7.121.

⁸⁶ AC Consultation Document paragraph 5.10.5.

until the AC regulation is removed. At that point, Sky's standard terms could turn out to be onerous for third parties who use Sky's AC services (or otherwise inadequate). In such a situation, given that the AC regulation would just have been removed, neither Ofcom nor any of these third parties would have a remedy against Sky. Ofcom acknowledges the existence of this uncertainty when it states:

*"We note the fact that Sky's standard terms and conditions would only be determined on the date any proposed commitments came into effect **could give rise to uncertainty** for third parties seeking to enter into or renew contracts with Sky".⁸⁷ (Emphasis added.)*

4.43. In practice, however, the word "could" is wholly inappropriate in this sentence. Such a situation **would** give rise to uncertainty. Up until the date on which the AC regulation is removed no-one but Sky would know what Sky's standard terms would be at that date. If, at that date, Sky's standard terms turned out to be unfair, unreasonable or onerous in any other way, it would be too late as neither Ofcom nor any third party would have a remedy against Sky.

4.44. In addition, the actual terms on which a third party could renew its existing AC contract would not be known until the renewal in question took place. At that point too Sky's standard terms could also turn out to be onerous or inadequate for third parties who use Sky's AC services. Again, in this situation, given that the AC regulation would have been removed, neither Ofcom nor any third party would have a remedy against Sky.

4.45. Ofcom suggests that:

"Sky commits not to alter its standard terms without 'good reason', namely changes required to ensure that the terms properly reflect the technologies and processes used by Sky to enable third parties to deliver interactive services via Sky STBs".⁸⁸

4.46. There are four points to make about this suggestion:

- (i) as noted above, the 'base line' to Sky's standard terms is at present uncertain so even if Sky limits any changes to its standard terms, those standard terms may well still be unacceptable;
- (ii) Ofcom errs when it uses the word "namely" in the sentence quoted above as that word implies that these are the only circumstances in which Sky would be able to claim to have "good reason" to change its standard terms. But the drafting of the commitments is not limited in this way;
- (iii) as Ofcom itself concedes, there is in any event "flexibility in how 'good reason' could be interpreted";⁸⁹ and
- (iv) as with the commitments as a whole, Sky's commitment only to alter its standard terms with 'good reason' is not binding.

⁸⁷ AC Consultation Document paragraph 5.10.7.

⁸⁸ AC Consultation Document paragraph 5.10.6.

⁸⁹ AC Consultation Document paragraph 5.10.7.

4.47. In the circumstances, it is clear that Ofcom has no basis for claiming that, under the commitments, Sky will continue to provide AC services *“on terms and conditions set out in or equivalent to its current agreements”*.⁹⁰ Once those current agreements expire, the terms (if any) on which Sky continues to provide AC services could be very different.

4.48. Given this situation, it is notable that Ofcom confirms that:

“... in the absence of regulation, Sky may look to vary the terms of contracts to reflect its own commercial incentives”.⁹¹

4.49. Ofcom goes on to confirm that:

“There are a number of cases where Sky’s incentives may lead to access not being available (or only on disadvantageous terms) ...”.⁹²

4.50. Putting these issues together leads to the following scenario if Ofcom accepts the commitments in lieu of new access conditions:

- (i) in the future, there may or may not be a contractual right for existing customers of Sky’s AC services to renew their contracts;
- (ii) even if there is such a right of renewal, it will be on Sky’s standard terms from time to time which are uncertain;
- (iii) even if Sky complies with the commitments, it has a great deal of flexibility to change its standard terms (and if it doesn’t comply with the commitments its flexibility to change and/or withdraw its standard terms is absolute);
- (iv) in the absence of regulation, Ofcom acknowledges that Sky may vary its terms to reflect its own commercial incentives; and
- (v) there are, according to Ofcom, a number of cases where Sky’s incentives may lead to access not being available or only on disadvantageous terms.

4.51. Ofcom can have no guarantee that this situation will not ensue if it accepts Sky’s commitments in lieu of new access conditions. Furthermore, in the circumstances, it is clear that Ofcom’s claim that Sky’s commitments *“provide certainty as to the terms on which it would give ... access”*⁹³ is without foundation.

4.52. There are two more points of principle to be made about the lack of certainty that would prevail under the commitments. Firstly, Ofcom notes that:

“Sky offers to provide standard terms which would be ‘reasonable’ for the provision of Technical Services”.⁹⁴

⁹⁰ AC Consultation Document paragraph 7.5(d).

⁹¹ AC Consultation Document paragraph 7.52.

⁹² AC Consultation Document paragraph 7.55.

⁹³ AC Consultation Document paragraphs 7.120 and 7.126.

⁹⁴ AC Consultation Document paragraph 5.11.5.

4.53. However, Ofcom goes on to acknowledge that:

*“The commitment to provide access on ‘reasonable’ terms would give Sky some flexibility to **interpret what it considered was ‘reasonable’** particularly in the absence of any published guidance”.⁹⁵ (Emphasis added.)*

4.54. In practice, if Sky did not comply with the unenforceable commitments, it could specify any terms (or even none). If Sky did comply with the commitments and offer “reasonable” terms, it could interpret what was reasonable in a way that suited its commercial objectives and neither Ofcom nor any third party would have any grounds for objecting to that interpretation.

4.55. The key issue to note here is that it would be down to Sky to decide whether or not to observe its commitments and, if it did observe them, it would, as Ofcom acknowledges, be down to Sky as to how its commitments would be interpreted. Yet for the reasons explained in Section 3 above (and as Ofcom notes) Sky’s incentives would be to confer an unfair competitive advantage on itself. For example, Ofcom notes that:

“... where [sports or other content] rights are being offered, it may be in Sky’s interests not to offer access or to guarantee access”.⁹⁶

4.56. In addition, Sky does not commit to offer terms that are fair and non-discriminatory. In this context, Ofcom erred when it claimed:

“... the fact that the proposed commitments and a reference offer would be published on Sky’s website emphasises Sky’s commitment to prevent discrimination”.⁹⁷

4.57. In fact Sky has made no commitment to prevent discrimination, as Ofcom partially acknowledged when it stated:

“there is no explicit commitment in relation to discrimination between internal supply by Sky and supply to external third parties within the proposed commitments”.⁹⁸

4.58. As a result, Sky could favour its own retail business in terms of access to its AC services without breaching the commitments. In fact, such an outcome is effectively hard-wired into the commitments as they do not cover the supply by Sky of AC services for new enhanced TV services over Sky’s new boxes but Sky will undoubtedly make use of such AC services for the benefit of its own retail business.

4.59. On the issue of discrimination between third parties, Sky offers no commitment to refrain from doing this and Ofcom should note that discrimination can arise in two ways: (i) by supplying parties in the same circumstances with different terms and (ii) by supplying parties in different circumstances with the same terms. Hence even if, under the commitments, Sky

⁹⁵ Ibid.

⁹⁶ AC Consultation Document paragraph 7.59.

⁹⁷ AC Consultation Document paragraph 7.124.

⁹⁸ AC Consultation Document paragraph 7.142.

were to publish a reference offer on its website and offer those terms to all prospective customers of AC services, Sky may well still be discriminating between different third parties.

- 4.60. In the circumstances, and in light of Ofcom's analysis as set out in the Consultation Document, it would be entirely inappropriate for Ofcom to usher in a situation in which all decisions as to whether, and if so on what terms, Sky would give third parties access to its AC services (at least, for enhanced TV services) were left to be determined by Sky. Yet that is precisely the situation that will arise if Ofcom accepts Sky's proposed commitments in lieu of new access conditions.
- 4.61. The final point of principle about lack of certainty under Sky's proposed commitments is that, even setting aside all the issues outlined above, Sky's drafting of the commitments results in a lack of certainty. For example, it should be noted that the definitions of Current and Future STBs in the commitments both contain the phrase "*Sky set top boxes **which Sky confirms are supported for use** ...*" (emphasis added). If Sky declines to provide that confirmation for certain types of boxes, they would fall outside the commitments and neither Ofcom nor any third party would have any remedy. Therefore, third parties cannot be certain in respect of which of Sky's satellite boxes (if any) they will be able to make use of access control services. This will risk giving rise to a material impediment to fair and effective competition, not least due to the resulting complex marketing message which is outlined in paragraph 4.15 above.
- 4.62. There are other examples of uncertainty resulting from Sky's drafting of the commitments and BT reserves its position in respect of them. BT does not intend to seek to correct that drafting here as such corrected drafting would not in any way address the fundamental defects in principle with the commitments outlined above.

Monitoring and compliance with the unenforceable commitments

- 4.63. The starting point when considering the likely effectiveness of Sky's proposed commitments should be Ofcom's acknowledgement that:

"Sky's proposed commitments are voluntary and are not legally binding. This means that Ofcom would not be able to take enforcement action against Sky if it did not act in accordance with its proposed commitments".⁹⁹

- 4.64. Notwithstanding the fact that the commitments are unenforceable, Ofcom seems to assume in the Consultation Document that Sky will comply with the commitments. In support of this assumption, Ofcom puts forward only the following:

"Sky told us that any commitments would be signed by its CEO and published on Sky's corporate website. It argued that it would suffer reputational damage if it were to renege on such commitments".¹⁰⁰

⁹⁹ AC Consultation Document paragraph 5.4.

¹⁰⁰ AC Consultation Document paragraph 5.5.

“Sky indicated that the proposed commitments would be signed by its Chief Executive Officer and would be available on its website. It also said it would suffer reputational damage if it were to renege on such commitments”.¹⁰¹

“However, the proposed commitments would be signed by Sky’s CEO and would be made available on its website. Sky has indicated that we should consider that this means that it takes the proposed commitments seriously and is unlikely to breach them”.¹⁰²

By reciting this claim three times in its Consultation Document, Ofcom seems to be trying to give it greater emphasis and hence greater credibility. Ofcom does not, however, make any attempt to analyse this claim.

- 4.65. In practice, if Sky were to depart from these commitments in the future, that would not be some inadvertent act that left Sky embarrassed and with a damaged reputation. Instead, it would be a very carefully orchestrated, deliberate action on Sky’s part.
- 4.66. Sky already has the reputation for being utterly uncompromising in opposing regulation of its business. If, at some point in the future, it were to consider it appropriate to depart from these unenforceable commitments, then its management would explain to its shareholders, the wider investment community and the media industry why it was doing this. In that situation, Sky would have persuaded its regulator to drop legally enforceable regulation, replace it with unenforceable commitments and then Sky would have decided that the circumstances were such that it no longer needed to comply with these unenforceable commitments and it would have been very careful to explain its rationale for this action. In this way, Sky would ensure that it did not suffer any reputational damage (although its reputation for being uncompromising with the regulators could be enhanced by this). Therefore, the claim that Sky will suffer reputational damage if it departs from the commitments is not credible.
- 4.67. More importantly, however, it would not be correct to think of this issue just in binary terms – i.e. that Sky either complies with the commitments or it doesn’t. As is explained above, there are ‘grey areas’ where the interpretation of the commitments would be down to Sky. It is highly likely that the interpretation of the ‘grey areas’ that Sky would choose to adopt would be very different from the interpretation of Ofcom and Sky’s competitors. Notwithstanding these differences of interpretation, Sky would claim that it was complying with the commitments. As the question of interpretation of the commitments would ultimately be down to Sky’s discretion, neither Ofcom nor any third party would have any means to try to achieve a different interpretation. Therefore, Sky would not have to renege on its commitments in order to impede fair and effective competition by restricting access to its AC services. By forbearing from regulating AC services, Ofcom would have left itself impotent in such a situation.
- 4.68. This question of interpretation of the commitments has been largely overlooked by Ofcom. Throughout the Consultation Document, Ofcom displays an unfounded optimism about the likely effectiveness of Sky’s proposed commitments which is implicitly based on the

¹⁰¹ AC Consultation Document paragraph 7.115.

¹⁰² AC Consultation Document paragraph 7.139.

assumption that Sky will interpret them in a benign way – pretty much as Ofcom itself would interpret them. For example, Ofcom states:

*“The proposed commitments would give access to its platform on an on-going basis to third parties to provide interactive services”.*¹⁰³

4.69. Yet there is no way that Ofcom can be sure that this will be the outcome. As is explained above, the scope of the commitments is limited and does not extend to future enhanced or interactive TV services over Sky’s new set top boxes. (Furthermore, Sky has expressly confirmed that it is *“reluctant ... to make [new] functionality available to third parties”*.¹⁰⁴) Thus Ofcom’s sweeping claim about access to the satellite platform (without any exception) will very quickly be shown not to be correct. In addition, given the uncertainty under the commitments which is highlighted above then, even if Sky complies with the commitments, Ofcom cannot be sure that third parties will achieve any access for interactive services in future – for example, because Sky may, under the commitments, introduce standard terms which are so onerous as to prevent third parties using its AC services. In practice, for the reasons explained in Section 3 above, given Sky’s incentives this benign outcome postulated by Ofcom is not likely to arise.

4.70. Ofcom also erroneously claims that:

*“... the proposed commitments provide evidence ... of what is likely to happen if regulation is removed”.*¹⁰⁵

4.71. But, among other things, not only can Ofcom not be certain what Sky’s standard terms will be under the commitments or how Sky will interpret the expressions *“reasonable”* and *“good reason”*, but also it does not know which (if any) of Sky’s boxes it will confirm as being covered by the commitments. So in its assessment in the Consultation Document Ofcom has failed to have due regard to the lack of certainty that prevails under the commitments. In the circumstances, Ofcom’s claim that the commitments are actual evidence of *“what is likely to happen”* is clearly without foundation.

4.72. Ofcom also makes a flawed claim when it states that:

*“We consider that the proposed commitments, if effective, offer largely the same outcome as the conditions”.*¹⁰⁶

4.73. Even if the commitments were effective and the myriad sources of uncertainty outlined above were resolved in a way that did not exclude third party enhanced TV services from Sky’s platform, the commitments would still not extend to new enhanced TV services over Sky’s new boxes – whereas the new access conditions would cover such new services. Therefore, even under the most benign and positive interpretation of the commitments (which, given Sky’s incentives, will not be the one that Sky can reasonably be expected to

¹⁰³ AC Consultation Document paragraph 7.116.

¹⁰⁴ See paragraph 4.24, above.

¹⁰⁵ AC Consultation Document paragraph 5.6.

¹⁰⁶ AC Consultation Document paragraph 7.135.

adopt), those commitments would still not have the same outcome as the new access conditions.

4.74. Ultimately, therefore, Ofcom needs to modify its assessment of the likely effectiveness of the commitments to take into account the following fundamental principles:

- (i) the commitments do not extend to new services over new boxes - which is a material omission;
- (ii) the commitments are uncertain in numerous critical respects, so Ofcom cannot predict the outcome even if Sky arguably complies with them; and
- (iii) the commitments are unenforceable in any event and so Ofcom is not justified in assuming that Sky will comply with them in a manner which will ensure that the pro-competitive objective of the (otherwise soon to be former) AC regulatory regime.

4.75. Notwithstanding all the issues cited above, Ofcom seems to draw some comfort from the fact that it would have a 'monitoring' role under Sky's proposed commitments. Specifically, Ofcom states:

"Sky has offered to provide Ofcom on written request all information that it would require to monitor adherence to the commitments".¹⁰⁷

4.76. There are two points to raise here. Firstly, although Ofcom says it will have access to a wide-range of information, it will apparently only be monitoring the adherence to the commitments, not whether the commitments are in fact effective. As noted above, given the uncertainty under the commitments and the fact that their interpretation is down to Sky, Sky could arguably be adhering to them whilst the outcome is materially adverse to fair and effective competition.

4.77. Secondly, if Ofcom were, as a result of this monitoring, to conclude that Sky was not adhering to the commitments, what would Ofcom do about it? If Ofcom were to conclude that, notwithstanding the commitments, third parties were being unfairly excluded from access to Sky's AC services, it would have no remedy available to it. The act of 'monitoring' in such circumstances offers little comfort.

4.78. In this regard, Ofcom suggests:

"We note however, that although the proposed commitments lack enforceability ... we would be able to consider the case for imposing access-conditions under sections 45 and 73 of the Act based on an updated assessment of the effectiveness of the commitments and examination of existing market conditions".¹⁰⁸

4.79. In this scenario, Ofcom would have taken over two years to consider and revoke the current AC conditions and to accept Sky's proposed commitments in lieu of new access conditions. Ofcom would subsequently conclude that Sky's commitments were not effective. It would need to conduct a further round of consultation to gather fresh evidence on the then

¹⁰⁷ AC Consultation Document paragraph 5.9.

¹⁰⁸ AC Consultation Document paragraph 7.143.

prevailing market conditions before deciding whether to introduce new access conditions. In practice, this scenario is so fraught with difficulties and delays that Ofcom cannot reasonably attach any weight to it when comparing the relative merits of (i) Sky's proposed commitments and (ii) the introduction of new access conditions at this stage. Again, such 'protection' provides no practical comfort to BT.

- 4.80. Given the substantial risks that would result if Ofcom were to cease to regulate Sky's AC services at this stage, and in light of the proven case of demand for AC services (at least, for enhanced TV services) and the harm to competition were AC services not made available on an FRND basis, the only reasonable course for Ofcom is to decline Sky's offer of unenforceable commitments and to imposed new access conditions.
- 4.81. In the section below, BT explains why none of the problems with Sky's proposed commitments which are highlighted above would arise in respect of new access conditions.

5. **REGULATION ADDRESSES THE COMPETITION CONCERNS WITH NO ADVERSE CONSEQUENCES**

Overview

- 5.1. The previous section highlighted a number of material shortcomings with Sky's proposed commitments. Due to these shortcomings, the commitments cannot achieve Ofcom's stated objectives of ensuring that:

"enhanced TV services provided by third parties have access to Sky's AC services [on fair, reasonable and non-discriminatory terms] and can continue to be provided for the benefit of end-users, thereby helping to ensure sustainable competition in both FTA and pay TV".¹⁰⁹

- 5.2. Section 4 also highlights a number of areas where Ofcom has overstated the benefits that would result from the commitments.
- 5.3. In this section, BT demonstrates that the shortcomings with the commitments would not arise if Ofcom were to adopt new access conditions and thus the conditions would achieve Ofcom's objectives cited above. In addition, in this section BT demonstrates that, under the new access conditions, Sky will have an *"incentive to invest and innovate and develop new platform services in the future"*,¹¹⁰ a point which Ofcom itself expressly acknowledges in the Consultation Document.¹¹¹

New access conditions address the problems identified with the unenforceable commitments

Scope

- 5.4. As noted in Section 4 above, a key deficiency with Sky's proposed commitments is that they would not address new enhanced TV services over new Sky boxes. Under condition 1, Sky would be obliged to provide the Access Control Services that are reasonably requested by any third party. These would include AC services over future as well as current Sky boxes and would not be limited to the current applications such as red button and commercial watermarking but would, for example, enable the provision of any Specified Programme Services which would include *"any ... service which is ancillary to a programme included within a television broadcasting service and directly related to its contents"*.¹¹²
- 5.5. Therefore this material deficiency with Sky's proposed commitments is resolved by the new access conditions.
- 5.6. In the Consultation Document, Ofcom states:

¹⁰⁹ AC Consultation Document paragraph 7.131.

¹¹⁰ Ibid.

¹¹¹ AC Consultation Document paragraphs 7.134 and 7.109.

¹¹² See the definition of *"Ancillary Service"* in Part 1 of the conditions.

*“...the draft conditions are limited to those services for which we have identified demand (e.g. enhanced TV services) and so may be narrower than the proposed commitments in this respect”.*¹¹³

5.7. As noted above, the AC services under the new access conditions would cover current and future enhanced TV services over Sky’s current and future boxes whereas the Sky’s proposed commitments would cover current and future enhanced TV services over Sky’s current boxes but only current enhanced TV services over Sky’s future boxes. It is clear, therefore that when comparing the new access conditions and Sky’s proposed commitments, Ofcom has failed to have due regard to the fact that the latter are narrower in scope in this material respect.

5.8. Ofcom compounds this misinterpretation later in the Consultation Document when it expressly considers new technology. Ofcom states:

*“Where new functionality is made available on Sky’s platform (for, example via a new STB), it may be possible to provide enhanced TV services in new and better ways. Under both commitments and conditions there may be a difference of opinion whether these constitute new services (that are excluded from the scope of the commitments and/or conditions)”.*¹¹⁴

5.9. However, under the new access conditions, it is not a relevant consideration whether the AC services are to be used by a third party to develop **new** enhanced TV services or old ones. Provided a third party makes a reasonable request for Access Control Services, then Sky must provide them. Yet again, therefore, Ofcom’s comparison between the commitments and the new access conditions is flawed because Ofcom has erroneously suggested that new enhanced TV services on new Sky set-top boxes are excluded from both the commitments and the new access conditions when, in practice, they are just excluded from the former.

AC Charges

5.10. As noted in Section 4 above, there are material issues with Sky’s proposals to set charges for some AC services under its commitments, not least the fact that the proposed approach could lead to material distortions in the pricing of other TPS more generally. Under Condition 2, as is the case today, Sky would be required to offer AC services on FRND terms and conditions, including charges.

5.11. This covers all AC services, with no exceptions. This means that all AC customers would have certainty that the prices they are charged are cost oriented, and, in particular, that these prices would fall if demand for AC services increased or the cost of supply falls over time. While BT accepts that this may mean that AC charges could also rise, the point is that this would only be the case if the proportion of legitimate costs that Sky was entitled to recover increased over time (with a backstop to Ofcom in the event of a dispute with Sky). In such circumstances, under the new access conditions any increase in AC charges would still need to be FRND.

¹¹³ AC Consultation Document paragraph 7.138.

¹¹⁴ AC Consultation Document paragraph 7.140 (iii).

- 5.12. In addition, it should be noted that Condition 2 would not cause issues with the existing TPS regime, since it replicates what is already in place today and, as such, should be fully compatible.

Uncertainty

- 5.13. Under Sky's proposed commitments, there is uncertainty over whether existing users of Sky's AC services would be able to renew their contracts with Sky. That uncertainty would not arise under the new access conditions because, under those conditions, Sky would be required to provide the AC services that are reasonably requested by any third party.
- 5.14. Under Sky's proposed commitments, there is uncertainty over the terms (if any) on which Sky would supply AC services. In contrast, under condition 2, Sky would be obliged to provide AC services on terms that are fair, reasonable and non-discriminatory.
- 5.15. Contrary to the situation under the commitments, there would be no risk under the new access conditions of Sky seeking to interpret the concept of 'reasonable' terms in a way that is adverse to fair and effective competition. This is because the interpretation of the new access conditions would ultimately be a matter for Ofcom in accordance with its published guidelines, whereas the interpretation of the commitments would be down to Sky's discretion.
- 5.16. Similarly any variations to Sky's terms for AC services would, under the new access conditions, have to be fair, reasonable and non-discriminatory. In contrast, under the commitments Sky would not be so constrained over any changes to its terms for AC services (and would, in fact, be totally unconstrained over such changes if it chose not to comply with the commitments). Even if Sky were to comply with its proposed commitments, it could specify terms for AC services which were unfair and discriminatory.
- 5.17. As noted in paragraph 4.47 above, Ofcom erroneously claims that, under the commitments, Sky will continue to provide AC services "*on terms and conditions set out in or equivalent to its current agreements*".¹¹⁵ Such a claim would, however, only be correct in respect of the situation that would prevail under the new access conditions.
- 5.18. As noted in paragraph 4.48 above, Ofcom confirms that "*in the absence of regulation, Sky may look to vary the terms of contracts to reflect its own commercial incentives*",¹¹⁶ and that "*There are a number of cases where Sky's incentives may lead to access not being available (or only on disadvantageous terms)*".¹¹⁷ Sky would, however, be unable to act on its incentives in this way under the new access conditions.
- 5.19. It is clear, therefore, that the very substantial uncertainty that would prevail under Sky's proposed commitments would not arise under the new access conditions.

¹¹⁵ AC Consultation Document paragraph 7.5(d).

¹¹⁶ AC Consultation Document paragraph 7.52.

¹¹⁷ AC Consultation Document paragraph 7.55.

Enforcement

- 5.20. Self-evidently, a very material difference between Sky's proposed commitments and the new access conditions is that the former would not be legally binding and so would be unenforceable whereas the latter would be legally binding and so could be enforced by Ofcom.
- 5.21. In addition to this point of principle, it is important to note that all the problems that could arise due to Sky interpreting and implementing its commitments in a way that is adverse to fair and effective competition would not arise under the new access conditions (e.g. in respect of the meaning of the term "*reasonable*"). This is because the interpretation of the new access conditions would be a matter for Ofcom, which would be impartial in this regard (and subject to various statutory duties in terms of promoting competition and consumer benefits), whereas Sky would be partial in this regard and would be able to favour its own commercial interests.
- 5.22. In addition, it should be noted that, under the new access conditions, Ofcom would have available to it all its statutory powers of monitoring and information gathering and these activities would clearly serve a very useful purpose in the context of any action by Ofcom to enforce the new access conditions. In contrast, as noted in paragraph 4.77 above, any monitoring activity by Ofcom under Sky's proposed commitments does not afford any meaningful comfort to BT.

The new access conditions do not impact Sky's incentives to innovate or invest

- 5.23. BT agrees with Ofcom's view that:

"Regulation should not unduly impede incentives to innovate and invest in new services and functionality".¹¹⁸

- 5.24. However, in the case of regulation of AC services, there is no evidence to suggest that Sky's legitimate incentives as a platform operator to innovate or invest have been or will be impacted by regulation in this area. Indeed, as set out in Section 3 above, the only arguments put forward by Sky to suggest that its incentives to innovate or invest have been impacted are vague assertions around its "*reluctance*" to develop new set-top box functionality, and its limited usage of the Ethernet connection.¹¹⁹ These clearly demonstrate that the impact results from Sky's desire to limit competition rather than any impact on its legitimate incentives as a platform operator.
- 5.25. However, given the relative size of Sky's subscriber base compared with the number of subscribers for each third party pay TV offerings using Sky's AC services, it is inconceivable that Sky would fail to undertake the necessary AC investment to implement a service that would benefit its own retail business on the satellite platform far more than its competitors on that platform. If Sky identified a new AC service that would have mass appeal to its own 10 million plus subscribers (including, on BT's internal estimates, 5 million plus sports subscribers), it is totally implausible that Sky would withhold development of such a service

¹¹⁸ AC Consultation Document, paragraph 1.6.

¹¹⁹ See paragraphs 31, 39 and 40 of Sky's initial submission.

merely to preclude BT from providing a similar service to its own [3<] BT Sport subscribers on satellite. It is, therefore, important that Ofcom has due regard to the fact that, given the relative size of Sky's own subscriber base, it will always be by far and away the biggest beneficiary of any new development on its platform.

- 5.26. In addition, AC services make up a relatively small proportion of the overall common costs associated with the provision of technical platform services (TPS) on Sky's platform. Even if AC regulation were removed, all other aspects of TPS would remain regulated (conditional access, access to the EPG, regionalisation services, etc). As such, given the relative costs and revenues associated with AC services it is difficult to see Sky's decision to undertake major investment in its platform and/or set-top boxes being withheld due to on-going AC regulation.
- 5.27. This is further borne out by the fact that, despite Sky's vague claims that it has been reluctant to develop new set-top box functionality and make use of its Ethernet port, in practice TPS regulation, including AC regulation, does not appear to have hampered Sky's investment in, and development of, new set-top box functionality to date. Despite the existence of TPS regulation, Sky has consistently produced new generations of set-top boxes, with updated features and functionality over the last 15 years, and Sky's Brand Director of TV Products has publicly confirmed that Sky *"...invest[s] pretty substantially in [its] broadcast platform every year"*¹²⁰.. It has also been widely reported that Sky is well advanced in its development of its "Project Ethan" set-top box, which will represent a major overhaul of its set-top box¹²¹, and Sky's proposed commitments have confirmed that its new set-top box will not have OpenTV v1.2/v1.3 middleware and thus AC services on this new set-top box may be quite different¹²².
- 5.28. Moreover, the suggestion that AC regulation has been the driving force behind Sky's limited usage of its Ethernet connection seems less plausible than the fact Sky did not have a strong incentive to roll out services that most of its subscriber base could not receive given the portion of Sky's base with older generation set-top boxes without Ethernet ports, and limited broadband connectivity. It is notable that Sky only "switched on" internet capabilities via the Ethernet port to its customer base in 2010 after resolving software integration issues.¹²³ Even as late as June 2013, only one quarter of Sky's existing base was connected.¹²⁴ Following extensive investment of £70 million in the financial year 2013/14¹²⁵, and *"a big push to drive take-up and usage of connected TV services,"*¹²⁶ Sky connected an additional 3

¹²⁰ www.stuff.tv/sky/project-ethan-revamp-will-transform-sky-s-set-top-box-service/news

¹²¹ www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/media/10789883/BSkyB-plans-major-overhaul-of-set-top-box-to-meet-Apple-threat.html and www.digitalspy.co.uk/tech/news/a567041/sky-to-launch-new-set-top-box-with-cloud-storage-4k-support.html#~oOHImM4wcut1Un

¹²² See BT's 21 January 2014 note to Ofcom following up on points that arose from the Ofcom/BT meeting on 10 December 2013.

¹²³ www.telegraph.co.uk/technology/news/7802800/Sky-turns-on-set-top-box-internet-connection.html

¹²⁴ corporate.sky.com/documents/pdf/latest_results/fy1213_press_release.pdf

¹²⁵ See slide 11 of corporate.sky.com/documents/announcement/bskyb_q4_results_2014.pdf and slide 54 corporate.sky.com/documents/pdf/latest_results/q2_1314_presentation.pdf; see also www.theguardian.com/media/2014/may/01/bskyb-tv-broadband-now-tv

¹²⁶ corporate.sky.com/media/press_releases/2014/most_sky_tv_customers_now_connected_to_on_demand

million boxes to a broadband line, meaning half of its TV customers (5.7 million subscribers)¹²⁷ now have the necessary capabilities to use AC services delivered via the Ethernet port and a broadband line.¹²⁸

- 5.29. It is unsurprising then, that over the period prior to 2013 Sky made limited usage of its Ethernet connection, and also why it is eager now, via its proposed commitments to limit other broadcasters' ability to deliver new enhanced or interactive TV services over new boxes as discussed in detail at paragraphs 4. 3 to 4.29 above.
- 5.30. It is also important to note, that the proposed new access conditions retain the existing FRND regime, rather than price control regulation, or detailed access related conditions such as those imposed on BT Openreach. Therefore, Sky would still be able to fully recover any costs of investment with a reasonable rate of return, within a flexible non-prescriptive regulatory regime. It is difficult to see how this can have the "chilling effect" on its willingness to innovate and invest that Sky claims. At the same time, third parties would also be afforded the certainty of access to AC services under an appropriate, enforceable regulatory regime, to ensure that the dynamic benefits from increased competition are preserved.
- 5.31. Finally, it is important to recognise that the issue of Sky's incentives to invest in new set-top box technology is not a differentiator between the new access conditions and Sky's proposed commitments. This is because Ofcom has confirmed that:

"We consider the proposed commitments would enable Sky to invest and innovate. Whilst developing the draft conditions, we have been mindful of Sky's investment and innovation incentives and consider that the draft conditions would also enable Sky to invest and innovate".¹²⁹

- 5.32. Therefore, Sky will maintain incentives to invest in platform technology under both its proposed commitments and the new access conditions. The fact that the new access conditions would not have an adverse effect on Sky's investment incentives was acknowledged by Ofcom when it stated:

"... we do not consider that the draft conditions would produce adverse effects for Sky".¹³⁰

¹²⁷ See slide 9 of http://corporate.sky.com/documents/announcement/bskyb_q4_results_2014.pdf

¹²⁸ http://corporate.sky.com/documents/pdf/latest_results/fy1314_press_release.pdf. It is notable that Sky highlights that increased connectivity has delivered "increased viewing, satisfaction and loyalty."

¹²⁹ AC Consultation Document paragraph 7.134.

¹³⁰ AC Consultation Document paragraph 7.109.

6. **THE QUESTION OF IMPOSING NEW ACCESS CONDITIONS VERSUS REGULATION IS NOT FINELY BALANCED**

Overview

6.1. Ofcom concludes its Consultation Document as follows:

*“Given the presence of Sky’s proposed commitments, our view is that the question of imposing conditions is finely balanced... The draft conditions address the concerns that we have identified following the July 2013 consultation and have the benefit of providing a regulatory framework within which complaints and disputes can be addressed. However, given Sky’s proposed commitments we consider that the concerns raised might be addressed without the imposition of conditions”.*¹³¹

6.2. Ofcom’s conclusion that the question of imposing the new access conditions is “*finely balanced*” is based upon an erroneous comparison between Sky’s proposed commitments and the new access conditions. In particular, as sections 4 and 5 above demonstrate, Ofcom has overstated the benefits of the commitments whilst ignoring certain benefits of the new access conditions and understating the risks associated with the commitments. Once these errors are corrected, it is clear that there is an overwhelming case for imposing the new access conditions.

Sky’s reasons for removing the new access conditions have been shown to be false

6.3. As Ofcom notes, Sky argued that the AC regulation should be removed because (i) it is no longer needed because there is no significant demand for AC services, (ii) the costs of this regulation on Sky are material and burdensome and (iii) it inhibits innovation.¹³²

6.4. Yet the previous round of consultation on this issue has proven that there still is demand from third parties for access to Sky’s AC services;¹³³ Ofcom has concluded on the basis of the evidence it has gathered that the proposed new access conditions allow Sky “*to recover the reasonably incurred costs of providing access*”,¹³⁴ and “*enable Sky to invest and innovate*”.¹³⁵

6.5. In the circumstances, Sky’s case for removing AC regulation clearly lacks merit.

The case for imposing new access conditions is not “*finely balanced*”

6.6. In reaching the conclusion that the case for imposing new access conditions is “*finely balanced*”, Ofcom’s assessment has made a number of material errors which are outlined in sections 4 and 5 above. Certain of these are briefly summarised below.

6.7. Ofcom does not have due regard to the fact that Sky’s proposed commitments would not cover new enhanced TV services over new Sky boxes, whereas access to Sky’s AC services in

¹³¹ AC Consultation Document paragraph 7.144.

¹³² AC Consultation Document paragraphs 2.26 and 5.1.

¹³³ AC Consultation Document, Section 3; see also Section 2 of this response.

¹³⁴ AC Consultation Document paragraph 7.109.

¹³⁵ AC Consultation Document paragraph 7.134.

this context would be ensured by the new access conditions. In practice, Ofcom's error in this respect is not just one of omission, as Ofcom mistakenly suggest that the scope of the new access conditions "*may be narrower than the proposed commitments*". Once this omission and mistaken belief on Ofcom's part are corrected, the case for the new access conditions clearly becomes very much stronger.

- 6.8. Ofcom does not have due regard to the fact that the terms, if any, on which Sky would provide access under the commitments are uncertain. In this context, Ofcom erroneously claims that:

"[Sky will] provide for services and capabilities to be maintained on terms and conditions set out in, or equivalent to, its current agreements";¹³⁶

"Sky's ... proposed commitments would ...provide certainty as to the terms on which it would give this access";¹³⁷ and

"the commitments would provide pay TV broadcasters with greater certainty both in relation to services but also to pricing and terms and conditions".¹³⁸

- 6.9. For the reasons explained in Section 4 above, this claimed certainty will not ensue under Sky's proposed commitments. Ofcom's assessment in the Consultation Document does not have due regard to this fact.
- 6.10. Furthermore, Ofcom has no basis for assuming that Sky will comply with the terms of its proposed commitments. The claim that Sky will suffer reputational damage if it departs from its commitments is not correct for the reasons set out in Section 4 above.
- 6.11. Even if Sky were to comply with its proposed commitments, it would still be able to interpret and implement them in a way that was adverse to fair and effective competition. Thus, for the reasons explained in Section 4 above, it is wrong to think of the issue of enforcement in purely binary terms – i.e. that Sky either complies with the commitments or it doesn't. There are many 'grey areas' where the interpretation of the commitments will be down to Sky's discretion. This issue has not been given appropriate weight by Ofcom in the Consultation Document.
- 6.12. In light of this, and the other issues set out in sections 4 and 5 above, Ofcom is not correct when it states:

"The commitments would appear to satisfy the majority of the concerns raised by stakeholders";¹³⁹ and

"The proposed commitments, should they come into effect, appear to address the major concerns raised by BT".¹⁴⁰

¹³⁶ AC Consultation Document paragraph 7.5(d).

¹³⁷ AC Consultation Document paragraph 7.120.

¹³⁸ AC Consultation Document paragraph 7.126.

¹³⁹ AC Consultation Document paragraph 7.124.

¹⁴⁰ AC Consultation Document paragraph 7.129.

6.13. This latter quote confirms that Ofcom has not had due regard to the shortcomings with the commitments. If it had done so, it would have realised that the commitments are incapable of addressing the concerns that BT has raised both previously and in this response.

6.14. Ofcom is also not correct when it suggests that:

“formal conditions may be less attractive to third parties than Sky’s proposed commitments”,¹⁴¹¹⁴² and

“There may be some advantages to the proposed commitments compared to conditions”.

6.15. The only example of such alleged advantages that Ofcom puts forward is the proposed fixing of Sky’s prices for AC services under the commitments. Ofcom claims that the “certainty” that would be derived due to Sky’s proposal to fix some of its charges for AC services would be an advantage. However, for the reasons explained in Section 4 above, this is simply not the case. Far from providing certainty, Sky’s proposals result in a diminution of the protections and certainties that exist under the FRND regime that exists today and are unlikely to represent a good deal for AC customers. More importantly, the commitments create the likelihood of either (i) Sky deriving an unwarranted windfall gain by over recovering its AC costs or (ii) a shortfall in common costs that would be made up by Sky in the charges for other TPS, creating unwarranted distortions across other products and operators.

6.16. In contrast, the new access conditions ensure that all AC customers would have certainty that the prices they are charged are cost oriented, FRND and, in particular, that prices would reflect the prevailing demand and supply conditions (with a backstop to Ofcom in the event of a dispute with Sky).

The new access conditions are objectively justifiable, not unduly discriminatory, proportionate and transparent

6.17. Ofcom states that:

“elements of the legal test in section 47 of the Act, notably objective justification and proportionality, require us to consider whether the proposed commitments would be sufficient, such that replacement regulatory conditions are not necessary”.¹⁴³

6.18. In light of all the issues outlined above, it is clear that the commitments are not sufficient to ensure that Sky does not obtain an unfair competitive advantage by restricting access to its AC services or by only providing such access on terms that are unfair, unreasonable and/or discriminatory. In the circumstances, the new access conditions are necessary to prevent such an adverse outcome for competition and consumers.

6.19. Furthermore, BT considers that the new access conditions satisfy all the criteria set out in section 47(2) of the Communications Act 2003 (the “Act”) which apply to the setting or

¹⁴¹ AC Consultation Document paragraph 7.136.

¹⁴² AC Consultation Document paragraph 1.15.

¹⁴³ AC Consultation Document paragraph 7.132.

modification of conditions under section 45 of the Act, because the new access conditions are objectively justifiable, not unduly discriminatory, proportionate and transparent for the reasons set out in Sections 2 to 6 of this submission.

7. FUTURE PROOFING

The need for a flexible regime for assessing new Access Control services

Enhanced TV services

- 7.1. Building on BT's arguments set out in Section 2 above, in particular paragraphs 2.56 – 2.59, BT agrees with Ofcom's conclusion that there is proven demand for AC services to enable the provision of enhanced TV services¹⁴⁴ and that, with ongoing technological developments (notably with the imminent introduction by Sky of a new set-top box), it is important to ensure that Sky's rivals are able to provide new enhanced TV services as well as continuing to provide existing enhanced TV services.¹⁴⁵
- 7.2. Sky's vertical integration and market position mean it can be expected to maintain its gateway control position in the provision of AC services and its incentives to limit access to third party services that compete with its own broadcast services. The introduction of Sky's next generation set-top box is likely to reinforce, rather than reduce, Sky's gateway control of access control services and so the competition concerns set out on in Section 3 of this response are likely to arise equally with new enhanced TV services. Such a position, when allied to an enduring incentive to restrict competitors' access to AC services, particularly if unfettered by an appropriate set of new access conditions, would inhibit the pro-consumer benefits of enhanced competition.
- 7.3. BT accepts that proven demand today arises for Sky's AC services which are a necessary input for certain enhanced TV services (in BT's case alternative video streams for clash management, commercial watermarking [3<]). BT does not propose that Ofcom attempts at this stage to anticipate all potential developments of AC services in the future (although it is important that Ofcom carefully monitors demand for AC services which are required for interactive services that are not enhanced TV services as discussed further in paragraphs 7.11 to 7.12 below).
- 7.4. In light of Sky's plans to develop new set-top boxes that will offer new functionality, it is to be expected that demand for AC services will grow (notably, to enable additional/alternative enhanced TV services to those that are available today). BT acknowledges that there may be genuine questions around the application of the new access conditions in the context of new enhanced TV services delivered over Sky's platform in the future.
- 7.5. However, any uncertainty over the application of the new access conditions to such developments would provide an opportunity for obfuscation and delay by Sky in the provision of AC Services (as defined under the new access conditions)¹⁴⁶ due to Sky's incentives to limit supply of AC services to third party rivals. It may also lead to fairly significant involvement by Ofcom in helping resolve such issues.
- 7.6. For example, Sky may refuse to provide AC services for a third party application that could be considered to be both a contextual/commercial service and an enhanced TV service. Sky

¹⁴⁴ AC Consultation Document, paragraph 3.80.

¹⁴⁵ AC Consultation Document, paragraph 3.82.

¹⁴⁶ This would cover the enhanced TV services which Ofcom discussed in the AC Consultation Document.

may seek to justify that refusal on the ground that the application is a contextual/commercial service. (As noted in paragraphs 2.40 – 2.42 above, if a service can be considered to be an enhanced TV service, even if it also has elements of being a contextual/commercial service, it should be treated as an enhanced TV service for the purposes of the AC regime.) Likewise, questions could arise over whether any proposed terms of provision (including charges) for AC services in relation to such enhanced TV services are FRND.

- 7.7. An inability for such questions to be resolved in a timely and efficient manner risks ultimately leaving Sky's competitors with an out-dated offering that would minimise their ability to offer compelling choices to consumers.¹⁴⁷ However, in the event of a disagreement between a broadcaster and Sky over issues such as (i) whether or not a service amounted to an enhanced TV service that falls within the scope of the new access conditions, or (ii) whether the terms offered for such services are FRND, a broadcaster would be left with no choice but to refer a dispute, or submit a compliance complaint, to Ofcom.
- 7.8. In order to streamline this process and attempt to minimise Ofcom's involvement (at least at an early stage), BT believes that an appropriate and proportionate FRND framework for requesting the provision of AC Services (as defined under the new access conditions) would provide an opportunity for questions relating to the scope and application of the new access conditions to be clarified and (potentially) resolved swiftly and efficiently. The objective of such a framework would be to avoid a situation in which the immediate recourse was to the Ofcom dispute or complaints process. As such, this would be in the interests of all parties - Sky, broadcasters and Ofcom:
- (i) Sky would be able to ensure that requests for AC Services (as defined under the access conditions) involve the provision of the information that is reasonably required for Sky to address the relevant request, minimising the need to have to deal with insufficiently reasoned or frivolous requests;
 - (ii) Broadcasters would have the certainty that Sky would follow transparent processes and be required to produce an appropriately reasoned response to their request;
 - (iii) Ofcom's engagement would be limited at the early stages of any requests for AC services, given that the framework would oblige Sky and the broadcaster to seek to resolve any issues in the first instance, and would provide a decision 'gate' before formal dispute resolution powers could be deployed. Ofcom would also benefit from the evidence collated during the discussions between Sky and the broadcaster as well as the reasoned views of the parties, were a dispute referred to Ofcom; and it would also assist Ofcom in fulfilling the monitoring role that it envisages adopting with respect to AC services for applications that are not enhanced TV services, and hence fall outside the new access conditions.
- 7.9. In practice, the roles for Sky and the broadcaster under such a request framework should largely amount to those that they would each ordinarily perform in any event when seeking

¹⁴⁷ Ofcom implicitly appears to acknowledge the need for such 'future-proofing' when it correctly identifies that access to enhanced TV services – existing and forthcoming – should take account of new technology and functionality (see AC Consultation Document, paragraph 7.79).

to agree regulated access terms, and so should not involve any additional costs or resource requirements (over and above what would be involved in addressing such questions properly in the ordinary course of business): the request framework is simply seeking to establish clarity around the process to be followed, thus providing certainty to all parties.

- 7.10. It is important to note that this framework is not seeking to extend the scope of the new access conditions beyond their proposed application as drafted. Where a broadcaster seeks access to AC services that sit outside the new access conditions as drafted, BT accepts that there would be a need for commercial negotiation with Sky in the first instance (and, potentially, further review by Ofcom as discussed in paragraph 7.11 to 7.12 below). However, BT anticipates that not all 'jurisdiction' questions around the scope of the new access conditions will be clear cut and, as outlined in paragraph 7.6 above, it is likely that there will be questions which fall within a 'grey' area, which merit examination and reasoning. The proposed framework would be beneficial in seeking to ensure that these issues of scope are appropriately addressed by the parties in the first instance, that Sky cannot undermine the efficacy of the regulation, and that Ofcom would avoid being called on to resolve such questions prematurely.

Other AC services that are not enhanced TV services

- 7.11. As BT explained in Section 2 above, in light of Sky's active programme to increase the overall number of broadband-connected set-top boxes in its base and its future plans for the development of a new generation of boxes that will offer new functionality, future demand for AC services that have yet to be developed, or are currently in their infancy is to be expected. It cannot be ruled out, therefore, that concerns as to Sky's control of a scale bottleneck may arise with AC services, even though they may be outside the scope of the new access conditions as drafted.
- 7.12. It is important that Ofcom monitors this situation closely. Given the pace of technology change and in light of Sky's incentives and ability to exercise gateway control over services provided via its set-top boxes, it is vital that Ofcom acts swiftly as and when demand for new AC services for applications that are not enhanced TV services is established, and potential competition concerns are identified. BT expects that, in assessing questions around the need to extend the scope of the new access conditions to include such services, Ofcom would adopt a similar approach taken in the present Consultation Document to assessing demand, potential alternatives to Sky's AC services, Sky's incentives of provision, and the impact on competition from the absence of provision (or the provision on terms that are not FRND). BT therefore expects that Ofcom would be able to benefit from the work it has undertaken in the current consultation process, over the course of the last two years, notably around the clear existence of Sky's gateway control to AC Services, enabling it expeditiously to reach decisions on the regulation of AC Services for applications other than enhanced TV services.

A timely process for provision requests and disputes: an AC Services Request Framework

- 7.13. For the reasons described above, BT has explained why a proportionate framework for requesting the provision of AC Services (as defined under the new access conditions) is necessary and would benefit Ofcom, Sky and other broadcasters. Below BT outlines the key requirements for such a framework – an "AC Services Request Framework". BT considers that the application of the Framework could be made legally binding on all parties, and therefore be referenced both within the new access conditions, and also the Reference Offer that Sky (SSSL) will be obliged to produce under Condition 3.4. The detailed terms of the

Framework itself need not form part of the new access conditions or Reference Offer, but could sit alongside these documents: this would afford appropriate flexibility for all parties, and allow the Framework to be amended and updated from time to time (on FRND terms in line with the new access conditions) in light of experience of its operation.

- 7.14. In developing the principles of the Framework, BT has had regard to the principles that apply to Openreach to ensure that it acts fairly and transparently in relation to Communications Providers customers' network access requirements. BT's proposal for the Framework does not, however, seek to replicate the Statement of Requirements process as applies to Openreach in full. Instead BT has sought to adopt a number of common principles – for example, around transparency, clarity of process, comprehensive documentation requirements - that lend themselves to an appropriate and proportionate Framework adapted to the specific requirements of all parties in this specific context.
- 7.15. In Annex 2 of this response, BT has set out its proposed amendments to the new access conditions included in Ofcom's Consultation Document. BT has not, at this stage, drafted the Framework itself, but would be happy to assist Ofcom in this regard, or provide input to Sky in drafting it.
- 7.16. The Framework would apply to requests for the FRND provision of AC Services (as defined under the new access conditions). This would cover both existing enhanced TV services and potential, future enhanced TV services (including where Sky itself is not seeking to develop a particular enhanced TV service).
- 7.17. Clearly the Framework should be implemented by SSSL acting in the capacity as platform operator, rather than Sky as broadcaster or pay TV retailer; appropriate references below are therefore to SSSL.
- 7.18. The Framework should:
- (i) Be fully documented as part of SSSL's Reference Offer, and referenced clearly in the new access conditions;
 - (ii) Set out clear information requirements (in terms of quality and quantity of information) to be met by broadcasters before SSSL must accept a reasonable request for AC Services under Condition 1, including the technical requirements of the broadcaster to launch the enhanced TV service;
 - (iii) Set out the criteria against which SSSL would assess a broadcaster's reasonable request for AC Services under Condition 1, including:
 - Technical feasibility
 - Commercial viability for SSSL developing or adapting the relevant AC Service
 - (iv) Set out a clear process, including timelines, for SSSL's (a) acceptance and (b) consideration and timely determination of any reasonable request for AC Services

under Condition 1. BT recommends that SSSL should be required to resolve such requests within [2]¹⁴⁸ months of its acceptance;

- (v) Allow broadcasters to submit comments on another broadcaster's request, and enable more than one broadcaster to submit a joint request (for the avoidance of doubt, this should equally apply to requests from Sky as a broadcaster);
- (vi) Set out a formal governance procedure to be followed by SSSL in the resolution of such requests;
- (vii) Establish a clear requirement that SSSL must provide appropriate reasoning in either case of accepting or rejecting a reasonable request, based on the criteria against which SSSL has assessed the request; in particular if SSSL considers that the request does not relate to AC Services and so falls outside the scope of the new access conditions, SSSL would be required to provide appropriate reasoning;
- (viii) Establish the terms and conditions, including charges, for the relevant AC Services, where approved, and confirmation that such terms, conditions and charges are FRND;
- (ix) Require SSSL to publish details of:
 - all broadcaster requests accepted (within [2] business days of acceptance) (subject to redaction of any confidential information) (for the avoidance of doubt, this should equally apply to requests from Sky as broadcaster);
 - the outcome and reasoning of its determination (subject to redaction of any confidential information);
 - where SSSL approves a request, the expected timing of implementation of the determination (including any reasons where such implementation is expected to take more than [1] month from date of the determination);
- (x) Require SSSL to provide all broadcasters with 3 months advance notice of impending service or technological changes such that they can (i) complete any necessary modifications to their own systems and processes and (ii) consider whether there is scope to adopt such changes in order to develop new Enhanced TV Services themselves.

7.19. BT suggests that Ofcom should require SSSL to publish the Framework at the same time that it publishes its Reference Offer.

BT, September 2014

¹⁴⁸ The timeframes adopted in this response are proposals that appear reasonable, though BT accepts that with further consultation Ofcom may reach a different conclusion as to the correct timings. The key factor from BT's perspective is that clear timings are specified to avoid unwarranted delay.

ANNEX 1: RESPONSE TO OFCOM'S CONSULTATION QUESTIONS

Consultation question 1: Do stakeholders agree with our assessment of demand for and potential alternatives to Sky's AC services?

BT agrees with Ofcom's conclusion that there is proven demand for AC services to provide content linked to a broadcast channel, particularly for enhanced TV services. BT also agrees that there are no viable alternatives to allow broadcasters to provide these services if access to Sky's AC services is not available.

While BT accepts that demand today arises for a specific set of enhanced TV services (in BT's case alternative video streams for clash management, commercial watermarking [X]), in light of Sky's plans to develop new boxes that will offer new functionality it is to be expected that demand for additional/alternative enhanced TV services will grow, particularly for AC services (or their equivalent) to enable enhanced TV content to be delivered via the Ethernet port. It is not possible today, given the asymmetry of information regarding Sky's set-top box development plans, for BT to determine exactly the kinds of new enhanced and interactive TV services that it would be able to, and therefore want to, develop and deliver in the future and what new types of AC services would need to be accessed in order to undertake that development and delivery. However, it is clear that, unless BT is able to deliver equivalent enhanced TV services on its BT Sport channels to those offered by Sky on Sky Sports, there is a significant risk that BT would be placed at a (further) material competitive disadvantage compared to Sky - both in relation to being able to attract customers and when bidding for sports rights.

Therefore, BT believes it is important that the regulatory regime for AC services is capable of recognising this future demand for enhanced TV services that have not yet been developed, and the need for all enhanced TV services (both existing and new) to be delivered on future generations of Sky's set-top boxes.

BT's views on these issues is set out in detail in Section 2 of this response.

Consultation question 2: What are stakeholders' views of Sky's proposed commitments?

In broad summary, the principal objective of the application to Sky of AC regulation (and the TPS regulatory regime more generally) is to prevent Sky from obtaining an unfair competitive advantage by restricting access to the functionality of its set-top boxes or by only providing such access on terms which are unfair, unreasonable and/or discriminatory. As is explained in the body of this response, an accurate assessment of Sky's proposed commitments confirms that they would not prevent Sky from obtaining an unfair competitive advantage by restricting access to the functionality of its set-top boxes or by only providing such access on terms that are unfair, unreasonable and/or discriminatory.

BT sets out the material deficiencies in Sky's proposed commitments in Section 4 of this response.

Consultation question 3: Does the provision of enhanced TV services via Sky's AC services result in benefits for end-users and competition, efficiency, innovation and investment benefits?

Given the absolute and relative scale of Sky's satellite platform, it remains the key means of delivering pay TV services in the UK. Ofcom has correctly identified that enhanced TV services, form an integral part of the viewer experience, and that such services can have a material bearing on competition for pay TV service more generally.

Assured access to AC services (which enable the development and delivery of enhanced TV services) is a critical component of a successful premium sports service. BT's incentives to invest in expensive sports rights, and its ability to recoup its investment will be negatively impacted if (i) the ability to exploit those rights fully across all platforms is curtailed or (ii) the quality of the underlying viewer experience of the channel is limited, due to a lack of access to critical AC services in order to deliver enhanced TV services that supplement and augment the viewer experience.

Sky's gateway control of AC services, in light of the scale bottleneck that is the Sky platform, gives Sky the ability to distort competition. By hindering BT's ability to offer AC services (either by not providing access to certain services, limiting the scope of such services or simply delaying the provision of these services), Sky has the potential to (further) limit BT's ability to create a compelling wholesale and retail sports proposition, as well as to make BT a less effective bidder for sports rights.

Addressing these competition problems through regulated access to enhanced TV services via Sky's AC services is essential to deliver benefits for end users, and competition, efficiency and investment benefits. These competition problems are discussed in more detail in Section 3 of this response.

Consultation question 4: What is your view of the case for replacement access-related conditions?

In light of the competition issues highlighted in Section 3 of this response, BT believes that effective regulation to ensure access to AC services in order to deliver enhanced TV services on Sky's platform is essential. BT sets out the very material deficiencies with Sky's proposed commitments in Section 4 of this response. As set out in detail in Section 5 of this response, these deficiencies would not arise if Ofcom were to adopt new access conditions which would address the identified competition issues and ensure that Sky could not act on its incentive and ability to limit access to essential AC services on its platform. BT, therefore, believes that replacement access-related conditions are justified and proportionate.

Consultation question 5: Do you consider that the proposed conditions would secure effective access to Sky's AC services to allow the provision of enhanced TV services? Please give your reasons.

BT believes that the proposed new access conditions, with some amendments, would secure effective access to Sky's AC services to allow the provision of enhanced TV services.

As set out in detail in Section 5 of this response, under the new access conditions Sky would be obliged to offer AC services on FRND terms for the development of new (and current) enhanced TV services over Sky's future generation (and current) set-top boxes. This would ensure access to

these services on terms that reflect the actual cost of providing these services, on a legally binding, enforceable basis.

However, in light of Sky's plans to develop new set-top boxes that will offer new functionality it is to be expected that demand for enhanced TV services will grow (notably, for additional/alternative enhanced TV services to those available today). Any uncertainty around the scope of such developments to fall within the new access conditions will provide not only an opportunity for obfuscation by Sky in the provision of AC Services (as defined under the new access conditions) and delays in the resolution of such questions (in light of Sky's incentives to limit supply of AC services to third party rivals) but also excessive involvement of Ofcom in helping resolve such questions and, ultimately, unnecessary litigation. Likewise, resolution of questions around whether any proposed terms of provision (including charges) are FRND could also be subject to unnecessary delays by Sky, or unnecessary involvement of Ofcom.

Therefore, in order to ensure that the new access conditions would secure effective access to Sky's AC Services (as defined under the new access conditions), BT believes that an appropriate and proportionate framework for requesting these services should be adopted. An outline of this framework is set out in Section 7 of this response. BT also sets out some further minor amendments to the new access conditions in Annex 2 of this response.

Consultation question 6: In light of Sky's proposed commitments, do you consider that it is necessary to impose access-related conditions on Sky to secure the continued provision of enhanced TV services? Please give your reasons.

BT notes Ofcom's suggestion in the Consultation Document that the decision whether to accept Sky's proposed commitments or impose new access conditions is 'finely balanced'. This suggestion is based on an erroneous comparison between the commitments and the conditions. As is set out in detail in Sections 4 to 6 in this response, Ofcom has overstated the benefits of the commitments whilst ignoring certain benefits of the new access conditions and understating the risks associated with the commitments. Once those errors are corrected, it is clear that there is an overwhelming case for imposing new access conditions.

In light of these issues, Ofcom is not correct when it suggests that the commitments seem to address the concerns of BT and other stakeholders. In practice, it is clear that the commitments would not prevent Sky from obtaining an unfair competitive advantage by restricting access to its AC services or by only providing such access on terms that are unfair, unreasonable and/or discriminatory. In the circumstances, the new access conditions are not only necessary to prevent such an adverse effect on competition and consumers, they are also manifestly proportionate.

ANNEX 2: BT'S PROPOSED AMENDMENTS TO AND GUIDANCE ON THE NEW ACCESS CONDITIONS

Further amendments to and guidance on the new access conditions

AC Services Request Framework to be included within the new access conditions

In Section 7, BT has set out why there is a need for a flexible regime for assessing new AC Services (as defined under the new access conditions) and outlined proposals for an AC Services Request Framework that would be FRND in line with the new access conditions. In order to facilitate the operation of this framework, BT proposes that the new access conditions should be amended to reference the framework explicitly.

"Two-way" communications to be clear on the face of the new access conditions

Ofcom appears to recognise in its discussion of the potential for overlap with contextual and commercial services that enhanced TV services should not be limited to those services that are based around a 'return' path with content/information going from the viewer to the broadcaster/service, but must encompass two-way communications. As is the case with betting and gaming the underlying data delivery may be transmitted via the Ethernet port (rather than via satellite), but this does not change the fact that such services are enhancing a linear channel broadcast via the Sky digital satellite platform.

BT notes that the proposed new access conditions have been drafted (appropriately) in a technology neutral way, so as not to refer to the nature of the connection of the return path (i.e. being limited to narrowband and not extending to broadband connections via the Ethernet port). BT agrees with this technology neutral approach, but proposes a further minor amendment to the proposed new access conditions (in the definition of Authentication Services) to clarify that access to the 'return' path is on a two-way basis, enabling transmission of components of enhanced TV services both from and to the set-top box. While this is clearly the intention underpinning the new access conditions (and is consistent with the analysis contained within Ofcom's Consultation Document), BT nonetheless believes that this clarification is necessary to avoid delays and disputes arising in the future when new services are developed.

This is also consistent with the approach Sky has taken in its proposed commitments where (other than the specific exclusion set out in paragraph D(a)), it has not sought to limit third party access to, or use of, the Ethernet port, and does not distinguish between narrowband and broadband connections to Sky set-top boxes (whether current or future generation, as defined by Sky).

Defining "reasonably practicable" in Condition 1.3

Condition 1.3 states that:

"The provision of Access Control Services under this condition must take place as soon as reasonably practicable after receiving the request from a Third Party".

However, this leaves scope for interpretation over what is a "*reasonably practicable*" timeframe. BT is concerned that absent a specific timeframe, Sky could potentially delay the process of providing AC Services under the new access conditions for a sufficient amount of time to provide Sky with a first mover advantage at the retail level and leave BT at a competitive disadvantage, contrary to the purpose of the new access conditions.

As set out above and in more detail in Section 7 above BT believes it is necessary for Ofcom to adopt a clear framework, with specified timetables as to how Sky should address requests for AC services under the new access conditions. The framework should be published by SSSL at the same time as the Reference Offer to avoid undue delay in its introduction.

Ensuring continuity of AC regulation

It is important to ensure that there is no lacuna in the regulation of AC services in the move from the existing Continuation Notice to the new access conditions. If the Continuation Notice were to be repealed prior to the new access conditions coming into force – or following implementation but prior to the resolution of any appeals brought against Ofcom’s decision – this could result in a regulatory gap which Sky could exploit to create a (further) competitive advantage to the detriment of consumers and competitors.

Therefore, it is important that Ofcom takes steps to ensure that the existing Continuation Notice continues in force until such time as the new access conditions are in force and any appeals against Ofcom’s decision to impose replacement new access conditions have been decided by the courts.

BT’s proposed amendments to the new access conditions

Below, BT sets out an amended set of new access conditions to take account of the points raised above. BT’s amendments are marked in red and underlined.

SCHEDULE

Access-related conditions

Part 1: Definitions and interpretation

1. In this Schedule:

“AC Services Request Framework” means a framework setting out obligations and processes which conform with guidance published by Ofcom from time to time and which SSSL shall follow when considering any reasonable request for AC Services from a Third Party;

“Act” means the Communications Act 2003;

“Access Control Services” means Application Signing Services, Authentication Services or any other service which SSSL may provide for equivalent purposes;

“Ancillary Service” means:

- a) a service authorised by section 48(4) of the Broadcasting Act 1990;
- b) a service authorised by section 204(6) or section 204(7) of the Act;
- c) a relevant ancillary service within the meaning of section 232(6) of the Act;
- d) any other service which is ancillary to a programme included within a television broadcasting service and directly related to its contents;

“Application Signing Services” means services which:

- a) enable the provision by a Third Party of Specified Programme Services selected by means of an interactive application available via an on-screen symbol or listing in an interactive menu; or
- b) enable the provision by a Third Party of Commercial Watermarking in connection with the provision of Specified Programme Services to a Subscriber;

“Authentication Services” means services which enable the operation by a Third Party of a return path for the transmission of two-way communications between that Third Party and end-users in connection with:

- a) the provision of Specified Programme Services to end-users; or
- b) the provision of Pay TV Subscriber Services to end-users;

“Commercial Watermarking” means the provision of an on-screen symbol to verify the authorisation of a Subscriber to receive a relevant Specified Programme Service;

“Pay TV Subscriber Services” means:

- a) the provision of information in relation to the use of and payment for a subscription for Specified Programme Services;
- b) services which allow an end-user to subscribe for Specified Programme Services;

“Reference Offer” means the terms and conditions (including charges) on which SSSL is willing to enter into an agreement with a Third Party for the provision of Access Control Services;

“Relevant Device” means an end-user terminal system, consisting of a set-top box or equivalent device integrated into a TV set, that is capable of decoding digital satellite transmissions and which is capable of providing functionality for SSSL’s Access Control Services;

“Specified Programme Services” means any of the following services:

- a) a television broadcasting service broadcast (whether by the person providing the service or by another) from a satellite;
- b) a television licensable content service broadcast (whether by the person providing the service or by another) from a satellite;
- c) an Ancillary Service;

“SSSL” means Sky Subscriber Services Limited (company number 02340150), any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;

“Subscriber” means an end-user who is party to a contract for the provision of Specified Programme Services; and

“Third Party” means a broadcaster or a retailer of Specified Programme Services (which term shall include any of SSSL’s subsidiaries or holding companies, or any other

subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006, when such subsidiary or holding company is acting in the capacity of a broadcaster or a retailer of Specified Programme Services).

2. For the purpose of interpreting the conditions set out in Part 2 of this Schedule:
- a) words or expressions shall have the meaning ascribed to them in this Part 1 and otherwise any word or expression shall have the same meaning as it has in the Act;
 - b) the Interpretation Act 1978 shall apply as if each of the conditions were an Act of Parliament; and
 - c) headings and titles shall be disregarded.

Part 2: The Conditions

Condition 1 – Requirement to provide Access Control Services on reasonable request

- 1.1 SSSL must provide to a Third Party such of the Access Control Services as that Third Party reasonably requests in writing for the purpose of, or in connection with, enabling end-users to have access to Specified Programme Services on Relevant Devices.
- 1.2 The provision of Access Control Services by SSSL in accordance with this condition must also include such associated facilities as may be reasonably necessary for the provision of the Access Control Services.
- 1.3 The provision of the Access Control Services under this condition must take place as soon as reasonably practicable after receiving the request from a Third Party.
- 1.4 SSSL must comply with any direction OFCOM may make from time to time under this condition.
- 1.5 The provision of the Access Control Services under this condition must take place in accordance with the AC Services Request Framework.

Condition 2 – Requirement to provide Access Control Services on fair and reasonable terms

- 2.1 In fulfilment of its obligations under condition 1, SSSL must provide the Access Control Services to a Third Party on terms and conditions (including charges) which:
 - a) are fair and reasonable;
 - b) do not involve, or tend to give rise to any undue discrimination against any person or description of person; and
 - c) are on such terms, conditions and charges as OFCOM may from time to time direct.
- 2.2 In this condition SSSL may be deemed to have shown undue discrimination if it unfairly favours to a material extent an activity carried on by it so as to place one or more Third Parties at a competitive disadvantage in relation to activities carried on by SSSL.

2.3 SSSL must comply with any direction OFCOM may make from time to time under this condition.

2.4 The provision of the Access Control Services under this condition must take place in accordance with the AC Services Request Framework, which shall conform with the principles set out in condition 2.1(a) and (b).

Condition 3 – Publication of charges, terms and conditions

3.1 Except in so far as OFCOM may otherwise consent in writing, SSSL must publish a Reference Offer in relation to the provision of Access Control Services and act in the manner set out below.

3.2 SSSL must ensure that a Reference Offer in relation to the provision of the Access Control Services includes at least the following:

- a) a description of the Access Control Services to be provided;
- b) relevant charges, terms of payment and billing procedures;
- c) details of maintenance and quality standards;
- d) the standard terms and conditions for the provision of the Access Control Services;

3.3 To the extent that SSSL provides to itself Access Control Services in a manner that differs from that detailed in a Reference Offer in relation to the provision of the Access Control Services to any Third Party, SSSL must ensure that it publishes a Reference Offer in relation to the Access Control Services that it provides to itself which includes, where relevant, at least those matters detailed in condition 3.2 a)-d).

3.4 SSSL must, within one month of the date that this condition enters into force, publish a Reference Offer in relation to the Access Control Services that it is providing as at the date that this condition enters into force. At the same time SSSL shall publish the AC Services Request Framework.

3.5 SSSL must update and publish the Reference Offer, and the AC Services Request Framework, in relation to any amendments or in relation to any further Access Control Services provided after the date that this condition enters into force.

3.6 Publication referred to above must be effected by SSSL placing a copy of the Reference Offer on any relevant publicly accessible website operated or controlled by SSSL.

3.7 SSSL must send to OFCOM written notice of any amendment to the terms of the Reference Offer in relation to the provision of Access Control Services, and any amendment to the AC Services Request Framework, on or before the day on which any such amendment comes into effect.

3.8 SSSL must ensure that a notice required by condition 3.7 includes:

- a) a description of the Access Control Services in question;

- b) a reference to the location in the SSSL's current Reference Offer of the terms and conditions associated with the provision of those Access Control Services;
 - c) the date on which or the period for which any amendments to charges, terms and conditions will take effect; and
 - d) the current and proposed new charges, terms and conditions (as applicable);
- 3.9 SSSL shall provide to OFCOM on request copies of any agreements entered into with Third Parties in relation to the provision of Access Control Services. SSSL shall provide the information requested by OFCOM under this condition 3.9 within 28 days of receiving such a request in writing.
- 3.10 SSSL must make such modifications to the Reference Offer as OFCOM may direct from time to time.
- 3.11 SSSL must comply with any direction OFCOM may make from time to time under this condition.

Condition 4 – Provision of accounting information to OFCOM

- 4.1 SSSL shall provide to OFCOM on request accounting information relating to the provision by SSSL of Access Control Services.
- 4.2 The information that OFCOM may request under condition 4.1 includes, in particular, financial information on the costs (including capital costs), revenues, assets employed in and liabilities attributable to (including attribution methodologies) the provision of Access Control Services to itself and Third Parties.
- 4.3 SSSL shall provide the information requested by OFCOM under condition 4.1 in a form specified within 28 days of receiving such a request in writing.