ANNEX 8: SKY'S RESPONSE TO SECTION 11 (CONSULTATION ON LICENCE CONDITIONS) OF THE CONSULTATION DOCUMENT

A. Introduction

A8.1 In this Annex we comment on Section 11 of the Consultation Document, in which Ofcom purports to "*set out… for consultation the proposed text of a condition to be inserted into the licences held by Sky listed… above*",[1] in order to implement its proposed wholesale must-offer remedy.

A8.2 Our comments below are provided without prejudice to the views expressed elsewhere in this Response – in particular, as to the necessity for, and proportionality of, the proposed new regulation which has led Ofcom to draft this text.

A8.3 We have three overarching comments on the proposed licence condition (the "**Draft Licence Condition**"):

(a) it is materially incomplete;

(b) it contains fundamental errors; and

(c) it extends the scope of Ofcom's proposed intervention beyond what Ofcom describes in the Consultation Document.

A8.4 For these reasons, contrary to its apparent intention,[2] Ofcom cannot treat this as a proper consultation which fulfils its Broadcasting Act obligations to give to a licence holder notice of any proposed variation to its licence and a *"reasonable opportunity of making representations… about the variation"*.[3] Such an inchoate document does not provide Sky with a reasonable opportunity to make representations on the proposed changes. Sky reserves all rights in this connection.

A8.5 Sky's detailed comments on the Draft Licence Condition are set out in the following sections.

B. General comments

Affected channel licences

A8.6 We note that the list of licences at paragraph 11.5 of the Consultation Document, which Ofcom describes as "*licences held by Sky*",[4] includes the licence for the Disney Cinemagic channel. As Ofcom should be aware, Disney Cinemagic is not a Sky channel and Sky does not hold the relevant licence.

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1 Paragraph 11.10 of the Consultation Document.

2 *Ibid.*

3 Section 3(4)(b) of the Broadcasting Act 1990.

4 Paragraph 11.5 of the Consultation Document.

Implementation

A8.7 The Draft Licence Condition does not contain a provision setting out the date on which it is to come into force. For the proper implementation of any condition, an appropriate transition period should be established to enable Sky to take all necessary steps to prepare for that implementation.

C. Specific comments

Condition 14A(1): Interactive Content

A8.8 Despite being capitalised, the term *"Interactive Content"* (which also appears in Condition 14A(6)) is not defined. Such a definition is clearly required. However, as Sky has noted in **Section 9** of this Response,[5] Ofcom's proposals in respect of Sky's interactive services are inchoate and cannot form the basis of a proper definition of this term.

Condition 14A(1): identity of the 'offeree'

A8.9 As currently drafted, the Draft Licence Condition would require Sky to offer the programme content of the Licensed Service to "*any person*" regardless of whether such a person had the ability to retail such services over a *"Qualifying Platform"*. In the case of open platforms (other than platforms operated by Sky),[6] Sky could be in the position of having to offer the Licensed Services to, and therefore embark on complex and time consuming negotiations and technical audits with, all-comers, including those without access to a *"Qualifying Platform"*. In the extreme, Sky could be in the position of having to offer wholesale supply of the Licensed Service to end consumers.

A8.10 The absence of any qualification to "*any person*" makes this Condition unreasonably burdensome to Sky.

Condition 14A(1): definition of Qualifying Platforms

A8.11 The definition of "*Qualifying Platform*" in Condition 14A(7) is unclear. As currently drafted, it appears that Sky's obligation to wholesale its premium channels would not be limited to 'TV platforms'. In particular, it could arguably catch the open internet. This is at odds with Ofcom's analysis and proposals in the Consultation Document.[7] There is no basis for extending the remedy to non-TV platforms.

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5 Paragraphs 9.77 to 9.108..

6 Platforms operated by Sky are excluded from the definition of "*Qualifying Platform*" in Condition 14A(7).

7 For example:

- Ofcom's discussion of the competition issues, purportedly necessitating its intervention, focuses on the provision of Sky's premium channels on "*TV platforms*" and glosses over the availability of the same content on non-TV platforms such as via Sky's PC-based Sky Player application which, Ofcom states, "*has thus far had limited impact on the market*" (paragraph 6.148 of the Consultation Document);

A8.12 Ofcom's rationale for not extending the proposed compulsory licensing regime to Sky's DTH satellite platform[8] applies equally to the open internet, where Sky already retails its premium channels via Sky Player. We can, therefore, only assume that Ofcom's intention is not to include the open internet in the definition of "*Qualifying Platform*", but Ofcom should clarify the point.

Condition 14A(2): Maximum Prices

A8.13 The maximum wholesale prices which Sky would be permitted to charge under the proposed compulsory licensing regime are clearly fundamental to the effect of any proposed licence condition, yet there is no definition of *"Maximum Prices"* in the Draft Licence Condition. Instead, in its place, Ofcom states that *"a set of prices would be established pursuant to the consultation, as discussed in Section 9 above"*.

A8.14 It is impossible to know at this point what principles for calculating the maximum prices for the relevant Sky channels will emerge from the consultation process. Even if and when Ofcom takes its decision to impose maximum prices on the wholesale supply of Sky's premium channels, it would not be appropriate for Ofcom simply to parachute a "*set of prices*" into the licence condition. Ofcom will need, at the very least, to provide sufficient information in conjunction with the proposed licence condition to allow Sky (and those firms to which the relevant prices are to be offered) to (a) understand the basis on which those prices have been derived and (b) assess whether they are consistent with that methodology. Without this information, Ofcom cannot meaningfully consult on a licence condition.

A8.15 If Ofcom decides to proceed with compulsory licensing which includes price regulation, Ofcom will need to consult on a draft licence condition which includes the relevant maximum wholesale prices and the underlying methodology by which they would be established. Ofcom will also need to provide details as to the circumstances in which, and process by which, the maximum prices would be adjusted.

Condition 14A(3): standard terms and conditions

A8.16 Draft Condition 14A(3) would require Sky to publish a set of standard terms and conditions for wholesale supply of its channels by a date yet to be specified. Ofcom has not indicated what it sees as the appropriate time gap between the date on which the licence condition comes into effect (which is not specified) and the deadline for Sky's publication of its terms and conditions. Sky

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- in discussing the scope for platform innovation, Ofcom seems to draw a distinction between TV platforms and non-TV platforms (such as iTunes) over which movies may be viewed (paragraph 7.92 of the Consultation Document); and
- Ofcom's concern over the availability of first-run movies on a SVoD basis focuses only on the non-availability of such content to UK consumers on this basis "*on any **TV** platform*" (paragraph 7.97 of the Consultation Document, emphasis added) and dismisses SVoD services on Sky Player.

[8] Paragraph 8.50 of the Consultation Document.

considers that it would require a minimum of three months in order to draw up a set of standard terms and conditions which would encompass the matters required by this paragraph.

A8.17 That said, sub-paragraph (d) of paragraph (3) (*"the arrangements under which changes to the* content *of the Licensed Service shall be notified and agreed"*) is far too vague for Sky (or any potential wholesale customer) to be able to understand what is intended: for example, the type of *"changes to the content"* which are to fall within the scope of this provision; how they are to be agreed and with whom; and what would happen if customers disagreed with each other.

A8.18 Sky's services are constantly evolving. This is particularly the case in relation to Sky's sports channels, with frequent changes to, for example, schedules, editorial content and the sports events covered. Whatever is intended by this provision, it is hard to imagine that it would not involve an unwarranted infringement on Sky's editorial control.

A8.19 Moreover, Sky notes Professor Cave's comment that this proposition "*may reflect a desire on Ofcom's part to ensure that changes in channel content are agreed with competing retailers and… the motive may be to prevent Sky from acting solely in its own commercial interests*".[9] Sky agrees with Professor Cave's observation that "*the effect of requiring agreement by retail competitors to changes in channel content may effectively congeal the status quo forever*".[10] Given Ofcom's general duty to "*further the interests of consumers*",[11] Ofcom could not properly pursue a provision that had such a negative effect.

Condition 14A(3)b): Minimum Qualifying Criteria

A8.20 Ofcom envisages that the *"Minimum Qualifying Criteria"* would document "*objectively justifiable reasons why* [Sky] *would not wish to wholesale its channels to a prospective* retailer",[12] and that any "*additional, objectively justifiable concerns in relation to individual retailers*" could be resolved though "*commercial negotiations*".[13] It is unclear, however, how this is intended to sit with the obligation on Sky, in Condition 14A(6), to use its "*best endeavours*" to enable a person operating a *"Qualifying Platform"* who meets the *"Minimum Qualifying Criteria"*, and who accepts Sky's wholesale offer under Condition 14A(1), to commence retailing of Sky's content (including *"Interactive Services"*) on their platform.

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9 Paragraph 44 of the Cave Report at **Annex 1** of this Response.

10 *Ibid.*

11 Section 3(1)(b) CA03.

12 Paragraph 9.215 of the Consultation Document.

13 Paragraph 9.217 of the Consultation Document.

Condition 14A(4): packages with Non-TV Products

A8.21 We discuss in **Section 9** above[14] the complex economic issues raised by this paragraph of the Draft Licence Condition. In addition, we have the following comments on its drafting:

(a) the calculation at its core, which is to trigger a reduction in wholesale prices, is drafted as the exact reverse of what Ofcom has said that it intends to be the case. Rather than providing for price reductions where *"the incremental price of that Non-TV Product exceeds the long-run average incremental cost of that Non-TV Product"*, to implement Ofcom's intention the drafting would need to provide for such reductions where the reverse is true – that is, where the *"long-run average incremental cost"* of a *"Non-TV Product"* exceeds its *"incremental price"*. This is a clear error;

(b) the term *"the Amount"* (being the amount by which wholesale prices are to be reduced) is incorrectly defined. As drafted, the *"Amount"* is the *"long-run average incremental cost"* of the relevant *"Non-TV Product"*, which is patently wrong and inconsistent with the principles set out by Ofcom at paragraph 9.207 of the Consultation Document. Clearly, applying Ofcom's (incorrect) reasoning, the *"Amount"* should be the **difference between** the "*incremental price"* and the *"long-run average incremental cost"* of the relevant product;

(c) there is no sign of the materiality threshold of *"around 5%"* of Sky's retail subscriber base for "*Core Premium"* channels proposed by Ofcom at paragraph 9.207 in this paragraph of the Draft Licence Condition. This is, in any event, an entirely arbitrary figure for which Ofcom has provided no justification;

(d) the definition of *"Non-TV Product"* could catch absolutely every service other than a programme service including, for example, Sky's subscriber magazine, Sky Multiroom (which Ofcom excludes from its modelling) and the Sky Protect and Sky Protect PC services (protection plans for customers' Sky equipment and PCs respectively). We did not understand this to be Ofcom's intention, given Ofcom's discussion at paragraphs 9.203 to 9.208 of the Consultation Document.

Condition 14A(6): best endeavours

A8.22 This paragraph of the Draft Licence Condition would require Sky to use its "*best endeavours*" to enable any person who has accepted an offer pursuant to Condition 14A(1) *"to commence retailing of the Licensed Service, including Interactive Content"*.

A8.23 The obligation to use "*best endeavours*" thus applies not only to the provision of content, but also to all other steps required to **enable the retailing** of Sky's

[14] See paragraphs 9.113 to 9.118.

content, which goes much further than the provision of a set of *"factory gate products"* discussed in the Consultation Document.[15] To the extent that this requires Sky, in its role as a broadcaster, to be involved in the day-to-day retail operations of platform operators, it is unreasonable. Furthermore, such an obligation potentially requires significant expenditure on Sky's part.

A8.24 This formulation is not used elsewhere in the Consultation Document and so there is no further guidance from Ofcom as to its intention.

D. Conclusion

A8.25 What Ofcom has produced in Section 11 of the Consultation Document falls far short of what is required, pursuant to section 3(4)(b) of the Broadcasting Act 1990, to enable a licence holder to assess the effect of the variation and provide an intelligent response.

A8.26 The gaps, inconsistencies, inadvertent omissions and fundamental errors identified in the brief review set out above demonstrate that the Draft Licence Condition is not fit for purpose.

A8.27 Ofcom's aim in consulting on a draft licence condition at this stage was presumably to avoid a further consultation stage before it could implement its proposed new regulation. But, as we have made clear, this step is premature; Ofcom cannot circumvent proper process in this way. Ofcom must consult properly on the full text of a licence condition (including connected documents); this will be possible only after Ofcom has considered the responses to the Consultation Document and only if and when it has finalised its proposals for any new regulation.

[15] Paragraph 9.57 of the Consultation Document.