Wholesale must-offer remedies: international examples

Annex 11 to pay TV phase three document

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FINAL REPORT

WHOLESALE MUST-OFFER REMEDIES: INTERNATIONAL EXAMPLES

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Contents

1 Introduction

In September 2008, **Ofcom** published its **Second Consultation** on the **pay TV Investigation** which focuses on **access to premium content** and whether **BSkyB's** (Sky) competitors are able to compete effectively at the wholesale level for such content. In the Second Consultation, Ofcom proposed that Sky has "market power" in the "premium content" markets (live top flight sports channels including live FAPL matches and first-run Hollywood movies) which has two potential negative implications:

- **limited distribution of premium channels by Sky** to other retailers
- **wholesale prices** set by Sky may be **above the competitive level**

To address this, Ofcom identified four potential approaches

- no further intervention
- changes to the way in which content rights are bought and sold (e.g. by imposing restrictions on rights-holders and buyers to aggregate content)
- structural separation whereby Sky's wholesale channel business is separated from its platform/retail business
- a **"wholesale must-offer" obligation** whereby Sky is required to provide wholesale access to premium content on regulated terms

Ofcom proposed that the last of these options was appropriate to address the concerns identified and commissioned **Value Partners** to conduct a study into international examples of where wholesale must-offer remedies have been introduced with respect to supplying pay TV channels to retail competitors.

Value Partners has conducted a detailed assessment of six markets, four of which (**France**, **Italy**, **Spain** and the **US**) have introduced some kind of wholesale must-offer remedy, one where a commercial content supply agreement was introduced by pay TV operators themselves (Australia), and one (**Singapore**) where the regulator decided against imposing such a requirement. Our study was informed by desk research, a detailed literature review, and a series of interviews with regulators, pay TV operators (both "incumbents" and new entrants) and industry experts in the markets studied.

This report outlines the findings of this study. In the Executive Summary which follows, the key headlines are presented. A more detailed discussion of each of the markets can be found in the individual country chapters.

2 Executive summary

2.1 Remedies have been introduced primarily to promote competition amongst pay TV retailers

The introduction of a wholesale must-offer remedy requires the operator to provide wholesale access to particular content on regulated terms to other operators. Typically, wholesale must-offer remedies are introduced by the *regulator* to promote competition in the pay TV market. Broadly speaking, two different catalysts for such an intervention may be identified:

- *a merger* between pay TV operators to create a bigger entity (Italy, Spain, France)
- to facilitate the *entry of new pay TV platforms* (US)

However, the rationale for the content supply agreement may be *commercial* rather than regulatory. In Australia, a content supply agreement was proposed by the players themselves to improve their financial position and was introduced after certain undertakings were agreed with the ACCC.

2.2 The scope of content covered by the remedies varies between markets, from a subset of content (e.g. "premium") to all channels

There is no consistent "formula" in terms of the type of content that is included. In some cases, the supply of all content is covered (Australia). More commonly, remedies apply to a sub-set of channels. These guidelines may be:

- relatively unspecific, simply requiring channels to be "balanced" or "attractive" (France)
- more precise, requiring particular channels to be made available, for example those containing "premium content" (Italy, Spain) or thematic channels which are vertically integrated with the incumbent's parent company (Spain)

However, even the definition of "premium" or "basic" can vary from market to market. A premium bundle in one market may not be as attractive or exclusive as another. For example, Italian premium content consists of sports and movies. However, often more is paid for movie rights on FTA than in the Sky Italia premium bundle. And the most attractive sports content, Serie A, is not exclusive to any one platform.

In the case of the US, the channels to be included are determined by *ownership* (at least 5% owned by a vertically integrated cable operator) and *delivery mechanism* (cable channels delivered to the cable head-end by satellite rather than terrestrially via fibre or cable). Effectively, this corresponds to *national* channels (which are typically delivered by satellite) as opposed to *regional* channels.

2.3 Regulators have imposed pricing rules ranging from the generic (e.g. "non-discriminatory") to the more specific (e.g. cost-plus or retail minus)

In the majority of cases in this study, the regulator has not imposed a particular pricing rule, preferring to give a set of more generic criteria (such as "non-discriminatory", "fair" and "transparent") to which pricing must conform (US). This is possible in the US where there are a large number of market benchmarks available. In some cases, particularly where there is a degree of vertical integration, these guidelines may be expanded to require the pay TV operator to make channels available to third parties at the same, or similar, price that it offers other retailers operated by its own parent companies (Spain and Australia). Regulators, in these cases, would only have visibility of pricing if a dispute arose.

Where a pricing rule has been introduced, there are examples of both "retail-minus" and "cost-plus" mechanisms. In France, the decision as to which of these methods to use reflected the way in which the channel was retailed before the wholesale must-offer remedy was introduced:

- *Retail-minus* was used in the case of channels which were retailed on a *standalone* basis before the remedy and for which there was therefore a benchmark to establish the unbundled retail price
- *Cost-plus* was used in the case of channels which were only available as part of a *bundle* before the remedy and for which it was difficult to establish the standalone retail price

In France, the regulator is notified of the prices charged annually, but not of the calculation methodology.

In Italy a "retail-minus" mechanism is used for all the channels covered by the remedy – regardless of whether they were available at the retail level on an unbundled basis or not. The wholesale must-offer price for the premium channels covered by the remedy is calculated by taking the retail price of the premium package (including basic channels) and subtracting those costs which are related solely to the basic channels and those which relate to serving Sky's own customers. This is one of the most transparent pricing rules among the sample countries.

2.4 Dispute resolution is challenging without formal pricing rules or the availability of suitable benchmarks

In all markets studied, a dispute resolution mechanism is in place. The aim is to give third party operators the opportunity to challenge the incumbent's pricing of wholesale content or access more broadly. However, there are several challenges to ensuring an effective dispute resolution process

- in some cases, the degree to which the regulator can become involved in settling a dispute is constrained by the remit it has been given by the relevant legislative Act (Australia)
- regulators are often placed in a *reactive* position, acting ex post only after a complaint has been made rather than assuming a more pre-emptive proactive role (US, Spain) although there are some examples of autonomous intervention (Italy)
- where there is no pricing rule in place, the task of establishing whether a price is "fair" or "non-discriminatory" is challenging, particularly in the absence of appropriate benchmarks
- where the term of the regulation has only a short period to run, incumbents may protract the dispute process (e.g. in Spain where the dispute resolution mechanism did not include a punitive element)

In the US, in particular, the regulator (the FCC) is considering a number of initiatives to enhance the dispute resolution process, including introducing binding arbitration and imposing a standstill provision, which prevents vertically integrated operators from pulling a channel during a dispute.

2.5 In some respects, wholesale must-offer remedies have been an effective means of increasing retail competition

Wholesale must-offer rules are frequently one part of a larger package of measures, so it is difficult to assess their specific impact in terms of consumer choice, prices and innovation. Nevertheless, to some degree, wholesale must-offer remedies have been successful in increasing, or at least maintaining, retail competition and increasing consumer choice by

- facilitating the entry of new retailers/platforms into pay TV (US)
- enhancing new entrants' (e.g. IPTV operators') pay TV propositions (France, Italy)

In contrast market entry occurred in Singapore, even without the introduction of wholesale must-offer. As a result, premium content in the market is now split between StarHub and SingTel.

2.6 The remedies studied have a number of limitations

Broadly speaking, four types of limitation can be identified

- insufficiently numerous or attractive channels are unlikely to enhance new entrants' pay TV propositions sufficiently (France) or in Italy, where only the premium channels were included within the wholesale must-offer but many of the basic channels were tied up in exclusive contracts
- unintended consequences where inadequately defined rules have been open to opportunistic interpretation on the part of incumbents who try to game the regulatory obligation to their advantage (e.g. how is "premium" defined)
- mandating access to a particular channel, rather than a particular type of content which can lead to reduced investment in the channel by the incumbent, making it less attractive and popular (Spain, France)
- lack of content unbundling at the wholesale level limits third party operators' freedom to create their own packages and innovate on pricing (Australia, US)

Perhaps the clearest indication of the potential limitation of a wholesale must-offer remedy has been demonstrated in Italy where the wholesale must offer is not taken up and instead unregulated commercial agreements in which the IPTV operators become "re-sellers" of the Sky Italia basic and premium packages are active. Reasons for this outcome include the current unavailability of basic channels which are not included within the wholesale must-offer, and the unwillingness and inability of the small scale IPTV operators to become competing content aggregators.

2.7 Contextual differences should also be taken into account when drawing conclusions about international examples

While the study of international cases provides valuable information about the experiences in other countries, there are necessarily limits on the extent of inferences that can be drawn due to contextual differences between the markets studied. These are of two sorts:

- market differences
- different catalysts for imposing the remedy

In terms of market, there are three major differences:

- the concentration of premium content and/or how premium content rights are sold. Premium content in the UK is much more concentrated with a single player (i.e. Sky) than in some of the other markets where premium rights, such as Premier League football, have been sold by clubs on an individual, as opposed to collective, basis (Spain, Italy) or whereby the rights are sold on a platform by platform basis (Italy)
- The attractiveness of premium content relative to basic tier content in each market differs substantially
- The ability to find suitable benchmarks to resolve a price dispute, in the absence of a formal pricing rule, is easier when there are a number or pre-existing deals and availability of pricing benchmarks (e.g. the US) than in the UK (one cable operator and a small number of IPTV providers).

The regulatory mechanism used for introducing wholesale must-offer remedies also varies in the markets studied, although similarities in the economic rationale for regulating the supply of content can be identified. In the Western European examples (France, Italy, Spain) the remedy was introduced following a merger of two pay TV operators in the market. In the US, sectoral power was used to restrict dominance of a core platform ex post. And, in Australia, although its development was led by commercial operators, the ACCC intervened using its sectoral power to ensure the Undertakings were effective.

3 Italy

Applicable to:	• Sky Italia
Imposed by:	• European Commission
Scope:	• Premium content: in the form of "any Premium Package or Premium Channel" or "any Basic Channels which contain premium content"
Pricing rule:	• Retail minus: based on the retail price of the premium package (which is bundled with the basic package offering). The minus then deducts the basic package costs and all avoidable distribution costs including marketing, sales, and customer service.
Reasons for selection:	• More transparency over the retail minus calculation than other markets • Instance of a successful dispute resolution between Fastweb and Sky Italia

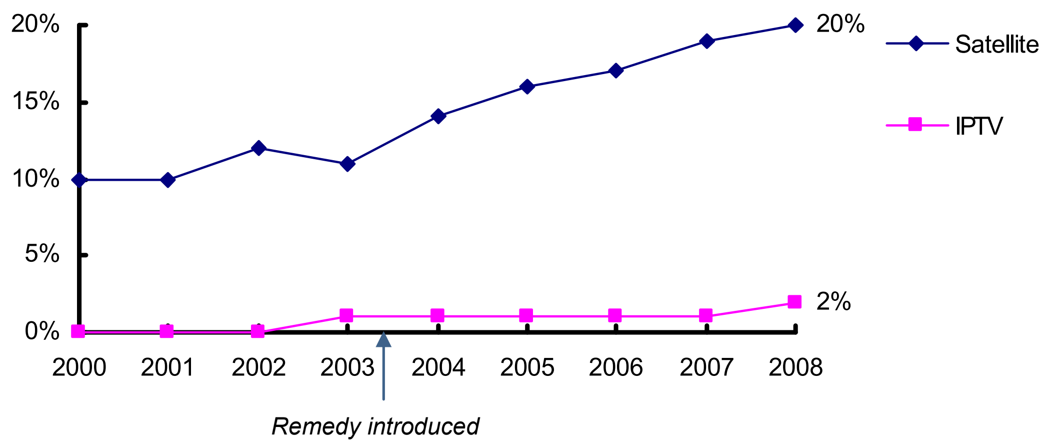
3.1 Background

In this section, we outline the Italian pay TV landscape, the background to the wholesale access obligations imposed on Sky Italia, following the Telepiu/Stream merger, and key contextual differences between Italy and the UK.

3.1.1 Major players in the Italian pay TV market

Pay TV penetration in Italy is relatively low, currently standing at 23%[1] of TV households. The exhibit below shows how the pay TV market is made up on a platform basis.

Exhibit 1: Italian pay TV penetration by platform (%TV households)[2]



Note: 2008 figures are a forecast
Source: ScreenDigest (2008)

[1] Screen Digest 2008 figure. However, this does not include Pay DTT households, so understates the actual level of pay TV penetration.
[2] Screen Digest

Satellite is the primary pay TV platform and there is no coaxial cable in Italy. **IPTV**, offering television services over the fixed telephone lines, emerged in 2000 as a competitor to satellite, and in 2005 **DTT** emerged as another pay platform. Mediaset[3] and Telecom Italia Media began selling prepaid cards to watch PPV[4] football. Subsequently, in 2007, a subscription-based DTT offer, **Mediaset Premium Gallery**, was launched. While there is little historic data for pay DTT penetration, figures as of end September 2008 suggest there are 2.5m active Mediaset pay TV cards in circulation, equivalent to a penetration of ~**11**% of TV households[5]. The exhibit below highlights the major players in the Italian pay TV market.

Exhibit 2: Italian pay TV operators

Platform	Operator	Subscribers (m)	Comments
Satellite	SKY.it	• **4.4**	• Created in 2002 from merger of Telepiu and Stream
IPTV	FASTWEB	• **0.2**	• First IPTV provider
	TELECOM ITALIA Alice	• **0.1**	• Incumbent telco's IPTV service
	tiscali.	• **n/a**	• ISP, launched IPTV service in December 2007
	WIND	• **n/a**	• 3rd largest mobile operator, launched IPTV service (Infostrada) end 2007
DTT	MEDIASET	• **2.5m** active smartcards	• Leading commercial broadcaster • Initially PPV on DTT, now subscription (Mediaset Premium)
	LA7	• **n/a**	• Offers Cartapiu PPV services (football content)

Source: ScreenDigest

3.1.2 *Background and rationale to the wholesale must-offer obligations*

The **European Commission** (Commission) concluded that the **2003 merge**r between **Stream**[6] and **Telepiu**[7] to form **Sky Italia** would create a "near monopoly" in the pay TV market:

- "the merged entity will have a monopoly as regards the DTH means of transmission and will have all the possibilities and economic incentives to foreclose actual and potential competitors wishing to enter the market via the same and/or other means of transmission, by raising rivals' costs and raising further barriers to entry"[8]

The Commission therefore imposed a number of "conditions" to address these concerns. These were in the form of commitments offered by News Corp, parent of Sky Italia, to the Commission, which the Commission

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3 Italy's largest TV broadcaster
4 Pay per view
5 Based on 23.3m TV households (Screen Digest)
6 Owned by News Corp
7 Owned by Vivendi
8 European Commission: Regulation No 4064/89 Merger Procedure Case No COMP/M.2876 Newscorp/Telepiu

ultimately approved[9]. One of these was the obligation for Sky Italia to provide **wholesale premium channels** to third parties**.** Other conditions included:

- **Intra-platform competition safeguards**: Sky Italia must provide third party broadcasters with access to the DTH platform, allowing them to offer different channels and compete with its retail offer. Sky Italia is obliged to provide technical services for the supply of these channels at fair, reasonable, and non-discriminatory terms, on a cost-plus basis, including a contribution to the investment costs of set-top box roll-out, related infrastructure and the associated cost of capital (WACC)
- **Exclusivity and availability of rights**: Limit the term of contract for which Sky Italia can hold exclusive premium rights
- **Facilitation of inter-platform competition**: Sky Italia must give up its exclusive rights to premium content beyond DTH
- **Cross-platform presence**: Sky Italia was forced to divest the analogue terrestrial frequencies held at the time of the merger
- **DTT presence:** Sky Italia was prohibited from operating on DTT as a pay TV operator
- **Interactive services:** mandated access to API (Application Programming Interface) for the provision of interactive services by third-party providers

The Commission designed the conditions independently, with the contribution of Italian media and telecoms regulator, Agcom**.** Normally, the merger would be assessed by the Italian anti-trust competition commission, AGCM[10]. However, according to Council Regulation (EEC) No 4064/89 of 21 December 1989, the merger had a Community dimension and therefore had to be elevated to the Commission.

Following the Commission's intervention, Agcom's role is focused on two Articles in relation to the merger conditions[11]:

- **Article 15: Dispute resolution.** If a dispute arises between Sky Italia and third parties, in relation to Sky Italia's compliance with the merger conditions, Agcom must resolve it using the criteria of the European Commission's Merger Procedure document[12]
- **Article 18: Monitoring of the merger conditions.** Sky Italia has to provide a report to the Commission annually outlining its implementation of the merger conditions. The report is also sent to Agcom.

3.1.3 *Contextual differences from the UK*

There are several important contextual differences between Italy and the UK:

- **No cable**
- **Individual**, rather than **collective**, selling of Serie A/B football rights (1999-2007), although the **Legge Delega** football legislation has mandated a return to collective selling
- **Relative strength of FTA:** for example, FTA movie rights have historically been sold for more money than pay TV movie rights – the reverse of the situation in the UK

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9 The Commission Decision of 02.04.2003 stated that the merger was compatible with the common market and the EEA Agreement (Case No. COMP/M 2876 – Newscorp/Telepiu). Through this decision the EC approved a second document – the so called "Commitments"

10 Before the European Commission decision, AGCM (Italian competition Authority) made two proceedings on the merger between Stream & Telepiu, (case n. C4754 and n. C5109). The European Commission, in its decision, also took into consideration the analysis from these proceedings.

11 Commitments (Articles15 and 18)

12 European Commission: Regulation No 4064/89 Merger Procedure Case No COMP/M.2876 Newscorp/Telepiu. All quotations in this section are from that document.

- **Relative strength of Basic vs. Premium package:** the large number of good movies available on FTA channels, and the distribution of football rights to each TV platform (e.g. satellite, cable, etc) makes the Italian premium package weaker than we would expect in the UK
- **Sky Italia signed exclusivity deals with many of the basic channels,** leaving the IPTV operators with a much weaker basic tier proposition
- **Sky Italia does not compete in the triple play market** as it does not sell broadband
- Wholesale must-offer obligations resulted from a **merger** and the "remedy" was designed by the **European Commission** rather than the domestic regulator

3.2 Details of the remedy

In this section, we look in more detail at how the wholesale must-offer obligation works in practice.

3.2.1 Overview of the wholesale must-offer remedy

The European Commission's Decision[13] document sets out the scope of the wholesale must-offer obligation. It applies only to "premium content" in the form of

- "any **Premium Package** or **Premium Channel**" *or*
- "any **Basic Channels which contain premium content[14]"**

At the time of the merger conditions, seven packages were defined as "premium content" and therefore subject to the wholesale must-offer obligation. These included the three premium packages:

- Calcio Sky: a package of 14 football channels
- Sport Sky: 3 Sky Sports channels, Eurosport and Yacht&Sail
- Cinema Sky : 9 movie channels

Additionally, all the combinations of the packages were also included:

- Cinema + Sport
- Cinema + Calcio
- Sport + Calcio
- Tutto (Cinema + Sport + Calcio)

All of the basic package channels including several high profile channels (e.g. MTV, Fox Kids and Discovery) and high profile US series (e.g. Lost, Desperate Housewives) were not in these packages and therefore not covered by the wholesale must-offer remedy.

The must-offer condition seeks to pre-empt opportunistic behaviour on Sky Italia's part by mandating that it should not "adopt a commercial policy of including premium content…in a wide variety of Basic channels with the object or effect of making it difficult in practice for third party distributors to acquire such content under the Premium wholesale offer".

Premium content must be made available to third parties to distribute on platforms other than satellite on:

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[13] Commission Decision of 02.04.2003, declaring a concentration to be compatible with the common market and the EEA Agreement (Case No. COMP/M. 2876 – Newscorp/Telepiu)
[14] For which Sky has waived exclusivity for non-DTH platforms

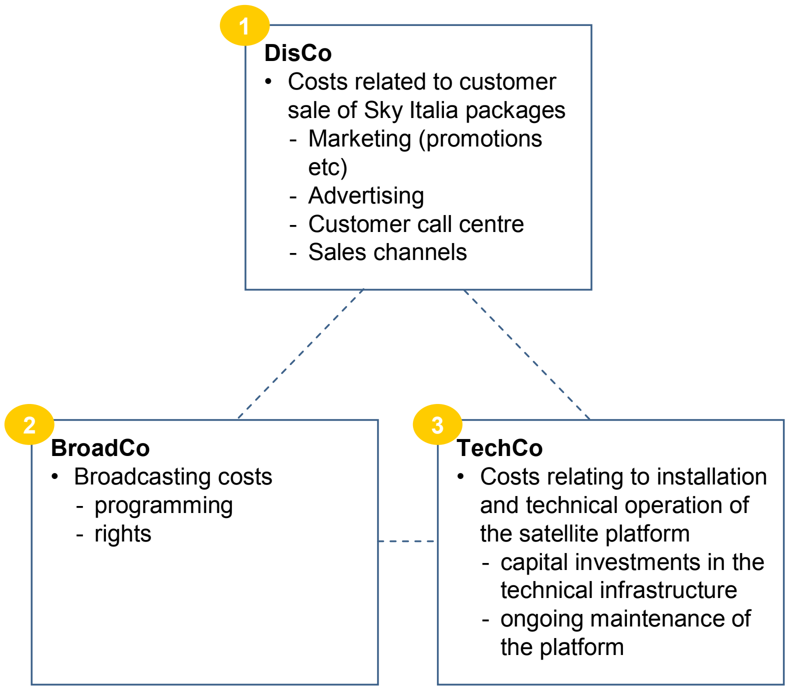
- "a non-exclusive, non-discriminatory and unbundled basis"
- "reasonable terms and conditions" *and*
- "in line with international best practices in the pay TV industry, taking into account the differences in operating and market conditions in different markets"

To facilitate the calculation of wholesale must offer prices, Sky Italia is mandated to split its accounting into three categories to maintain accounting separation:

- **Broadcasting activities** ("BroadCo"):
- **Commercial activities** ("DisCo")
- **Platform operations** ("TechCo")

Aggregated costs are allocated between the three categories according to the services/products that cause those costs and revenues to arise i.e. based on "appropriate economic and accounting principles" and the "Principle of Causation"[15]. The exhibit below illustrates how major costs are allocated between the three groups.

Exhibit 3: Sky Italia Cost Distribution

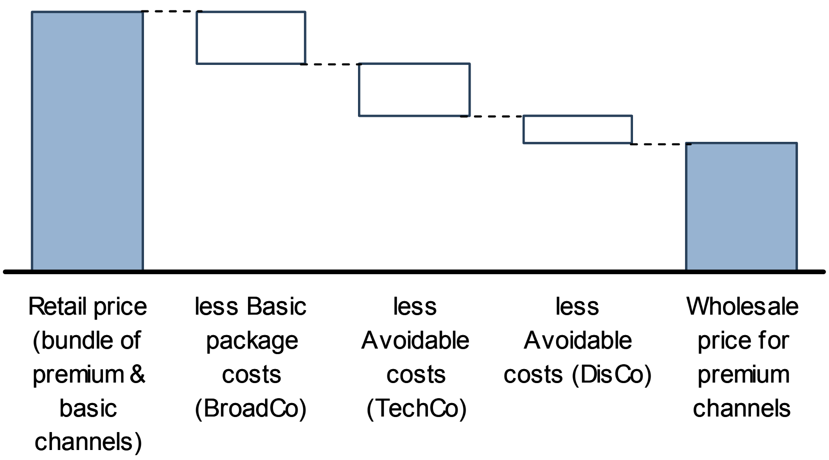


3.2.2 *Pricing mechanics*

The pricing mechanism specified is **retail-minus.** The exhibit below outlines how the wholesale price is calculated and the different components of the retail-minus.

[15] European Commission Regulation No 4064/89

Exhibit 4: Retail-minus calculation (per subscriber)



The **retail-minus** mechanism works by starting from the **bundled retail price** of the combined basic and premium packages[16] (excluding VAT). The bundled price is used because the premium packages are not sold on a standalone basis, therefore this is the closest retail price comparison in the market.

The **minus** comprises two elements of costs related to Sky Italia (i.e. not the costs of the third party):

- **Basic package costs:** the costs in **BroadCo** which relate to the costs of procuring and assembling content for the basic package (e.g. cost of production, rights), including a reasonable margin
- **Avoidable retail distribution costs**: the costs incurred by Sky Italia when retailing the premium packages to its own subscribers including marketing, sales, and customer care. This is equivalent to all costs in DisCo and TechCo

In the case of **PPV** or **VoD,** the wholesale price is the ex-VAT retail price charged by Sky Italia minus a reasonable margin. This minus represents the costs avoided by Sky Italia by not retailing directly the PPV event or the content purchased by the customer using VoD[17].

The European Commission conditions dictate that the "minus" should not be "applied in a discriminatory way among different retail operators". Consequently, unlike in some other European markets (e.g. France), there is a single price for all platforms (per subscriber), irrespective of the number of subscribers. This also means that Sky Italia is not allowed to apply any "theoretical" discriminatory discounts to its own retail arm, DisCo. Third party retailers are also completely free to set their own retail price and to offer premium packages and premium channels in combination with any other services/content.

Sky Italia is required to publish an indicative **rate card** setting out its wholesale charges at least once a year and to submit this to the Commission.

The pricing mechanism was altered following a **dispute** between **e.Biscom/Fastweb** and **Sky Italia** in **2004** (see below). Agcom concluded that the method of calculating the "minus" should be modified slightly from that which Sky Italia had been using. Overall, there was no difference in terms of the key "buckets" of costs

[16] Sky Italia, like Sky in the UK, operates a "buy-through" model at the retail level, whereby the consumer can only buy premium content if they also subscribe to a basic package

[17] NB Sky Italia is not currently selling VoD

considered by Sky Italia before the dispute and Agcom's recommendation. Based on the revised calculation methodology, Agcom concluded that the wholesale cost of Sky Italia packages was too high and should be reduced to between a minimum of **37**% and a maximum of **48**% of the correspondent retail price[18] (i.e. equivalent to a minus, or discount, on retail price of minimum **52**% and maximum **63**%).

The discount range imposed by Agcom applied to the results of the regulatory accounts for that year only. Since that time, Sky Italia has been free to calculate the relevant discount itself, based on its application of the price calculation methodology mandated by Agcom. While current wholesale prices are not available, interviews suggest the wholesale price level has not changed significantly over time.

3.2.3 Dispute resolution process

Agcom has the power to intervene autonomously if it believes there is a problem in the implementation of the merger commitments. Typically, however, it only intervenes following a complaint.

The process involves two phases[19]:

1. Agcom's **Departments** carry out a settlement attempt
2. Agcom's **Council** attempts to come to a settlement by a binding agreement between the parties

So far, only **Fastweb** (via its parent at the time, e.Biscom) has raised a dispute on the wholesale prices[20].

After the Commission published its merger conditions, e.Biscom failed to reach an agreement on wholesale pricing for Sky Italia premium channels and Sky-produced football match games[21]. Effectively e.Biscom refused to pay the wholesale price offered by Sky Italia and only paid the price it determined from its own calculations to be appropriate.

In January 2004, e.Biscom requested Agcom to intervene and arbitrate, as it is mandated to do under the Commission's ruling. Essentially, e.Biscom's dispute was on four issues[22]:

- **Retail price used:** e-Biscom was not happy with using the bundled retail price as the starting point for determining the standalone premium wholesale price
- **Level of wholesale discount:** e.Biscom claimed the price offered by Sky Italia was too high. It asked for a 50% discount on the (excl. VAT) retail price; at the time Sky Italia was offering 35%
  - e.Biscom's price calculation was based on a different methodology for calculating retail-minus
  - it calculated the base retail price *incrementally* (i.e. it determined the price of the premium package by subtracting the price of the basic standalone package from the bundled basic+premium price)
  - this calculation methodology resulted in significantly lower proposed wholesale fees (due to bundling discounts)
- **Freedom over re-packaging:** e-Biscom requested Sky Italia to leave it to package/bundle the channels freely, while Sky Italia wanted Fastweb to retail its content in exactly the same way as it was packaged on satellite
- **Level of unbundling:** e.Biscom wanted wholesale premium content to be unbundled on the level of a single channel or single event/movie

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18 Source: Analysys
19 Agcom 2005 report on activities
20 Additionally, two complaints have been lodged against Sky Italia on *access* prices
21 Source: Enders Analysis
22 Source: Enders Analysis

The dispute was settled by Agcom with a binding agreement (Resolution no. 360/04/CONS). In this Resolution, Agcom concluded that:[23]

- The wholesale pricing set by Sky Italia was too high. The minus value of the six packages should be between 51.6% (the most expensive package) and 62.6% (the cheapest ones) of the net (ex VAT) retail price of the premium package[24]
- The unbundling level of Sky Italia's wholesale offer (i.e. at a package level rather than channel or programme) was consistent with the EU Commission's condition as it was in line with the format of the premium offer at the retail level
  - Agcom did not agree with Fastweb's contention that the "unbundling" requirement in the Commission's merger conditions applied to the level of individual channels
  - There are technical difficulties of making available a single event for wholesale
- Third party operators should not be prohibited from using their own brands to market their distribution offer, provided no confusion is caused for the end-user

Agcom was also called upon to intervene in two other disputes between e.Biscom and Sky Italia. The first of these concerned the broadcasting of "**Grande Fratello**" (Big Brother) and the definition of premium content. In **March 2004**, Sky Italia blocked other pay TV operators from carrying the programme, leading e.Biscom to call upon Agcom to intervene[25]. E.Biscom argued that Grande Fratello was "premium content" and therefore should be covered by the wholesale must-offer obligation. However, in the event, the parties reached a commercial agreement without the need for Agcom to become further involved in the dispute resolution process. The second of the disputes related to **the diffusion of movie PPV content** and was settled under Resolution 442/04/CONS. Again, parties reached a commercial agreement before Agcom's intervention.

3.3 Impact of the remedy

The overall impact of the remedy has been mixed. On the one hand, access to premium content allowed Fastweb and other IPTV operators to offer customers a pay TV package. However, **the competitors claim that the absence of basic content from the conditions, coupled with Sky Italia's exclusive contracts with basic channel owners, placed a heavy restriction on IPTV operators' ability to deliver a comprehensive pay TV offer.** The fact that Sky Italia and the IPTV operators ultimately agreed a new commercial agreement (see below) also indicates the limitations of the remedy.

3.3.1 Positive impact

There has been one main positive impact as a result of the wholesale must-offer obligations:

- Greater consumer choice as a result of cross-platform availability of Sky Italia packages

One of the benefits of the wholesale must-offer remedy has been the availability of Sky Italia premium content to all of the new entrants on "reasonable" terms. Furthermore, following the initial dispute, **Fastweb has commented** (unlike some of the third party operators in other markets studied in this report) that they are **reasonably happy with the wholesale prices** and the **margins it is able to achieve.** ABN Amro estimated that Fastweb was making an EBITDA margin of around 30% on Sky Italia's premium wholesale content.

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[23] Agcom 2005 report on activities
[24] Conclusion was reached based on the accounting data submitted during the investigation and changes in the original allocation of sales and marketing costs
[25] Forbes.com

To compete, the IPTV operators have also been:

- introducing innovative pricing promotions: e.g. in September 2005, Fastweb launched a very competitive football pay TV offer for €9/month which included all matches for which Sky Italia holds rights (including the 2006 World Cup)
- innovating using their platform to differentiate from Sky Italia and enhance consumer choice[26] e.g.:
  - **VideoRec:** a network-based video recording service that allows the user to record all programs that are being broadcast over the following week and watch them later
  - **ReplayTV:** allows the user to watch any program broadcast during the last three days without having to activate the recording function
  - **OnTV:** a premium movie VoD service, with a particularly innovative navigation tool and full DVD player functionality
  - **RAIClick:** a joint venture with RAI, offering all RAI's current and back catalogue
  - **OnTV Musica:** joint venture with Bertelsmann, offering on-demand music videos
  - **Fastgame**: games portal

3.3.2 *Limitations of the remedy*

Several drawbacks to the wholesale must-offer obligation have become apparent:

- Exclusion of basic package channels
- Freedom of Sky Italia to lock up the basic package channels exclusively

The primary drawback to the obligation is that it **only applies to premium content**[27]. Following the ruling, Sky Italia was able to **sign exclusive contracts with many of the basic package channels**. Between 2005 and 2007, it invested in expanding the basic package offering by adding new channels. For example, it invested in a suite of Fox channels that showcase all of the international US hit series including Lost and Desperate Housewives. This content was not included in the wholesale must-offer and was often tied up in exclusive contracts and was therefore not available to Fastweb or other IPTV subscribers. Fastweb's recent research shows that for 70% of people, the basic package is the primary reason for obtaining a pay TV offer.

Fastweb's basic package line up was therefore much weaker than Sky Italia's (e.g. it did not have thematic channels such as Discovery and Fox Kids). With a narrower basic package offering, Fastweb struggled to capture subscribers despite its premium TV proposition being the same as Sky Italia's and its ability to offer more services (e.g. VoD/PPV events).

Take-up of the Fastweb TV package has been lower than expected – only around **17**% of Fastweb on-net subscribers take IPTV and this share has fallen since 2004[28]. At the end of 2006, Fastweb had only 150k pay

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26 ABN Amro

27 The rationale for the partial exclusion of basic content is given in par. 246 of the Commission Decision: "The wholesale offer is intended to allow competitors of the new entity on platforms other than DTH to subsist or to enter into the Italian pay-TV market. The underlying idea is that such a wholesale offer will lower barriers to entry in the pay-TV market by allowing non-DTH pay-TV operators to access premium contents which would otherwise be too costly for them to purchase directly or which are locked away by means of long-duration exclusivity agreements entered into by the incumbent players with the content providers. Some types of content (mainly, but not exclusively, football and films) are considered to be "subscription-drivers" and are therefore crucial for the success of any pay-TV operation."

28 Enders, August 2007

TV subscribers, an increase of just 20k since 2004, leading some observers to describe Fastweb's IPTV proposition as a "commercial failure"[29].

Perhaps the clearest indication of the limitation of the wholesale must-offer remedy in Italy has been the shift away from taking up the wholesale must-offer to unregulated commercial agreements between Sky Italia and the IPTV players. Today, the wholesale must-offer arrangement is no longer taken up (with the exception of **Tiscali** which has signed a wholesale contract with Sky Italia, although has yet to offer Sky services) and **Fastweb, Wind** and **Telecom Italia** have all ceased their wholesale agreement. Instead, Fastweb (followed later by Wind and TI) entered into a free contractual agreement with Sky Italia, whereby they act as distributors for both Sky's premium *and* basic packages. The commercial model is essentially a revenue-sharing model based on the number of subscribers and the value of the package.

In this model, Sky Italia bills the customer directly and owns the customer relationship. Both Agcom and Sky Italia view this as a favourable development. Fastweb views this as a good outcome as well. Its first preference would be for Sky Italia to be forced to wholesale all content, both basic and premium. But in the absence of this, the new commercial arrangement allows Fastweb to:

- offer consumers a comprehensive content offering
- make reasonable economic returns from being a carriage pipe for Sky Italia
- focus on its core telco products without needing to diversify and build new skills
- minimises risk for Fastweb (e.g. no need to make big fixed cost commitments on the back of a small user base to the content business)

Since Sky Italia sets the retail price in this model, there is no price differential for the content between platforms which consequently could have a negative consumer impact. However, all operators which previously bought Sky Italia's wholesale channels also offered the same retail prices as Sky Italia (except for ad hoc promotions/discounts), suggesting that consumer prices would not necessarily decrease if Sky Italia ceased to set the retail price in the "commercial" model.

In addition, Sky Italia is not incentivised to innovate directly for the IPTV platform which has richer functionality (e.g. ability to offer on-demand content channel or interactive content applications). Its preference is to maintain the same service offering to all customers, despite access technology, which therefore reduces the likelihood of subscribers switching from DTH to IPTV.

Finally, it should be emphasised that a far more significant driver of **consumer choice** in the Italian pay TV market than then wholesale must-offer regulation has been Mediaset's launch of pay TV packages on DTT. Key to this was another one of the merger conditions that prevented Sky Italia from operating on the DTT platform as a pay TV operator. In addition Mediaset has the financial ability to purchase premium content rights and its Premium Gallery offer allows a lower priced entry-level pay TV option which nevertheless includes compelling content.

3.4 Future

The Sky Italia merger conditions are due to expire in 2011. The European Commission is currently conducting an investigation into the impact of all the merger conditions, including the wholesale must-offer obligation.

Factors that may be taken into consideration:

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[29] ibid

- Mediaset has emerged as a pay TV competitor on the DTT platform and has deep pockets allowing it to compete for premium content. It recently acquired the exclusive rights to Hollywood movies from Warner and Universal studios for all platforms, including satellite, thereby excluding Sky Italia from this premium content
- The wholesale must-offer remedy is not actively used by any third parties; instead, IPTV operators prefer a commercial arrangement whereby Sky Italia's packages are sold directly to consumers over the IPTV platforms.

3.5 Summary

The Italian experience demonstrates the importance of the **scope of the wholesale must-offer remedy** in achieving the desired outcomes. Although the IPTV operators had access to premium content, without access the basic channels, they felt the package was not attractive enough. They ultimately settled upon a commercial agreement which effectively turned them into resellers for Sky Italia but ensured that they had access to all content, including basic. It is important to stress this is likely to be as a result of the **contextual situation** in the Italian market:

- No traditional pay TV competitor to satellite i.e. cable
- IPTV operators/telcos, the only competitors to satellite in Italy, are not media companies and therefore they must both invest heavily in content acquisition and manage a different skill base to create and package their own TV bundles. Their small scale makes this investment largely prohibitive.
- Sky Italia's ability to tie basic channel providers into exclusive contracts

Other key takeaways from the Italian experience are:

- The difficulty of using **retail-minus** pricing in the case of a product that is sold as part of a **bundle** at the retail level
- The benefit of a clearly defined pricing rule
  - "if we were to design it again, we would be more explicit about the pricing rule and not give as much autonomy to Sky[30]" (Agcom)
- **Disaggregating the cost base** into "broadcast", "commercial" and "technical" is one way of allocating costs and identifying "avoidable costs" for calculating the "minus"
- Pay TV operators are likely to be **opportunistic** in interpreting regulations in the most favourable way to them (e.g. Fastweb vs. Sky's interpretation of "unbundled"); since no language used is likely to be completely unambiguous, an **effective dispute resolution mechanism** is essential

[30] It should be noted, however, that, originally the "retail-minus" pricing was not the Commission's preferred option but was actually the mechanism requested by the smaller players themselves, e.g. e.Biscom

4 France

Applicable to:	The merged satellite player, CanalSat
Imposed by:	The French Competition Council, Le Conseil de la Concurrence, as one of the 59 merger conditions
Scope:	Eight channels identified by CanalSat together with the Finance Ministry – channels to be "balanced" and "attractive"
Pricing rule:	No specific rule. Pricing to be "transparent, objective and non-discriminatory". Canal+ France chose the pricing rule itself, selecting "retail-minus" for channels which existed in standalone form before the merger and "cost-plus" for those channels which were only available bundled before the merger.
Reasons for selection:	The case of France is interesting for three main reasons • Relatively similar market context to the UK • It is an example of both the cost-plus and retail-minus pricing mechanisms • It indicates the importance of making premium channels available on a wholesale basis (CanalSat retains much of its power since it does not do so, with third parties merely reselling its most premium Canal+ Le Bouquet packages)

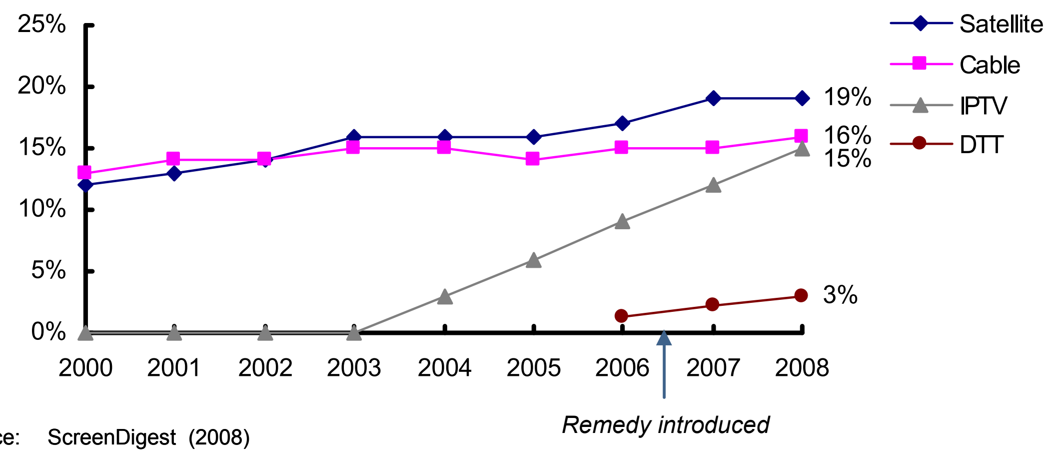
4.1 Background

In this section, we outline the French pay TV landscape, the background to the wholesale access obligations imposed on Canal+ France and key contextual differences between France and the UK.

4.1.1 Major players in the French pay TV market

The French pay TV market is relatively mature, with penetration currently standing at 55% of TV households. The exhibit below shows how the pay TV market is made up on a platform basis.

Exhibit 5: French pay TV penetration by platform (%TV households)



Source: ScreenDigest (2008)

Canal+ France, the entity resulting from the merger between Groupe Canal+ (GCP)[31] and TPS and which includes CanalSat, TPS, Canal+[32] and thematic channels edited by Groupe Canal+ is, is the largest pay TV operator[33]. The exhibit below highlights the major players.

Exhibit 6: French pay TV operators

Platform	Operator	Subscribers (m)	Comments
Satellite	CANALSAT	• **4.7**	• Only satellite player following merger of Canal Sat with TPS
Cable	numericable	• **3.6**	• Main cable operator (~90% all cable subs)
IPTV	free	• **2.9***	• Leading IPTV service, owned by Iliad
	orange	• **1.1**	• Has created its own, exclusive sports and movies packages - Orange Foot and Orange Cinema • Low proportion of premium subs although may change given new movies/sports packages
	SFR	• **0.8**	• Neuf Cegetel IPTV service fully owned by mobile operator, SFR
	Alice	• **0.1**	• Telecom Italia owned IPTV servic
Pay DTT	CANALSAT TV NUMERIC TNtop	• **0.6****	• Three pay DTT operators • Groupe Canal Plus's "Mini Pack TNT CanalSat" has the largest number of subscribers (~590k) • Other operators have <10k

Notes: * The number of Free IPTV subscribers is likely to be overly high: Free only sell triple play and make an assumption that all of its subscribers who are in an IPTV coverage area (75% total subs) are able to access
** As of end 2007

Source: ScreenDigest, Informa, CSA

Several factors have contributed to pay TV growth in France

- **Long history of pay TV,** with the analogue terrestrial pay TV channel, Canal+, available since 1984
- **Consolidation** resulting in a strong premium offering
  - merger of the two satellite players (CanalSat and TPS) in 2006 (effective since January 2007)
  - merger of the four largest cable operators[34] under the Numericable brand in July 2006

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31 100% owned by Vivendi
32 The premium channel
33 Throughout this report, the merged satellite operator will be referred to as CanalSat, the brand name for satellite TV

- As a result of the **strong pay TV premium offer**, **FTA** in France is relatively weak (e.g. premium La Ligue football is only available on pay TV)
- Strength of the IPTV market (15%[35] penetration of TV households), meaning there are four competing pay TV platforms (satellite, cable, IPTV and DTT)
  - has introduced lower-price basic pay TV entry point (e.g. in June 2008, Orange TV basic package was €16/month compared to €20.90 on CanalSat and €29.90 on Numericable[36])
  - also greater competition for cable has accelerated Numericable's FTTH roll-out

4.1.2 *Background and rationale to the wholesale must-offer obligations*

The 2006 merger of **Canal Satellite** and **TPS** to create Canal+ France raised several concerns in particular with respect to the acquisition of broadcasting rights for **premium content**. The **French Competition Council**, Le Conseil de la Concurrence[37], found that, following the merger, Canal+ France would be dominant at every level of the pay TV value chain which could cause **market foreclosure** and consequent harm to **consumer welfare**.

As a result, the Competition Council therefore only approved the merger subject to **59 merger conditions**, one of which was mandating Canal+ France to **wholesale attractive[38] channels to third party retailers.** Other merger conditions included:

- guaranteeing **platform access** to independent channels
- **phasing out its exclusivity** over existing content rights (for VoD)
- **limiting the duration** of its future content rights contracts (e.g. **3 years maximum** for US studio contracts and sports rights)
- guaranteeing non-discriminatory access to **StudioCanal's** film library
- limiting duration of contracts involving exclusive broadcasting rights of **popular American TV shows** to a maximum of **12 months** for each release window
- maintaining as part of its pay TV offer at least as many **independent channels[39]** as were available pre-merger

The French Competition Council and the Finance Ministry were responsible for designing the merger conditions. Both the CSA[40], the audiovisual regulator, and Arcep, the telecoms regulator, gave their recommendations to the Council which informed its final decision.

4.1.3 *Contextual differences from the UK*

Unlike some of the other markets in this study, the French pay TV market is **quite similar** to the UK

- Similar market structure, i.e. a single satellite and single cable player
- Collective football rights selling and pay TV ownership of football rights

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34 Private equity company Cinven together with cable operator Altice acquired UPC France, Noos, NC Numericable and France Telecom Cable
35 Screen Digest 2008 forecast
36 Source: Informa
37 This has recently become the Autorité de la Concurrence
38 As opposed to premium – technically speaking only TPS Star is a premium channel
39 Defined as TV channels authorised by the CSA broadcasting in the French language that are not linked with either the merged entity or its minority shareholders (Source: Freshfields)
40 Conseil superieur de l'audiovisuel

- Sport and movie content are premium

However, there are also some noteworthy differences, such as the stronger IPTV market in France (partly due to restrictions which limit the installation of satellite dishes in certain areas) and the context of the wholesale must-offer obligations (i.e. as a result of a merger).

4.2 Details of the remedy

In this section, we look at how the wholesale must-offer obligation works in practice.

4.2.1 Overview of the wholesale must-offer remedy

Seven channels are covered by the wholesale must-offer obligation. These are shown in the Exhibit below.

Exhibit 7: Channels subject to wholesale must-offer obligations

Channel	Description	Origin
TPS cinestar	• Non-premium cinema channel (popular movies)	• TPS
TPS CINETOILE	• Non-premium cinema channel (classic movies)	• TPS
TPS CINECULTE	• Non-premium cinema channel (cult movies)	• TPS
TPS star	• Premium channel with sports and movies content • Main competitor to Canal+ • No Ligue 1 football	• TPS
Sport+	• Generalist sports channel • Not very premium sports (foreign football, rugby, no Ligue 1)	• Canal+
piwi	• Children's channel	• Canal+
télé TOON	• Children's channel	• TPS

Additionally, following the SFR/Neuf Cegetel merger in 2007 an additional channel, CineCinema Famiz was made available on a wholesale basis. The Ministry of Economy was concerned that, as a result of this merger, competition between pay TV platforms, and IPTV in particular, would likely be reduced since Vivendi would have a significant stake in a second consolidated pay TV operation (via its 56% shareholding in SFR[41]). As a result, it mandated that the CineCinema Famiz channel should be made available to the other IPTV players (Orange, Free and Alice).

Canal+ France itself, together with the Finance Ministry, identified the seven channels in the exhibit above. The CSA set high-level guidelines around the selection, namely that the channels made available needed to be "balanced" (i.e. covering all major genres – sport, cinema and thematic) and "attractive" to ensure that other players would have an opportunity to build a compelling offer competitive to Canal+.

[41] In addition to owning 100% of Groupe Canal Plus which owned 65% Canal+ France

Significantly, the **CanalSat** basic package and the premium **Canal+ Le Bouquet** (Canal+, Canal+ Cine, Canal+ Sports, Canal+ Family) were not included in the wholesale obligations. Canal+ does distribute these over other operators' platforms (for commercial, rather than regulatory, reasons) but it retains the billing relationship with the end consumer. Also, neither of the two most popular thematic channels, **Planete** and **Voyage**, were included.

The main reason for not extending the obligations to Canal+, the premium channel, was a long-standing agreement with Canal+ in place since the time of the merger between Canal+ and Vivendi in 2000. As part of this agreement, the distribution arm, Canal+ Distribution, was granted exclusive distribution of Canal+ the premium channel and Canal+ Le Bouquet in return for the "editor" arm, Canal+ SA, guaranteeing minimum investment in national cinematic production[42].

While this agreement could be changed, French cinema would likely suffer as a result:

- Canal+ SA could argue that it was no longer obliged to invest in French cinema since its exclusive distribution privilege would have been removed
- The cinematic players/studios feared that it would be more complicated to collect the contribution (multiple sources of money) if another distributor began to distribute Canal+ content

The wholesale-must offer remedy includes obligations on Canal+ to maintain the quality of the seven channels offered for wholesale. "Quality" is measured by a series of objective and assessable criteria. The exhibit below highlights some of the requirements.

Exhibit 8: Obligations on maintaining channel quality[43]

Channel	Criteria
• TPS Star	• Movie content • Minimum of **100 first-run films** to be shown a year – 30 to be US movies – 50 to be in the first window – – Sport content • Maintain at least the **same number of weekly hours** as existed prior to the merger • of "attractive" sports content • A significant % TPS Star content to be **exclusive**, i.e. not also shown on Sport+ • **1 exclusive** and **live** match per week, chosen by Canal+, from the **5 leading European leagues** • **1 live match per week**, selected by Canal+, from – the 6 leading European championships – the European cups (Champions League and UEFA) – the most attractive national cups (FA Cup, Copa del Rey, Coupe d'Italie, Coupe de France, Coupe de la Ligue)
3 cinema channels	• **50% transmission hours** to be of films not available on another channel
Sport+	• **50% transmission hours** to be of first-showing sport events • Maintain pre-merger editorial position and daily hours of transmission (or 17 hours)
Children's channels	• Maintain pre-merger editorial position • Maintain pre-merger daily **hours of transmission**

42 Based on both a minimum guarantee per subscriber and a fixed % of subscription revenues. In France, unlike in many other European markets, the subscription revenues were paid to the editorial arm, Canal+ SA, rather than the distribution arm, Canal+ Distribution since the cinema industry was concerned that the process of collecting subscription revenues would be less transparent with Canal+ Distribution than with Canal+ SA.

43 Bulletin Officiel de la Concurrence, de la Consommation et de la Répression des Fraudes, 15th September 2006

Channel	Criteria
	– **16** hours for Piwi – **24** hours for Teletoon

Even though these obligations were imposed on Canal+ France, there is some suggestion that the quality of some of the channels has deteriorated post-merger. In the case for **TPS Star**, for example, whereas before the merger it would show "first tier" FA Premier League matches (e.g. Chelsea v Arsenal), after the merger these matches are shown on Canal+ and "second tier" FA Premier League matches would be shown on TPS Star instead. Technically, this "re-allocation" of matches does not breach any of the obligations but it indicates the **difficulties of imposing criteria** that are sufficiently specific and precise as to avoid opportunistic "interpretations" of the stated terms on the part of the pay TV player.

4.2.2 *Pricing mechanics*

There are regulated pricing mechanics for those channels covered by the wholesale must-offer rules, and other commercial pricing mechanics for the premium channels that we also explore in this section.

Wholesale channels

While the Finance Minister, the Competition Council and the CSA recommended the unbundling of Canal+ France channels, and wholesaling to third parties, none of them made any indication regarding the pricing mechanism. The criteria given were for the pricing to be "transparent, objective and non-discriminatory" (no reference was made to "reasonable" or "fair").

Canal+ France was therefore free to choose the pricing rule it wanted and set wholesale pricing itself. The method Canal+ used varied according to the channel type:

- **Retail-minus** in the case of channels which existed in **standalone** form before the merger (TPS Star)
  - i.e. for which there was a benchmark to establish the unbundled retail price
- **Cost-plus** in the case of channels which were only available **bundled** before the merger (Cine Cinema Channels, Sport Plus, Piwi and Teletoon)
  - i.e. for which it was difficult to establish the standalone retail price

Canal+ does not make public the details on how the pricing is calculated to anyone including the regulators. Prices are reviewed every year. The CSA is not able to intervene to increase transparency, unless there is a dispute on pricing raised by one of the third parties (which has not been the case to date).

The CSA has no legal basis to intervene on the wholesale price autonomously. Some concern has been expressed, although this is not an official position of the CSA, that the **retail price of TPS Star is high** which not only translates into a higher wholesale price (since the "retail-minus" mechanism is used) but is also likely to be a disincentive for end-users to take the channel, particularly since it is a weaker proposition than pre-merger.

CanalSat and Canal+ Le Bouquet channels

As mentioned above, Canal+ France does distribute its CanalSat and Canal+ Le Bouquet channels over other operators' platforms but under commercial terms rather than regulatory obligations. DSL operators are paid by Canal+ France for the **transport** of the channels only (approximately €1.5/month per subscriber). Canal+ France **owns the relationship with the end user** for these channels. As a result, it sets the retail price which means that there is **no competition between satellite and DSL** on the price for Le Bouquet (the most popular channels).

The terms of the arrangement are also very specific in terms of what DSL players are able to do with the packages – they are **pure resellers** and cannot include the content properly in the form of a differentiated triple play offer, nor do they have the autonomy of setting their own retail price.

Cable operators are able to play a more active role as commercial distributors with respect to most of the CanalSat channels. An agreement was in place prior to the merger that enabled them to **unbundle channels** and **set the retail price**. However, in the case of Canal+ Le Bouquet they, like the DSL operators, are pure resellers:

- Unable to distribute Le Bouquet directly
- Canal+ France owns the billing relationship with the end-user
- Canal+ France sets the retail price

4.2.3 *Dispute resolution process*

To date, there have been no disputes in relation to the wholesale must-offer obligations although Free, Neuf and Orange have tried to negotiate with Canal+ France directly without going through the dispute process.

So far, the most significant dispute received by the CSA has been a **disagreement on carriage fees** between **Voyage** (the second most attractive thematic channel in the CanalSat package) and **CanalSat**. While this was not a dispute related to wholesale fees, it provides some insight into the dispute resolution process and the type of role the CSA can play:

- The dispute arose when the contract between CanalSat and Voyage expired
- CanalSat had been paying Voyage around €8m/year for the channel and at renewal proposed a reduction to around €2m/year
- Voyage went before the CSA who concluded that the new price was neither “fair” nor “objective” and thus contravened the regulation in place
- The CSA gave guidelines on what a “fair “ and “objective” price should be and ordered CanalSat to review and increase the price – the CSA did not specify a price but said the price had to cover the optimised cost base of Voyage (e.g. marketing, personnel, programming costs)

4.3 Impact of the remedy

Overall, the wholesale must-offer obligation has not been particularly successful in fulfilling its ultimate objective of **allowing competitors to offer competing bundled packages to Canal+ France**. This section outlines in more detail why this has been the case.

4.3.1 *Positive impact of the wholesale must-offer remedy*

The main positive consequence of the wholesale must-offer remedy is the availability of seven extra channels to France’s IPTV operators, allowing them to enhance their pay TV offer. As is shown in the exhibit below, with the exception of TPS Star on Orange and Neuf, all channels are offered by all IPTV players.

Exhibit 9: Wholesale channels offered by IPTV players and monthly retail price (December 2008)

Channel offered on standalone basis (shaded)
Channel offered as part of a bundle (unshaded)

	orange	SFR	free	Alice
TPS star	×	×	✓ (€18.99)	✓ (€15.00)
Cine Cinema Star, Cine Cinema Club, Cine Cinema Classic	✓1 (€9.90)	✓4 (€15.90)	✓ (€5.99)	✓6 (€14.95)
Sport+	✓2 (€9.90)	✓5 (€10.90)	✓ (€4.99)	✓7 (€7.95)
piwi	✓3 (€4.90)	✓5 (€10.90)	✓ (€0.49)	✓7 (€7.95)
télé TOON	✓3 (€4.90)	✓5 (€10.90)	✓ (€0.49)	✓7 (€7.95)

Notes: (1) As part of Bouquet Ciné: **7** channels in total, also including Action, Cine Polar, Cine FX and TCM
(2) As part of Bouquet Thématique: thematic bundle with **19** channels including ESPN, Fox Life and Boomerang
(3) As part of Bouquet Jeunesse:**4** children's channels also including Foot School TV and Baby TV
(4) Also includes Cine Cinema Famiz as part of Bouquet Grand Spectacle Sans Adulte: **47** channels, including TCM, Sport+, Teletoon, Piwi, Action, Cine Polar, Cine FX, Fox Life, National Geographic, ESPN
(5) As part of Bouquet Selection: **39** channels, including all Bouquet Grand Spectacle Sans Adulte channels, with the exception of the 8 cinema channels (4 Cine Cinema channels, Cine FX, Cine Polar, Cine First, Action)
(6) As part of Bouquet TV Integral: **32** channels including all Bouquet TV Essentiel channels plus 8 cinema channels (3 Cine Cinema channels (no Cine Cinema Famiz), Cine FX, Cine Polar, Action, TCM)
(7) As part of Bouquet TV Essentiel: **24** channels, including Fox Life, ESPN, CNBC Europe, Odyssee

Source: Spectrum Value Partners analysis, Company websites

The table also illustrates, however, that, with the exception of Free and Alice with TPS Star, the IPTV players have used the channels as **part of a broader bouquet** rather than a **standalone** proposition. This may suggest that the operators have concluded it is **not possible to make a margin** on the channels by selling them individually. It also points to the fact that the channels that were offered were not particularly attractive and therefore unlikely to be compelling as a standalone proposition.

4.3.2 *Limitations of the wholesale must-offer remedy*

There are several limitations to the wholesale must-offer remedy:

- Only eight (including Cine cinema Famiz) channels have been made available
- Channels that have been made available are not particularly attractive – in particular, the most popular channels are not included
- Wholesale prices, particularly of TPS Star, are high – as a result, neither Orange or Neuf offer the channel

Given the above, IPTV operators are not in a position to offer compelling bundles which could compete with CanalSat or Canal+ Le Bouquet, and instead simply resell these packages to their subscribers, limiting consumer choice. Orange is an exception here, since it now offers competing movies and sports packages:

- **Orange Cinema Series** (€12/month): 5 movie channels with more than 1300 films a year
- **Orange Foot** (€6/month): built around Orange's acquisition of Ligue 1 football rights for the 2008-2012 seasons[44]

The fact that Canal+ Le Bouquet and CanalSat channels are not available on a wholesale basis also has some negative consumer implications

- Post-merger price of both packages has increased by €1-€2. This may be due to the absence of competition from TPS and inability of IPTV players to offer a sufficiently competitive alternative
- The most popular thematic channels from the CanalSat package (**Planete** or **Voyage for instance**) are likely to be the channels that consumers would most want to access on a standalone basis – however they are not part of the wholesale agreement and IPTV operators can therefore only offer them as part of a CanalSat bundle

4.4 Future

While the Competition Commission suggested no time-limit to the merger conditions, the Ministry decision was for the conditions to last a maximum of six years, i.e. to 2012.[45] However, the CSA and Arcep both consider that continuation of the wholesale must-offer obligation beyond this point is important. Moreover, Arcep has called for it to go further, for example, by being extended to CanalSat and Canal+ Le Bouquet packages.

4.5 Summary

The French experience highlights:

- The limits on other pay TV players' ability to compete if **premium channels** are not made available on a wholesale basis – CanalSat retains much of its power as it does not wholesale its most popular or attractive channels to other platforms
- The importance of offering **attractive channels** in order to allow competitors to build a viable alternative proposition
- The benefit of **imposing clearly defined pricing rules**, or at least **mandating that the wholesaler makes its pricing methodology transparent**

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44 Following European Commission's ruling that live football rights must be sold to more than one buyer, Orange won one of the three rights bundles, giving it 38 Saturday matches, VOD and mobile rights

45 With the exception of the VoD related commissions which were to last a maximum of five years

- The **difficulty of maintaining the quality of channel packages** post-wholesale if not all channels of that genre (e.g. sports channels) are included in the remedy

5 US

Applicable to:	• Vertically integrated cable operators who own 5% or more of channels
Imposed by:	• Congress initially and extended by the FCC
Scope:	• All channels which are at least 5% owned by a vertically integrated cable operator and which are delivered via satellite to cable head ends across the operators' networks as opposed to other means e.g. fibre
Pricing rule:	• Channels must be made available on a "non-discriminatory" basis
Reasons for selection:	• Different interpretation of "non-discriminatory" • The content definition is based on ownership and delivery methods rather than the specific content itself • Use of benchmarks are possible within the dispute resolution process

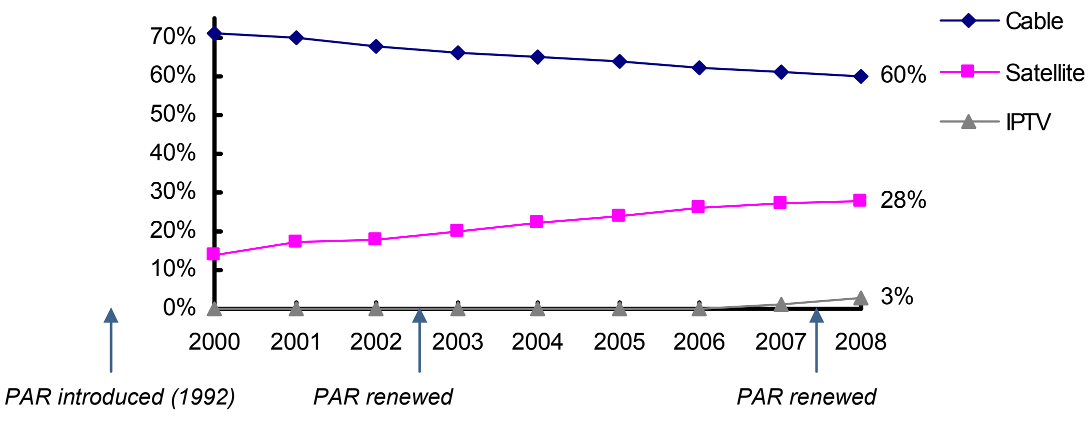
5.1 Background

In this section, we outline the US pay TV landscape, the background to the Program Access Rules (PAR) imposed on vertically integrated cable operators as part of the 1992 Cable Act and key contextual differences from the UK.

5.1.1 *Major players in the US pay TV market*

Pay TV penetration in the US is high, currently standing at 91%[46] of TV households. The exhibit below shows how the pay TV market is made up on a platform basis.

Exhibit 10: US pay TV penetration by platform (%TV households)[47]



Source: ScreenDigest (2008)

46 Screen Digest 2008 figure.
47 Screen Digest

Cable was the only pay TV platform in the US until 1994 when satellite TV was launched. **Comcast,** the cable operator, is the largest pay TV player, followed by the satellite operator, **DirecTV.** The exhibit below outlines the main players in the US pay TV market.

Exhibit 11: US platform operators[48]

Platform	Operator	Subscribers (m)	Comments
Cable (largest players)	comcast	• **24**	• Largest cable operator • Vertically integrated with major TV/movie networks - e.g. E!, The Golf Channel,
	TIME WARNER CABLE	• **13**	• 2nd largest cable operator • Vertically integrated with movie studio and major TV/movie networks - e.g. CNN, TNT, HBO, Cinemax
	COX	• **6**	• Vertically integrated cable operator - owns part of Discovery network
	Charter Cable • Internet • Telephone	• **5**	
	CABLEVISION	• **1**	• Vertically integrated cable operator - e.g. ACM, WE, IFC
Satellite	DIRECTV	• **17**	• Leading satellite operator (55% satellite market)
	dish NETWORK	• **14**	• Echostar's satellite network
IPTV	verizon	• **0.9** IPTV, **1.5** total TV	• Also bundles DirecTV
	AT&T U-verse	• **0.2** IPTV, **2.3** total TV	• Also bundles Dish satellite TV
	Qwest Spirit of Service	• **0.05** IPTV, **0.6** total TV	• Also bundles DirecTV

Source: ScreenDigest, Informa

5.1.2 Background and rationale to the Program Access Rules

The Program Access Rules were mandated as part of the **1992 Cable Television Consumer Protection and Competition Act**. They were introduced primarily to facilitate the entry of new pay TV platforms to compete with existing cable operators:

- an FCC report, published in 1990, discussed allegations around **discrimination** on the part of cable-owned programming and the fact that if a distributor had "market power" then it would have the incentive to withhold programming; the report therefore concluded that if robust programming was to be widely distributed, the PAR were essential
- at the time of the Rules' introduction, there was no effective competing platform to cable. The discrimination was in relation to C band satellite and MDS (a terrestrial microwave) immature services

48 For a more detailed overview of the TV players, including major broadcasters/networks, see appendix

The PAR were initially introduced for a period of ten years (1992-2002). Congress ordered the FCC to end the rules in 2002 unless the Commission found the rules still to be *"necessary to preserve and protect competition and diversity in the distribution of video programming"* [49].

In 2002, the FCC found that cable companies "*retained the incentive and ability to inhibit the growth of alternative programming distributors"* (then FCC Cable Services Bureau Chief, Kenneth Ferree)[50] and therefore decided to renew the PAR for another five years.

In 2007, the PAR were renewed again for a further five years after the FCC again concluded that cable operators continued to have the ability and incentive to withhold programming from competitors. The rules are currently in place until 2012.

The FCC's role in the implementation of the PAR is to **monitor** their application and **resolve** disputes, although they stress that, due to the language in the statute, often their "hands are tied" in this respect (the statute language approved by Congress is very specific and it is not possible to change it without undertaking a major legal process, i.e. involving Congress). Consequently, the FCC only gets involved in disputes when a **formal complaint** is filed.

5.1.3 Contextual differences from the UK

There are several important contextual differences between the US and the UK. In terms of market context:

- There is a far l**arger number of competing pay TV operators** in the US (over 1000 cable operators) than in the UK
- The **regional dimension** is far more important in the US (many of the smaller cable players only operate in a single region)
- The free-to-air **major networks carry more of the major live sports matches and events**
- The PAR were introduced **before competing pay TV platforms** had been launched to encourage pay TV competition rather than ex post
- Wholesale access mandated for content was based on **delivery mechanism** (cable programming delivered by satellite to the cable head-end) rather than whether it is premium
- Remedy applied to a number of players on **one platform** rather than an individual player

5.2 Details of the remedy

In this section, we look at how the Program Access Rules work in practice.

5.2.1 Overview of the Program Access Rules

The PAR applies to networks/channels which are at least **5% owned** by a **vertically integrated cable operator** and which are **delivered via satellite** across cable operators' networks as opposed to other means, e.g. fibre.

Most national and regional programming is delivered by satellite. Some regional programming can be delivered locally by fibre. Cable operators maintain that it is important to make this distinction to enable differentiation of content at the regional level.

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[49] The Communications Act, Section 628 "Development of competition and diversity in video programming distribution"
[50] Cable World, http://fjallfoss.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6513282036

According to the FCC's most recent cable competition report[51], there are 57 national and 44 regional networks that are both cable owned and satellite delivered. The exhibit below highlights some of the major channels involved.

Exhibit 12: Channels subject to PAR (selected examples)[52]

Vertically integrated operator	Example channels
Time Warner Cable	CNN, TNT, CN Cartoon Network, HBO, tbs, TCM Turner Classic Movies, Boomerang
Comcast	E! Entertainment Television, Golf Channel, VS Versus Sports, truTV Not Reality. Actuality., mystyle Before Meets After
Cablevision	MSG Madison Square Garden Network, We tv Women's Entertainment, amc American movie classics, IFC.com Independent Film channel

Occasionally, cable operators can request a waiver from distributing their content to third party operators (i.e. allow **exclusivity**) for a limited period (i.e. a few years) if it is seen to be in the public interest. For example, they might argue that they would only invest in a new strand of programming if they can retain exclusive rights to it. From the FCC's point of view, this could be acceptable for a limited period but it depends on the channel involved[53].

Under the PAR, vertically integrated cable operators must offer their channels to all **multi-video programming distributors** (**MVPDs**), i.e. other cable operators, satellite operators and IPTV players. However, distributors of linear programming over the internet are not eligible since they are not considered to be MVPDs.

5.2.2 Pricing mechanics

The Program Access Rules mandate that vertically integrated cable operators should make their networks **available on a "non-discriminatory" basis**. However, Congress did not impose a specific pricing mechanism (e.g. "cost-plus", "retail-minus") because it considered this would be extremely complex:

- different prices would apply to different operators/retailers (depending on number of subscribers, economies of scale, distribution costs)

The **Communications Act** explicitly states that any vertically integrated cable operator **should not be prohibited from *"establishing different prices, terms, and conditions*** *which take into account economies of scale, cost savings, or other direct and legitimate economic benefits reasonably attributable to the number of subscribers served by the distributor"*[54]. As a result, operators with smaller subscriber numbers will generally have to pay more on a per subscriber level than larger operators.

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[51] Source: Multichannel News, citing FCC's 2006 Video Competition Report to Congress
[52] http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-07-206A1.doc - *see appendix C-1*
[53] For example, a waiver was deemed appropriate for a new regional news network in New England but was not approved in the case of Court TV (which already existed).
[54] Communications Act, Section 628

The Communications Act also gives guidelines on the different variables that can be taken into account both to determine the price charged and whether or not it is "discriminatory". These include:

- Costs of creation
- Costs of sale
- Costs of delivery
- Costs of transmission

Generally speaking, there are two types of disputes related to "price discrimination":

- Prices charged to smaller operators
- Pricing of bundles

Several organisations, most notably the **American Cable Association (ACA)** which represents over a thousand smaller US cable operators, have argued that the higher per subscriber prices charged for operators with a smaller number of subscribers are excessively high and not justified by any substantive "economic rationale or discernable public policy"[55]. The FCC has not found in favour of this.

The other main point of contention with respect to pricing is around **the pricing of channel bundles**. Technically speaking, vertically integrated cable operators do provide an option for MVPDs to acquire the programming on an a-la-carte basis. However, it is often the case that the per subscriber pricing for the à-la-carte channel is so high that it makes greater economic sense to buy a bundle rather than a standalone channel (in some cases, it can be more expensive to carry the standalone channel than to carry the entire bundle). For example, Disney's price for the ESPN channel standalone is *higher* than for a bundle of channels including ESPN.

5.2.3 *Dispute resolution process*

Since there is no formal pricing rule, the FCC's focus is on dispute-resolution ex post (in the event of a complaint) rather than on ex ante pricing regulation.

When a dispute is referred to the FCC, its first step is to bring together the companies involved and encourage them to settle the dispute themselves. Resolution between the parties has been achieved in all but one instance.

In that one case, the FCC had to proceed to a second step, which involved it investigating the details of the contracts between the vertically integrated cable operator (Company A) and the complainant (Company B). The FCC identified some comparable distributors to act as pricing benchmarks. Company A argued that it cost more to distribute to Company B than the comparative distributors, but the FCC found the differential was too large to justify this rationale. In a "leap of faith", the FCC ordered the two parties to sit back down again and gave them 30 days to negotiate and resolve the dispute - which they then achieved.

As part of the renewal of the PAR in 2007, the PAR complaint process was revised. The main change involved requiring the subjects of PAR complaints (i.e. the vertically integrated cable operators) to turn over documents directly to the complainant without FCC mediation. This is designed to make it easier for complainants to get access to programming contracts to determine if any discrimination exists.

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[55] William Rogerson The Economic Effects of price Discrimination in Retransmission Consent Agreements, February 2008

5.3 Impact of the remedy

5.3.1 Positive impact

Overall, the FCC considers the PAR to have been very successful in fulfilling their original intention, i.e. to enable new entrants to emerge in the pay TV market over the long-term

- Cable's share of the MVPD market has declined from 94% in 1996 to 61% by end 2007[56]
- Satellite operators represent the 2nd (DirecTV) and 4th (Echostar/Dish) largest pay TV players

In 2007, FCC Commissioner, Michael Copps, called the PAR "one of the true success stories of the 1992 Cable Act" and considers that DirecTV and Echostar "just would not exist without them"[57].

5.3.2 Limitations

However, there are several limitations to the remedy and free market shortcomings that the PAR doesn't fully address. Broadly speaking these are of five types which are each explored in turn: Price discrimination; "Take it or leave it" bundling/channel tying; Tiering obligations; the "Terrestrial loophole"; and, lack of a "standstill provision" in PAR disputes.

1. Price discrimination

As discussed above, smaller cable operators pay significantly more for wholesale channels than their larger counterparts. This has several potential negative impacts[58]:

- May increase costs for consumers, particularly those in regions served by smaller pay TV operators:
  - *"MVPDs pass higher programming costs back to their subscribers in the form of higher subscriber fees"* (Former FCC Chief Economist, William Rogerson)
- May decrease competition by limiting smaller operators' ability to compete on price with the satellite operators or telcos in that area
- May restrict broadband development, particularly in smaller rural markets, by diverting resources away from infrastructure/bandwidth investment to content investment

2. Channel bundling

The PAR have not addressed the issue of channel bundling whereby companies such as Disney "encourage" distributors to take bundles of their channels. Channel bundling and discriminatory bundle pricing has additional negative impacts:

- May "squeeze out" independent programming which could harm both independent networks and consumers
  - pay TV operators will have less money to invest in independent programming as more of their budget is taken up by bundles
  - consumers are potentially deprived of their first-choice channel line-up (independent programming may be of a higher quality and more popular with viewers)

56 Screen Digest
57 Multichannel News
58 Source: ACA Reply Comments "Review of the Commission's program Access Rules and Examination of Programming Tying Arrangements", February 2008

- Inefficient use of scarce capacity
  - according to an FCC report, the typical American consumer is only interested in watching 17 channels, referred to as "highly desired" programming (e.g. ESPN, USA, Discovery, MTV)[59] but estimates suggest that in order for pay TV operators to secure the rights to carry the most popular channels, they have to carry at least 60 other channels[60]
- Limits MVPDs' ability to competitively differentiate at the retail level in terms of either price or content
  - pressure (due to relative pricing of standalone and bundled channels) to take a bundle means MVPDs are effectively left with exactly the same content proposition as vertically integrated cable players, and often have little budget left to invest in alternative third party content
  - the content available to MVPD's is typically at a high price and in a bundle of other channels. They can not afford to undercut the prices of vertically integrated operators on key content offerings

3. Tiering

The flexibility of pay TV operators to design how packages are sold at the retail level is further restricted by tiering requirements often imposed by vertically integrated operators, **requiring MVPDs to include their channels as part of specific tiers**. For example, ABC/Disney generally insists that the ESPN channels should be part of the extended basic tier – when some distributors might prefer to place some of these channels in a sports tier.

The argument is made that this requirement "*offers incentives for wider distribution*"[61]. However, non vertically-integrated players have a different view:

- *"*contractual obligations to distribute channels on the "most widely distributed package"…affect significantly *the flexibility* of MVPDs to offer *creative and alternative programming packages"* (Echostar[62])

4. Terrestrial Loop-hole

The "terrestrial loophole" points to another potential limitation in the PAR, namely the exclusion of vertically integrated programming that is delivered to the cable head-end by means other than satellite. The most notable example of this was EchoStar's complaint (in 1997) against Comcast and its SportsNet channel, the Philadelphia based regional sports network[63], which was exempt from the PAR because it was not satellite delivered. Both EchoStar and DirecTV claimed that Comcast's refusal to sell the channel compromised their ability to compete in the Philadelphia region. However, the FCC rejected Echostar's complaint, ruling that no evasion had taken place because the channel was a regional service, and terrestrial delivery could be used for regional programming (lower costs). The FCC's decision was later approved by the federal court.

5. Lack of standstill provision

Finally, while it is often argued that the presence of a dispute resolution system acts as a disincentive for vertically integrated cable operators to violate the PAR, the absence of a "standstill provision" has been criticised by some, most notably the ACA. The absence of such a provision means that, in the case of a formal complaint being made over the price of a channel, the vertically integrated cable operator is entitled to remove that channel until the dispute is resolved. This impacts the relative bargaining power of the respective parties:

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59 Source: American Cable Association (ACA)
60 ACA
61 For example, see NBC Comments on In the Matter of Implementation Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements, Report and Order and Notice of Proposed Rulemaking, MB Docket No. 07-198
62 Dish Network Comments on "In the Matter of Implementation review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements, Report and Order and Notice of Proposed Rulemaking, MB Docket No 07-198
63 Carries games of the National Hockey League's Philadelphia Flyers, the National Basketball Association's Philadelphia 76ers and Major League Baseball's Philadelphia Phillies [Source: Multichannel News]

"when a smaller [player] is involved, the threat of temporary withdrawal of a must-have channel overwhelmingly skews a negotiation in favour of the [vertically integrated operator]"[64].

5.4 Future

Currently the FCC is undertaking a "Wholesale Programming Rulemaking" and it remains pending with the Commission. This is addressing several issues that could affect the future design of the PAR. As part of this Rulemaking the FCC is considering several issues:

- whether the PAR should be **extended to satellite operators** (i.e. DirecTV and Echostar), since satellite players now have a sizeable subscriber base and also have a degree of vertical integration (e.g. Echostar is now vertically integrated with USA Networks' owner Vivendi Universal)
- whether the PAR should be **extended to non-affiliated programming**
- whether the **"terrestrial loophole" should be eradicated** by making the PAR applicable to all vertically integrated cable programming, rather than just that which is delivered over satellite
- whether the FCC should intervene to **curtail wholesale bundling requirements** and **price discrimination** (e.g. pricing a standalone channel more highly than a bundle of channels)
- whether it should further toughen up the dispute resolution process by introducing **binding arbitration** for dispute resolution[65] or a **standstill provision** which would prevent vertically integrating operators removing channels during a dispute

Several stakeholders are putting pressure on the FCC to make the PAR more stringent. For example,

- In June 2008, the Chairman of the Senate Antitrust Committee, Herb Kohl, wrote to the FCC Chairman, Kevin Martin[66], **calling for several modifications to the PAR, preventing operators from unreasonably bundling channels, improvements to the dispute resolution mechanism** (e.g. a tightening up the definition of "discrimination" and preventing vertically integrated operators from moving channels to a "disfavoured or costly" tier during disputes)
- Two smaller cable operators, **Trust Cable TV** and **Baja Broadband Operating Company,** have filed complaints with the FCC calling for the FCC to intervene to prevent channels being removed during a dispute

Other cable organisations are calling for the PAR to be pared back or eliminated altogether. In January 2008, for example, the **National Cable and Telecommunications Association** told the FCC that rather than expanding the PAR it should focus on helping cable operators to get relief from the rules already in place, particularly as satellite's position in the pay TV market is significantly stronger than when the PAR were first introduced.

The FCC will next make a decision on whether to renew the PAR in 2012.

5.5 Summary

The US experience demonstrates that, in a larger market, it is possible to use commercial benchmarks from deals in other parts of the US, rather than specific pricing rules. In the absence of formalised ex ante pricing regulation, the FCC has focused on **dispute resolution** encouraging operators to sit down and come to a deal. The FCC is now considering several potential measures to enhance the effectiveness of the dispute

64 ACA
65 This already applies to mergers and acquisitions but not to the PAR
66 Source: Broadcasting & Cable

resolution process. These include introducing binding arbitration and imposing a standstill provision which prevents vertically integrated operators from pulling a channel from the complainant's platform during a dispute.

The Program Access Rules also indicate the relative ease in interpretation/implementation of a wholesale must-offer remedy that is based on **delivery mechanism** (i.e. either satellite or not) rather than access to particular content.

Finally, the US experience highlights the fact that, even a relatively well designed wholesale must-offer remedy, such as the PAR, is subject to **opportunistic plays** on the part of the different players involved (e.g. the introduction of tiering requirements) and **consensus** about the "first-best" configuration of the regulation is difficult to achieve (e.g. should the PAR be extended to terrestrially-delivered programming?)

6 Spain

Applicable to:	• Sogecable (Digital+), the merged satellite operator
Imposed by:	• SDC, Competition Commission
Scope:	• 20% of channels, one premium channel but not premium Canal+ bouquet
Pricing rule:	• “Fair, transparent and non-discriminatory” but no price mechanism specified
Reasons for selection:	• The case of Spain is interesting because it highlights the importance of an effective dispute resolution mechanism and the problems which arise with a poorly defined wholesale must-offer remedy.

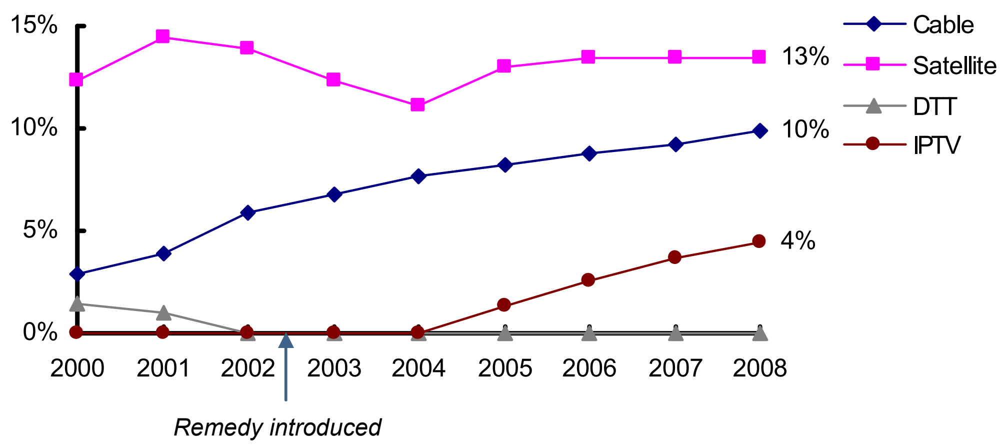
6.1 Background

In this section, we outline the Spanish pay TV landscape and the background to the wholesale must-offer obligations imposed on Sogecable (Digital+) following the merger of Via Digital and Canal Satellite in 2002.

6.1.1 Major players in the Spanish pay TV market

Pay TV penetration in Spain stands at 28%. The exhibit below shows how the pay TV market is made up on a platform basis.

Exhibit 13: Spanish pay TV penetration by platform (%TV households)



Source: ScreenDigest (2008)

Satellite is the leading pay TV platform with 13% penetration – cable has 10% and IPTV 5%. The exhibit below outlines the main operators in the Spanish pay TV market.

Exhibit 14: Key Spanish pay TV operators

Platform	Operator	Subscribers (m)	Comments
Satellite	DIGITAL+	• **2.1**	• Created in 2002 from merger of Via Digital and Canal Satellite • Owned by Sogecable which owns - The premium Canal+ bouquet (five channels) - Cuatro (FTA terrestrial channel) - Other significant content and production assets, including 80% stake in Audiovisual Sport* and film distribution subsidiaries (e.g. Warner Sogecine)
Cable	ONO	• **1.0**	• Largest cable operator folowing Ono-Auna merger • Has invested in Teuve (production company) which operates 11 thematic channels and has PPV volume deals with major Hollywood studios
	TeleCable	• **0.1**	
	euskaltel	• **0.3**	• Basque cable operator
IPTV	Telefonica imagenio	• **0.5**	• Telefonica's IPTV service • Telefonica had a 17% stake in Sogecable prior to selling it to Prisa in May 2008 • Largest IPTV player in Spain
	orange	• **0.1**	• 2nd largest IPTV service
	Jazztel	• **0.06**	• Jazztelia IPTV service launched 2006 • No premium content, targets mid-low end of market

Note: * A broker of sports rights
Source: ScreenDigest

6.1.2 *Background and rationale to the wholesale must-offer obligations*

Overview

In July 2002, the **SDC**[67], the Spanish Competition Commission, approved the merger of Via Digital and Canal Satellite to create Digital+ owned by Sogecable subject to certain legal conditions[68].

One of these conditions was mandated wholesale access to specific channels on the Digital+ platform, including at least one premium channel. Other conditions included requiring Sogecable to:

67 It has since been renamed as the CNC
68 These conditions were accepted by the Council of Ministers in November 2002 and were subject to the review of the Competition Commission under Article 1b of the 1989 Anti-Trust Law.

- Give wholesale access to its digital satellite platform to independent channels, both Spanish and EU, in a fair and non-discriminatory way
- Limit contracts for premium football rights or premium movie rights[69] to three years or less
- Give up purchase options and waive its rights of first refusal over premium football rights (i.e. Spanish League and Copa del Rey football matches) and premium movie rights
- Not acquire exclusive rights for either premium football or premium movies for exploitation through mobile telecoms and data transmission systems
- Not raise prices any higher than inflation until 2006

The merger conditions expired in November 2007.

6.1.3 *Contextual differences from the UK*

There are three important contextual differences between Spain and the UK:

- Premium football (La Liga) is available on FTA as well as pay TV, strengthening the Spanish FTA level and limiting consumers' incentives to invest in pay TV
  - La Sexta, the FTA channel, has live rights to 38 matches a season
- Pay TV penetration in Spain is still relatively low, meaning that FTA channels are strong and well placed to buy sports rights.
- There is no specific pay TV legislation or a dedicated regulator with powers of enforcement
  - the CMT, the telecoms regulator, plays a primarily advisory role and lacks enforcement powers
  - the lack of specific pay TV legislation in Spain means that authorities frequently have to resort to generic competition law and the courts – generally very lengthy processes.

6.2 Details of the remedy

In this section, we look at how the wholesale must-offer remedy works in practice.

6.2.1 *Overview of the wholesale must-offer remedy*

The condition pertaining to wholesale must-offer mandated that Digital+ should make available 20% of its channels to third operators. These should be different channels to those that were already operating on Canal Satellite prior to the merger. The number of channels agreed upon was 13. Several requirements were made in terms of which channels should be included for wholesale:

- at least one channel including premium first-run movies (i.e. movies produced by the big US studios in the first broadcast window)
- thematic channels produced by Sogecable, parent of Digital+

The CMT was invested with powers of monitoring Sogecable's fulfilment of the merger conditions, including writing an annual report on compliance.

[69] Defined as films produced by the major studios

6.2.2 *Pricing mechanics*

The remedy mandated that Sogecable made the wholesale channels available on a "fair, transparent and non-discriminatory basis". Additionally, Sogecable was unable to sell content to Telefonica[70] on terms that were more favourable than those agreed with other third parties. However, it appears that the SDC did not impose a specific pricing mechanism (e.g. "cost-plus", "retail-minus")[71].

6.2.3 *Dispute resolution process*

The Council of Ministers introduced arbitration measures in the case of a dispute. If the two parties failed to agree, the CMT was empowered to arbitrate and provide "quick solutions" to conflicts arising between the different parties.

6.3 Impact of the remedy

In some respects, the wholesale must-offer remedy may be considered to have increased competition in the Spanish pay TV market. Following the Via Digital and Canal Satellite merger, three IPTV services have been launched and cable's position has also been strengthened (largely as a result of the Ono-Auna merger). However it is difficult to assess to what extent the wholesale must-offer remedy specifically has had an impact as opposed to the merger conditions more broadly.

Overall, however, the experience of the wholesale must-offer remedy in Spain has not been particularly successful. Several factors were responsible for this:

- **Limitations in terms of content available:** Sogecable was not required to make its most attractive package, **Canal Plus** bouquet available on the wholesale level and its satellite platform, Digital Plus, is the only operator that offers the Canal Plus channels
- **Unclear language:** vagueness of definitions over what constituted a "premium channel"
- **Lack of clear pricing rules:** absence of "cost-plus" or "retail-minus" mechanism, or pricing benchmarks
- **Lack of a dedicated media regulator-** moreover**,** the CMT lacks enforcement powers

Two disputes about the application of the wholesale must-offer obligations in particular highlight the limitations of the remedy:

- **Ono** complaint over the **Gran Via** channel
- **Auna** and **Canal+ Deportes** dispute

The vagueness of language in the wholesale must-offer which only required that Sogecable share "at least one premium channel" with other operators has led to a number of disputes. Most notably, Sogecable offered Ono the Gran Via channel as a premium channel. After the merger, Sogecable began to reduce its investment in the channel and its programming quality and popularity deteriorated as a result. Ono complained to the SDC, arguing that the Gran Via channel was "not premium enough", particularly given this reduced investment. However, before the SDC investigation could reach any conclusions, the contract between Ono and Sogecable expired. Ono chose not to renew the deal and Sogecable stopped producing the channel.

70 Telefonica had a 17% stake in Sogecable prior to selling it to Prisa in May 2008

71 Unlike the case with wholesale access to the Sogecable platform for which cost-plus pricing was mandated. As part of this cost-plus mechanism, Sogecable had to maintain accounting separation between its wholesale services as a digital platform and the rest of its services.

The lack of clarity around pricing led to the dispute between Auna and Sogecable over the Canal+ Deportes channel. Sogecable only sells the channel as part of a bundle, so determining the appropriate wholesale fee for the standalone channel is difficult. SDC initiated arbitration procedures to try and enable Sogecable and Auna to reach an agreement about the Canal+ Deportes channel but Sogecable refused to participate.

6.4 Future

The merger conditions, including the wholesale must-offer requirement, expired in November 2007. Since then Sogecable has not been subject to any further obligations/conditions and its actions are monitored ex-post by the competition authorities.

6.5 Summary

The Spanish experience demonstrates the limitations associated with a poorly defined wholesale must-offer remedy (in terms of both pricing rule and “premium” definition). It also indicates the importance of an effective dispute resolution mechanism (particularly when no pricing rule is specified and complaints are therefore more likely to occur).

7 Australia

Applicable to:	Leading pay TV operator Foxtel, Although the number two player, Austar also entered into a Content Supply Agreement
Imposed by:	Commercial agreement between the players themselves
Scope:	All channels (basic and premium)
Pricing rule:	Retail-minus
Reasons for selection:	The case of Australia is interesting for three main reasons • Unlike in other markets studied, the commercial agreement (the **"Content Supply Agreement"**) was **initiated by the pay TV operators themselves**, rather than being imposed by the regulatory authorities (it was eventually approved by the regulator following a series of amendments/undertakings) • It is an example of a wholesale supply agreement which includes ***all* content**, not just premium packages • The difficulties encountered with the Content Supply Agreement allow several important lessons to be drawn about how to structure a wholesale must-offer remedy effectively (e.g. a **clear pricing rule** and robust **dispute resolution process**)

7.1 Background

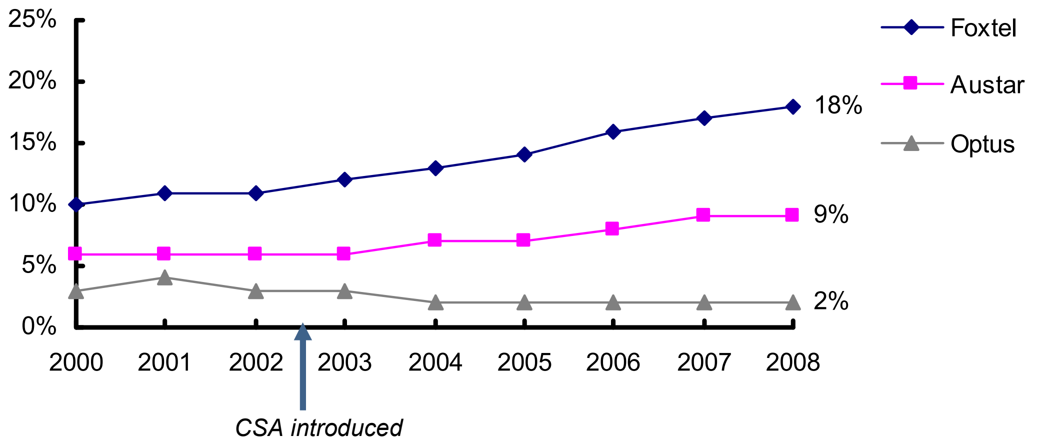
In this section we outline the Australian pay TV landscape, the background to the **Content Supply Agreement** and key contextual differences between Australia and the UK.

7.1.1 *Major players in the Australian pay TV market*

Pay TV penetration in Australia is relatively low, currently standing at 30%[72] of TV households[73]. The three major pay TV players are **Foxtel**, **Austar** and **Optus**. Their respective penetration of TV households is shown in the exhibit below.

[72] Screen Digest 2008 figure, vs. 51% UK, 55% France, 60% Singapore, 91% US
[73] 7.8m TV households as of 2008 (Screen Digest)

Exhibit 15: Australian pay TV penetration by player (%TV households)[74]



Source: ScreenDigest (2008)

The exhibit below gives a more detailed overview of the pay TV operators. The market leader is **Foxtel**, accounting for >60% total pay TV households.

[74] Screen Digest

Exhibit 16: Australian pay TV operators

<table>
<tr><th>Platform</th><th>Operator</th><th>Subscribers (m)</th><th>Comments</th></tr>
<tr><td rowspan="2">Satellite and cable</td><td>FOXTEL</td><td>• 1.3 (0.7 DTH, 0.6 cable)</td><td>• Leading Pay TV operator – 50% owned by Telstra, 25% by NewsCorp, 25% by Consolidated Media Holdings*
• 62% total Pay TV subscribers
• Has investments in several channels
- E.g. The Comedy Channel, Fox Classics, The History Channel, XYZ Networks (The LifeStyle Channel, Nickelodeon Australia, Channel V, Max)</td></tr>
<tr><td>AUSTAR</td><td>• 0.7 (0.6 DTH, 0.1 cable)</td><td>• 31% total Pay TV subscribers
• Owns 50% of XYZnetworks, a pay television program provider (50-50 joint venture between Foxtel and Austar)</td></tr>
<tr><td rowspan="2">Cable</td><td>'yes' OPTUS</td><td>• 0.2</td><td>• Cable only
• 157k subs
• Geographical coverage overlaps with Foxtel</td></tr>
<tr><td>Telstra</td><td>• n/a</td><td>• Largest telco in Australia and 50% owner of Foxtel
• Re-sells Foxtel packages (subscriber numbers included within Foxtel cable subs, no split given)
• Also used to re-sell Austar packages, but stopped offering this to new customers as of end June 2008</td></tr>
<tr><td></td><td>TransACT</td><td>• n/a</td><td>• Smaller regional player operating in Canberra
• Bought another regional player, Neighbourhood Cable (Victoria) in 2007</td></tr>
</table>

Notes: (*) Formerly known as Publishing and Broadcasting limited (PBL)
Source: ScreenDigest, Informa

Several factors impact pay TV take-up in Australia:

- Strength of the **FTA sports proposition** bolstered both by anti-siphoning regulation which allows FTA operators first right of refusal on rights to major sporting events and by aggressive **rights acquisition strategies** (e.g. Seven and Ten won the Australian Football League rights for the 2007-2011 seasons)
- **High prices,** due to a lack of competition
  - **Limited geographical competition**: the two largest players, Foxtel and Austar, operate in different geographical areas
    - Foxtel: metropolitan areas (Adelaide, Brisbane Canberra, New South Wales, Melbourne, Perth, Sydney and others)
    - Austar: regional remote areas (e.g. of NSW, Victoria and Tasmania. Also the Gold Coast area)
  - **Absence of platform-based competition** – Foxtel and Austar operate via both cable and satellite. IPTV remains in trial stage

7.1.2 Background and rationale to the Content Supply Agreement

In March 2002, Foxtel and Optus proposed a **content supply agreement (CSA)** whereby:

- Foxtel would wholesale its pay TV package to Optus
- Foxtel would take on financial obligations that Optus had incurred for US programming (i.e. its pre-existing contracts worth ~AUS$620m)

The main rationale for the CSA was **commercial expediency** on the part of both Foxtel and Optus:

- For **Foxtel** (809k[75] subs at the time of the CSA), it provided a **larger subscriber base** over which it could distribute its own content and helped to **strengthen** its **negotiating power** with content owners
- For **Optus** (241k[76] subs at the time of the CSA), it provided access to "killer" content (particularly movies and sports) to **attract subscribers** and drive growth. Optus expected the deal to add **~$30m** to its EBITDA annually and to be key to its goal of being cash-flow positive by 2003-04

Approval of the CSA was not automatic since it first had to get clearance from the **Australian Competition and Consumer Commission (ACCC).** The initial submission raised opposition from broadcasters (e.g. Seven and Ten) and local pay TV operators and was blocked by the ACCC in June 2002. The ACCC argued that it breached the Trade Practices Act and was "likely to substantially lessen competition" in the Australian pay TV market. Its main areas of concern are highlighted in the exhibit below:

Exhibit 17: ACCC concerns about the CSA

Area of concern	Description
Acquisition of content	• Shift from two-buyer to one buyer market would mean reduced competition between pay TV operators to acquire content, depressing bid levels
Access to Foxtel content	• **It might be difficult for other operators to secure access to Foxtel content:** particularly for other "bundled service providers", e.g. telcos/BB providers, not included in CSA • **Terms of access to Foxtel content:** Foxtel's increase in negotiating power as the only significant pay TV buyer would strengthen its ability to dictate the price and terms of supply of content, e.g. - positioining / tiering of programming - viewing times - wholesale price for access
Market for the supply of retail Pay TV services	• Lessening of competition between Foxtel and Optus in the retail Pay TV market - reduction in content-based competition - less price differentiation

Source: ACCC "Report to Senator Alston, Minister for Communications, IT and the Arts", June 2003

In response to these concerns, Foxtel, Optus, Austar and Telstra produced a series of **undertakings**. These are listed in the table below – the most relevant undertakings from the wholesale must-offer point of view are highlighted.

[75] Screen Digest
[76] Screen Digest

Exhibit 18: Undertakings

Most relevant undertakings

Area	Undertaking	Description
• **Wholesale obligation**	• **Supply of Foxtel pay TV services**	• Foxtel to supply its Pay TV services to infrastructure operators who operate cable, satellite or microwave networks • To maintain pricing relativity between the price at which it supplies third party Pay TV operators and that at which it supplies Telstra* • To supply its Pay TV services to ADSL operators if it starts to offer its own pay TV service over ADSL - it has not yet launched its own IPTV proposition, perhaps incentivised not to do so by the requirement to make available to broadband operators
• **Content acquisition obligations**	• **Exclusive acquisition**	• Foxtel and Optus undertake not to acquire pay TV rights to "shared channels"** on an exclusive basis • Foxtel also undertakes that it will not acquire rights to ESPN, the Movie One, Movie Extra and Movie Greats channels **on an exclusive basis** or seek to re-negotiate its agreement so as to do so - other Pay TV operators therefore have some certainty about access to movie and sport content that can be sourced independently of Foxtel
	• **Local content**	• Foxtel to spend $3m on Australian programmes produced by independent third parties
	• **3G Content rights**	• Foxtel not to license exclusively to Telstra, Sky Cable, News Corp or PBL*** any 3G rights it acquired with Pay TV rights • Foxtel will also offer to all 3rd parties on comparable terms and conditions any 3G rights for which it issues a non-excl licence
• **Obligations on Foxtel**	• **AFL sub-licensing**	• Foxtel to sub-license AFL match coverage/ its AFL channel to 3rd party pay TV operators for as long as it has exclusive pay rights
	• **Foxtel's basic tier price**	• Foxtel not to increase retail price of basic package for three years, except for adjustments for CPI
	• **Non-affiliated channels**	• Foxtel to ensure that at least 30% of the Pay TV channels in its basic package are non-affiliated channels
• **Obligations on Optus**	• **Non-Foxtel channels**	• For a period of at least three years, Optus to provide at least seven channels on its pay TV service that are not offered by Foxtel
	• **Optus channels**	• Optus to provide to Foxtel, for no less than three years, two channels that are compiled by it and which predominantly comprise programming created by it or acquired by it from independent third parties
	• **Australian drama**	• Optus will, for the duration of the CSA, maintain its spending on new Australian drama programmes
• **Access related obligations**	• **Analogue and digital access undertakings**	• Foxtel and Telstra to give access undertakings specifying terms and conditions of access to analogue/digital cable set top units - annual charge for analogue channel is $750k or, if auctioned, the auction price. No reserve price for digital.
	• **Digitisation commitment**	• Foxtel and Telstra commit to digitise their networks
• **Other**	• **Amendments to CSA**	• Foxtel and Optus to amend CSA to remove Foxtel's first and last bid rights over Optus network assets

Note: (*) Telstra, 50% owner of Foxtel, was already retailing Foxtel's channel packages (**) Shared channels are Antenna, BBC World, Cartoon Network, CNBC, CNN, Disney, National Geographic, RAI, Sky News, Sky Racing, TCM, TVSN and World Movies. (***) Renamed as Consolidated Media Holdings

Source: Value Partners analysis, ACCC website, CSA documentation from Foxtel, Austar, Optus and Telstra

Ultimately, the ACCC approved the CSA which will remain in place until December 2010. This was due in large part to the undertakings but also to several other important factors:

- **Optus threat to exit** the Australian pay TV market if the deal was not approved
- **low pay TV penetration** which some observers claimed would grow as a result of the CSA (e.g. PwC suggested pay TV subscribers would grow by 9.4% as a result of the agreement)
- **weak financial position** of the Australian pay TV industry (all platforms were loss-making despite collective pay TV industry investment of >$8bn[77] since 1995) largely due to **high content costs** which would be reduced by greater rationalisation
- **the degree of competition Optus could provide in the absence of the CSA:** there was evidence that Optus' competitive position was being adversely affected by its inability to source and supply key content to its subscribers[78]

In **2005**, the **CSA was amended** by the pay TV operators to allow Optus to offer digital pay TV services (the original CSA applied to just analogue services). Again, the process of amendment was not smooth:

- In February 2005, Foxtel's 25% shareholders, **PBL[79]** and **News Corp,** proposed an amendment to the CSA, allowing Optus **access to digital content**
- **Telstra,** Foxtel's 50% shareholder, subsequently **opposed** the proposal, arguing that Optus had already been "subsidised" in the original CSA
- In April 2005, **agreement was reached** between Telstra and Foxtel
  - Optus to fund its own digital TV conversion but Foxtel to offer reduced wholesale costs
  - Telstra's financial contribution to Foxtel to fall

The parties informed the ACCC of the proposed amendments. The ACCC, after reviewing the arrangements, considered that they did not raise competition concerns.

The main reason for the amendment was **Optus's falling subscriber numbers** since the introduction of the CSA[80].

- Optus's subscriber numbers had fallen by **100k** from 270k to 170k – more than a third of its total base

It was felt that amending the CSA to allow Optus to offer digital services (in addition to analogue services) could reverse the decline as its customers would no longer have an incentive to churn to Telstra's superior digital offer.

7.1.3 *Contextual differences from the UK*

There are several **important differences** between the Australian and UK pay TV markets which need to be taken into account when considering what lessons can be learnt from the experience of the CSA:

- **Vertical integration** of **Foxtel** (50% owned by Telstra)
- **Weakness** of **pay TV sports** proposition due to most sports content being available on FTA

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77 Astra submission to ACCC report on Emerging Market Structures in the communications sector, July 2003
78 ACCC report to Senator Alston on Emerging Market Structures in the Communications Sector
79 Now Consolidated Media Holdings
80 At this time, Telstra was offering a digital service which provided more channels than the Optus analogue service

Additionally, unlike the other markets considered in this study, the wholesale must-offer "remedy" in the Australian case was assumed by the pay TV operators themselves rather than being imposed by the regulator. As a result, the ACCC's role was largely reactive.

7.2 Details of the remedy

In this section we look at how the CSA works in practice.

7.2.1 Overview of the CSA

Unlike many of the wholesale-must-offer remedies considered in this report in which regulatory intervention led to the wholesale of premium content only, the CSA applies to **all Foxtel channels** (i.e. both premium *and* basic content). Several types of content however were not included:

- Interactive pay TV services
- VoD
- FTA retransmissions

The initial CSA proposal involved just **Foxtel** and **Optus**. However, **Austar** subsequently also submitted a CSA proposal to the ACCC for consideration. Today, Foxtel content is available on Optus, Austar and Telstra. TransACT and Neighbourhood Cable both entered into agreements with Foxtel to offer its basic and tiered packages at the time of the CSA/undertakings. However, premium Fox channels are no longer available on TransACT or Neighbourhood Cable.

Foxtel placed several restrictions on other operators in terms of the **packaging and tiering** of its content:

- Foxtel **retained control** over the packaging and tiering of the Foxtel services offered by third party retailers
- Third parties could not **reduce**, **expand** or **vary** the packaging or tiering of the Foxtel services except as permitted by Foxtel's "Infrastructure Operator Content Supply Agreement"[81]
- Foxtel also retained control over the **channel positioning** on third parties' EPGs

Effectively, third parties only have access to the same content as Foxtel if they re-transmit, in unaltered form, the Foxtel basic and tiered packages. If they **choose to develop their own basic and tiered packages**, they will not have access to all premium pay TV content.

- The Movie Network channels and Fox Footy[82] are eligible for inclusion in such packages[83]
- Fox Sports and the PMP[84] movie channels[85] are not available for inclusion in such packages

Restrictions also applied to **new programming acquisition:**

- If the third party acquires new programming content, this has to be placed on a tier, rather than as part of a basic service
- If it is similar to a Foxtel service, the new programming must be placed on a higher tier

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[81] Foxtel/Infrastructure Operator Content Supply Agreement: Public version
[82] This channel now no longer exists
[83] The Section 87B undertakings dictated that Fox Footy must be on-supplied to third parties and Movie Network channels had to be supplied non-exclusively
[84] Premium Movie Partnership: a joint venture between Sony, Paramount, Universal, 20th Century Fox and Liberty Media
[85] Showtime, Showcase and Showtime Greats

- If the new programming includes sport or movie content, it must also be made available to Foxtel[86]

7.2.2 *Pricing mechanics*

Access to Foxtel content is based on **retail-minus pricing.** Details on the pricing methodology are set out in the Infrastructure Operator Content Supply Agreement (see exhibit below) although the "minus" used is not given in the public domain. The only specific requirement that was made public was that, in the case of Telstra distributing Foxtel content, the price Telstra paid Foxtel could not undercut the price paid by Optus by **more than 3%**[87].

Exhibit 19: Wholesale pricing guidelines from the Infrastructure Operator Content Supply Agreement

Content type	Wholesale price
Basic	• An amount equal to the **Standard Foxtel retail price** in the territory for the basic tier of the Foxtel services (exclusive of taxGST*) less **[*] %** multiplied by the Monthly average number of third party subs taking the basic tier of the Foxtel services that month
Tiered component	• An amount equal to the **standard Foxtel retail price** in the territory for that tier (exclusive of GST*) less **[*]%** multiplied by the monthly average number of third party subs taking that tier during the month
PPV	• An amount equal to the **standard Foxtel retail price** in the territory for that PPV service (exclusive of GST*) multiplied by the number of third party subs who receive that service
Second set-top box	• For each additional set-top box, a price equivalent to 50% of the standard Foxtel retail price for an additional set-top box

Notes: (*) Goods and services tax
Source: Foxtel/Infrastructure Operator Content Supply Agreement: public version

Following **the 2005 amendment**, the pricing appears to have become **more favourable** to third party retailers, after Optus called for a wholesale price that allowed enough margin to break-even, while also providing it with an incentive to spend up to **$100m swapping out** its subscribers' analogue set-top boxes for **digital boxes**[88]. As a result of the new pricing agreement, the discount Optus received was brought more in line with that received by Telstra[89] to ensure that Optus was able to make sufficient margin to justify the upgrade from analogue to digital. The discount was not fixed but **varied according to the number of customers** Optus converted form analogue to digital[90]. Foxtel claim that this discount structure "gives Optus the ability and incentive to grow its subscriber base"[91].

Third parties are free to set their own retail prices; however their ability to do so is constrained by the wholesale price and the need to make margin on this.

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86 Source: ACCC "Report to Senator Alston, Minister for Communications, IT and the Arts, on Emerging Market Structures in the Communications Sector", June 2003
87 CoRE Research "Competitive effects of the Foxtel undertakings: A report on behalf of C7", Stephen King, 3rd October 2002
88 News.com.au
89 Australian IT, "Foxtel, Optus pact on digital"
90 Foxtel sent a letter to the ACCC (Foxtel Response to ACCC Draft Decision, October 2008) outlining the discount structure and the percentage of discounts available to Optus for different bands of Optus pay TV subscribers. However, the terms of the discount are not available in the public domain.
91 Foxtel, Response to ACCC Draft Decision, October 2008

7.2.3 *Dispute resolution process*

The dispute resolution process is outlined in Section 6 of Annexure A of the Foxtel undertakings, which includes possible mediation through the Australian Commercial Disputes Centre (ACDC). The process is as follows:

- If there is still a dispute 21 days after the start of negotiations (e.g. over the wholesale price payable as part of the CSA), either party is able to issue a "Dispute Notice" (i.e. give the other party notice in writing specifying the dispute and calling for the dispute resolution mechanism to be implemented)
- A mediator, agreed on by the parties, is to be appointed. If they cannot agree within seven days, the ACDC is to appoint a mediator. The mediation must begin within 14 days of the mediator being appointed.
- At any time during the mediation, either party can give an "Expert Determination Notice" (i.e. call for the dispute to be settled by Expert Determination). The ACDC is responsible for administering the Expert Determination. The parties agree to be bound by the determination of the expert.

7.3 Impact of the remedy

Overall, the CSA has done little to increase pay TV competition at the retail level or enhance consumer choice. This section outlines its impact in more detail.

7.3.1 *Positive impact of the CSA*

In some respects, the CSA has had a beneficial impact:

- It has **maintained a three player market:** Optus has publicly stated that it would not have survived without the content share deal
- Several industry players (e.g. ABC[92]) believe that this regime has provided a beneficial boost to the pay television industry and helped to **drive penetration** which has increased from 20% in 2002 to 30% in 2008
- Third party operators are able to access a **better quality product** than previously, increasing their ability to compete since they are no longer disadvantaged in terms of content
- The undertakings included a requirement for the digitisation of Foxtel's network. This, together with the 2005 amendment of the CSA (which led to the digitisation of Optus's network), has helped accelerate the transition to digital TV amongst pay households

Moreover, one of the concerns voiced by the ACCC prior to the CSA, namely that the shift to a one buyer market could lead to negative competitive effects upstream by depressing content bids, has not materialised, at least with respect to premium sports content. In the most recent round of negotiations (January 2006), the AFL TV rights were awarded to free-to-air (FTA) commercial broadcasters **Seven** and **Ten** for **AUS$156m/year**, up from around $100mover the previous period and the largest deal in Australian sports history.

The situation in Australia is unusual since the **FTA broadcasters are major bidders for premium content** (unlike in the UK, for example, where pay TV players are the primary bidders for FA Premier League rights). Anti-siphoning legislation also gave FTA players first right of refusal over certain sports rights. Thus the bidding market remained competitive in Australia even after the CSA due to the presence of the FTA players.

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92 Australian Broadcasting Corporation , in its response to the ACCC's Report on Emerging market Structures in the communications sector

7.3.2 Limitations of the CSA

In terms of **consumer choice**, the onerous restrictions placed on third party operators with respect to the way they package content have resulted in Optus's pay TV offer becoming virtually identical to Foxtel's. As such, consumer choice has arguably been *reduced* as a result of the CSA.

The table below compares the Foxtel and Optus **basic packages**:

Exhibit 20: Comparison of Foxtel and Optus basic packages (December 2008)

	Foxtel	Optus
• Number of • Channels	• 32	• 32
Number of different channels	• 2	• 2 (obligation on Optus to carry 7 additional channels has now expired)
Channels not carried on competitor's basic	• The Business Channel • Nickelodeon[93]	• Ovation[94] • Disney[95] •
Price (AUS$/month)	• 40	• 42.95 (standalone) • 37.95 (bundled with ADSL/telephone)

As can be seen, there is very little differentiation between the two packages at the level of either content or price, even though Optus was free to set its own retail price.

In terms of the **tiered packages**, while again essentially very similar, Foxtel's proposition remains more compelling both from a content and price perspective. For example:

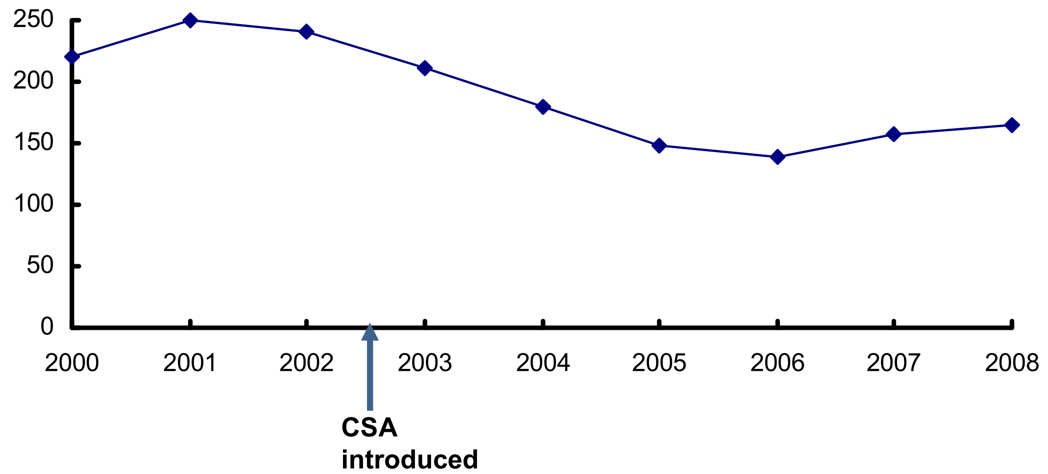
- **Spor**t package costs $16 a month on Foxtel vs. $17 a month on Optus
- Optus subscribers can only get the premium **"Total Movies"** package, including **the movie channels** (Showtime, Showcase and Showtime Greats), if they subscribe to the "**Platinum**" package (**$110.95**/month standalone price[96]) whereas the equivalent **"My Showcase"** package is available for just **$16** a month on top of the basic package on Foxtel
- **Time-shifted versions** of channels, that are available on both Foxtel's movies packages (**"My Movie Network"**[97] and **"My Showcase"**[98]) are not available on Optus movies packages ("**Movies**" and "**Total Movies**")
- To get both **World Movies** and **TCM**, Optus subscribers need to subscribe to *both* movie packages[99] whereas Foxtel subscribers only need to subscribe to one

Overall, therefore, while the CSA undoubtedly strengthened Optus's pay TV offering[100], the similarity of the packages offered by Foxtel and Optus has meant that ultimately consumers have little choice in terms of packaging or pricing.

A second negative impact of the CSA was that, following its introduction, **Optus' subscriber numbers actually fell significantly** (see Exhibit below).

93 Available on Optus's "Fun" package
94 Arts and culture channel created by Optus, available on Foxtel's "My World" package
95 Available on Foxtel's "My Playtime package"
96 Bundled price is $100.95
97 Movie Two which provides viewers with different viewing times
98 Showtime + 2 which shows same films two hours later
99 World movies is only available on "Movies" while TCM is only available on "Total Movies"
100 Prior to the CSA Optus had just 28 channels (July 2002) vs., 43 channels after the CSA (January 2003)

Exhibit 21: Optus subscribers (000s)



Source: ScreenDigest

Subscriber numbers have recovered following the CSA amendment which extended the content supply agreement to digital TV services (one of the main triggers for Optus' subscriber loss was churn to Telstra's digital package); however they remain lower than they were prior to the CSA. On the other hand, had the CSA not been in place at all, Optus may well have hade to close its TV operations altogether.

7.4 Future

The CSA is due to expire on **31st December 2010**. The ACCC plans to reassess the situation at that time.

7.5 Summary

As has been seen, the CSA and its associated undertakings were very much a "**compromise**" measure, addressing the different, and often conflicting, concerns at the time (e.g. anti-competitive impact of the CSA vs. financial position of the Australian pay TV industry as a whole). Nevertheless, several important and useful, lessons can be drawn from the Australian experience:

- The importance of a **clear**, **transparent** and **enforceable pricing rule:**
  - to allow regulatory bodies to monitor pricing
  - to act as an incentive for wholesalers to price at a more "fair" level, enabling third party operators to make a margin
- The benefit of **unbundling content** so that third party operators do not need to buy all the packages
  - to give third party operators greater freedom in creating their own packages
- The need for an **effective dispute resolution process** to give third party operators the opportunity to challenge Foxtel's interpretation of the terms of access, pricing etc.

8 Singapore

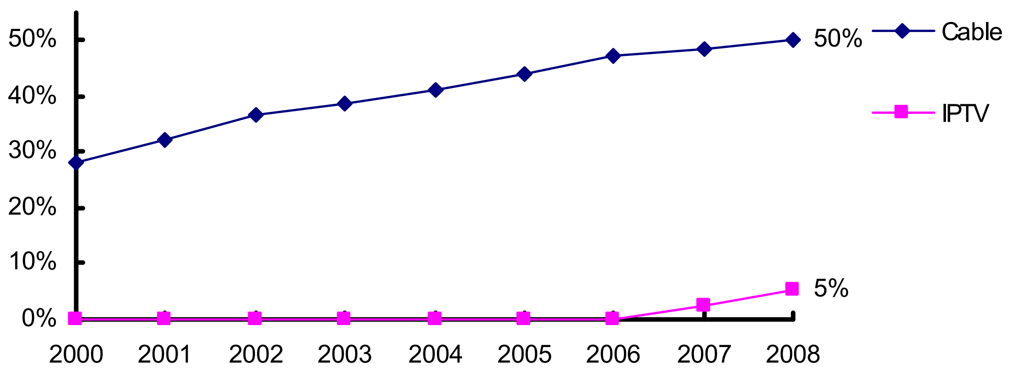
Applicable to:	• NA
Imposed by:	• NA
Scope:	• NA
Pricing rule:	• NA
Reasons for selection:	• Singapore provides an interesting example of where the regulatory authority, MDA, decided not to intervene against exclusive carriage contracts • The new entrant has adopted a premium content-led strategy to try and attract subscribers

8.1 Background

8.1.1 Major players in the Singapore pay TV market

Pay TV penetration in Singapore currently stands at around 50% of TV households. The exhibit below shows how the pay TV is made up on a platform basis.

Exhibit 22: Singapore pay TV penetration by platform (% of TV households)[101]



Note: 2008 figures are a forecast
Source: ScreenDigest (2008)

Cable operator **StarHub** is the largest pay TV operator and until 2007 was the only pay TV operator. There is no satellite in Singapore. **SingTel**, the IPTV player, entered the pay TV market in 2007 and is now StarHub's major competitor as the only operator which has sufficient financial backing to compete credibly[102]. The exhibit below highlights the major players.

[101] Informa
[102] Informa

Exhibit 23: Singapore pay TV operators

Platform	Operator	Subscribers (m)	Comments
Cable	StarHub	• **>0.5**	• Dominant Pay TV operator • Leader in innovation (launched HD first) • Offers triple and quad play
Satellite	N/A		• No satellite due to a long-term ban on satellite dishes
IPTV	SingTel	• **0.03**	• Launched IPTV offering, Mio TV in July 2007 • Offers triple and quad play • Only player to have sufficient financial backing to challenge StarHub

Source: ScreenDigest

8.1.2 *Background and rationale for the wholesale investigation*

In early 2006, the Singapore media regulatory body, the **Media Development Authority (MDA)** conducted an investigation into whether **exclusive channel agreements (ECAs)** between a pay TV operator (Starhub) and content providers led to market foreclosure by preventing a new entrant from securing popular content critical to its ability to attract subscribers.

- StarHub has exclusive carriage of certain premium content (e.g. English Premier League **(EPL)** rights) and major channels (e.g. **HBO, CNN, ESPN)**

The **Media Market Conduct Code (the Code)**, designed by the MDA, does not preclude exclusive contracts per se, unless they result in a foreclosure of competition. A number of factors are considered to determine whether "market foreclosure" exists[103]:

Exhibit 24: Criteria for determining market foreclosure

- **% of the market that is foreclosed**: calculated by dividing the number of exclusive channels by the number of available channels in Singapore
- **Duration of the agreement**: in line with international practices, exclusive carriage agreements with a duration over three years for the sports and English movies genres were considered long
- **Whether the agreement has a legitimate business purpose or whether its principal effect is to foreclose competitors' access to inputs or distribution channels**: determined by such factors as who initiated the exclusive carriage agreement, whether entering into exclusive carriage agreements is content providers' standard practice, whether the exclusive carriage agreement was necessary to achieve significant efficiencies and whether the potential anti-competitive effects were relatively limited
- Whether competitors retain the ability to obtain comparable inputs or distribution, from other providers, on reasonable prices, terms and conditions: MDA determined whether potential pay TV operators had the ability to obtain comparable channels e.g. could they self-package or produce their own channels

The MDA issued its decision on 10 May 2006, echoing the Media Market Conduct Code by concluding that while certain content could be considered "critical" for "the success of a pay TV service", ECAs in and of

[103] Media Market Conduct code Paragraph 7.5.6

themselves do not necessarily “substantially foreclose potential entrants’ access to key content for the pay TV market in Singapore”[104].

Subsequently, on 24 May 2006, SingTel submitted an appeal to the **Minister of Information, Communications and the Arts** under Section 27 of the MDA Act against the MDA’s decision. SingTel requested that the Minister overrule the MDA’s findings and suggested the government should

- *either* engage independent consultants to conduct objective economic analysis of ECAs in the Singapore pay TV market
- *or* rule that StarHub’s ECAs unreasonably restrict competition under the Code and mandate StarHub to provide wholesale access to key content

On 27 July 2007, the Minister upheld the MDA’s decision. He agreed that ECAs per se do not substantially foreclose potential entrants’ access to key content and ruled that SingTel had not provided sufficient evidence to prove the contrary.

If the complaint had been sustained, the MDA would have had the power to **void** the exclusive contract(s) concerned and introduce other provisions.

Instead, the MDA decided to focus on market liberalisation via new platforms (e.g. introducing a formal IPTV licensing framework) as a means of encouraging pay TV competition.

8.1.3 Contextual differences from the UK

There are several contextual differences between Singapore and the UK:

- No satellite
- Starhub is not a content producer or rights holder
- Both operators, Starhub and SingTel, have a strong financial position
- Premium sports content, e.g. English Premier League rights, is held by a third party, EPSN Star, rather than directly owned by one of the platform operators

8.2 Details of the MDA’s investigation

The objective of the MDA’s investigation was to[105]:

- examine whether exclusive carriage agreements between a pay TV operator and its content providers would prevent a newcomer from securing popular content critical to its ability to attract subscribers
- assess whether, as a result, competition in the pay TV market was being prevented, distorted or restricted

As part of this investigation, the MDA launched a **public consultation exercise** which sought comment from industry stakeholders and consumer groups. It also conducted a **market research study** to identify the key content genres consumers perceived to be critical to pay TV. This involved six focus groups and 600 telephone interviews with both StarHub and non-StarHub subscribers. The market research study identified 14 content genres, with **Sports** and **Educational** genres identified as being the most important (see exhibit below).

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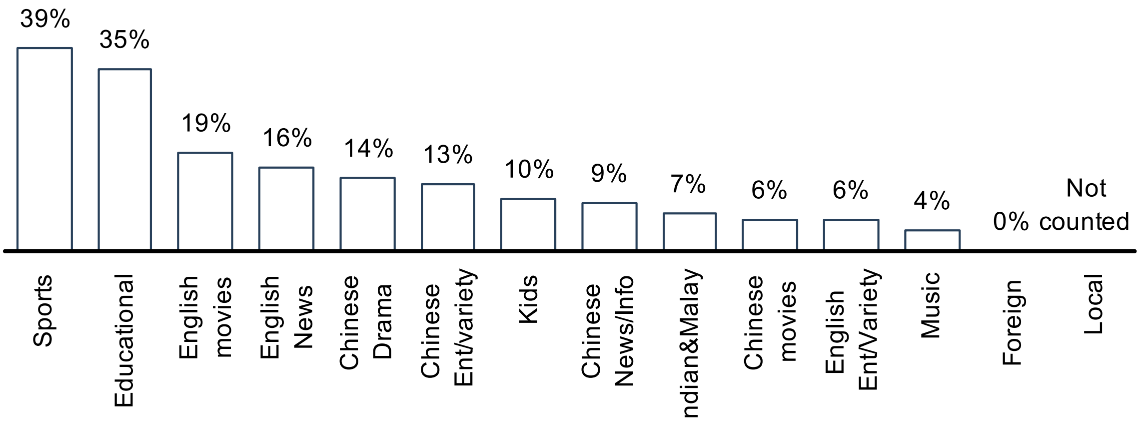
[104] MDA decision, MDA website
[105] Source: MDA

Exhibit 25: % respondents who considered genre to be "top genre"



Note: Total Base N = 600
Source: Spectrum Value Partners analysis, MDA

The MDA concluded that the four most popular genres (**Sports, Educational**, **English movies** and **English news)** could be considered critical to the success of any pay TV operator in Singapore. Having identified the relevant sub-section of channels containing this content, the MDA assessed whether StarHub's exclusive agreements with these channels amounted to market foreclosure based on the measures outlined above. The MDA also held extensive discussions with industry players.

The MDA did not find sufficient evidence to suggest that there was market foreclosure in the key genres and hence it rejected the complaint. The MDA considered its decision represented the optimal balance between respecting commercial decisions and preventing anti-competitive behaviour since in its view:

- considerable scope for commercial negotiations remained
- exclusive arrangements were not preventing the entrance of new players to the market

In his ruling on SingTel's complaint, the Minister concluded it was inappropriate to apply international precedents to the Singapore situation (which formed a significant element of SingTel's submission) because of the different Singapore context

- StarHub neither owned nor was affiliated with any providers of key content
- many of the international precedents cited were the result of Mergers and Acquisitions
- the Foxtel-Optus content sharing agreement in Australia was a commercial outcome, not due to intervention by the regulator

8.3 Impact of the MDA's decision

Following the MDA's focus on market liberation via new platforms, **SingTel** launched **MioTV**, its IPTV pay service in July 2007:

- focus on entertainment, movies, documentaries and "infotainment"
- offers six HD channels

By June 2008, it had reportedly achieved subscriber numbers of 45k and is expected to reach >56k homes by the end 2008 (~5% penetration) compared to total pay TV penetration of ~50%.

Growth in subscriber numbers has been due to SingTel's content-driven strategy and willingness to invest in attractive sports and movie content[106], e.g.

- in March 2008, it won the rights for the UEFA Champions League and UEFA Cup from 2009 – 12[107]
- in November 2008, it secured the rights to live Italian Serie A matches
- it has secured VOD rights for films from major US studios (Sony, 20th Century Fox and Buena Vista)
- deal with Disney-ABC International Television to host a subscription VOD channel, Film Factory

However, **StarHub** still retains the English Premier League rights, which are considered to be the most attractive and popular sports content[108] and it remains to be seen whether SingTel can grow further and whether it will be in a position to make a positive margin on its pay TV product.

At present, consumers have to pay for two separate pay TV packages if they want to have the full range of pay TV content.

8.4 Future

The MDA emphasised that its decision was subject to change, depending on the evolution of the market, and that it would continue to monitor developments around exclusive carriage agreements. The MDA has the power to instigate another investigation at any time it decides – it does not need to wait for a dispute or complaint before initiating action.

Another issue the MDA will likely need to address going forward is the complaints by certain consumer groups that due to greater competition upstream in the content acquisition market (i.e. multiple bidders for premium content) consumers are now required to buy two separate pay TV packages if they want to watch all of the major football competitions.

8.5 Summary

The case of Singapore indicates that in certain contexts, wholesale pay TV must-offer obligations may not be necessary to encourage new entrants. The MDA considered whether the exclusive contracts foreclosed the market and decided that this was not the case. SingTel has chosen to invest in content itself. Its content-led strategy has ensured that its pay TV proposition is compelling even though it does not have wholesale access to StarHub's content. Ultimately SingTel's investment in content, together with market liberalisation and the introduction of an IPTV licensing framework, has allowed a new entrant to consolidate its pay TV proposition.

There are contextual differences between the UK and Singapore. In particular, the "deep pockets" of SingTel have enabled it to make significant investments in content. Moreover, SingTel's IPTV business is still in the early stages of development and it remains to be seen how successful the proposition will be, from the perspective of both subscriber numbers and margin potential.

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[106] Growth in Starhub's subscriber base has remained unchanged at 4% annual growth from FY06-07 and FY07-08

[108] It also had the Euro 2008 tournament rights and has the German Bundesliga and Japan's J-League rights

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