

BBC's response

Proposed BSkyB Digital Terrestrial Television Services Second consultation on Sky's 'Picnic' proposal

EXECUTIVE SUMMARY

The BBC welcomes Ofcom's assessment and broadly agrees with the proposals made in this document, which build upon its own response to the first phase of this consultation.

The BBC also welcomes Ofcom's decision to link its consideration of this proposal to its Pay TV Market investigation. The BBC agrees with Ofcom's view that issues raised by the Sky/Arqiva proposal, such as access to premium content also relate to the wider pay TV market investigation and vice versa. In particular, the BBC agrees that Sky has market power in separate wholesale markets for premium sports and movies channels, and that it is likely to exploit that market power by limiting the distribution of those channels to other retailers.

We are separately responding to the regulator's second consultation on the pay TV market.

The BBC agrees with Ofcom's proposal to approve BSkyB and Arqiva's Picnic proposal subject to conditions. We recognise and fully support the importance of the effective fulfilment of the following conditions proposed by the regulator:

- A **wholesale must-offer arrangement**, under which Sky would be required to supply its premium sports and movies channels on a suitable wholesale basis which is commercially viable, in particular, subject to certain conditions in relation to wholesale pricing.
- The **use of simulcrypt**, under which other retailers of pay TV services on DTT, using different conditional access systems, could access Sky's premium sports and so consumers can access via one box movies channels without the need to transmit the same channels more than once, subject to suitable security requirements that protect rights holders but do not allow Sky to impose overly onerous conditions that make this remedy ineffective.
- We also agree with Ofcom's view that these main conditions should be complemented by **ancillary conditions** to ensure that a wholesale must-offer arrangement cannot be easily rendered ineffective, even if it is commercially and technically workable. These conditions should be formulated in such a way that the proposal is only allowed to be implemented once they are effectively complied with. Therefore, we would insist on the importance of very strict and detailed criteria and ex-ante conditions to ensure that Sky does not abuse its position and specific strengths to restrict competition.

- As set out in our previous response, the BBC does not believe there could be sustainable retail competition on pay DTT without suitable conditions, and that, after a short period, there is most likely to be one retailer of pay services on DTT. More generally, it believes that could be the case for all platforms. If competition in the pay TV market is to come from inter-platform rather than from intra-platform competition, it is important to ensure that the same operators do not have significant market power on all the main platforms.

The BBC agrees that there are two key drivers of competition in pay TV: (1) access to premium content, which drives take-up and (2) functionalities of the equipment, which can create a bottleneck by restricting consumers' ability to switch from one retailer to another.

The BBC is therefore very happy that Ofcom proposes to take measures on these two matters.

Access to content

The BBC fully agrees with Ofcom's assessment of the importance of access to content for fostering retail competition in pay-TV.

We welcome Ofcom's current conclusions on the pay TV market investigation that some premium content (key sports and movies) form part of a specific market, on which Sky has a significant market power. In order to compete effectively, other pay TV retailers must be able to access this content, and in particular to Sky's sports and movies channels which Ofcom refer to as "Core premium channels".

However, it is essential to ensure that Sky does not render this condition ineffective by moving its premium content across different channels to make this definition of Core premium channels unworkable.

Simulcrypt

We also agree with Ofcom's view that in order for a wholesale supply arrangement to work effectively on DTT, where capacity constraints, and the need to ensure spectrum efficiency, would prevent duplicate transmission of the channels, the use of simulcrypt is necessary.

Without simulcrypt arrangements, retailers wishing to offer Sky channels to their subscribers would have to transmit them a second time. Not only would this be very expensive for the retailer (and possibly impractical given the very few slots available on DTT with strong competition for those), it would also represent a very inefficient use of a scarce and valuable public resource, and impose costs on consumers who would need to buy different boxes.

Therefore, the BBC would argue that the proposal made by Ofcom is fully consistent not only with its competition duties, but also with its spectrum duties, and ultimately with consumers' best interests.

Ancillary conditions

The most thoroughly thought-through conditions will be absolutely ineffective if they are not in place **before** the launch of Picnic. Therefore, the BBC very strongly supports Ofcom's desire to impose ancillary conditions which focus on delivering the intended outcome for competition and consumers and which are proportionate to the issues they address, rather than attempt to address a wide range of potential behaviours.,.

In particular, we believe that such ancillary conditions, to be met before the launch of Picnic, should include:

- The effective signature of agreements between Sky and other retailers of pay services on DTT allowing them to sell the "core premium channels" as part of their subscription packages. It would be appropriate to ensure that at least one third party retailer is in a position to market and retail the wholesale channels at the same time as Sky. We believe such a condition would be appropriate to ensure that sky cannot abuse its strong marketing power to pre-empt any marketing and retailing efforts by a third party retailer.

and

- The signature of a simulcrypt agreement with these operators.

The BBC understands Ofcom's concern that some operators might have incentives to delay the fulfilment of these conditions. Therefore we agree that, should such arrangements not be approved in the six months following Ofcom's final statement, (or at an earlier date if requested by an interested party and agreed by Ofcom) the regulator could take further action to assess the reasons for this failure. In particular, as suggested by Ofcom, it could oversee the completion of a simulcrypt trial involving Sky, Arqiva and one or more prospective third party retailers.

Without such simulcrypt arrangements, we believe there is a strong risk that Sky will introduce set-top boxes incapable of supporting existing pay DTT services and/or encrypt its own services in a way that cannot be decrypted by the equipment used by existing pay DTT platforms.

This could exclude third party retailers from a significant part of the retail market and could impose additional costs on consumers wishing to also access PSB HD channels. We do not consider that Sky's stated intention "to promote an environment where, in principle, any manufacturer could build and supply Picnic compatible set-top boxes, subject to meeting Sky's technical specifications, and to provide technical platform services to broadcasters of other pay DTT channels, subject to a number of conditions" would be a strong enough guarantee that Sky would not gain control over technical platform services on DTT. However, we consider a suitable arrangement where competitors could gain access to Sky's premium channels would address this concern since it would then be possible to watch these sports and movies channels on a competitor's DTT platform, and not only on Sky's DTT platform.

BBC RESPONSE TO OFCOM QUESTIONS

1. Do you agree with our current view that under the Proposal, Sky would be likely to emerge as the sole or main retailer of pay TV services on DTT, given its market power in the wholesale markets for Core Premium channels and its incentives to withhold its Core Premium channels from other retailers of pay TV services?

Yes. As set out in our previous response, we do believe that the most likely consequence of allowing the Application without conditions would be that Sky would become the sole retailer of pay DTT channels.. Combined with its pre-eminent position on pay satellite, Sky would reinforce its dominance as a pay TV channel retailer in the pay TV market, which would have a very significant impact on channel providers, other platform operators and consumers.

There are a number of reasons why this would happen.

1. Sky could leverage its market power for Core Premium channels.

As well assessed by Ofcom, Sky has the majority of Core Premium channels on Pay TV on DTT, which are one of the main drivers for the take-up of pay TV services. An operator willing to compete with Sky would have to either:

- Obtain the same Core Premium channels on a suitable wholesale basis; or
- Retail new Core Premium services, created by itself or a third party who would have to have:
 - obtained enough “premium” rights to do so, and
 - secured the relevant multiplex capacity.

The first outcome is unlikely to occur without intervention as Sky has strong incentives to withhold its Core

Premium channels from other retailers of pay TV services. Whilst Sky might have a short-term interest in making these services available, their longer term interest would be to prevent potential competitors from emerging. We agree with Ofcom’s assessment (paragraphs 6.107 to 6.113 of their second MI consultation) in this regard.

The second outcome is also very unlikely according to Ofcom analysis that given its platform dominance, Sky will continue to win the majority of the key Sports (Live FAPL) and Movie rights, as they become available - at least for the next few years. This is particularly important when bidding against Sky, who benefit from its strength on the satellite platform to make a joint offer for rights (which other bidders cannot match).

2. Sky could also leverage its position as the main satellite platform operator

A channel operator wishing to launch new Premium channels would need to gain carriage not only on DTT but also on cable and most importantly on satellite. As explained in our previous submission, from a channel operator’s perspective, access to satellite, which until switchover has the widest digital coverage (and hence the largest potential customer base with 8.7 million subscribers) is an absolute necessity.

Whilst Sky has to make its EPG and CAS services available on FRND terms,, it is in a very strong negotiating position when it comes to carriage terms, launch dates and the ability of a channel operator to offer innovate services, for instance interactive services, which might help it to differentiate its offer.

In addition, the absence of a simulcrypt solution in satellite set top boxes and the unwillingness of Sky to licence its proprietary CA software to third party channels or third party set top box manufacturers make it difficult for a third party to emerge, and possibly impossible to survive, as an independent packager and retailer of pay channels on the digital satellite platform.

3. Sky could also leverage its position with retailers and with suppliers of set-top boxes

The BBC agrees with Ofcom's assessment that:

- a) Sky may be able to influence the marketing of STBs in such a way as to distort competition, for example by incentivising leading retailers with discounts and commissions.
- b) Sky would have a particular advantage as a result of its existing relationships with manufacturers for DSat STBs: for instance, it might benefit from economies of scope in terms of DTT STB design, economies of scale in terms of volume of orders or preferential treatment in terms of timing of production.

Ultimately consumers would suffer from a lessening of competition. Whilst some consumers can choose freely between platforms, various coverage restrictions mean that most consumers can only choose between satellite and DTT for the provision of pay services. If the same operator controls both platforms, it will be able to increase prices or reduce quality without those consumers being able to switch to another platform. Sky is also a key broadband service provider offering bundled products, which may allow it to increase its market power by increasing consumer switching costs, thereby reducing churn and competition in the market.

2. Do you agree with our current view that the emergence of Sky as the sole or main retailer of pay TV services on DTT and the consequent adverse effects on competition would be likely to occur in a relatively short timeframe?

If Sky were to become the only provider of pay television on DTT, its combined position on satellite and DTT will give it an insurmountable advantage in its negotiations with channel operators and right holders. It would also decrease the ability of consumers to move to other platforms. By strengthening further Sky's position, the combination of its market dominance on DTT and satellite would enhance its ability to capture premium content.

We agree with Ofcom that this could happen in a very short timeframe. Picnic's content offering would contain the vast majority of the premium content available on the platform and is likely to be much more popular than the other content available on other pay TV services on DTT.

Without 'wholesale must offer and simulcrypt, switching consumers would also have to purchase a new set-top box to access Premium content and would be locked-in to Sky's retail package. This is one of the reasons why we fully agree with Ofcom's proposal to require simulcrypt arrangements.

Such a scenario would make it even more difficult for existing pay TV operators to compete against Sky for rights, thereby maintaining (if not increasing) Sky's position on the premium content market. This could lead to a quick demise of existing Pay TV operators.

3. Do you agree with our current view that Sky should not be prohibited from retailing Pay TV services on DTT provided that its Core Premium channels on DTT are made available to its retail competitors on a suitable wholesale basis?

We understand and agree with Ofcom's position. However, we would like to stress that it is only the combination of conditions proposed by Ofcom that would suffice and Sky should only be authorised to retail Pay TV services on DTT once these conditions are met effectively and cumulatively. If Sky is to be allowed to retail Pay TV services on DTT, it should be at the same time be required to:

- Make available its Core Premium channels to its retail competitors on a suitable wholesale basis, such that:
 - prices are appropriate and allow those retailers to effectively compete; Ofcom should be able to control such prices ex-ante, for instance requiring the adoption of a "retail-minus" approach or "ex ante margin squeeze" rule; and
 - content is made available in a form which supports the full range of any value-added services (e.g. interactive services), and on equivalent terms and conditions to those which might be expected in a competitive market;

and

- Adopt a simulcrypt solution.

Without these combined remedies, effectively implemented, there is a strong risk that there could be no effective competition to Sky at the retail level. We believe that at least one third party retailer must have the opportunity to reach agreement with Sky and market its retail package at the same time as – or even before – Sky launches its own retail package. This would give them a "window of opportunity" where they could establish themselves at the same time as Sky begins marketing its own offer. Without such an opportunity, Sky's reputation and marketing strength risks stifling third party retailers thereby leaving Sky as the single Pay TV retailer on DTT, with all the risks that entails.

4. If we were to consent to the Proposal, subject to a condition that Sky must make its Core Premium channels available to competing retailers on a suitable wholesale basis, do you agree that it would not be necessary to impose additional conditions addressing the provision of TPS by Sky?

Yes, provided Sky is required to implement a simulcrypt solution.

5. Do you agree with our current view that the Proposal is unlikely to have a significant adverse effect on the DSO process or the appeal of Freeview to consumers?

Yes. As set out in our previous submission, we believe the proposal has the potential to deliver significant benefits to pay DTT subscribers by offering a richer selection of premium and non-premium pay content than they have today. This is likely to complement the FTA DTT offering and strengthen the appeal of the platform.

However, we raised two specific concerns:

- 1) This would crucially dependent on the maintaining of DTT as an effective and open platform. We believe the cumulative use of the remedies proposed by Ofcom is able to meet that concern subject to our concerns about Sky's position on the Freeview Board (see question 7 below).
- 2) The loss of Sky's free to air channels to users of FTA DTT, in particular the effect on plurality from the loss of Sky News from FTA DTT. We believe this should be part of Ofcom's assessment of the multiplex licence changes.

6. Do you agree with our current view that the extent to which the Proposal may increase complexity in the decision-making process for consumers wishing to buy DTT reception equipment, this issue can be managed effectively without the need for imposing relevant conditions on Sky?

The BBC, ITV, Channel 4, S4C and Ofcom are working on a complex programme of work to strengthen DTT by allowing the platform to carry high definition (HD) channels and upgrade to more efficient technologies. As the plan requires that consumers willing to get the HD services acquire new equipment, we believe it is essential to ensure consumers do not get confused by the simultaneous launch of equipment with different functionalities. In particular, we believe it would be very damaging for the platform, and confusing for consumers, to see the introduction of MPEG4/DVB-T equipment, at the same time as or shortly before the introduction of the MPEG4/DVB-T2 products which will be required for the new HD services. We therefore believe it is important for Ofcom to consider imposing a requirement on Sky to include DVB-T2 in any MPEG4 capable box it offers to consumers.

7. Do you consider that to the extent the Proposal may lead to a (greater) conflict of interests between Sky and the other members of DTVSL (the company which operates Freeview), this is a matter which in the first instance should be resolved by the relevant parties through commercial negotiation?

Confidential response

Joint response to Questions 8 and 10

8. Do you agree with our current view that a wholesale must-offer arrangement, under which Sky must provide wholesale access to its Core Premium channels on DTT, is the most appropriate solution for us to pursue to address the competition concerns we have identified?

10. Do you consider that Sky or relevant third party retailers on DTT would be provided with an incentive to reduce the effectiveness of a wholesale must-offer arrangement? If so, in what ways might they seek to achieve this?

The BBC agrees with Ofcom's view that a wholesale must-offer arrangement, under which Sky must provide wholesale access to its Core Premium channels on DTT, is necessary to ensure that the launch by Sky of its pay-television offer on DTT does not damage competition. However, the BBC would like to stress that whilst such a measure is absolutely necessary, Ofcom will have to take actions to ensure it is genuinely effective, and keep those under review.

In particular, Ofcom would need to ensure that

(1) prices are appropriate and allow those retailers to effectively compete; Ofcom should be able to control such prices ex-ante, for instance requiring the adoption of a "retail-minus" approach or "ex ante margin squeeze" rule;

(2) the wholesale obligation applied to the Core Premium Channels also includes interactive content (for instance extra matches delivered through the red button, high definition versions).

Ofcom should also keep the flexibility to reverse its decision to allow Sky to retail its services on DTT, should Sky obviously act in an anticompetitive manner.

9. Do you agree that simulcrypt is the most appropriate means of allowing multiple retailers to have access to Sky's Core Premium channels on DTT?

Yes. We agree with Ofcom's assessment of the options regarding conditional access. Simulcrypt arrangements are necessary to ensure DTT remains an open and competitive platform, easy for viewers to access. To reap the benefits of additional choice in pay DTT, it is vital that consumers can receive both the new Sky services and the existing pay DTT (Top-Up TV and Setanta) services on the same equipment. As set out in our previous submission, we do not believe that the option of having two set top boxes is an attractive consumer proposition and, unless an open platform is available, consumers will have to choose which pay TV package to consume – somewhat negating the benefits of increased channel availability.

Without simulcrypt arrangements, there is a risk that Sky uses set-top boxes incompatible with existing DTT pay TV services or with the new T2 standard.

Whilst Sky holds that it will allow the conditional access technology they use to be licensed from NDS, and that manufacturers will be free to include support for other CAS modules using a common interface, they make clear that they would expect manufacturers to ensure that any such equipment is secure in order to minimise/prevent signal theft and internet redistribution of Sky's programming, and that these arrangements will be subject to technical feasibility. Previous experience on satellite (which we have repeatedly documented with Ofcom) suggests this will allow Sky to retain full control of whether and when such agreements are concluded.

Sky has stated its intention "to promote an environment where, in principle, any manufacturer could build and supply Picnic compatible set-top boxes, subject to meeting Sky's technical specifications, and to provide technical platform services to broadcasters of other pay DTT channels, subject to a number of conditions". However, we do not consider that this statement of intent gives a strong enough guarantee that Sky would not gain control over technical platform services on DTT. However, we consider a suitable arrangement where competitors could gain access to Sky's premium channels would address this concern since it would then be possible to watch these sports and movies channels on a competitor's DTT platform, and not only on Sky's DTT platform.

11. If we were to consent to the Proposal subject to a suitable wholesale must-offer arrangement being put in place, do you consider that any ancillary conditions would be required to ensure that it was workable from a commercial and technical perspective? If so, please explain: (i) the ancillary conditions that would be required and the specific concern(s) they would seek to address and (ii) why there would be no other practicable and less restrictive means of addressing the concern(s) in question.

The most thoroughly thought-through remedies will be absolutely ineffective if they are not met in practice **before** Picnic is allowed to launch. Therefore, the BBC very strongly supports Ofcom's desire to impose ancillary conditions which focus on delivering the intended outcome for competition and consumers rather than attempt to address a wide range of potential behaviours, and which are proportionate to the issues they address.

In particular, we believe that such ancillary conditions, to be met **before** the launch of Picnic, should include:

- The effective signature of agreements between Sky and other retailers of pay services on DTT allowing them to sell the "core premium channels" as part of their subscription packages. We believe that at least one third party retailer must have the opportunity to reach agreement with Sky and market its retail package at the same time as – or even before – Sky launches its own retail package. This would give them a "window of opportunity" where they could establish themselves at the same time as Sky begins marketing its own offer. Without such an opportunity, Sky's reputation and marketing strength risks stifling third party retailers thereby leaving Sky as the single Pay TV retailer on DTT, with all the risks that entails.

and

- The signature of an effective simulcrypt agreement with these operators.

The BBC understands Ofcom's concern that some operators might have incentives to delay the fulfilment of these conditions. We therefore agree that, should such arrangements not be approved in the six months following Ofcom's final statement (or at an earlier date if requested by an interested party and agreed by Ofcom) the regulator could take further action to assess the reasons for this failure. In particular, as suggested by Ofcom, it could oversee the completion of a simulcrypt trial involving Sky, Arqiva and one or more prospective third party retailers.