

Non confidential version

non confidential version

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title: **Competition in premium pay TV movies. Proposed reference to the Competition Commission**

To (Ofcom contact): **Monika Kochanowska**

Name of respondent: **Stephen Dean**

Representing (self or organisation/s): **BT**

Address (if not received by email):

CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Non confidential version

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

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments. Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name **Stephen Dean** Signed (if hard copy)



BT's Response to Ofcom's Proposed Reference to the Competition Commission in respect of Premium Pay TV Movies

14 May 2010

BT welcomes any comments on its position as laid out in this document, which will be available electronically at <http://www.btplc.com/responses>.

Comments should be addressed to Stephen Dean, BT, Newcastle Telephone Exchange, Carliol Square, Newcastle upon Tyne, NE1 1BB. or by email to stephen.h.dean@bt.com

1. Introduction and Executive Summary

- 1.1 BT is one of three parties¹ who have jointly responded to Ofcom's various consultations over the course of the Pay TV Investigation launched in March 2007². As part of the Pay TV Investigation BT and the other three parties have submitted a substantial body of evidence demonstrating that material competition issues exist in respect of premium pay TV movies, both upstream, in terms of how the rights for the first pay TV subscription window are sold, and downstream in wholesale markets as a result of Sky's market power. These competition issues have led to significant consumer detriment in terms of higher prices, lower quality and less choice and innovation.
- 1.2 In its various submissions to date BT has highlighted the importance of addressing these competition concerns in full, both in relation to premium linear movies and Subscription Video on Demand (SVoD). BT continues to believe that certain aspects of the competition concerns with premium pay TV movies could have been addressed – at least in the short term – by a Wholesale Must Offer (WMO) obligation in respect of Sky's Core Premium Movies channels using Ofcom's s.316 powers. However, BT also agrees with Ofcom's assessment that a WMO in respect of Sky's Core Premium Movies channels would not in itself be an effective forward-looking solution to the full range of competition issues identified by Ofcom. In particular, given the relative (and increasing) importance of SVoD services in pay TV markets it is essential that the features that prevent, restrict and distort the exploitation of SVoD rights are fully remedied.
- 1.3 Therefore, BT supports Ofcom's views that a market investigation reference (MIR) to the Competition Commission (CC) is now the most appropriate course of action. The threshold for making such a reference is that Ofcom has "*reasonable grounds to suspect*" that a feature, or combination of features, prevents, restricts or distorts competition in a market in the UK for goods and services. Following Ofcom's extensive analysis of wholesale and retail pay TV markets as part of the Pay TV Investigation, and the concerns identified throughout that review, this hurdle is more than met. The supplemental analysis contained within Ofcom's consultation on its proposed MIR (MIR Consultation) reinforces this fact.
- 1.4 Moreover, in the Three Parties' initial submissions, from three years ago, it was argued that a MIR would be the most appropriate route to address many of the competition issues identified. While Ofcom's Pay TV Statement³ has set out a way forward to address certain competitive distortions in respect of premium pay TV sports channels, the issues in respect of premium pay TV movies rights and channels have yet to be resolved. BT believes that Ofcom must now urgently conclude on the issues set out in its MIR Consultation, and exercise its discretion to make a MIR to the CC. Recognising that the CC will take many months to consider and remedy these issues, it is imperative that the reference is made as soon as possible.

¹ The parties are BT, Top up TV and Virgin (The Three Parties).

² http://www.ofcom.org.uk/media/news/2007/03/nr_20070320, 20 March 2007

³ Ofcom Pay TV Statement, 31 March 2010

1.5 This paper addresses the following issues raised in Ofcom's MIR Consultation:

- Section 2 sets out the importance of linear movie channels and SVoD services in the development of effective competition in pay TV markets;
- Section 3 considers Ofcom's assessment of the relevant markets that it proposes to refer to the CC;
- Section 4 discusses the features of the market identified by Ofcom and considers the prevention, restriction and distort competition that these features cause;
- Section 5 sets out BT's views why the relevant hurdles for making an MIR to the CC are met in this case; and
- Annex A responds to the specific consultation questions posed in Ofcom's MIR Consultation.

2. The importance of linear movie channels and SVoD services in the development of effective competition in pay TV markets

Premium movies content drives pay TV subscriptions

- 2.1 Ofcom's Pay TV Statement states that the content which is likely to be most effective in driving pay TV subscriptions requires two characteristics:
- A significant appeal to a broad audience; and
 - Limited availability via FTA TV channels⁴.
- 2.2 Ofcom's research into the genres of content that are most attractive to customers found that the top three genres that are most valued by customers in multi-channel households were sports, soap operas and movies⁵. Other high ranking genres included comedy, drama and documentaries. Ofcom concluded that as soap operas, comedy, drama and documentaries are all widely available on free-to-air television, they are unlikely to be a primary driver of pay TV subscriptions. Ofcom, therefore, found that:
- "Sports and movies are the genres which stand out as being among the most valued genres by consumers, and also having a high degree of exclusivity to pay TV. On this basis alone we would expect them to be key drivers of pay TV subscriptions."*⁶
- 2.3 Ofcom also found that evidence on the sums paid by Sky for sports and movies rights (particularly first run Hollywood movie rights), as well as internal documents obtained from Sky reinforced this view⁷.
- 2.4 BT agrees with Ofcom's findings. Premium movies channels and/or subscription services that encompass first-run Hollywood movies are, along with sports, the most effective driver of pay TV subscriptions⁸. Without access to such channels/services, a pay TV operator's ability to compete in retail pay TV markets is severely limited. [~~BT~~]
- 2.5 This is despite the fact that BT's pay TV offering introduced considerable consumer flexibility both in terms of pricing (including access to premium content with no buy-through obligations and allowing subscribers to pay only for the content that they want to watch) and in terms of product choice (on-demand content allowing consumers to determine what and when they wish to watch).

⁴ Ofcom Pay TV Statement para 4.105

⁵ Ofcom Pay TV Statement para 4.110

⁶ Ofcom Pay TV Statement para 4.111

⁷ Ofcom Pay TV Statement paras 4.113 – 4.120

⁸ Over the course of the Pay TV Investigation BT has set out its views that the ability to provide Sky's premium sports channels is essential to driving pay TV subscription take-up. However, for the purposes of responding to Ofcom's MIR Consultation BT has limited its comments in this document to issues around premium movies.

- 2.6 BT Vision's approach to date has given customers a wider choice of content packages at lower price points than were previously available in pay TV markets. As a result of BT's entry in to pay TV markets and the value of its consumer proposition, Sky's entry level price for pay TV subscriptions has fallen and Sky announced last year that it intends to imitate BT's video-on-demand (VoD) offering this year⁹. Therefore, BT's entry in to pay TV markets has led to a reduction in prices and increased innovation for consumers. However, despite these benefits, BT Vision has been unable to build scale because it has been unable to offer the premium channels/services that are necessary to build a large scale subscriber base.
- 2.7 This issue is not unique to BT Vision. Those platforms where operators have been unable to access Sky's premium channels on a wholesale basis have typically struggled to build scale. On DTT, Top-Up TV (TUTV) has been unable to access Sky's premium content [X]; on DSL, TalkTalk does not have wholesale access to Sky's premium channels [X]. However, it is only by achieving revenue scale that the fixed costs of developing pay TV platforms can be recovered. Therefore, it is central to the development of sustainable competing platforms that they are able to offer premium pay TV channels and subscription services that incorporate that content which is likely to be most effective in driving pay TV subscriptions. This means being able to offer premium movie channels and subscription services containing movies from the first pay subscription TV window.

The importance of SVoD

- 2.8 Ofcom recognised in its Pay TV Statement that:

*"Premium subscription VoD services could provide a very similar experience to subscribing to a linear channel, but with added convenience...."*¹⁰

- 2.9 BT has, in previous submissions to Ofcom, emphasised the potential for SVoD movie services to be a critical driver of innovation in pay TV markets. The fact that SVoD services could provide a very similar – only enhanced – experience for pay TV subscribers means that the development of such services is likely to lead to substantial consumer benefits. At its most basic level, the development of SVoD movies services could provide subscribers with a wider range of content and a more convenient method of accessing that content at the time when they wish to watch a movie. Subscribers would be freed from the restrictions of linear movie channels, which only allow access to those movies available on that channel at a given point in time. Equally, they would be freed from the micro-payment system required under a pay-per-view (PPV) model in order to access the content they wished to watch when they wished to watch it. However, more importantly, these changes in how consumers could access movies content would also allow pay TV operators to develop new business models, and, in particular, new ways of attracting payment for content¹¹.

⁹ http://corporate.sky.com/media/press_releases/2009/3d_tv.htm

¹⁰ Ofcom Pay TV Statement para 6.5

¹¹ This in turn could also help combat piracy and illegal downloading in the industry.

- 2.10 BT Vision has previously provided evidence of the clear latent demand for SVoD services and BT Vision customers' preference for SVoD services over PPV services. In particular:
- Whilst BT Vision provides both a SVoD and a Pay per view VoD service, [X] of customer now recruited to BT Vision are doing so with a VOD subscription.
 - A significantly higher proportion of the BT Vision customer-base takes BT Vision's PictureBox SVoD service rather than PPV. [X] On 1 May 2010, BT launched Film Club, alongside Universal's standalone PictureBox service, incorporating movies from the second pay TV subscription window and library content from Universal, Warner Brothers and Sony. Going forward, BT expects the difference in SVoD versus PPV consumption to be even more marked as a result of Film Club's increased portfolio of content.
- 2.11 BT has also previously provided evidence that usage of its SVoD service is significantly higher than its PPV services amongst its customers, and that SVoD services are more popular with consumers than PPV services in terms of the customer base that actively use such services.¹² This evidence is further supported by more recent data from March 2010, [X] These SVoD figures are based on BT's PictureBox service, which was limited to certain second pay TV subscription window output from one Hollywood studio (the NBC Universal PictureBox service), primarily by virtue of the restrictions that Sky imposes on distributors as part of its acquisition of movies rights. Thus, despite severe limitations on content availability, in BT's experience there is significant consumer preference for SVoD services over PPV services. [X]
- 2.12 As BT has previously highlighted, BT's views as to the importance of SVoD are reinforced by the success that SVoD has enjoyed in other markets (such as the US) where competitive distortions in accessing SVoD rights such as those that exist in the UK market do not exist.

Investment in super fast broadband and the development of IPTV

- 2.13 Both Ofcom's Pay TV Statement and its MIR Consultation highlight the linkages between access to premium movie content and the necessary investment to deliver superfast broadband and new IPTV platforms¹³. In addition, Ofcom's statement on the provision of superfast broadband also highlights the fact that HDTV and IPTV services have played an important role in driving Next Generation Access (NGA) in Europe¹⁴.
- 2.14 As BT set out in its response to Ofcom's 2nd Pay TV Consultation, in every country in the world investing in fibre, the investment in superfast broadband is heavily dependent on TV subscriptions. Pay TV is the primary source of additional revenue per user necessary to pay for such infrastructure investments. The UK is no different. The substantial investment

¹² See BT's Response to Ofcom's 3rd Pay TV Consultation for further details.

¹³ Pay TV Statement Section 8 and MIR Consultation para 6.39

¹⁴ Delivering super-fast broadband in the UK, Promoting investment and competition, 3 March 2009.

necessary to deliver the significant benefits of superfast broadband will be underpinned by the ability to deliver a sufficiently scaled pay TV subscription business.

- 2.15 The BT Retail superfast broadband programme is based on being able to balance the cost of wholesale inputs with revenue from additional services. The primary additional service envisaged in terms of revenue generation will be pay TV services via BT Vision. However, in order for BT Vision to be able to develop a sufficiently attractive and competitive pay TV offering it will need to be able to offer the kinds of high value content that drives subscription take-up. Movies from the first pay TV subscription window, particularly in HD quality are increasingly important in this context. Movies are one of the two key genres that have a demonstrated capability to drive subscription take-up. They are also particularly well suited to exploitation as part of a true VoD service which is likely to be more closely aligned with future consumer demand than the restrictions on consumption associated with linear movies channels.
- 2.16 There are also clear consumer benefits in terms of the delivery of movie services and investment in superfast broadband, which makes the development of a consumer proposition to recoup investment costs more straightforward. For example, on standard broadband an HD movie could take up to 5 or 6 hours to download. However, with superfast broadband it would be possible to provide multiple concurrent streams of HD quality content (including multiroom and multicast) through streaming video without any need to download in advance. However, without investment in superfast broadband it would be impossible to offer multiple high quality functionality. But without access to the kind of content that will allow such investment to be recouped then the investment case in superfast broadband is substantially undermined.
- 2.17 BT agrees with Ofcom's views that lack of access to SVoD content could affect IPTV's prospects in the UK in the future¹⁵, though BT would argue that it has already restricted the development of IPTV to date. It is notable that IPTV penetration is substantially higher elsewhere in Europe, where market operators have had access to the necessary content to recoup investment in new delivery mechanisms. This compares to the UK, which was one of the first countries to launch an IPTV platform, yet take-up has been limited as a direct result of the existence of features that prevent, restrict and distort competition in respect of the upstream supply of SVoD movie rights.

¹⁵ MIR Consultation para 6.21

3. Ofcom's assessment of the relevant markets

3.1 Ofcom has identified three distinct economic markets for:

- The upstream supply of movie rights from Major Hollywood Studios in the first pay TV subscription window in the UK. This encompasses both linear rights and SVoD rights.
- The wholesale supply of packages containing Core Premium Movies channels.
- The retail supply of packages containing Core Premium Movies channels.¹⁶

3.2 BT broadly agrees with Ofcom's assessment of the relevant markets as set out in its MIR Consultation, though does not fully agree with Ofcom's views on the degree of competition that exists as between movie studios (discussed further below). However, BT notes that while the OFT's MIR Guidance¹⁷ requires "*some consideration to the definition of the relevant market' in making an MIR*"¹⁸, it is also clear that "*Market definition.... need not always be a necessary step*"¹⁹. In particular the OFT's MIR Guidance highlights circumstances where "*the effects on competition of some features may be clear enough that firm conclusions on the definition of the relevant market ... are unnecessary*"²⁰.

3.3 In this particular instance BT believes that the effects on competition are sufficiently clear that it is unnecessary to draw firm conclusions on the exact boundaries of the relevant markets. A change in the precise market definition in this case would not negate the clear prevention, restriction and distortion on competition from the identified features. Therefore, despite the fact that BT does not fully agree with certain aspects of Ofcom's market definition assessment, a MIR should not be delayed further in order for Ofcom to consider these views and reach a definitive conclusion on market definitions. Instead, the issue of market definition should be considered in more detail by the CC following reference.

The relevant focal products

3.4 BT agrees that market definition is ultimately a tool to facilitate the assessment of a particular competition concern. With that in mind, the market definition exercise in this case should be conducted around the specific competition concerns that Ofcom has identified as part of its detailed examination of premium movies content as part of the Pay TV Investigation.

3.5 In its Pay TV Statement Ofcom has identified a concern that as a result of Sky's vertical integration and market power in the market for the wholesale provision of Core Premium

¹⁶ MIR Consultation para 4.36

¹⁷ OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006

¹⁸ OFT's MIR Guidance para 4.8

¹⁹ Ibid

²⁰ Ibid

Movies channels, Sky has the incentive and ability to distribute these channels in a manner that favours its own platform and retail business to the detriment of competition in downstream markets. Moreover, over the course of the Pay TV Investigation Ofcom has amassed a substantial body of evidence showing that Sky has, in fact, acted on these incentives²¹. This provides a clear starting point for the focal product in respect of the relevant wholesale market in this case.

- 3.6 BT agrees with Ofcom's assessment that Core Premium Movies channels are distinct from other movies formats as they allow subscribers to see a large number of recent high quality movies on TV for a monthly subscription – features which are particularly important in driving pay TV take-up as discussed in Section 2 of this response. Ofcom has also identified a concern that the way in which upstream rights are sold may create a barrier to entry in the wholesaling of packages that include Core Premium Movies channels.

- 3.7 In addition, Ofcom highlights that:

*“Premium subscription VoD services could provide a very similar experience to subscribing to a linear channel... and are likely to be a close substitute, particularly given that the rights are for the same window as linear channels.”*²²

- 3.8 To date there has been limited development of premium SVoD services as the rights that would enable such a service are currently held by Sky, or are sold to Sky under contractual terms that prevent studios from selling SVoD rights separate to linear channel rights on commercially viable terms to other pay TV operators. Sky has a limited ability to exploit these rights and, therefore, has limited incentive to develop (or allow other third parties to develop) wholesale SVoD services to supply to other pay TV operators. Nonetheless, since both the linear channel rights and the SVoD rights are sold together as an exclusive package in the first pay TV subscription rights window in BT's view it is impossible to distinguish these two sets of rights as separate focal products. This is further reinforced by the fact that both types of rights would (if fully and properly exploited) underpin services with very similar product characteristics. Therefore, in BT's view both linear channel rights and SVoD rights should be encompassed within the focal product in the assessment of upstream issues. As such, BT agrees with Ofcom's view that the relevant focal product in respect of the upstream market is the sale of movie rights in the first pay TV subscription window (incorporating both linear and SVoD rights) in the UK from the Major Hollywood Studios²³.

Upstream market definition

- 3.9 BT broadly agrees with Ofcom's market definition in respect of upstream rights. Specifically BT agrees that:

²¹ Pay TV Statement Section 7

²² Pay TV Statement para 6.5

²³ MIR Consultation para 4.13

- In response to an increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window a wholesale channel provider is unlikely to replace these rights with non-movies content or movies content from other studios.²⁴ As Ofcom's research and analysis has clearly demonstrated, there are likely to be few close substitutes for the content on Core Premium Movies channels for consumers. Therefore, replacing these rights with non-movies content or movies content from other studios is unlikely to be sufficient to satisfy consumer preferences.
- In response to an increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window a wholesale channel provider is unlikely to replace these rights with movie rights from other release windows (eg rights from the second pay TV subscription window).²⁵ The structure of the release windows is designed specifically to segment consumer preferences in order to exploit different preferences and hence price discriminate. As a result, in BT's view this implies distinct markets against each release window.²⁶
- Equally, for the same reason, rights to DVD rentals are unlikely to constrain the pricing of movies rights in the first pay TV subscription window.²⁷
- It is possible that in the event of an increase in the price of movie rights from Major Hollywood Studios in the first pay TV subscription window Sky would continue to purchase these rights, rather than substituting away to other content. Sky's prices for retail and wholesale packages including Core Premium Movies channels are above the competitive level, and therefore it may be in a position simply to absorb such an increase in price. This may be more profitable for Sky than switching to other rights content which is likely to be perceived by subscribers as a poor substitute.²⁸
- The necessary conditions for supply-side substitution are unlikely to occur in this case and therefore supply-side substitution does not cause the market boundaries to be extended beyond the focal product identified.²⁹

3.10 Therefore, BT agrees with Ofcom's conclusions that substantial direct constraints on pricing in the upstream supply of movie rights from Major Hollywood Studios in the first pay TV subscription window do not exist.

3.11 However, BT does not agree with Ofcom's characterisation of the nature of competition as between the movie studios themselves in the sale of rights. Despite its statement that it has "*not assessed the degree of competition*"³⁰ as between the six movie studios Ofcom nonetheless states that it has "*no basis for believing that their prices are above competitive*

²⁴ MIR Consultation para 4.20

²⁵ MIR Consultation para 4.21

²⁶ BT notes that release windows are getting earlier, but as different windows are still maintained, this would not be expected to affect this finding.

²⁷ MIR Consultation para 4.21

²⁸ MIR Consultation para 4.22

²⁹ MIR Consultation para 4.24

³⁰ MIR Consultation para 4.17

levels”³¹. Ofcom also states that “Given market structure and the existence of competing rights holders, it seems likely that upstream prices for rights will be relatively close to the competitive level.”³²

3.12 [✂]

3.13 [✂]

Downstream markets and indirect upstream constraints

- 3.14 Over the course of the Pay TV Investigation the Three Parties have submitted a substantial body of evidence on the boundary of the relevant wholesale and retail markets that incorporate Core Premium Movies channels. BT has previously set out its views why the relevant retail market is not sufficiently broad to encompass theatrical releases, DVD rentals, FTA movies or alternative non-movies based content. Equally, BT has set out its views that the scope of the relevant wholesale market is no wider than the relevant retail market.
- 3.15 Therefore, BT supports Ofcom’s conclusions in respect of downstream markets namely that there is a relevant economic market for the wholesale supply of packages including Core Premium Movies channels.
- 3.16 As a result of this view, BT also agrees that it can be inferred that any indirect constraints on upstream prices are likely to be very limited (given the identification of narrow wholesale and retail markets in respect of Core Premium Movies channels). Since neither direct nor indirect constraints are likely to exist this demonstrates that the boundary of the relevant upstream market is no wider than the supply of movie rights from Major Hollywood Studios in the first pay TV subscription window in the UK.

³¹ Ibid

³² MIR Consultation para 4.22

4. Features of the market that prevent, restrict or distort competition

The identified features

- 4.1 The Three Parties have previously provided a substantial body of evidence demonstrating that there are structural features of pay TV markets (such as Sky's vertical integration and its control of mutually reinforcing bottlenecks) which confer on Sky unique advantages in the acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and in the distribution of Core Premium Movies channels. The parties have also previously highlighted concerns with Sky's warehousing of SVoD movie rights (buying rights and then not using them) and the contractual hold-backs (negotiating with content owners such that on-demand rights will not be sold to rivals) and other upstream contractual arrangements between Sky and the movie studios designed to limit competition from rival pay TV operators.
- 4.2 Ofcom has identified a list of features of the markets for the upstream supply of movie rights from the Major Hollywood Studios in the first pay TV subscription window and wholesale supply of packages including Core Premium Movies channels which it believes adversely affect competition. The features identified are:
- A limited pool of premium content from the Major Hollywood Studios, and the need to acquire a minimum volume of rights in order to viably launch a Core Premium Movies channel.³³
 - The release windows structure, which allows studios to segment their offerings and price discriminate.³⁴
 - The joint sale and licensing of linear channel and SVoD rights by individual studios, which increases the risk that only one set of rights is exploited and the other is effectively warehoused. Sky has exclusively purchased both sets of rights since they have been available, despite Sky's inability to fully exploit SVoD rights due to technological restrictions. This is despite the fact that other operators (including BT) have had the capability to provide SVoD services for several years.³⁵
 - Exclusivity of rights licensing agreements between the individual studios and wholesale distributors. Exclusive licensing limits the availability of alternative competing products to Sky's Core Premium Movies channels in the wholesale and retail markets.³⁶

³³ MIR Consultation paras 5.5 – 5.11

³⁴ MIR Consultation paras 5.12 – 5.17

³⁵ MIR Consultation paras 5.18 – 5.23

³⁶ MIR Consultation paras 5.24 – 5.29

- Other restrictions in contracts for the rights in the first pay TV subscription window, which may directly limit the flexibility of the wholesaler to develop premium movie packages.³⁷
- Staggered availability of content rights and the duration of contracts for premium movie rights. As a wholesaler wishing to launch a new service typically needs to acquire the movie output from more than one studio, the staggered availability of rights means that creating a viable proposition may take several years to achieve. This is likely to constitute a barrier to entry for a wholesaler.³⁸
- Aggregation of substitutable premium movies content into a single wholesale offering. Sky's aggregation of a high proportion of available substitutable content dampens the competition that would otherwise exist between competing premium movie services.³⁹
- Sky's market power in the distribution of wholesale Core Premium Movies channels, which translates in to considerable advantages in winning key premium movie rights in the future. This market power is likely to sustain in the future and thus the threat of entry is not sufficient to prevent Sky from exercising its market power.⁴⁰
- Vertical integration of firms across wholesale and retail activities which, absent regulation, may create an incentive to refuse to supply wholesale services to other retailers, or to supply them on less favourable terms than it supplies itself.⁴¹

4.3 BT largely agrees that each of the features identified by Ofcom plays a role in preventing restricting or distorting competition in one or other (or both) of the relevant markets identified. However, BT believes that it is important to recognise that both the exclusive licensing of rights and vertical integration can bring substantial consumer benefits in the absence of market power. Product differentiation due to exclusivity can allow platforms to drive take-up which in turn generates a wider base against which fixed costs can be recovered. Absent market power, these benefits can be delivered without a generating a consumer detriment that outweighs such benefits. Similarly, absent market power vertical integration can allow firms to deliver products that are more closely targeted to consumer demand in terms of both content and technical specifications, without the detriment to competition identified by Ofcom. Therefore, BT believes that it is important that Ofcom is clear that the exclusive licensing of rights and vertical integration are features that prevent, restrict or distort competition in the context of Sky's existing market power rather than in and of themselves.

4.4 BT also notes Ofcom's statement that each of the identified features:

"...can be regarded as relating to each of the two interdependent but related markets: the upstream market for the sale of movie rights in the first pay TV subscription window in the

³⁷ MIR Consultation paras 5.30 – 5.33

³⁸ MIR Consultation paras 5.34 – 5.37

³⁹ MIR Consultation paras 5.38 – 5.41

⁴⁰ MIR Consultation paras 5.42 – 5.50

⁴¹ MIR Consultation paras 5.51 – 5.54

UK and the wholesale market for the supply of packages including Core Premium Movies channels in the UK.”⁴²

4.5 And that:

*“...in the context of these particular markets it is therefore not possible to conclude that a particular feature is exclusive to only one of the markets.”*⁴³

4.6 BT agrees that there is a significant degree of overlap between the identified features, and that most of these features are not exclusive to only one of the relevant markets identified. As such, the effects of these features are likely to be observed in both the upstream rights market and the downstream wholesale market.

4.7 However, Ofcom goes on to state that it is “*the combination*” of the identified features which it suspects adversely affects competition⁴⁴. This could imply that all of the identified features are necessary prerequisites for an adverse effect on competition to be found. BT disagrees strongly with this view. BT believes that many of the individual identified features are sufficient in and of themselves to adversely affect competition. Indeed, the evidence considered over the course of the Pay TV Investigation demonstrates that Sky’s market power in the market for the wholesale supply of packages containing Core Premium Movies channels is sufficient in itself to have adversely affected competition. Based on the evidence it has submitted over the course of the Pay TV Investigation, [X]

4.8 The existence of multiple features that prevent, restrict and distort competition is likely to magnify each of the adverse effects arising from any one individual features. [X]. BT believes that Ofcom’s reference to the CC should make this clear.

Prevention, restriction or distortion of competition

4.9 BT believes that the features identified by Ofcom adversely affect competition in the identified relevant markets. Due to the existence of the identified features, Sky has been able to limit the degree of competitive constraint it faces from other pay TV operators and from its customers, leading to significant consumer detriments.

4.10 BT agrees with Ofcom’s assessment that the key competition concern arises due to:

“the fact that the linear and SVoD rights within that [the first Pay TV subscription] window are sold jointly and exclusively to one broadcaster. Indeed, we note that in the UK Sky aggregates all substitutable premium movie content from the Major Hollywood Studios within this window. Moreover, the joint licensing of rights and other contractual restrictions limit

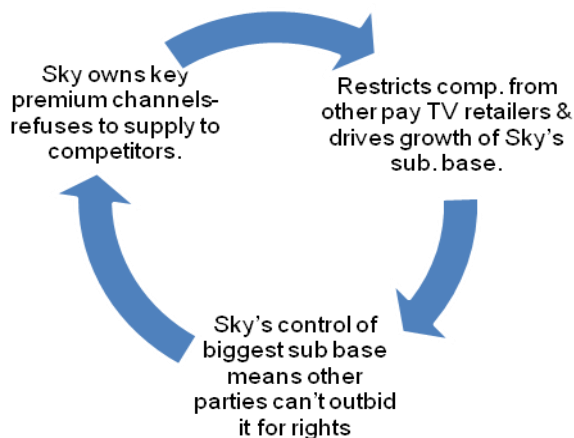
⁴² MIR Consultation para 5.2

⁴³ Ibid

⁴⁴ MIR Consultation para 5.3

*the possibility that the supply of SVoD services will constrain linear channel services and vice versa.*⁴⁵

- 4.11 Other identified features of the market (such as the release window process, content aggregation and the limited pool of premium content) reinforce these core concerns as they limit the scope for competing services to emerge.
- 4.12 From the outset of the Pay TV Investigation the Three Parties have highlighted the “vicious circle” which allows Sky to continuously reinforce its market power due to its considerable advantages in winning key premium movie rights in future:



- 4.13 As such, BT fully supports Ofcom’s assessment that Sky is always likely to win the majority of the premium movie rights that become available, and it is unlikely that other wholesalers would be able to bid successfully for enough premium movie rights to erode Sky’s market position.⁴⁶
- 4.14 BT agrees with the three competition issues that Ofcom has identified as arising directly due to concerns in respect of the identified market features, namely:
- Limited exploitation of premium SVoD rights from the first pay TV subscription window: Wholesalers are unable to access SVoD rights, yet Sky does not exploit these rights fully itself.
 - Restricted distribution of Sky’s Core Premium Movies channels: As a vertically integrated firm with market power, Sky has acted on incentives to distribute its Core Premium Movies channels in a manner that favours its own platform, as well as protect its position when bidding for key content rights upstream.

⁴⁵ MIR Consultation para 6.9

⁴⁶ MIR Consultation, para 6.12. This is also consistent with Ofcom’s views in respect of premium sports rights set out in the Pay TV Statement, para 5.9.

- High wholesale prices for Sky's Core Premium Movies channels, as supported by Oxera's analysis of Sky's persistent and significant profits.

4.15 In BT's view, these competition issues have a significant consumer detriment attached:

- Historically, Sky has warehoused the SVoD rights it has acquired for the first pay TV subscription window. Currently, Sky customers have access to SVoD services (via SkyPlayer, on a limited basis) but only as an add-on if they already subscribe to Sky Movies channels. Therefore, to date SVoD services incorporating the first pay TV subscription window rights have not been made available on a standalone basis in the UK. This contrasts with other countries where SVoD services have been successfully developed and widely exploited as market operators have not faced the competitive distortions inherent in the UK market.
- Equally, due to warehousing and rights holdbacks, third parties have been prevented from developing new, innovative SVoD services which could compete directly with Sky's linear movies channels. This is despite the fact that competitors such as BT have had the technology in place to offer a full SVoD service for several years now and have demonstrated that there is clear latent demand for such a service.
- BT has highlighted above the important linkages between SVoD services and access to key premium movies content in the development of IPTV and investment in the underlying superfast broadband networks.
- In turn, the development of IPTV and investment in the underlying superfast broadband networks should lead to the development of new innovative services for consumers⁴⁷. Such benefits risk being delayed – or even not delivered – if competitive distortions in respect of access to key content are not resolved
- As described at length in Ofcom's Pay TV Statement, Sky's policy of restricting the wholesale supply of its Core Premium Movies channels significantly distorts consumer choice in downstream markets⁴⁸. Sky currently wholesales only to cable, and provides standard definition channels only. Moreover, Sky's wholesale pricing structure creates an incentive for cable to use these channels solely as a retention tool, rather than as a source of added value for customers.
- As described in Ofcom's Pay TV Statement, Sky's policy of restricting the wholesale supply of its Core Premium Movies channels has limited the range and variety of packages and price points that consumers can access as compared to a counterfactual where Core Premium Movies channels were supplied to retailers on a wholesale basis on terms that enable them to compete at the retail level⁴⁹.

⁴⁷ Please see BT's Response to Ofcom's 3rd Pay TV Consultation, Section 2 for a detailed description of the kinds of consumer benefits that could be delivered.

⁴⁸ Pay TV Statement Section 8

⁴⁹ Ibid

- Based on the Oxera analysis contained in Ofcom's Pay TV Statement, retail prices to customers subscribing to Sky's Core Premium Movies channels are likely to be higher than competitive prices⁵⁰.
- The restricted distribution of Core Premium Movies channels limits choice in triple-play bundles, as consumers increasingly buy their telephony, internet and Pay TV services as a single standalone bundle. This leads to market distortions in other telecommunications markets outside pay TV.

4.16 It is clear that the identified features of the market prevent, restrict and distort competition and have a significant impact on consumer choice, prices and innovation. As such, BT believes that the test for making a MIR to the CC under section 131 of the Enterprise Act 2002 is met. There are clearly reasonable grounds for suspecting that the identified features (both individually and collectively) prevent, restrict or distort competition in connection with the supply and acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels.

4.17

⁵⁰ Pay TV Statement Section 5

5. The relevant test for making an MIR is met

- 5.1 Under section 131 of the Enterprise Act Ofcom has the discretion to make MIR to the CC where:

“it has reasonable grounds to suspect that any feature, or combination of features, of a market in the United Kingdom for goods and services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.”

- 5.2 As set out in the preceding section of this response BT believes that this test is met. BT believes that there are clearly reasonable grounds for suspecting that the identified features discussed in the preceding section of this response prevent, restrict or distort competition in connection with the supply and acquisition of movie rights from Major Hollywood Studios in the first pay TV subscription window and packages including Core Premium Movies channels. Moreover, the “*reasonable grounds*” threshold is recognised as being a low hurdle, reflecting Ofcom’s role as the first phase investigator in this process⁵¹. Indeed, the OFT rejected a claim by BAA that the OFT had not made a ‘*compelling case for reference founded on a robust analysis of the market*’ on the basis that a ‘*compelling case*’ implied a higher standard of proof than the legal test requires.⁵² Accordingly, Ofcom need not reach a definitive view on the issues set out in its consultation document.
- 5.3 Below BT assesses the other four criteria set out in the OFT’s MIR Guidance that should be considered prior to making an MIR⁵³.

Application of alternative competition powers

- 5.4 Ofcom has a range of competition powers open to it to address competition concerns, including making a MIR, a Competition Act investigation or intervention to ensure fair and effective competition under its sectoral (s.316) competition powers. Each of these powers are designed to address particular competition issues, depending on the nature and scope of the relevant concern and the form of remedy necessary to address fully the particular concern identified. Therefore, it is incumbent on Ofcom to determine which of its competition powers would be most appropriate to address the identified competition concerns in this case.
- 5.5 In BT’s view the prohibitions contained in the Competition Act do not provide appropriate tools to deal with a situation where, as here, there are inter-related competition concerns at multiple different levels of the supply chain. Moreover, as Ofcom highlights, some of the features identified (such as the release window process or the limited pool of rights) may not

⁵¹ See Peter Freeman’s speech “Regulation and Competition - Chalk and Cheese? The Role of the Competition Commission”, CRI Frontiers of Regulation Conference Keynote Speech, 7 September 2006.

⁵² See paragraph 8.2 of the OFT’s reference to the CC of BAA, dated April 2007.

⁵³ OFT’s MIR Guidance, para 2.1

in themselves raise competition concerns if considered in isolation but when considered with other features are likely to reinforce or amplify competition concerns. Accordingly, piecemeal intervention under the Competition Act may fail to address certain issues, or may fail to identify (and address) the severity of an issue considered on an individual basis. Therefore, even if a breach of one or more of the relevant Competition Act prohibitions were established, this would not be effective in resolving all of the adverse effects on competition identified in Ofcom's MIR Consultation.

- 5.6 In addition, a Competition Act investigation is concerned with behaviour that has occurred in the past, yet some of the specific concerns identified by Ofcom relate to future market developments. As such, it is clear that the Competition Act would not be capable of addressing these concerns.
- 5.7 BT notes Ofcom's conclusions in its Pay TV Statement as to why Ofcom does not believe that a WMO remedy implemented under Ofcom's sectoral competition powers would be an appropriate remedy to address issues in respect of the wholesale supply of Sky's Core Premium Movies channels⁵⁴. This appears to have been underpinned by a view that there is "limited demand" for wholesale linear movie channels, while the importance of SVoD is increasing. BT agrees that SVoD is very important, but believes that Ofcom has underestimated the importance of Sky's Core Premium Movies channels. [✂]
- 5.8 BT accepts Ofcom's view that a linear channel wholesale must-offer remedy would not by itself be an effective solution to all of the various competition concerns identified, as it would not address the serious issue of the restriction on the development of competing SVoD services. However, BT notes that Ofcom has been considering these matters for over three years now without resolution. It is expected that the CC will take up to another two years to reach its conclusions once Ofcom has made a MIR. As such, five years will have passed – in a very fast moving market - without any remedy put in place to address serious competition issues in either the relevant upstream or downstream movies markets.
- 5.9 Moreover, in the Three Parties' initial submissions of January 2007 and July 2007, it was argued that an Enterprise Act reference would be the most appropriate route to address many of the competition issues identified. BT is disappointed, therefore, that it has taken three years to reach this point. In light of the already significant delay, BT believes it is now incumbent on Ofcom to make a MIR to the CC promptly, without any further delay.

Undertakings in lieu of a reference

- 5.10 Over the course of the Pay TV Investigation, and in its discussions with the Hollywood studios, Ofcom has made its concerns clear to third parties. Therefore, the relevant third parties that could offer undertakings in lieu of a reference have been aware of Ofcom's concerns for a considerable period of time, yet to date have not offered to discuss undertakings in lieu of a reference with Ofcom.

⁵⁴ Pay TV Statement Section 9.

- 5.11 It is possible that third parties may now seek to engage with Ofcom as a stalling tactic in order to further delay Ofcom in making a MIR to the CC promptly. In light of the fact that Ofcom has been examining these markets for over three years without resolution of the identified competition issues BT believes it would be inappropriate for Ofcom to delay a reference further by now engaging with these parties. It is clear, given the nature of the competition concerns identified, that it is highly unlikely that satisfactory undertakings could or would be agreed.
- 5.12 BT notes the potential remedies that Ofcom suggests may address the identified competition concerns. As discussed in detail below, BT does not believe that Ofcom's suggested remedies are sufficient to address the adverse effects on competition identified. As such, in the event Ofcom does decide to consider undertakings in lieu of a reference any proposals should not be considered unless they address the short-comings of the remedies set out in Ofcom's MIR Consultation, discussed below.

Proportionality and scale of the suspected problem

- 5.13 The OFT's MIR Guidance states that a MIR should only be made when there are reasonable grounds to suspect that the adverse effects on competition of features of a market are 'significant'⁵⁵. As part of this assessment, the guidance states that the detrimental effect on customers "through higher prices, lower quality, less choice or less innovation"⁵⁶ should be considered. The guidance also lists three factors which are relevant to determining whether a market reference is proportionate:
- The size of the market.
 - The proportion of the market affected by the feature giving rise to adverse effects on competition.
 - The persistence of the feature giving rise to adverse effects on competition⁵⁷.
- 5.14 As Ofcom sets out, the pay TV market in the UK is worth in excess of £4 billion per annum, and the proportion of the market that is expected to be adversely affected by the identified features is likely to be significant. As BT set out in the preceding section of this response, the "vicious circle" created due to the features that prevent, restrict and distort competition in this market will not be broken absent regulatory intervention. As such, the identified features themselves will continue to persist going forward, and thus the identified associated competition concerns will also persist.
- 5.15 BT set out a substantive list of consumer detriments arising due to the identified market features in the preceding section of this response. It is clear from that list that the identified

⁵⁵ OFT's MIR Guidance para 2.27

⁵⁶ Ibid

⁵⁷ OFT's MIR Guidance para 2.28

features have had an adverse effect on competition to the detriment of consumers in terms of higher prices, lower quality and less choice and innovation.

- 5.16 As a result, BT agrees with Ofcom's conclusions that a MIR is a proportionate response to the persistent nature of competition concerns in the relevant markets and the scale of the sector impacted by these concerns. The benefits of remedying any adverse effects which might be found to exist would outweigh the costs associated with a reference.

Remedies

- 5.17 The OFT's MIR Guidance states that Ofcom should also:

- 5.18 *"...take into account the likely availability of appropriate remedies in the event that the suspected adverse effects on competition were found by the CC to exist."*⁵⁸

- 5.19 Ofcom puts forward two possible forms of remedy that could address the adverse effects on competition:

- Intervention at source to change the way the rights are sold.
- Intervention to reduce Sky's ability to act on its incentives to exploit market power.

- 5.20 Ofcom appears to suggest that either intervention upstream in how the rights are sold or intervention downstream in terms of changing Sky's incentives may be sufficient to resolve the identified competition concerns. However, in BT's view, it is likely that the CC may need to impose remedies targeted at both the upstream and downstream markets, at least in the short to medium term. In this regard BT notes the previous upstream intervention in the sale of FAPL rights which was intended to address downstream competition issues in respect of premium sports channels. This intervention failed as changes to the upstream sale of rights were not sufficient to lead to effective competition and thereby counter Sky's downstream incentives. While the CC could learn from the failure of the upstream intervention in respect of FAPL and devise a more appropriate upstream regime, given specific issues with the staggered sale of movies rights, Sky's installed customer base, and other contractual restrictions, BT questions whether upstream intervention alone would be sufficient to remedy the identified competition concerns in the short to medium term.

- 5.21 BT also notes that certain of Ofcom's proposed remedies – such as limiting exclusivity and aggregation of rights – could unnecessarily adversely affect other pay TV operators. In particular, exclusivity and rights aggregation lead to competition issues only in the context of Sky's market power. Absent market power, exclusivity and rights aggregation can bring significant consumer benefits without an associated consumer detriment. As such, any remedy should recognise that exclusivity and rights aggregation should not be prohibited per se, but rather should be regulated where market power exists. It is important that any

⁵⁸ OFT's MIR Guidance para 2.31

remedies introduced are targeted to address the identified competition concerns while minimising distortions for other pay TV operators.

- 5.22 BT agrees with Ofcom's assessment that any intervention in respect of Sky's wholesale provision of Core Premium Movies channels would also have to address SVoD issues.
- 5.23 BT notes Ofcom's reiteration of its view that "operationally separating" Sky's channel and distribution businesses would be disproportionate compared to other remedies available. Equally Ofcom states that structural separation would be disproportionate in this case. BT does not believe that any potential remedy should be ruled out at this stage of the process. Once the CC has fully assessed the identified features and considered the magnitude of the adverse effect on competition it will then be clear what remedies may or may not be proportionate. Until such an assessment is completed BT believes it is inappropriate to unilaterally rule out any potential remedies.
- 5.24 Despite its reservations with respect to Ofcom's specific remedy proposals BT agrees nonetheless that there is a reasonable prospect that the CC would have appropriate remedies open to it to address the identified competition concerns in these markets.
- 5.25 Therefore, BT believes that all of the provisos set out in the OFT's MIR Guidance are met. As such, BT believes strongly that Ofcom should exercise its discretion to make a MIR to the CC immediately.

British Telecommunications

May 2010

Annex A: Consultation Questions

1. Do you agree with our analysis of the market for the sale of Movie Rights from Major Hollywood Studios in the first pay TV subscription window in the United Kingdom? Please provide any relevant evidence you have to support your view.

As discussed in Section 3 of the main body of this submission BT broadly agrees with Ofcom's analysis of the market for the sale of Movie Rights from Major Hollywood Studios in the first pay TV subscription window in the United Kingdom. However, as discussed in the main body of the submission [&]

2. Do you agree with our analysis of the features of the markets identified?

BT largely agrees with Ofcom's analysis of the features of the markets identified. However, as set out in Section 4 of the main body of this submission BT believes that it is important to recognise that certain features are a concern due to the existence of Sky's market power and should not necessarily be considered to prevent, restrict or distort competition in the absence of market power.

3. Are there any other features that we are missing and might be relevant to this assessment of competition in the identified markets?

BT has not currently found any additional features of the identified markets that might be relevant to this assessment of competition. Nonetheless, BT believes that it is possible that other features of the market may exist which have an adverse effect on competition in the relevant markets. It is possible that such features may come to light as part of the CC's in-depth assessment of these markets. However, the features already identified by Ofcom have a sufficiently material adverse effect on competition to warrant immediate referral of the relevant markets for investigation.

4. Do you agree with our analysis of the prevention, distortion and restriction of competition caused by the features we have described?

As set out in Section 4 of the main body of this submission, BT largely agrees with Ofcom's analysis of the prevention, restriction and distortion of competition caused by the features that Ofcom has described. However, Ofcom's MIR Consultation could imply that all of the identified features are necessary prerequisites for an adverse effect on competition to be found. BT disagrees strongly with this view. BT believes that many of the individual identified features are sufficient in and of themselves to adversely affect competition. The existence of multiple features that prevent, restrict and distort competition is likely to magnify each of the adverse effects arising from any one individual feature. However, while such amplification may strengthen the urgent need for Ofcom to make a MIR to the CC, BT believes that many of the individual features alone have a sufficiently material adverse impact on competition that a MIR is warranted.

5. Do you agree with our analysis of the impact on consumers regarding choice, innovation and pricing?

As set out in Section 4 of the main body of this submission, BT agrees that there is a significant impact on consumers regarding choice, innovation and pricing.

6. Do you agree with our analysis of the likely effects of the limited exploitation of SVoD services on competition?

As set out in both Section 2 and Section 4 of the main body of this submission, BT believes that SVoD is likely to be of material importance in the development of new, innovative competing services going forward. It is also likely to play a significant role in the development of IPTV and the underlying investment in superfast broadband. Therefore, BT agrees with Ofcom's assessment that the limited exploitation of SVoD services will have a significant detrimental impact on competition.

7. Do you consider that the threshold for making a market investigation reference to the Competition Commission is met?

As set out in both Section 4 and Section 5 of the main body of this submission, BT believes that the threshold for making a MIR to the CC is met.

8. Do you consider that we should exercise our discretion to make a market investigation reference to the Competition Commission?

As set out in Section 5 of the main body of this submission, BT believes that all of the provisos set out in the OFT's MIR Guidance are met. As such, BT believes strongly that Ofcom should exercise its discretion to make a MIR to the CC. Moreover, BT notes that Ofcom has been considering these matters for over three years now without resolution. In light of the already significant delay in a fast moving market, BT believes it is now incumbent on Ofcom to make a MIR to the CC promptly, without any further delay.

9. Do you have any comments on the draft wording of the proposed terms of the market investigation reference as set out in Annex 1?

BT has no comments on the draft wording of the proposed terms of the market investigation reference as set out in Annex 1.

British Telecommunications

May 2010