OFCOM PAY TV MARKET INVESTIGATION

RESPONSE OF VIRGIN MEDIA TO OFCOM'S CONSULTATION ON A PROPOSED REFERENCE TO THE COMPETITION COMMISSION IN RELATION TO PREMIUM PAY TV MOVIES

1. EXECUTIVE SUMMARY

1.1 It is clear, from the voluminous material collated and reviewed by Ofcom to date, and the exhaustive analysis undertaken in Ofcom's Pay TV Statement ("**Pay TV Statement**") and Pay TV Movies Consultation Document ("**Consultation**"), that Ofcom has more than sufficient grounds on which to refer to the Competition Commission ("**CC**") the markets for the upstream sale of movie rights by Major Hollywood Studios in the first pay TV subscription window, and the wholesale and retail supply of packages including Core Premium Movies channels.

1.2 In order to make a reference, Ofcom needs only "*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. This threshold is recognised as being a low one, reflecting Ofcom's role as first phase investigator, and is quite clearly met in the present case. Based on voluminous evidence and material obtained from third parties, and its own detailed investigation, Ofcom has found in its Pay TV Statement and Consultation that:

(a) Sky has market power in the wholesale supply of Core Premium Movie channels;

(b) Sky has market power in the retailing of packages containing Core Premium Movies channels;

(c) barriers to entry in each of the above markets are high;

(d) Sky, as a vertically integrated operator with wholesale market power, has the ability and incentive to restrict wholesale supply of packages including Core Premium Movies channels; and

(e) there exist a range of factors which point to Sky's behaviour having had the effect of foreclosing, or marginalising, other market participants at all levels of the pay TV supply chain.

1.3 It should also be noted that Ofcom, in its Third Consultation Document, identified specific competition concerns and evidence of consumer detriment in relation to the wholesale supply of Core Premium Movies which were sufficient to support its view, at the time, that movies should fall within the scope of its proposed WMO remedy. Ofcom's subsequent decision to exclude movies from the WMO remedy is not based on any reconsideration of this position (indeed, in the Pay TV Statement Ofcom reaffirms its view that its findings on market power and restricted distribution extend to Sky Movies channels) but rather reflect the view that a solution encompassing competition concerns at the upstream and wholesale levels of the market would be preferable.[1] This alone is sufficient to require Ofcom to make the proposed reference to the CC.

1.4 Virgin Media considers that the absence of movies from the WMO remedy makes it absolutely vital that a reference is made to the CC in order to address the competition concerns identified in the various movies markets (upstream rights procurement, wholesale and retail), and that this reference is made without delay. The longer the current market features and Sky's conduct are allowed to persist, the greater the

[1] Paragraphs 1.40 to 142, Pay TV Statement.

detriment suffered by consumers. A considerable period of time has passed since Ofcom began its investigation into the pay TV market, during which ample evidence of continuing consumer detriment has been revealed, and further delay will perpetuate the features of the market that are distorting competition and that are leading to consumer detriment.

1.5 Against this background, Virgin Media wishes to emphasise that whilst Ofcom focused on the Consultation on restrictions on competition in relation to SVoD rights for Core Premium Movies content, Sky's linear Core Premium Movie channels are a very important element of the relevant retail and wholesale markets and will continue to be very attractive to consumers for the foreseeable future. Against this background, Sky has consistently supplied its Core Premium Movies channels to Virgin Media only on uneconomic terms, and has not ([✂]) supplied Virgin Media with HD versions of those channels. Given that (as Ofcom has found) the linear broadcasting sector of the market suffers from a lack of effective competition and Virgin Media considers that in order for a remedy to be effective in addressing this lack of competition it must extend to Core Premium linear channels, any reference to the Competition Commission ("**CC**") must give due consideration to competition concerns in relation to the supply of linear Core Premium Movie channels (as well as in relation to movie SVoD services).

1.6 The remainder of this response sets out Virgin Media's views on the key consultation questions identified at Annex 5 of the Consultation.

1.7 Where appropriate defined terms are consistent with the definitions used by Ofcom in the Pay TV Statement and the Consultation.

2. <u>QUESTION 1:</u> DOES VIRGIN MEDIA AGREE 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 UK? PLEASE PROVIDE ANY RELEVANT EVIDENCE YOU HAVE TO SUPPORT YOUR VIEW.

2.1 Virgin Media broadly agrees with Ofcom's approach to market definition, and agrees with its conclusion that there is a distinct economic market for the upstream supply of movie rights from Major Hollywood Studios (as defined in the Pay TV Statement) in the first pay TV subscription window in the UK.

2.2 Virgin Media also agrees that a number of features of the market for the sale of movies rights act to enable and incentivise Sky to limit competition. The market is characterised by high barriers to entry facing (potential) competitors, with key barriers to entry being the need to acquire premium movies content in circumstances in which:

(a) there is a limited pool of premium content;

(b) Sky has exclusive agreements with the major studios for both linear and SVoD rights;

(c) contracts are long in duration; and

(d) expiration dates are staggered.

2.3 These factors prevent Virgin Media and other potential competitors from accessing sufficient premium movies content to make their services attractive to consumers (no competitor could compete effectively with Sky on the basis of only a minimum level of premium content). Virgin Media considers that deals with no fewer than three of the major Hollywood studios would be required to support a viable competitive offering,[2] and Virgin Media notes that the studios themselves have also confirmed that content from

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[2] See, for example, Virgin Media's response to Ofcom's third consultation document, at paragraph 4.5.

multiple studios would be required to launch an effective competing service to that of Sky.[3]

2.4 The need to acquire premium movies rights from multiple studios means that any potential competitor to Sky could take a number of years to acquire a viable portfolio of premium content in order to be able to launch an attractive competing service. In the meantime, with rights from only one or two of the studios (and it should be noted that a single studio only releases on average 1 to 2 new movies a month), any such new competitor, with such a limited proposition, would be very materially disadvantaged in its ability to build-up a customer base in the face of competition from Sky's highly attractive service. Problems with building a customer base, and resultant uncertainty about future revenues, would serve to further undermine any such retailer's ability to negotiate attractive terms with additional major studios.

2.5 Virgin Media's experience (which is described in detail in its previous submissions to Ofcom[4]) bears out Ofcom's finding that there is little prospect of Sky losing the majority of its premium movies rights given:

(a) the strength of Sky vis-à-vis the studios;

(b) the staggered availability of content rights and contract durations, which increase the risks and timescales that would be associated with new entry; and

(c) Sky's advantages deriving from its vertical integration with its retail arm which has a significant movie subscriber base. This provides Sky with greater certainty about wholesale income, which in turn supports its negotiations with the studios.

2.6 The combination of the features described above has given rise to a situation whereby Sky has monopolised the acquisition of premium linear and SVoD movie rights for almost 20 years.[5]

3. <u>QUESTION 2:</u> DOES VIRGIN MEDIA AGREE WITH OFCOM'S ANALYSIS OF THE FEATURES OF THE MARKETS IDENTIFIED?

3.1 Virgin Media broadly agrees with Ofcom's approach to market definition, and agrees with its conclusion that there are distinct economic markets for:

(a) the wholesale supply of wholesale packages containing Core Premium Movies channels; and

(b) the retail supply of packages containing Core Premium Movies channels.

3.2 Virgin Media also agrees that Ofcom has identified the key features of the relevant markets which work both alone and in combination to prevent, restrict and distort competition. In practice, a number of these features are, in themselves, sufficient to justify a reference to the CC. The combination of these features merely exacerbates the competition problems in the markets, further reinforcing Sky's market power.

3.3 Relevant features of the market, insofar as they pertain to premium movie rights procurement from major Hollywood studios, are considered in Section 2 above. The other key features identified by Ofcom at paragraph 5.1 of the Consultation Document are addressed below.

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3 Paragraph 5.11 of the Consultation Document.

4 See Virgin Media's response to Ofcom's information request of 20 December 2007. Virgin Media's response was submitted on 21 February 2008, and Virgin Media refers Ofcom specifically to paragraphs 1.14 to 1.18 and 1.23 to 1.26.

5 See paragraph 4.17 of the Consultation.

A) Aggregation of substitutable premium movies into a single wholesale offering

3.4 Sky's domination of the acquisition of premium movie rights underpins its market power at the wholesale and retail level. Virgin Media agrees that Sky has enjoyed very high and sustained market shares in the wholesale sector, pointing to market power. [6]

3.5 Virgin Media considers that Sky's aggregation of a high proportion of available premium movie rights from major Hollywood studios has the effect of restricting competition that might otherwise exist between competing broadcasters of premium movies content. Since much of the content that Sky aggregates into its movie channels is substitutable in the eyes of consumers, Sky's ability to prevent Virgin Media and other potential competitors from accessing that content enables Sky to render the services of (potential) competitors unattractive to consumers. Even if Virgin Media or another potential competitor were able to secure premium movie rights from one studio, such content would not be sufficiently "unique" to enable that broadcaster to compete effectively with Sky in the retail market.

3.6 Accordingly, with the premium movie content available from the major Hollywood studios being largely substitutable, the attractiveness of any retail offering will depend critically on the mass of content available. Ofcom notes[7], and Virgin Media agrees, that the content available from a single studio does not provide the volumes required to create an attractive package.

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

3.7 For the reasons set out above, Virgin Media agrees that Sky has been able to monopolise the acquisition of premium content, including the acquisition of premium SD, HD and SVoD movie rights, and that this is evidenced by the fact that for almost 20 years Sky has not lost any premium movie rights from any of the major studios. This dominance is likely to extend into new formats such as 3D.

3.8 As the sole entity with access to sufficient premium movies content, Sky has very material market power in the wholesale market for the supply of packages including core premium movies channels. This is evidenced by:

(a) its very high and sustained market share in the wholesale market. As discussed further below, Virgin Media considers that Ofcom's analysis of Sky's market power in the wholesale market gives undue weight to what Virgin Media strongly considers to be very distant substitutes, such as DVDs, library films (on FTA and basic channels, including dedicated FTA movie channels), online DVD rental subscription packages, Disney Cinemagic and movie downloads;

(b) the existence of barriers to entry. A key barrier to entry into the wholesale market is the need to acquire a sufficient mass of premium content rights which, as set out in detail at Section 2 above, has proven to be unachievable by Virgin Media and other (potential) competitors for many years. As Ofcom notes in the Pay TV Statement (paragraph 6.302) "*material changes in a wholesale channel provider's portfolio of Movie Rights can lead to a very significant expansion (or contraction) in that broadcaster's market share*". Ofcom goes on to observe that "*given the strength of Sky's current position, small-scale entry and expansion is unlikely materially to undermine its wholesale position*" (paragraph 6.307). Accordingly, in order for there to be a prospect of Sky facing effective competition from another broadcaster in respect of premium movies content, Ofcom considers that Sky would need to lose "*the majority*" of its premium movies rights. This is extremely unlikely as is evidenced by Virgin Media's experience in the market; and

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6 See, for example, Virgin Media's response to Ofcom's third consultation document, at paragraphs 4.4-4.5.

7 Paragraph 5.39 of the Consultation Document.

(c) a lack of countervailing buyer power on the part of Virgin Media and other potential purchasers of premium movies channels. Whilst Virgin Media may be well-informed, its bargaining power vis-à-vis Sky is demonstrably weak:

(i) it is reliant upon Sky's premium content. Virgin Media cannot switch to alternative wholesale inputs (either its own premium movie channels or those of alternative wholesale suppliers) because of the significant barriers to entry into the wholesale market.[8] In this regard, Virgin Media agrees with Ofcom's view that "*we do not believe there are currently credible direct competitive alternatives to Sky's Core Premium Movies channels*";[9] and

(ii) it has been unable to negotiate wholesale supply at a price that enables it to earn a sufficient margin to allow it to effectively compete;[10] and

(iii) Virgin Media notes and agrees with Ofcom's conclusion that "*we remain of the view that Virgin Media has little if any buyer power in relation to Sky's premium channels*".[11]

3.9 Sky's domination of premium movies rights procurement, its first-mover advantages and its very strong negotiating position in the wholesale market are evidenced by its stranglehold over premium movies rights for almost 20 years and the fact that, as Ofcom has found, its wholesale prices and margins for premium movies are above competitive levels. Further, Ofcom has found that Sky's wholesale margins are higher for movies than for sports.[12]

3.10 However, Ofcom's analysis of Sky's market power in the wholesale market for packages containing Core Premium Movies channels gives undue weight to what Virgin Media considers to be very distant substitutes, such as DVDs, library films (on FTA and basic channels, including dedicated FTA movie channels), online DVD rental subscription packages, Disney Cinemagic and movie downloads (paragraphs 6.279-6.293 of Pay TV Statement). In particular:

(a) the Consultation Document indicates that although Sky has a 100 per cent share in the defined wholesale market, "*we also acknowledge that this market share figure substantially overstates the degree of market power held by Sky….the aggregate constraint* [from alternatives]*..may be significant.*" (paragraph 5.45);

(b) a "best-case" market share for Sky of 30-40 to 40-50 per cent is presented in the Consultation Document, taking into account all of these possible alternatives, although Ofcom stresses that this figure <u>understates</u> the degree of market power held by Sky because it treats moderate substitutes as if they were close substitutes (paragraph 5.46);

(c) Ofcom concludes that "[t]*he balance of evidence*" (paragraph 5.46) leads it to take the view that Sky has market power.

3.11 Ofcom's approach understates the market power enjoyed by Sky. The vast majority of the evidence considered by Ofcom points to Sky enjoying a position of market power throughout the supply chain (from procurement of premium rights, through to the wholesale supply of Premium Movies channels and in the retail supply of Core Premium Movies channels). Virgin Media therefore considers that Sky unambiguously enjoys

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8 This is acknowledged by Ofcom at paragraph 6.271 of the Pay TV Statement.

9 Pay TV Statement, paragraph 10.109.

10 See paragraphs 2.7-2.15 of Annex 6 of the Joint Submission to Ofcom, dated July 2007.

11 Paragraph 5.506 of the Pay TV Statement.

12 Paragraph 6.27 of the Consultation Document.

market power and such a conclusion is not reliant on a consideration of the "*balance of evidence*".

3.12 In this connection Virgin Media notes that in its third consultation document, Ofcom reached a much firmer finding on Sky's market power:[13]

> "*Sky's very high market share indicates that it holds a position of market power. Under a CA98 analysis it would create a (rebuttable) presumption that it enjoys a dominant position. If this share is retained over the next three to four years, we would expect any dominance to be retained over that period. <u>Our conclusions take into account the constraint imposed by 'out of market' products.</u> Under alternative market definitions that include moderate substitutes Sky's market share remains above the 50% threshold that the ECJ has stated is associated with a presumption of dominance (in the absence of evidence of the contrary). <u>Moreover we recognise that these alternative market share figures will overstate the strength of the competitive constraint exercised by these 'out of market' products and thus understate the extent of Sky's market power.</u>*" (emphasis added)

3.13 Accordingly, whilst noting that so-called "out of market" products may have the effect of diluting Sky's very high market share, Ofcom did not consider at that stage that such alternative products imposed any material competitive constraint upon Sky's activities, even in aggregate. This was the correct conclusion, in light of:

(a) the voluminous evidence that Sky has enjoyed market power for many years;

(b) the evidence that Sky is earning returns significantly above its cost of capital; and

(c) Ofcom's finding that Sky's margins are likely to be higher in movies than in sports, which suggests directly that Sky has market power, and that it is <u>not</u> significantly constrained by any existing or potential competitors.[14]

C) Vertical integration

3.14 Virgin Media agrees that Sky's vertical integration, together with its wholesale market power, gives it the ability and incentive to restrict wholesale supply of packages including Core Premium Movies channels.[15] This is entirely consistent with Virgin Media's previous submissions.[16] Sky enjoys market power at the retail level and in the procurement of premium movie rights, as well as at the wholesale level. Sky's market power at all levels of the supply chain provides Sky with incentives to engage in behaviour that forecloses, or at the very least marginalises, competitors.

3.15 As Ofcom notes in the Pay TV Statement (paragraph 7.9): "*we consider that the terms of Sky's existing supply to Virgin Media have the effect of weakening Virgin Media's ability to compete with Sky. The non-supply of the various enhanced or alternative versions of Sky's premium channels to Virgin Media – in particular HD – is and will remain a significant prejudice to fair and effective competition.*"

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13 Paragraph 5.95 of Ofcom's third Consultation Document, 26 June 2009.

14 Paragraph 6.27 of the Consultation Document. As noted by Ofcom at paragraph 5.49, the evidence of high returns is directly indicative of market power and this is not dependent on the precise market definition or market shares.

15 Paragraph 5.54 of the Consultation Document.

16 See, for example, Virgin Media's supplementary submission dated 15 August 2008, at paragraph 6.10, and its response to Ofcom's third consultation document, at paragraphs 5.1-5.2.

4. **QUESTION 3: ARE THERE ANY OTHER FEATURES THAT OFCOM IS MISSING AND MIGHT BE RELEVANT TO THIS ASSESSMENT OF COMPETITION IN THE IDENTIFIED MARKETS?**

4.1 Virgin Media notes that whilst Ofcom has concluded that Sky has retail market power, it considers that Sky can best be characterised as exercising that market power at the wholesale level, rather than the retail level.[17] As such, the primary focus of the Consultation Document is on the wholesale market (as well as premium rights procurement).

4.2 Nevertheless, Virgin Media would emphasise that the adverse effects of the exercise of Sky's market power are felt at the retail level. It is, therefore, important that the scope of the proposed reference to the CC extends to retail markets. The absence of a reference of the retail market would, following the logical construction of Ofcom's arguments, undermine the CC's ability to remedy the problems identified by Ofcom, particularly in light of the mutually reinforcing effect of market power at the wholesale and retail levels.

5. **QUESTION 4: DOES VIRGIN MEDIA AGREE WITH OFCOM'S ANALYSIS OF THE PREVENTION, DISTORTION AND RESTRICTION OF COMPETITION CAUSED BY THE FEATURES OFCOM HAS DESCRIBED?**

5.1 Virgin Media broadly agrees with the specific grounds set out by Ofcom for suspecting that the identified features of the market prevent, restrict or distort competition. In particular:

(a) the limited exploitation of premium SVoD rights; and

(b) high wholesale prices.

5.2 Virgin Media is concerned, however, that Ofcom has not placed sufficient weight on the prevention, restriction and distortion to competition arising from the terms on which Sky supplies Sky's Core Premium Movies channels to Virgin Media. This issue is addressed before commenting on Ofcom's conclusions in relation to SVoD rights and high wholesale prices.

A) Terms of supply of Sky's Core Premium Movies channels

5.3 Although there is increasing demand amongst consumers for SVoD services, linear broadcasting continues to represent the primary delivery medium for this content, and is therefore an important service for which there is significant consumer demand. Furthermore, strong demand for linear services is expected to continue for some time to come, reflecting the familiarity amongst consumers for this type of viewing experience. Accordingly, Virgin Media does not agree with Ofcom's statement that there is limited demand for linear movie channels from pay TV retailers[18]. There is, and will continue to be, significant demand for linear movie channels.

5.4 As a consequence, Sky has an incentive to weaken or eliminate Virgin Media as a competitor in relation to the supply of linear Core Premium Movie channels, as well as in relation to movie SVoD services. In particular, Sky engages in various practices in order to foreclose downstream competition in relation to the wholesale supply of its Core Premium Movies linear channels in both SD and HD format. Specifically:

(a) Sky supplies SD premium channels to Virgin Media only on uneconomic terms; and

(b) Sky has not (**[✂]**) supplied HD versions of Sky's Premium Movies channels to Virgin Media;

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[17] At paragraph 6.364.

[18] Paragraph 1.9 of the Consultation Document.

5.5 Virgin Media sets out below Sky's conduct in relation to each of these practices and also discusses why each of these practices distorts competition.

Sky supplies SD premium channels to Virgin Media only on uneconomic terms

5.6 Sky has consistently supplied its premium channels to Virgin Media only on uneconomic terms. At paragraph 7.270 and figure 114 of the Pay TV Statement Ofcom found that Virgin Media earns only a very small positive incremental margin, before retailing costs, for Sky Movies subscribers (which account for **[✂]** of Virgin Media's premium subscribers) and a negative incremental margin for subscribers taking a package of Sky Sports and Sky Movie channels (which account for **[✂]** of Virgin Media's premium subscribers). As a consequence, Sky's conduct removes any incentive on Virgin Media's part to compete with Sky as regards the retailing of Core Premium Movie channels.

5.7 Virgin Media agrees with the clear conclusion reached by Ofcom in the Pay TV Statement that current cable rate-card prices do not allow competing retailers to compete effectively: For example, it states:

> "*We do not believe it to be a reasonable expectation for retailers other than Sky to be prepared to pay the rate-card prices for Sky's Core Premium channels, as these prices would not allow them to compete effectively*" (paragraph 7.5, Pay TV Statement).

5.8 More specifically, in relation to the ability of Virgin Media to compete on the basis of the cable rate-card, Ofcom states:

> "*Sky's wholesale prices are, in our assessment, close to the highest Sky could charge while passing a margin squeeze test based on Sky's scale. Virgin Media's scale is smaller than Sky's, so it is unsurprising that <u>prices set on such a basis do not allow Virgin Media to compete effectively with Sky</u>.*" (paragraph 7.324) [emphasis added]

5.9 The supply by Sky of SD versions of Sky Movies channels on uneconomic terms, in itself, distorts competition.

Sky does not supply HD versions of Sky's Premium Movies channels to Virgin Media

5.10 Sky does not currently supply Sky's Premium Movies channels to Virgin Media in HD. The supply of HD content is particularly important to Virgin Media. During the course of 2006, Sky launched the first range of HD channels on the DSat platform. Virgin Media's cable platform is technically able to provide HD services as is demonstrated by the fact that Virgin Media currently carries 12 HD channels across a range of suppliers and genres, including BBC, ITV, Channel 4, ESPN, Eurosport and Discovery. Despite Virgin Media's technical ability to carry Sky's HD channels, its commercial desire to do so, and repeated and protracted attempts to reach a commercial agreement with Sky in relation to supply of those channels, Sky has (**[✂]**) declined to supply any of its premium HD channels to Virgin Media.[19]

5.11 At the time the original complaint was made by Virgin Media, BT, Setanta and Top Up TV to Ofcom in January 2007, HD channels and HD content were a reasonably new innovation. This is no longer the case. HD channels and content are now becoming a mainstream requirement and are important to a large number of consumers (more than **[✂]** of Virgin Media 's premium subscribers are able to receive HD services). The fact

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19 See, for example, paragraphs 2.16 to 2.39 of Annex 6 of the July 2007 Joint Submission, and Virgin Media's supplementary submission dated 15 August 2008, at paragraphs 3.9(d) and 4.3(d).

that Sky has now ceased offering SD set-top boxes is illustrative of the increasing ubiquity of pay TV subscribers with HD services. **[✂]**

5.12 Against this background, Ofcom has recognised the importance of having access to enhanced services such as interactive services and HD in order for rival retailers to compete effectively with Sky. It states for example:

> "*HD is already important to a large number of consumers, and this importance is expected to increase with time, to the extent that it may replace SD as the standard means of viewing content*". (paragraph 8.112, Pay TV Statement)
>
> "*The non-supply of the various enhanced or alternative versions of Sky's premium channels to Virgin Media – in particular HD – is and will remain of significant prejudice to fair and effective competition.*" (paragraph 7.9, Pay TV Statement)

5.13 The inability of Virgin Media to offer HD versions of Sky's premium channels, including movies channels, means that Virgin Media's pay TV services compare very unfavourably with those of Sky. Sky further exploits this disadvantage by heavily cross-promoting its HD services on the SD versions of its premium channels which it supplies to Virgin Media. **[✂]** The lack of supply of HD channels adversely impacts the ability of Virgin Media to compete effectively with Sky in relation to the supply of premium movie services.

5.14 In the context of the Pay TV Statement and Core Premium Sports channels, Ofcom has therefore included interactive services and HD within the scope of its WMO remedy applying to Core Premium Sports channels. The same considerations apply in relation to HD versions of the Sky's Core Premium Movie channels. Accordingly, when considering whether to refer the identified movies markets to the CC, Ofcom must also pay particular attention to the restricted supply of HD content, whether in linear or SVoD format.

5.15 The combination of uneconomic terms in relation to linear SD versions of Sky's Core premium Movies channels and lack of access (**[✂]**) to HD versions of Sky Premium Movies channels has restricted Virgin Media's ability to compete with Sky. As Ofcom recognises, this has led to substantially lower penetration of Sky's Core Premium channels on the cable platform as compared with Sky's own platform.[20] Ofcom concludes that:

(a) the low margin offered to Virgin Media by Sky contributes to unmet demand for Core Premium channels on the cable platform, a distortion of consumer choice, and consumer harm;[21] and

(b) the restricted supply of HD Core Premium channels to Virgin Media results, and will continue to result, in significant harm to consumers because it limits choice.[22]

5.16 In summary, on Ofcom's own analysis it is clear that in addition to concerns arising from limited exploitation of premium SVoD rights and high wholesale prices, the terms on which Sky supplies its Premium Movies channels to Virgin Media also prevent, restrict and distort competition.

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20 See Pay TV Statement at paragraph 7.325.

21 See Pay TV Statement at paragraphs 8.136 and 8.137.

22 See Pay TV Statement at paragraph 8.114.

B) The joint sale of linear and SVoD rights has prevented, restricted or distorted competition in relation to premium SVoD services which Virgin Media is uniquely well-placed to offer

5.17 Virgin Media agrees that the joint sale of linear and SVoD rights has prevented, restricted or distorted competition in relation to premium SVoD services.

5.18 Virgin Media considers itself to be uniquely well-placed to meet the growing demand for VOD services because it can offer high quality "true" VOD services on TV. True VOD is "always on": more specifically, it uses technology which allows streamed content to be delivered (including in HD format) whenever requested by the viewer, via a "return path", directly to the customer's television. However, despite this capability Virgin Media is prevented from launching an SVoD movie service in competition with Sky's linear Premium Movies channels due to a lack of access to premium content at economic prices.

5.19 As set out in Virgin Media's previous submissions,[23] the major limiting factor of a traditional linear broadcast from a viewer's perspective is that viewers without a PVR do not have flexibility as to when they watch individual programmes; rather individual programmes are only available at the time slots determined by the broadcaster. Further, linear broadcasts are limited in their ability to offer functionality such as pausing, rewinding and fast-forwarding.

5.20 Consumers are increasingly demanding the ability to choose what content they wish to view and at what time they watch it. They also seek the ability to control the way content is viewed (e.g., pausing, rewinding etc.). This is leading to an increase in demand for VOD services. This increase in demand is evident from Virgin Media's experience and general industry developments, including:

(a) the steady growth in demand for Virgin Media's VOD services since the launch of the service in 2005. In March 2010 there were approximately **[✂]** views of VOD content on Virgin Media's TV platform with approximately **[✂]** subscribers using Virgin Media's VOD service on a monthly basis. This represents about **[✂]** of Virgin Media's customer base;

(b) the report for Ofcom *Movie Markets in the UK* (Annex 11 of Ofcom's First Pay TV Consultation of 18 December 2007) indicates that uptake of true VOD services is expected to increase: "*By the end of 2011 true VOD enabled homes is expected to have increased from 2.5 million UK households in 2006 to 14.6 million (55 per cent of all UK households). The proportion of nVOD-enabled homes (8.7 million) within this bracket is expected to stagnate, and all digital cable subscribers will be migrated to true VOD*";

(c) the decision of the UK terrestrial channels to each launch their own branded VOD service; and

(d) the proliferation and investment in VOD services and related technology, in the UK for example Tiscali (then HomeChoice) introduced its VOD service in 2004, and more recently, Project Canvas (a proposed new joint venture, led by the BBC, is intended to establish a new VOD platform in the UK).

5.21 In particular, there is a strong demand for SVoD as customers in the UK show a clear preference for subscription VOD services over pay-per-view (**"PPV"**) VOD services. This is borne out by:

(a) Virgin Media's own experience that its most successful pay VOD services are those offered on a subscription basis. For example when Virgin Media offered music

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[23] Virgin Media's supplementary submission dated 15 August 2008, at paragraphs 5.8-5.11.

videos on a PPV basis for the first six months of 2007, there were an average of **[✂]** views per month. After music videos were included free for XL customers (i.e. as part of a subscription service), there were an average of **[✂]** views per month (data for the first 6 months of 2008);

(b) Virgin Media's market research, has consistently shown that there is considerable latent consumer demand for a first pay TV window SVoD service. By way of example, research conducted for Virgin Media indicates that **[✂]** of respondents would be "very/extremely interested" in a subscription VOD proposition where there was no cost per movie.[24] This was nearly **[✂]** as many responses as the next most important consideration with **[✂]** citing "lower monthly cost than Sky movies". An SVoD movie service would be an extremely compelling proposition by enabling a consumer to watch a movie of their choice at their convenience and without paying an additional specific fee per movie;

(c) the differing experiences of ntl and Telewest when offering their respective VOD services, from which it was clear that a model incorporating a free VOD and SVoD is much simpler for prospective customers to understand, and that subscribers exhibited considerable resistance to itemised billing for every programme viewed and expressed dissatisfaction about the cost of PPV TV VOD content. The clear preference for free or SVoD models was supported by churn data, which clearly indicated that a dissatisfaction with PPV services increased the potential of subscribers to churn away from ntl. In contrast, Telewest data pointed to increased customer satisfaction and a reduction in churn.[25]

5.22 Against this background, an SVoD movie service in the first pay TV window would be an extremely compelling proposition by enabling customers to watch a movie of their choice at their convenience and without paying an additional specific fee per movie. Virgin Media is acutely aware that retailers in this market must continue to innovate as consumer demands evolve, and previously novel solutions or services become mainstream features. As a consequence, Virgin Media has continued to innovate, by investing in solutions/platforms to deliver VOD. For example:

(a) in July 2009 Virgin Media launched Picture Box, an SVoD movie service which allows consumers to access a limited number of movies from NBC Universal for £5/month. The service, which offers a selection of movies released in the second pay TV window, **[✂]** having achieved almost **[✂]** views by the end of April 2010. **[✂]**;

(b) in April 2010 Virgin Media launched an online movie proposition, Virgin Media Online Movies. The service is available online to all, and comprises a collection of PPV movies provided by Filmflex in SD and a limited number of HD movies. However, given the clear consumer demand for a subscription-based service in the first pay TV window, and the preference amongst many movies consumers for HD versions, **[✂]**

5.23 In summary, whilst Virgin Media's has sought to innovate in relation to the supply of VOD services, and all of its customer tiers have access to a wide-range of VoD functionality, Virgin Media's services will continue to be of limited appeal due to lack of access to premium movie content in the first pay TV window.

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[24] See Virgin Media internal document *Virgin Movies Draft: 29th March 2007* included at Annex 1, tab 16 of Virgin Media's Consolidated Response to Request for Further Information of 20 December 2007 as submitted to Ofcom on 21 February 2008.

[25] Virgin Media's supplementary submission dated 15 August 2008, at paragraphs 5.20-5.21.

5.24 Ofcom has identified that the limited exploitation of SVoD rights prevents, restricts or distorts competition.[26] Virgin Media notes that Sky plans to launch a new pull VOD called Sky Anytime Plus/Darwin[27] over which it is expected that Sky will seek to exploit its library of SVOD rights. However, this will not address the distortions of competition arising from limited exploitation of SVoD rights for the following reasons:

(a) most importantly, even if Sky exploits these SVoD rights through Anytime Plus, this would simply lead to an extension of Sky's dominance in relation to premium movie content into another form of delivery. Anytime Plus will not, therefore, serve to introduce more competition into the market. Sky would continue to be free to price these services in such a way as to maximise its own profits, without risk of effective competition in either the linear broadcasting or SVoD sectors;

(b) as Anytime Plus relies on the internet, it will be subject to streaming and capacity issues; and

(c) finally, as observed by Ofcom, Anytime Plus will, at least initially, only be available to a minority of Sky's installed base.[28]

C) High wholesale prices

5.25 In addition, Virgin Media notes from the evidence which Ofcom has presented that Sky has achieved persistent and significant profits in excess of its cost of capital, and Ofcom’s conclusion from this evidence that the prices of packages including Sky’s Core Premium Movies channels are above the competitive level. [29]

5.26 Whilst Virgin Media cannot comment in detail on Oxera's analysis of Sky's profitability, Virgin Media indicated in its response to the third consultation document[30] that it considers this analysis to be robust. In particular:

(a) Oxera has undertaken its analysis carefully and conservatively using the appropriate conceptual framework;

(b) the study makes sensible use of scenarios to test the sensitivity of results to key assumptions and thereby allows conclusions to be drawn which are robust to different assumptions;

(c) Oxera has also cross-checked the results using alternative measures, in particular the ROCE, as well as carefully considering potential comparator companies against which Sky's returns could be appropriately measured.

D) Virgin Media is an ineffective competitor

5.27 In summary, Virgin Media agrees that the various features of the markets identified by Ofcom, together with Sky's conduct, have led to ineffective retail competition in relation to the supply of Premium Movies services in the UK. There is currently no scope for competition "on the merits" either from Virgin Media or any other potential competitor:

(a) although linear broadcasting continues to represent the primary delivery medium for premium movies content, Virgin Media is unable to compete in relation to

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26 Consultation at paragraph 1.7

27 This service will connect a Sky Plus HD box with an Ethernet connection so that customers will be able to access on-demand content over the internet. It is a "true" VOD proposition. Darwin is the project name for an update that will allow all suitably equipped Sky set-top boxes to connect to the Internet.

28 Consultation at paragraph 1.7

29 Paragraph 6.27 of the Consultation Document.

30 Paragraphs 5.10-5.11 of Virgin Media's response.

prices. Virgin Media would like to be able to provide its customers with access to the most desirable movies content at a competitive price, but is prevented from doing so due to Sky's uneconomic wholesale terms. As a consequence, Virgin Media's current incentive is to market Sky's Premium Movies channels only as a retention tool rather than as a source of added value.[31] As Ofcom notes:[32]

> "*One specific consequence of this approach to pricing* [Sky setting wholesale prices which are close to the highest Sky could charge while passing a margin squeeze test based on Sky's scale] *is that Virgin Media's incremental margin on the SD versions of Sky's Core Premium channels is negative. Virgin Media therefore has little incentive to sell premium channels to an existing basic subscriber. This is reflected in the relatively weak incentives offered to Virgin Media sales staff for selling Sky Core Premium channels*";

(b) Virgin Media would like to be able to provide its customers with similar levels of access to HD and VoD services as those enjoyed by Sky's customers. However, Sky has **[✂]** consistently refused to make HD and VoD content available to Virgin Media;

(c) Virgin Media, albeit well-placed from a technological perspective to develop a competing SVoD movie service, is prevented from doing so due to lack of access to premium movie content. **[✂]** Virgin Media has sought to innovate within the constraints of the content rights available, **[✂]** This illustrates how innovation has been stifled – Sky has no incentive to innovate in ways which are suited to platforms other than its own. This has prevented consumers from enjoying the benefits that would arise from the effective exploitation of new technologies; and

(d) Virgin Media is unable to offer an IPTV-based movie service, including for those consumers outside the cable network. Virgin Media notes Ofcom's conclusion that "*the ability to provide high-value video content on demand is one of the commercial justifications for investing in new superfast broadband networks. Movies are particularly important in this context, being both valuable to consumers, and well-suited to a true VoD service. Limited access to such content risks holding back such investment, with a wide range of resulting consequences for consumers*".[33] Virgin Media agrees with Ofcom. **[✂]**

5.28 Sky has enjoyed a stranglehold over premium movies rights for almost 20 years, and its domination of the supply of Core Premium Movies channels and strategies to withhold and/or restrict economic access to content and other features have prevented the development of dynamic competition within the UK. Once a key innovator, Sky's conduct has for years held back technological progress within the UK, denying consumers access to competitively and flexibly priced content, and suppressing the technological innovations which have occurred in other countries.

5.29 As a consequence, UK consumers do not enjoy the benefit of accessing the most desirable VoD content at competitive prices. Further, even after Sky's proposed launch of its Darwin VoD service, UK consumers will be able to access the most desirable content <u>only</u> if they subscribe to Sky's Darwin service and obtain the appropriate set top box. There will remain the risk that service quality may be low for some of these customers (if a satisfactory quality of signal cannot be obtained), and there may be limits on the amount of content accessible due to capacity constraints caused by the limited hard drive storage capacity of the DTH set top boxes. There will also be no constraint on Sky to charge competitive prices, given that the launch of the Darwin service will merely represent an

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31 Paragraph 1.31 of the Pay TV Statement.

32 Paragraph 7.324 of the Pay TV Statement.

33 Consultation Document at paragraph 1.10.

extension of its existing market power into the SVoD sector, within which Sky will not face any effective competition.

5.30 By contrast, all cable customers are able to access high quality (in terms of signal and capacity) VoD services, irrespective of their set top box or their distance from the cable head end. Virgin Media has invested in a number of innovative VoD services, and these are available to all cable customers. However, due to the existing arrangements for the exclusive sale of premium movies SVoD rights to Sky, cable customers cannot access this content, leading directly to consumer detriment.

5.31 In this regard, and as described at Section 3, Virgin Media does not agree with Ofcom's conclusion that Sky has market power only on the basis of the "*balance of evidence*". Virgin Media considers that the vast majority of the evidence points to Sky enjoying a position of market power throughout the supply chain (from procurement of premium rights, through to the wholesale supply of premium movies channels and the retail market). Specifically (and as described above), Virgin Media does not agree that other possible constraints, such as DVDs, library films, online DVD rental subscription packages, Disney Cinemagic and movie downloads, impose any discernible form of competitive constraint on Sky's activities, even in aggregate.

6. <u>QUESTION 5:</u> DOES VIRGIN MEDIA AGREE WITH OFCOM'S ANALYSIS OF THE IMPACT ON CONSUMERS REGARDING CHOICE, INNOVATION AND PRICING?

6.1 Virgin Media considers that there is a wealth of evidence that consumer needs are not currently being met (in terms of both pricing and product choice) in relation to premium movies content. Evidence relating to consumer choice, innovation and pricing are set out below.

Reduced consumer choice

6.2 Examples of reduced consumer choice include the following:

(a) Sky's refusal to supply Core Premium Movie channels to pay TV retailers on the DTT platform means that consumers on those platforms are denied the ability to choose to subscribe to those channels;[34]

(b) Sky's refusal ([✂]) to supply HD services to Virgin Media means that customers on the cable platform are faced with a restricted choice of services. This is particularly detrimental given that the availability of HD channels is becoming an increasingly important factor in consumer choice; [35]

(c) Sky's stranglehold on premium movie content prevents third parties from creating attractive movie channels in competition with Sky's Premium Movies channels;[36] and

(d) Sky's acquisition of SVoD rights for premium movies on an exclusive basis in the first pay TV window, although not yet exploited, forecloses Virgin Media (as the retailer best-placed to offer an SVoD service (including both SD and HD movies), and others, from providing effective competition to Sky's premium Movies channels. As noted above, any decision by Sky to exploit these rights in the future will not serve to introduce more competition but simply lead to an extension on Sky's dominance into another form of delivery.

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[34] July 2007 Joint Submission, Part 4, paragraph 5.3(a). See also paragraphs 8.60-8.72 of Ofcom's Pay TV Statement.

[35] July 2007 Joint Submission, Part 4, paragraph 5.3(c). Paragraph 7.312 of Pay TV Statement

[36] July 2007 Joint Submission, Part 4, paragraph 5.5(a). See also paragraphs 7.4-7.7 of Ofcom's Pay TV Statement.

Reduced innovation

6.3 Examples of reduced innovation, leading to consumer detriments, include the following:

(a) by wholesaling its Premium Movies channels to Virgin Media at uneconomic rates, Sky effectively forces Virgin Media to follow Sky's pricing model, leading to less innovation in how pay TV services are packaged and priced;[37]

(b) the lack of certainty in terms of supply makes it more difficult for Virgin Media to adopt a forward-looking strategy, and this reduces the incentives for Virgin Media to make the marketing and other investments necessary to launch innovative pricing mechanisms and new or improved services;[38]

(c) the warehousing by Sky of SVoD rights means that Virgin Media is deprived of the ability to provide an attractive SVoD movies service to consumers. Whilst Virgin Media has continued to innovate within the constraints of the content rights available, for example through the launch of the Picture Box and Virgin Media Online Movies services (described at paragraph 5.22 above), **[✂]**;

(d) the uneconomic terms imposed on cable reduces the ability of Virgin Media to invest in research and development of new products and services;[39] and

(e) since Sky is able to marginalise its upstream competitors, Sky faces reduced upstream competition and, as a consequence, has a reduced incentive to innovate and develop new products and services.[40]

6.4 Further, Virgin Media notes that Ofcom has provided evidence of a lack of innovation by way of international comparisons. As set out in the Consultation Document, the UK has not benefited from the levels of technological innovations witnessed in other countries, with the development of SVoD being held-back by a lack of access to premium movies content at economic prices.[41]

Higher prices

6.5 The following evidence supports Ofcom's view[42] that consumer detriments have arisen due to high wholesale prices:

(a) Sky's market power, high wholesale prices and restrictive terms of supply mean that Virgin Media neither has neither the incentive nor the ability to compete on price at the retail level. As a result, Virgin Media is unable to exert any real competitive pressure on Sky's prices;[43]

(b) at paragraph 7.270 and figure 114 of the Pay TV Statement Ofcom found that Virgin Media earns only a very small positive incremental margin, before retailing costs, for Sky Movies subscribers (which in March 2010 accounted for approximately **[✂]** of Virgin Media's premium subscribers) and a negative incremental margin for subscribers taking a package of Sky Sports and Sky Movies channels (which in March 2010 accounted for approximately **[✂]** of Virgin Media's premium subscribers). As a consequence, Sky's conduct removes any incentive on

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37 July 2007 Joint Submission, Part 4, paragraph 5.4(a).

38 July 2007 Joint Submission, Part 4, paragraph 5.4(b).

39 July 2007 Joint Submission, Part 4, paragraph 5.6(c).

40 July 2007 Joint Submission, Part 4, paragraph 5.6(d).

41 Paragraphs 4.123-4.145 of the Pay TV Statement.

42 Paragraphs 6.45-6.48 of the Consultation Document.

43 July 2007 Joint Submission, Annex 6, paragraphs 2.10 to 2.11.

Virgin Media's part to compete aggressively on price with Sky as regards the retailing of premium channels.

6.6 Further, as regards high wholesale prices, Virgin Media notes that as well as Sky's high wholesale prices tending to result in high retail prices for both Sky's DSat subscribers and also subscribers on other platforms, high wholesale prices also affect the ability of competing retailers to invest in research and development, and accordingly this can reduce innovation in the retailing of such channels.

6.7 Finally, Ofcom's own analysis has indicated that Sky's wholesale prices and margins for premium movies are above competitive levels, with Sky's wholesale margins being higher for movies than for sports.[44]

Consumer satisfaction

6.8 Virgin Media notes that evidence presented by Ofcom at figures 123 and 124 of the Pay TV Statement suggests that overall satisfaction amongst consumers with services from their main supplier are high, but that satisfaction with value for money is much lower. Virgin Media agrees with Ofcom, however, that high rates of satisfaction do not demonstrate that competition is operating fairly and effectively in the market.[45]

6.9 Virgin Media notes that in its third consultation, Ofcom expressed caution over making use of data on consumer satisfaction to draw inferences on the strength of competition in the retail market:

> "*Customers may well express high levels of satisfaction if a service is provided at a quality and price they have come to expect, but that does not rule out the possibility that a change in the market, through greater price competition or more innovation, would greatly increase consumer welfare.*"

6.10 Virgin Media agrees with this statement. As set out in detail in Virgin Media's supplementary submission dated 15 August 2008,[46] quantitative research can often give rise to misleading indicators of true consumer satisfaction, in that consumers rationalise their responses in the context of quantitative surveys. In particular, stated consumer satisfaction is not meaningful where consumers do not know what they are paying for the product or service and/or have a low awareness of comparative prices or service offerings (or in fact, what could be available absent conditions which restrict competition).

6.11 In short, Virgin Media agrees with Ofcom that the apparently high levels of consumer satisfaction reported in the Pay TV Statement must be treated with considerable caution.

7. QUESTION 6: DOES VIRGIN MEDIA AGREE WITH OFCOM'S ANALYSIS OF THE LIKELY EFFECTS OF THE LIMITED EXPLOITATION OF SVOD SERVICES ON COMPETITION?

7.1 As set out at Section 5 above, Virgin Media considers itself to be well-placed to promote SVoD as an effective competitor to Sky, because it can offer high quality "true" VOD services. True VOD uses technology which allows streamed SD and HD content to be delivered whenever requested by the viewer, via a "return path", directly to the customer's television.

7.2 Virgin Media also considers that SVoD as a technology has significant potential to "shake-up" the market in terms of innovation, competitive pricing and consumer choice, and

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44 Paragraph 6.27 of the Consultation Document.

45 Paragraph 8.281 of the Pay TV Statement.

46 Paragraphs 3.5-3.7.

Section 5 sets out evidence of there being a strong demand for SVoD, as customers in the UK show a clear preference for subscription services over PPV services.

7.3 However, SVoD will develop as an effective competitive constraint on Sky *only* when attractive content can be made available at economic prices to consumers. **[✂]** Virgin Media's experience in this regard is described in detail in its previous submissions to Ofcom.[47]

7.4 As set out at Section 7, Sky enjoys high wholesale prices and margins – particularly in relation to its Premium Movies channels – whilst consumers are suffering from a lack of choice, a lack of innovation in the marketplace and (as evidenced by Virgin Media's consumer research) widespread dissatisfaction with the product offerings and prices available to them.

7.5 Against this background, Virgin Media considers that there can be little doubt that if it were able to access premium movies content on economic terms for SVoD services, it would represent a real competitive threat to Sky's dominance of the wholesale and retail markets for the supply of packages containing Core Premium Movie channels.

8. <u>QUESTION 7:</u> DOES VIRGIN MEDIA CONSIDER THAT THE THRESHOLD FOR MAKING A MARKET INVESTIGATION REFERENCE TO THE COMPETITION COMMISSION IS MET?

8.1 It is clear, from the voluminous material collated and reviewed by Ofcom to date, and the exhaustive analysis undertaken in Ofcom's Consultation documents, that Ofcom has more than sufficient evidence to refer the matter to the CC for a market investigation.

8.2 As described in the above sections, as well as in Virgin Media's numerous submissions, there is no scope for competition "on the merits" in the supply of Premium Movies channel or services:

(a) there are high barriers to entry facing (potential) competitors, with a key barrier to entry being the need to acquire premium movies content in circumstances where there is a limited pool of premium content, contracts are long in duration and expiration dates are staggered, Sky has negotiated exclusive arrangements with the studios, and enjoys a position of considerable strength vis-à-vis the studios;

(b) at the wholesale level there is a lack of countervailing buyer power on the part of Virgin and other potential purchasers of premium movies channels vis-à-vis Sky, resulting in Sky's wholesale prices and margins for premium movies being above competitive levels (and even higher for movies than for sports). Sky is also acting on incentives to weaken or eliminate Virgin Media as a competitor by engaging in various practices designed to foreclose downstream competition in relation to the wholesale supply of its Core Premium Movies channels; and

(c) at the retail level Virgin Media and other (potential) competitors face considerable disadvantages due to their inability to acquire the necessary premium movies content on economic terms, or to acquire HD linear channels on a wholesale basis.

8.3 These factors have led to a lack of consumer choice, a lack of innovation, high prices and consumer dissatisfaction.

8.4 As noted in the Consultation Document, Ofcom has a discretion under section 131 of the EA to make a market investigation reference to the CC where:

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47 See Virgin Media's response to Ofcom's information request of 20 December 2007. Virgin Media's response was submitted on 21 February 2008, and Virgin Media refers Ofcom specifically to paragraphs 1.14 to 1.18 and 1.23 to 1.26.

"... *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.*"

8.5 In order to make a reference, Ofcom needs only "*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. This threshold is recognised as being a low one, reflecting Ofcom's role as first phase investigator, and Ofcom need not reach a definitive view on the concerns that have been identified. Nonetheless, based on voluminous evidence and material obtained from third parties, and its own detailed investigation, Ofcom has found in its Pay TV Statement and movies consultation document that:

(a) Sky has market power in the wholesale supply of Premium Movie channels;[48]

(b) Sky has market power in the retailing of packages containing Premium Movies channels; [49]

(c) barriers to entry in each of the above markets are high; [50]

(d) Sky, as a vertically integrated operator with wholesale market power, has the ability and incentive to restrict wholesale supply of packages including Core Premium Movies channels; [51] and

(e) there exist a range of factors which point to Sky's behaviour having had the effect of foreclosing, or marginalising, other market participants at all levels of the pay TV supply chain.

8.6 In its Third Consultation Document, Ofcom considered these competition concerns to be sufficient to support its view that Sky's Core Premium Movie channels should fall within the scope of its proposed WMO remedy. Ofcom's subsequent decision to exclude movies from the WMO remedy is not based on any reconsideration of this position but rather the view that a solution encompassing competition concerns at the upstream and wholesale levels of the market is preferable.[52]

8.7 Further, Virgin Media also notes that despite the length and the detail in which some issues are addressed in Sky's submissions, Sky's responses have failed meaningfully to address the substance of the very real concerns and conclusions reached by Ofcom.

8.8 In conclusion, on the basis of the above, Ofcom has more evidence than could reasonably be required for it make a market investigation reference to the CC. It is appropriate for Ofcom, in its role as the sectoral regulator, to make that reference as a matter of urgency.

9. QUESTION 8: DOES VIRGIN MEDIA CONSIDER THAT OFCOM SHOULD EXERCISE ITS DISCRETION TO MAKE A MARKET INVESTIGATION REFERENCE TO THE COMPETITION COMMISSION?

9.1 Virgin Media considers that the absence of movies from the WMO remedy makes it absolutely vital that a reference is made in order to address the competition concerns

48 Paragraphs 5.42-5.50 of the Consultation Document.

49 Paragraph 6.364 of the Pay TV Statement.

50 Paragraphs 6.318, 6.353 and 6.355 of the Pay TV Statement.

51 Paragraph 5.54 of the Consultation Document.

52 Paragraphs 1.40 to 142, Pay TV Statement.

identified in the various movies markets (upstream rights procurement, wholesale and retail).

9.2 The legal thresholds for making a reference are clearly met, and the longer the current market features and Sky's conduct are allowed to persist, the greater the detriment suffered by consumers. Indeed, a considerable period of time has passed since Ofcom began its investigation into the pay TV market, during which ample evidence of continuing consumer detriment has been revealed.

9.3 Further delay will perpetuate the features of the market that are distorting competition and that are leading to consumer detriment:

(a) in relation to the retailing of packages focussed on premium movies content, Virgin Media and other (potential) competitors will remain at a material disadvantage vis-à-vis Sky; and

(b) Ofcom has not set prices for wholesale bundles including sports and movies channels. In March 2010, approximately **[✂]** of Virgin Media's customers who took premium movie and/or sport content took its "Sky Sports and Movies Collection" (comprising Sky Sports 1, 2, 3 and 4 as well as the Sky Movies channels), and approximately **[✂]** of Virgin Media's customers who took premium movie and/or sport content took a package including movies. Virgin Media will therefore be supplied with these products in accordance with the current cable rate-card, will not be able to compete effectively with Sky at these prices and will remain an ineffective competitor in relation to these packages. This is acknowledged by Ofcom:

> "*...we do not believe there are currently credible direct competitive alternatives to Sky's Core Premium Movies channels and therefore we do not expect other retailers to compete directly with Sky by offering retail packages including both Core Premium Sports and Movies channels in the short term.*" [53]

9.4 For the reasons set out by Ofcom in detail in 7.42 to 7.67 of the Consultation, there can be no doubt that the CC would have appropriate remedies open to it to address the competition concerns identified by Ofcom. The CC has a wide range of powers available to it, and the necessary resources, to enable it to design, implement, and enforce effective remedies.

9.5 Finally, there can be no suggestion, by Sky or any other party, that any reference to the CC should be delayed until the outcome of any appeal of the Pay TV Statement for the following reasons:

(a) first, the operative directions of the Pay TV Statement have been implemented, and any reference made to the CC would be made, pursuant to powers set out in different statutes and on the basis of different tests. Even if Sky were to be successful in relation to one of more elements of any appeal of the Pay TV Statement, this would not impact the validity of a decision by Ofcom to make a reference to the CC in accordance with the test set out in section 131 of the Enterprise Act 2003, and on the basis of the evidence and reasoning set out in the Consultation;

(b) proceeding with a reference in advance of the outcome of any appeal of the Pay TV Statement would not deprive Sky of its rights of defence. Sky will have a full opportunity to make representations to the CC in the normal way; and

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[53] Paragraph 10.109, Pay TV Statement.

(c) to delay any reference to the CC until the outcome of any appeal of the Pay TV Statement would introduce yet further substantial delay to what has already been an unduly protracted process. Further delay would allow the consumer detriments identified by Ofcom to persist for an unacceptable additional period.

10. **<u>QUESTION 9:</u> DOES VIRGIN MEDIA HAVE ANY COMMENTS ON THE DRAFT WORDING OF THE PROPOSED TERMS OF THE MARKET INVESTIGATION REFERENCE AS SET OUT IN ANNEX 1 OF THE CONSULTATION DOCUMENT?**

10.1 Virgin Media has two observations on the draft wording of the proposed terms of reference.

10.2 First, paragraph A1.5 might be argued to be drafted so as to limit the reference to the **wholesale** supply of packages including Core Premium Movie channels, albeit that the definition of "Packages including Core premium Movie channels" (at A1.12) appears implicitly, but not explicitly, to refer to retail markets. Virgin Media assumes that it was not the intention of Ofcom to exclude a consideration of retail markets from the terms of reference as this would impose an impracticable constraint on the CC and would not allow the CC properly to evaluate the interaction between wholesale and retail markets. To address this ambiguity, Virgin Media would suggest that:

(a) paragraph A1.5 is amended as follows (with amends identified **in bold**):

> "*Ofcom has reasonable grounds for suspecting that a feature or a combination of features of the wholesale* ***and retail*** *market or markets in which packages including Core Premium Movie channels are supplied or acquired prevents, restricts or distorts competition in connection with the* ***wholesale and retail*** *supply* ***in the UK*** *of Movie Rights and packages including Core Premium Movie channels in the UK.*"

(b) the first line of Paragraph A1.12 is amended as follows (with amends identified **in bold**):

> "*Packages including Core Premium Movie channels" are* ***wholesale and/or retail*** *packages including ...."*

10.3 Second, Virgin Media considers that the definitions of "Movie Rights" and "Sky Movies channels" are drafted sufficiently broadly to capture SD, HD and, indeed, 3D versions of the rights and/or channels. It is not, however, explicit that this is the case, and there may be merit in amending the relevant definitions so that HD and 3D variants are expressly brought within the terms of the reference.