

Proposed BSkyB Digital Terrestrial Services - 2nd Ofcom Consultation

Sky Response

1. Introduction and Summary

- 1.1 In April 2007, Sky and National Grid Wireless (which has since been acquired by Arqiva) applied to Ofcom to vary their respective DPS and Multiplex licences, to replace Sky's current three FTA channels (*Sky Three*, *Sky Sports News*, *Sky News*) broadcast on DTT with five pay channels (*Sky Sports 1*, *Sky Movies Screen 1*, *Sky One*, *Disney* and *Discovery*), to be retailed by Sky under the new brand name *Picnic* (the "**Picnic Application**").
- 1.2 The approach Ofcom has taken to the review of the Picnic Application has been to raise a number of concerns, leading to the issue of two consultation documents, the first in October 2007, and this second one in September 2008. Ofcom's concerns about Picnic stem from its belief that Sky has market power in relation to the wholesale provision of certain premium channels (the "*Core Premium channels*"¹), and that this market power would, if Picnic launched without Ofcom imposing certain restrictions, distort competition downstream at the retail level, such that competition from existing pay TV retailers on DTT would be eliminated, and/or future pay TV entry to DTT would not be feasible. Ofcom believes that, were Picnic to launch unconditionally, this outcome would materialise so quickly (possibly within a matter of months) that *ex post* intervention would not be effective.
- 1.3 The nature of these concerns means that Ofcom has decided to link the Picnic and pay TV review consultation processes: in its press release of 13 May 2008, Ofcom stated that it "*recognised that there are issues raised by the Sky/NGW proposal that will inform the market investigation and vice versa*" such that it would consult on the two issues "*simultaneously*", but that "*it is important to understand that, while related, they remain separate matters and while progressing these issues in parallel, they will not necessarily follow the same timetable moving forward*" (paragraph 2.29).
- 1.4 Nonetheless, Ofcom is proposing only to allow the launch of Picnic subject to various conditions, primarily relating to the wholesale availability of the Core Premium channels, i.e. predicated on the imposition of new compulsory licensing regulation on Sky, as proposed in the pay TV review, being put in place before Picnic is allowed to launch.
- 1.5 Sky agrees that separation of the two reviews represents an important principle and that the Picnic Application is capable of decision on its own merits, and should be decided on its own merits. Insufficient reasons have been advanced by Ofcom as to why approval of the Picnic Application should not be forthcoming immediately and unconditionally. To the extent that Ofcom has concerns relating to the wholesaling of premium channels, those issues are already being considered as part of its pay TV review, and are more appropriately dealt with under that "*separate*" review. For example, if Ofcom considers that the protection of fair and effective competition requires mandatory wholesaling of

¹ Ofcom defines "*Core Premium channels*" as channels containing "*pay TV content .. of particular importance: live Premier League football and first-run blockbuster movies...*" (paragraph 1.13 of the Picnic consultation document).

Sky's channels to existing DTT operators, that is an issue that should be considered under the pay TV review, and not as part of its review of the Picnic Application.

- 1.6 Yet this is clearly not what is happening: it is hard to avoid the impression that Ofcom is using the Picnic Application as a lever to attempt to achieve the desired goals of its pay TV review (an impression confirmed by Ed Richards at the recent Ofcom media analysts' briefing when he indicated that if Sky wanted to implement its Picnic proposals, that would need to be "*entirely subject to those conditions*", despite those conditions apparently still being subject to the present consultations).² Such an approach is wholly unreasonable. Ofcom states that the Picnic and pay TV reviews are separate matters; it should live up to this statement, and deal with these two reviews (including any appropriate and necessary remedies) separately.
- 1.7 As fully explained in our separate response to the second pay TV consultation document, we consider Ofcom's analysis of the competition concerns (both at the wholesale and retail level) to be flawed, undermining the concerns that Ofcom has about the impact Picnic's launch will have on the development of competition, particularly on DTT. We consider the concerns that Ofcom considers are raised about the possible competitive impact of Picnic, being based on assumption and hypothesis, have not been demonstrated to the requisite legal standards of proof or materiality. Ofcom itself recognises this shortcoming in paragraph A6.59: "*many of the assumptions used in our analysis are subject to considerable uncertainty*". Accordingly they do not provide a basis for Ofcom to do anything other than approve Picnic unconditionally. Over the course of the last 21 months, Ofcom has had ample time and scope to develop and assess relevant available evidence of the impact that the launch of Picnic is likely to have on relevant markets, and to reach a decision to the requisite legal standards about any concerns. It has, however, failed to do this.
- 1.8 As a result of the evidential and analytical shortcomings of its competition concerns, Ofcom has misdirected itself in relation to the application of its general duties, notably by misinterpreting its duty under section 3(1)(b) Communications Act 2003 (CA03) (to further the interests of consumers, where appropriate by promoting competition), and paying insufficient regard to its other duties – notably s.3(4)(d) CA03 to encourage investment and innovation in relevant markets – as well as its "procedural" duties under s.3(3) to have regard to the principles under which its regulatory activities should be (amongst other things) proportionate, consistent and targeted only at cases where action is needed. The deficiencies in Ofcom's evidence base means that it has not demonstrated that consumers' interests would necessarily be damaged without the promotion of competitors' interests in the intrusive manner proposed (to the detriment of incentives on regulated companies such as Sky to invest).
- 1.9 Ofcom may be (rightly) "*wary of prohibiting Sky from retailing pay TV services on DTT, a highly interventionist measure, without being convinced that such action is necessary and proportionate*" (paragraph 3.84). Given the inadequacies of its apparent evidence base, Ofcom should be equally wary about pursuing its favoured Option 2, which in practice should not be seen as significantly less interventionist than Option 3.
- 1.10 Nor has Ofcom adequately explained why the launch of Picnic, without the restrictions advocated by Ofcom, would lead to any competition concerns materialising so quickly

² Ofcom media analysts' briefing, 22 October 2008: <http://www.ofcom.org.uk/media/speeches/2008/10/briefing>.

that any future recourse to *ex post* enforcement powers (such as under the Competition Act 1998 (CA98)) would necessarily be ineffective. This is a particularly key part of Ofcom’s case for *ex ante* regulation – without evidenced support for such arguments Ofcom’s justification for *ex ante* intervention in relation to Picnic would be fundamentally undermined.

- 1.11 It is clear that, after 21 months, this review still has a long way to go. Ofcom indicates, at paragraph 3.148 of the Picnic consultation document, that it has not yet even carried out the core assessment required by the Picnic Application, notably “*the applicable statutory test relating to the variety of tastes and interests served by the programmes broadcast*”. Ofcom has instead decided to devote all its attention to the “*competition implications*” of Picnic (in effect using the “convenience” of the Picnic Application to examine issues related to the wholesaling of Sky’s premium channels – which is not something directly related to the launch of Picnic, and which Ofcom is already considering as part of its pay TV review). It is perplexing that this key part of Ofcom’s review of the Picnic Application has been left so late and been treated as a secondary matter to Ofcom’s pursuit of matters that are already being dealt with in the pay TV review.
- 1.12 Likewise, Ofcom notes in a number of places in the consultation document (such as paragraph 3.97, in relation to Sky as a pay TV retailer on DTT, and paragraph 3.126, in relation to the provision of platform services) that “*if we do not choose to pursue a wholesale remedy then this assessment [of the concerns in question] would have to be revisited*”. This is troubling for Sky: if Ofcom accepts Sky’s arguments, then there would appear to be a significant prospect of an even more protracted review of the Picnic Application.
- 1.13 The length of time that Ofcom has taken to review the Picnic Application, exacerbated by the link to the pay TV review, cannot be considered consistent with Ofcom’s duties: Ofcom must recognise the chilling effect such a glacial approach to regulation can (and has) had, with the consequence of depriving consumers of the substantial benefits and efficiencies that Ofcom recognises Picnic would create. To prevent any further consumer detriment, Ofcom should approve the Picnic Application unconditionally forthwith.

2. Required standard of Ofcom’s review

- 2.1 The Picnic Application requested permission for Sky to change its DTT channel line up.³ Ofcom has raised a number of concerns in its two Picnic consultation documents originating from Sky’s role as a supplier of the Core Premium channels, and the consequential impact on Picnic’s future position as a retailer of pay TV services on DTT.
- 2.2 Rather than restrict its regulatory activity to the matter specifically applied for, i.e. the change in DTT channel line-up, Ofcom has decided to investigate wider concerns (which are separately being considered as part of Ofcom’s pay TV review). Using its powers under section 316 CA03, Ofcom proposes to introduce conditions in Sky’s broadcasting licences concerning the wholesaling of the Core Premium channels (and ancillary

³ It is important to remember that the Picnic Application is not for approval to be a pay TV retailer – for which prior approval is not required (especially since the pay TV-related restrictions in the Mux C licence were relaxed by Ofcom in 2006). This is consistent with the treatment Ofcom has afforded to other, existing pay TV retailers on DTT, who did not need prior authorisation for their activities.

matters), even though the Picnic Application does not directly relate to channel wholesaling, or even to channel retailing.

- 2.3 Leaving aside the question of whether Ofcom is entitled to take this approach, it is imperative that its process and quality of review are compatible with its regulatory duties, in particular under sections 3 and 6 CA03, which include acting proportionately, targeting regulatory activity only at cases in which action is needed, and not imposing regulatory burdens that are unnecessary. Regulatory decisions of this nature can only be reasonably reached when based on a cogent evidence base (a standard that Ofcom itself refers to in paragraph A5.12 of the Picnic consultation document).
- 2.4 In paragraph 2.16, Ofcom states that it is required “to take a dynamic and forward-looking view of the effectiveness with which competition is expected to deliver benefits to consumers”. However, Ofcom admits (in paragraph A6.36) that “given the uncertainty about the [future] development of pay TV services on DTT it is virtually impossible to make any proper probabilistic assessment of the likelihood of there being a widespread consumer detriment in the longer term...”. Nonetheless, it apparently considers that the imposition of *ex ante* content-related conditions under s.316 CA03 in relation to Picnic to be justified – notably as a result of its longer term competition concerns. Given the inadequacies in Ofcom’s evidence base, this is a very surprising approach, to say the least.

Standard of proof

- 2.5 Any concerns which Ofcom wishes to use as support for regulatory intervention must, accordingly, be supported by an evidence base which amounts to more than supposition or hypothesis. To be compatible with its duties, this means that the appropriate standard of proof must be met: this is the civil standard of the balance of probabilities, i.e. that an outcome is more likely than not to happen.
- 2.6 If a concern is speculative – i.e. not more likely than not to happen – that cannot provide a basis for regulation, and in particular *ex ante* intervention when *ex post* powers are available. Given that Ofcom is proposing the imposition of highly intrusive and burdensome regulation as a condition of approval of Picnic (including the possibility of preventing the launch of Picnic at least until other pay TV retailers have first established subscriber bases using Sky’s channels on DTT), it is especially important that this standard is met.

Materiality

- 2.7 Ofcom’s concerns must also be sufficiently material – i.e. Ofcom’s competition concerns must be more likely than not to result in a material adverse effect on competition.⁴ If the impact of a concern on competition (or consumer choice) is unlikely to be material, again that cannot provide appropriate support for (in particular, *ex ante*) regulation. Such an assessment of materiality can only be undertaken via a proper assessment of the relevant conditions of competition – i.e. within the framework of a properly defined relevant market.

⁴ Ofcom has previously stated, in its Statement on the review of the cross-promotion rules, in relation to the use of s.316 CA03, that “the assessment of whether a course of conduct is likely to be prejudicial to fair and effective competition needs to be tempered by notion of materiality” (see paragraph 5.33).

- 2.8 It is apparent that Ofcom’s key concern is that Picnic’s launch will “*restrict or prevent the growth or entry of efficient competitors at the retail level*” (paragraph 3.50). Intervention cannot be justified by any competitive impact that Picnic has: rather, consistent with established competition law policy (and in line with its own past practice on the cross-promotion rules), Ofcom must show that (it is more likely than not that) the launch of Picnic will result in a material adverse effect on competition in the relevant market (i.e. on the process of competition generally, rather than on any particular competitor(s)). The fact that, in a case such as this, Ofcom’s assessment is “*dynamic and forward looking*” (paragraph 2.16) does not somehow excuse its analysis and evidence base from meeting these standards.

Bias against intervention

- 2.9 Further, given the availability of *ex post* powers and Ofcom’s “bias against intervention”, Ofcom must also demonstrate to the requisite standard that their use would not be possible or ineffective, thus justifying *ex ante* intervention. As noted in paragraph 1.10 above, this is particularly important in this case: Ofcom believes that any competition concerns at the retail level will materialise quickly, such that it argues that *ex post* enforcement would essentially be ineffective, being too slow. If Ofcom is, however, wrong in this regard, then its bias against intervention should lead it to place much greater reliance on its *ex post* powers (under the CA98 or broadcasting sectoral powers) than it is currently contemplating.⁵

Conclusion

- 2.10 Ofcom clearly recognises the importance of the standards referred to in this Section 2, as it accepts that the likely outcome of the impact of Picnic “*depends on the likelihood and magnitude of higher prices for consumers in the future due to reduced competitive pressure*” (in paragraph 4.9) – i.e. depends on its evidential and analytical base.

3 Deficiencies in Ofcom’s analysis

- 3.1 Despite Sky highlighting the inadequacies in Ofcom’s evidential basis in the first Picnic consultation document, the second consultation document is no better. Ofcom’s concerns continue to be based on assumptions and speculation, and its analysis still fails to meet the requisite standards set out in Section 2 above on any reasonable analysis. Its assessment of its different options is not supported by the evidential base required to justify the imposition of the proposed conditions.

- 3.2 This inadequacy in Ofcom’s evidence is highlighted by its inconsistent approach to analysis of different issues in the consultation document:

- 3.2.1 some concerns have specifically been dismissed by Ofcom on the basis of a lack of evidence - such as the lack of platform-specific preferences by consumers (paragraph 3.39), Sky’s influence over STB manufacturers (paragraph 3.104), or the impact of Sky’s February 2007 announcement (paragraph 3.109);

⁵ We address in paragraph 5.39 below Ofcom’s concerns about the inadequacies of its *ex post* powers set out in paragraph 4.16 of the Picnic consultation document.

- 3.2.2 in contrast, similar evidential caution is not expressed in relation to its approach to its content-related concerns, despite Ofcom’s language being in the form of “*Sky might emerge as the sole provider of pay TV services on DTT...*” (paragraph 3.16) “*unconditional consent to the Proposal may have a potential detrimental impact on competition*” (paragraph A6.32) and “*if Picnic were to become the largest provider of pay TV services on DTT...*” (paragraph A6.54) (emphases added);
- 3.2.3 likewise, the equivocation in the latter statements (“*might*”, “*if*”, “*may*”) can be contrasted with the much greater certainty that Ofcom is willing to express about the consumer benefits that Picnic “*will*” or “*would be likely to*” produce in the short to medium term (e.g. in paragraphs 3.30, A6.6), as well as recognising that the “*enhanced competition and choice [that Picnic would be likely to bring] is likely to benefit subscribers of existing pay TV providers*” (paragraph A6.25).
- 3.3 Ofcom’s assessment of the different options under consideration is, in its own words, “*stylised*” and only “*aimed at facilitating comparisons between different approaches rather than representing projections or forecasts of what we actually think will happen*” (paragraph 4.7). This appears to be aimed largely at assisting Ofcom in considering what regulation would, in its view, enable the introduction of the greatest level of consumer benefits, even if that was as a result of unduly intrusive, disproportionate, costly regulation that was not justified by evidence (paragraph 4.9). This is not the right approach, which is inappropriately focused on benefits, with insufficient regard being made to the regulatory burden and other detriments that would entail. Ofcom’s duties require it to intervene only to the minimum extent necessary to protect against likely harm, rather than imposing excessive, costly regulation to extract as many benefits as possible, without regard to detriments.

Impact Assessment

- 3.4 Sky welcomes the fact that Ofcom has, in this case, attempted to fulfil its duty to undertake a proper impact assessment of the options it is considering. That said, however, Ofcom’s impact assessment is subject to a number of significant flaws which fatally undermine the conclusion Ofcom reaches in that impact assessment. It is a good example of an analysis that, in an attempt to examine issues in an overly complex way, loses sight of the basic realities of the situation being assessed.
- 3.5 Ofcom’s own “Better Policy Making” guidelines indicate that “*the more substantial and wide-ranging the impact on stakeholders, the more comprehensive the Impact Assessment should be*”, and that “*it should be borne in mind ... that Ofcom’s bias against intervention means that a high standard of proof must be satisfied. In other words, there must be a clear case for regulation, and the prospective benefits must exceed the costs*”.⁶ As recently noted by the CAT in the *Vodafone* case, such assessments of the costs and benefits of its regulatory proposals must be able to withstand “*profound and rigorous scrutiny*”.⁷

⁶ Better Policy Making – Ofcom’s Approach to Impact Assessments (21 July 2005) paragraphs 5.1 and 5.16.

⁷ Paragraph 47 of *Vodafone Ltd vs. Office of Communications* [2008] CAT 22, judgment of CAT 18 September 2008.

- 3.6 In the present case, Ofcom recognises that the new Picnic service would deliver significant consumer benefits, a point with which we agree ⁸ (these are somewhat offset by the withdrawal of Sky's free to air channels from DTT households, but the net consumer benefits remain significant). In theory, such benefits would arise under both Options 1 and 2 and, accordingly, either should be preferred to Option 3 (maintaining the status quo), in which they do not arise.
- 3.7 Ofcom considers that the total benefits arising under Option 2 are greater than those under Option 1 due to competition being weaker in Option 1 than in Option 2. As a result, Ofcom concludes that Option 2 should be preferred to Option 1. This conclusion, however, is wholly untenable for the following reasons.
- (i) *Ofcom fails to recognise that in practice the outcomes under Option 2 and 3 are likely to be the same*
- 3.8 Sky's response to the second pay TV consultation document sets out in full its reasons for considering that the types of new regulation proposed by Ofcom – which comprise the key conditions that Ofcom proposes would be the *quid pro quo* for approval of the Picnic Application under Option 2 – are both unnecessary and disproportionate. The disproportionate nature of these proposals, in particular, means that there is a significant risk that, under the conditions proposed by Ofcom, Picnic would become an unattractive investment for Sky, and it would seek to apply its resources and expertise elsewhere. In this case, there is in practice no difference between Option 2 (conditional approval of the proposal), and Option 3 (an outright ban). Given that Ofcom appears to recognise that Option 1 is preferable to Option 3, the logical conclusion is that Option 1 should also be preferred to Option 2. Consumers would be significantly worse off under Option 2/3.
- 3.9 The points made below are without prejudice to the fundamental point that Option 1 is clearly the option that, of the three that Ofcom has identified, would result in the greatest benefit to consumers.
- (ii) *Extreme caution must be attached to consideration of the "long term" in this sector*
- 3.10 Ofcom's calculations in its impact assessment are based entirely on static analysis – the estimation of the areas of triangles under tidy (linear) demand curves, in markets in which demand and supply are assumed to be both stable and readily predictable. Such an approach to a sector in which constant and rapid change in services, technology and consumer demand are defining characteristics – as confirmed in numerous Ofcom statements to that effect – is highly likely to produce misleading if not wholly erroneous conclusions. To take but two examples relevant to the provision of DTT services:
- (i) eighteen months ago, it was inconceivable that high definition television services would be available via DTT – at least prior to analogue switch-off, and, under a pure auction approach to the allocation of digital dividend spectrum, potentially at all. Yet it is now a reality that such services will be available in the relatively near future; and

⁸ Ofcom should place a greater weight on consumer than producer benefits in this impact assessment for a number of reasons. Most importantly, it is reasonably certain that consumer benefits will be generated by the proposition. By contrast, there is no guarantee of producer benefits – and Sky considers that Ofcom's view of large returns to suppliers from provision of pay TV services to consumers via DTT is wholly speculative.

- (ii) the forthcoming auction of digital dividend spectrum itself gives rise to major uncertainty about the future course of outcomes in relation to DTT in the relatively near future. In the reasonably foreseeable future, there is a distinct prospect of significant new spectrum becoming available which could be used for new DTT-based pay TV services, or additional free to air television services. Indeed, the OFT referred to the auction of digital dividend spectrum as giving rise to the potential for an “*equilibrium shift*” in the UK television sector.⁹
- 3.11 Accordingly, given the rapidly changing market circumstances, an analysis that relies heavily on calculations of future static gains and losses to consumers should be treated with extreme caution.

(iii) *Ofcom’s reasons for preferring Option 2 to Option 1 are not well founded*

- 3.12 As noted above, Ofcom’s reasons for preferring Option 2 to Ofcom 1 depends on a belief that market outcomes would be better under Option 2 as a result of greater competition (in a relevant market). As discussed in Section 5, below, however, Ofcom has not undertaken sufficient analysis to enable it to support such a belief. Accordingly, notwithstanding the points above, Ofcom has no basis for concluding that Option 2 would deliver superior market outcomes to Option 1. Such an observation is significantly reinforced by the fact that, as in Ofcom’s second pay TV consultation document, it has had no regard at all to the costs associated with the regulation it has proposed, which are likely to be significant.

Misdirection as to general duties

- 3.13 These deficiencies in approach contribute to the fact that Ofcom’s analysis is very much (and erroneously) skewed towards perceived detriments of Sky being the “*sole*” (or “*main*”) retailer of the Core Premium channels, whilst significantly underplaying the benefit of those channels being made available at all via DTT. This mistaken approach is compounded by the insufficient evidence base supporting Ofcom’s perceived concerns of long term competition concerns, resulting in a wholly mistaken approach to the interpretation of its general duties.
- 3.14 In paragraph 4.3, Ofcom acknowledges that there is a potential conflict between its duties (notably s.3(1)(b) CA03 and s.3(4)(d) CA03); it has decided to resolve this conflict very much in favour of the promotion of competition, as justification for the imposition of new regulation on Sky aimed at supporting other pay TV retailers on DTT. In fact, to reflect the inadequacies of the evidence base on which Ofcom is seeking to rely, much greater regard should have been taken of Ofcom’s duties under sections 3(3)(a) and (b), and of the insufficiencies in the evidence base that Ofcom uses to support its preference for its duty under s. 3(1)(b).
- 3.15 Against this background, it is important to remember that the Picnic Application is simply a request to change the line-up of channels referred to in Sky’s DPS licence (and in Arqiva’s Mux C licence), not an application to become a pay TV retailer (for which there is no requirement for *ex ante* approval). Further, as Ofcom is separately

⁹ See paragraph 7 of the OFT’s report to the Secretary of State for Trade and Industry: *Acquisition by British Sky Broadcasting Group plc of a 17.9 per cent stake in ITV plc*, April 2007.

considering the wholesale-related issues under its pay TV review, this does not provide the only (or indeed an appropriate) opportunity for it to assess such concerns. Therefore, without a cogent supporting evidence base, there is a clear risk of discrimination against Sky, through making the launch of Sky’s new service subject to burdensome and unwarranted conditions.¹⁰

4 Concerns set out in Ofcom’s second consultation document

4.1 Ofcom has set out the concerns it considers are raised by Picnic in four broad categories:

- (i) Access to content;
- (ii) Sky as retailer of pay TV services;
- (iii) Technical platform services; and
- (iv) Other policy considerations.

4.2 Some of the concerns raised by Ofcom relate more generally to the issues on which it is consulting in its pay TV review – particularly in the Access to Content section of the second pay TV consultation document. Despite the fact that consideration of the Picnic Application and the pay TV review are capable of, and should receive, separate treatment, Ofcom’s linked approach means it makes no sense for us to respond to the two consultation documents entirely separately. As many of the issues raised, in particular, in the Access to Content section of the Picnic consultation document, reiterate arguments set out in the pay TV review (notably in relation to the wholesaling of content), it is appropriate for us to address those issues fully in our response to the second pay TV consultation document. We indicate where below.

5 Access to Content

5.1 In the Access to Content section of the consultation document, Ofcom’s overriding competition concern with Picnic does not actually relate to the changes specifically required to Sky’s DPS (and Arqiva’s Mux C) licence, but rather to the fact that Ofcom considers that:

“the Proposal, unchanged, would be likely to result in Sky becoming the sole or main retailer of pay TV services on DTT as a result of its market power in the wholesale markets for Core Premium channels”,

and that this:

“would diminish significantly the number of addressable consumers on the platform for other retailers, thereby restricting or preventing the growth or entry of efficient competitors at the retail level” (paragraph 3.50).¹¹

¹⁰ The enforcement route of s.316 CA03 raises similar concerns of discriminatory treatment. Please refer to Section 3 of our response to the pay TV consultation document for a full discussion of the application of this section.

¹¹ Ofcom states that it aims to encourage growth or entry of “*efficient competitors*” (emphasis added). As we note in Section 5 of our response to the pay TV consultation document, the effect of Ofcom’s proposed “extended retail-minus approach” would, in fact, be to force Sky to set its wholesale prices at levels that new and *less efficient* retailers could afford.

- 5.2 Consequently, Ofcom considers that it is “*unlikely that a third party retailer of pay TV services on DTT would be able to compete on equal terms with Sky’s Picnic service unless it could obtain the same Core Premium channels on a suitable wholesale basis*” (paragraph 3.55). Using its principal duty under s.3(1)(b) CA03 as support, Ofcom proposes to “*promote the wider availability of content and provide more scope for competitors to Picnic to develop alternative packages of services, providing greater choice for consumers*” (paragraph 4.10) which amounts to using its proposed new compulsory licensing regime to support (or even protect) alternative pay TV retailers. This approach very much reflects that being taken in the pay TV review, though in this case specifically tailored to DTT.
- 5.3 Even if such an outcome (hypothetically) may become a consequence of the launch of Picnic, as noted above in Section 2 of this response, such concerns should only be taken into account by Ofcom, as a basis for imposing conditions on Picnic’s launch, if its evidence-base meets the requisite standards, and supports the links being inferred by Ofcom between Sky’s alleged upstream market power and the assumed downstream effects. If not (as we consider is the case), then Ofcom’s decision would not be compatible with its general duties under s.3(3) CA03, exposing it to the risk of misdirecting itself in relation to its duties, and resolving any conflicts between its duties incorrectly.

Pay TV review

- 5.4 The main reasons provided by Ofcom (in paragraphs 3.30–3.49 of the Picnic consultation document) for the outcome referred to in paragraph 5.1 above relate to (i) the role of certain premium content in the take-up of pay TV services, (ii) Sky’s alleged market power in wholesale markets for the supply of premium content, and (iii) Sky’s alleged incentives to withhold supply of its premium channels from other retailers. Ofcom also considers that “*for at least the next few years*” Sky “*will continue to win the majority of live FAPL Rights and Movie Rights*”, so maintaining Sky’s alleged upstream market power (paragraph 3.60).
- 5.5 As Ofcom notes in the Picnic consultation document, these issues are all dealt with in detail in its second pay TV consultation document. Consequently, we refer Ofcom to our separate response to that consultation, where these allegations have been fully addressed.¹²
- 5.6 On the basis that Ofcom’s case in the second pay TV consultation document does not meet the required standards of analysis, that fundamentally undermines Ofcom’s position on Picnic, preventing Ofcom approving Picnic on any basis other than unconditionally.
- 5.7 The ensuing paragraphs of the Access to Content section (paragraphs 3.50 – 3.65) are distinct to the issues looked at in the pay TV review, and so are more appropriately addressed in this response.

¹² Such allegations cannot be considered in isolation from a proper consideration of the extent of competition of the relevant downstream market(s), which is discussed in Section 4 of our response to the pay TV consultation document. Our rebuttal of Ofcom’s allegations of Sky’s incentives to withhold supply of premium content is set out in Section 5 of that response.

“The impact on competition”

5.8 The specific concerns that Ofcom has with the launch of Picnic are summarised in paragraph 3.61: *“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 time frame”*. This statement sums up the three factors central to Ofcom’s content-related concerns with Picnic:

- Sky emerging as the *“sole or main”* pay TV retailer on DTT;
- A consequent adverse effect on competition; and
- Any such adverse effect being likely to materialise quickly.

5.9 However, Ofcom has failed to demonstrate that each of the above three factors is likely to occur to the relevant standard. The arguments set out in Section 4 of the consultation document essentially amount to assertion and hypothesis: the evidence and analysis provided (particularly in Annex 6) are insufficient or misguided, heavily based on assumptions (for which limited reasoning is given); much of the analysis that Ofcom has set out in Annex 6 is difficult to verify (and thus fully interrogate), given the absence of supporting data. It is therefore not possible to ascertain whether Ofcom’s concerns would be more likely than not to have a material adverse effect on competition, and so Ofcom lacks the support necessary to reconcile its analysis with its general duties and with the outcome set out in paragraph 3.50 of the Picnic consultation document (as referred to in paragraph 5.1 above).

Likely to emerge as the sole or main retailer of pay TV services on DTT

5.10 Ofcom sets out three main reasons in paragraphs 3.54 – 3.60 for why it considers Picnic is likely to emerge as the sole or main retailer of pay TV services on DTT, all of which duplicate Ofcom’s thinking in its pay TV review. We have refuted Ofcom’s concerns about Sky’s premium channels being the *“main driver for the take-up of pay TV services”* and established that Sky has incentives to restrict the supply of its premium channels in our separate response to that consultation (see, in particular, Parts 5 and 7), to which we accordingly refer Ofcom.

5.11 In relation to Sky becoming the *“sole or main”* pay TV retailer on DTT, Ofcom does not specify which of these alternatives it considers would occur, nor does it consider whether there is any difference between either state. *“Sole”* and *“main”* appear to be quite different states – the former being one where there is only one pay TV retailer on DTT, the latter being where one (out of a number of retailers) is significant. Further, Ofcom fails to explore whether either (or both) states is more likely than not to have a material adverse effect on competition.

5.12 Indeed, the terms *“sole”* and *“main”* (or even *“sole or main”*) are used interchangeably throughout the consultation document, without any consistency or explanation.¹³ Separately, Ofcom also frames this concern as a belief that *“Sky would, under current market conditions, be the **exclusive retailer** of the majority of the Core Premium channels on DTT”* (emphasis added) (paragraph 3.55) – yet another state which may have different connotations.

¹³ *“Sole”* appears in paragraphs 3.16, 3.28 and 4.44 (but not in Annex 6); *“main”* appears in paragraphs 1.8, 3.16, 3.31, 4.3, A6.32 and A6.38; *“sole or main”* appears in paragraphs 3.50, 3.53, 3.54, 3.60 and 3.61.

Consequent (material) adverse effect on competition

- 5.13 In order to gauge whether any of these states is more likely than not to give rise to a material adverse effect on competition, it is necessary for Ofcom to have undertaken a thorough analysis of competition at the retail level. Ofcom has, however, failed to do this – in either of the Picnic or the pay TV consultation documents, instead focussing on market definition at the wholesale level in both documents.¹⁴ Thus it is not clear how Ofcom can credibly use the hypothesis of Sky becoming the “sole” or “main” pay TV retailer on DTT as a basis for its “consequent” competition concerns, given the lack of assessment, within an appropriate frame of reference, as to whether it is more likely than not to have a material adverse effect on competition (and indeed whether links between the alleged upstream market power and downstream effects are proved to be sufficiently strong).
- 5.14 Ofcom acknowledges (in paragraphs 3.16, 3.45 and 3.52) that existing pay TV retailers on DTT already compete with (at least) other pay TV retailers on other platforms – Ofcom is very clear that it accepts competition between pay TV retailers takes place on a cross-platform basis. Notwithstanding this position, its concerns appear to come back to a need for it to promote competition specifically on DTT: it states that, without intervention, “*it is unlikely that a third party retailer of pay TV services on DTT would be able to compete on equal terms with Sky’s Picnic service*” (paragraph 3.55, emphasis added).
- 5.15 No explanation is provided of why, in such a cross-platform market, intra-platform competition on DTT is so important. Ofcom states that “*the critical stage in the development of pay TV on DTT provides an opportunity for a pay TV provider on DTT to emerge to compete with existing providers on satellite and cable*” (paragraph 1.8),¹⁵ but no attempt is made to reconcile this outcome with Ofcom’s principal duty to further the interests of consumers (and thus whether it is appropriate for Ofcom to intervene to promote such competition, especially in relation to a specific platform). Given Ofcom’s focus on DTT in what Ofcom admits is a cross-platform retail market, there is no discussion of whether it is appropriate to adopt a non-platform neutral approach of this nature.
- 5.16 It would also be reasonable to expect that Ofcom should pay greater regard to other factors including comparative content availability, consumer demand generally, likely switching behaviour, and contestability (or “addressability”) of consumers, which we discuss briefly below. Only following a thorough analysis of such issues could Ofcom reach an informed, evidence-based view on Picnic’s likely impact on competition. Ofcom has, however, not done this.

(i) *Content availability*

- 5.17 No proper consideration is made of the nature of the Picnic content line-up. Through reference to the pay TV review, Ofcom considers that the Core Premium channels

¹⁴ Sky’s responses to both pay TV consultation documents set out Sky’s views on the appropriate retail market definition, and the vibrant nature of competition on that market.

¹⁵ Ofcom also claims that the “*evolution of DTT is ... reaching a significant transition point*” (paragraph 1.7) and that this is (also) “*a critical stage in the development of DTT*” generally (paragraph 3.123), without any proper explanation why.

provide Sky with market power, and that they are so important that without them a retailer cannot compete effectively. (In the Picnic consultation document, Ofcom simply describes the Core Premium channels as “popular” (paragraph 3.62), or “some of the most attractive premium pay TV content” (paragraph A6.26).) Yet Ofcom does not substantiate this concern in the Picnic consultation document, or explain how its purported retail level concerns will consequently materialise.

- 5.18 Further, Ofcom’s assertions about market power are in stark contrast to previous statements it has made when considering the removal of the free to air only restrictions on Multiplexes B, C and D, where it considered that Sky’s premium channels were not sufficiently attractive to persuade significant numbers of DTT homes to replace their set top boxes with ones from Sky.¹⁶ Nor is any attempt made to reconcile these different positions, or explain what, in Ofcom’s view, has changed over the last 3 years to merit such a shift in position.
- 5.19 Nor does Ofcom consider, in relation to Picnic, whether the restricted line-up of the Core Premium channels on DTT affects that analysis (e.g. the fact that only 12 hours a day of one movie channel would be made available via Picnic), but rather simply relies on the analysis undertaken in its pay TV review.
- 5.20 In addition, no consideration is given to the availability of *Setanta Sports 1* to BT Vision and Top Up TV subscribers, and whether this impacts Ofcom’s analysis, even though Ofcom considers *Setanta Sports 1* to fall within the same relevant wholesale market as *Sky Sports 1* and *Sky Sports 2*.

(ii) *Consumer demand*

- 5.21 Limited account is seemingly taken of the projections that Sky provided to Ofcom about subscriber numbers for Picnic, which (in June 2007) indicated that Picnic expected to have around [CONFIDENTIAL], and how this fits with the requirements of materiality.
- 5.22 Nor has Ofcom generally considered the likely demand for pay TV services via DTT. The consultation document contains no explanation of how DTT viewers are currently underserved by pay TV services, or even considered whether they are already well served by existing TV services across all platforms (such that the promotion of pay TV on DTT is appropriate), particularly given the specific circumstances of DTT:
- its viewing being primarily driven by the popularity of Freeview (recognised in paragraph 1.7), aided by its extensive cross-promotion by the PSBs (reflected by their very high combined viewing share of over 90% - paragraph 3.147);
 - the multiplex licences were reissued in 2002, following the demise of ITV Digital, with the availability of FTA services on DTT very much being made a priority. In addition, it was only in 2006 that the restrictions on pay TV services were lifted from the licences for Muxes C & D – to which the Picnic Application was a direct response; and

¹⁶ See paragraph 2.28 of Ofcom’s consultation “Pay TV channels on multiplexes B, C and D: proposal to remove the ‘free to air only’ requirement” 27 October 2005.

- the fact that pay TV subscriber numbers on DTT are presently comparatively lower than on other platforms is not, of itself, informative; the context of the platform’s development clearly being relevant.
- 5.23 Nor is much, if any, account taken of actual or likely prices for reception equipment, content packages, contractual terms, and the corresponding impact that differences between providers will have on comparative rates of consumer demand for services from different providers.
- 5.24 In fact, Ofcom itself admits, in paragraph A6.36, that “*given the uncertainty about the development of pay TV services on DTT, it is virtually impossible to make any proper probabilistic assessment of the likelihood of there being a widespread consumer detriment in the longer term which we could use to calculate an expected value to this outcome*”.

(iii) *Switching from existing providers*

- 5.25 What is likely to happen to the existing pay TV retailers, particularly those on DTT (would they exit DTT, or the market as a whole and, if so, why?), and what is likely to happen to their customers, has also not been satisfactorily addressed. For example, in paragraph A6.17, Ofcom considers the possible detriment to subscribers of existing pay TV providers that exit the market – but, again, without any consideration of the likelihood of that happening. In fact, Ofcom admits, in paragraph A6.26, that “*the absence of actual information on consumer switching behaviour in response to the launch of Picnic means that it is difficult to attempt any quantification of the scale of any detriment to competitors*”.
- 5.26 The churn analysis that is set out in the consultation document does not provide adequate support for Ofcom’s concerns about impact on existing pay TV retailers on DTT; in Ofcom’s own words, this analysis amounts to assumption, rather than evidence. Ofcom considers that switching costs are sufficiently low so as to be unlikely to deter switching between (DTT) retailers (paragraph 3.63), and goes on to argue that:
- (a) “*potentially high rates of subscribers switching away to Picnic combined with lower levels of new subscribers are likely to threaten the economic viability of Sky’s competitors on DTT*” (paragraph 3.65);
 - (b) yet Ofcom reveals (in paragraph A6.26) that “*the absence of actual information on consumer switching behaviour in response to the launch of Picnic means that it is difficult to attempt any quantification of the scale of any detriment to competitors*”;
 - (c) Ofcom goes on to state that “*at this stage we assume that there will be some switching away from existing pay TV providers to Picnic services on the grounds that the Picnic service makes some of the most attractive premium pay TV content available to DTT households*” (emphasis added);
 - (d) but this assumption is clarified in paragraph A6.50 simply to be that “*as our starting point, we have assumed that around 50 per cent of subscribers to Picnic’s competitors on DTT switch across to the Picnic service relative to the situation without Picnic. However, we do not assume that Picnic’s competitors*

exit in the short term". No explanation is given why this 50% level was chosen, or the basis on which Ofcom is satisfied as to its accuracy.

- 5.27 In addition to this assumed churn rate of 50%, mention is also made, in paragraph A6.46, of an assumed "blended" churn rate of 12% (based on Sky and Virgin Media published rates, rather than of rates of pay TV retailers already available on DTT). Ofcom has not explained the relationship between these two rates. [CONFIDENTIAL] Thus it is not clear that Ofcom's assumptions have, in this regard, been properly tested.
- 5.28 In this regard, Ofcom does not appear to have taken into account the fact that Top Up TV, BT Vision and Setanta DTT subscribers have all, already, rejected the opportunity to use an alternative platform, each offering a range of different content choices, in favour of taking offerings available via DTT. In many respects, therefore, it cannot be assumed that existing DTT pay TV subscribers are inherently likely to switch.¹⁷

(iv) *Entry deterrence*

- 5.29 Ofcom also notes (in paragraph 3.57), that "*various companies are making decisions about their entry strategy on DTT*" suggesting that it views further, new entry (at least to DTT) as important. Yet no explanation is given of whether such entry is likely, why any such new entry would be sufficiently material to competition overall such that the consumer interest is best served by Ofcom intervening to promote such platform entry.¹⁸ Such questions would appear fundamental to the substantiation of Ofcom's concerns.
- 5.30 Given the requirements that Ofcom's analysis should be based on strong evidence, it has not been able to demonstrate that its concerns about the impact of Picnic on retail competition are anything other than based on assumption; it is clear that Ofcom's analysis has not met the standard that such concerns are more likely than not to result in a material adverse effect on competition.

(v) *Addressable consumers*

- 5.31 Despite asserting a concern in paragraph 3.50 that Sky's alleged wholesale market power "*would diminish significantly the number of addressable consumers on the platform for other retailers*", Ofcom has not explained why it considers the "*addressable*" base of consumers would diminish (rather than remain constant, which would in fact be the case), or how this outcome could be expected to arise and so why, in a cross-platform retail market, the protection of fair and effective competition would require the promotion of intra-platform competition.

Likely to occur over a relatively short time frame

- 5.32 Given Ofcom's stated bias against intervention, the case for intervention in Picnic on an *ex ante* basis can only be made if there are compelling reasons why *ex post* intervention

¹⁷ A view seemingly confirmed by Dan Marks, Chief Executive of BT Vision, who was recently reported as being "*adamant that pay TV does not begin and end with football*" (Daily Telegraph, 6 January 2009).

¹⁸ Ofcom refers, in paragraph 3.57, in the context of considering various companies' entry strategies on DTT, to Sky's wholesaling incentives and, in paragraph 3.58, to the reasons for the outcome of specific wholesaling negotiations. We comment on both these issues fully in our response to the pay TV consultation document, rather than in this response, but again consider that Ofcom's analysis in this regard does not provide it with support for its assertions.

would be insufficient to protect against any clearly identified consumer harm occurring. Ofcom argues that the adverse effects on competition that it considers will materialise will do so over a “*relatively short timeframe*” (paragraph 3.61) such that *ex post* intervention would be too slow and so ineffective. In paragraph 4.16, Ofcom explains:

*“in our view there may be a risk that damage to the market would occur during that period [before the CA98 could be invoked] because potential new retailers will not be able to take advantage of technological changes to enter the market”.*¹⁹

- 5.33 As noted in paragraph 1.10 above, this is a particularly key part of Ofcom’s case for *ex ante* regulation – without the evidenced support of such arguments, Ofcom’s justification for *ex ante* intervention in relation to Picnic would be fundamentally undermined.
- 5.34 The reasons advanced for such concerns are that as Sky’s content will be “*popular*”, that “*a significant number subscribers to BT Vision, Setanta and Top Up TV would switch away from those services to Picnic*” (paragraph 3.63), and consequently that “*Sky’s retail competitors on DTT would be less likely to attract new subscribers to their services*” (paragraph 3.64), thus “*threatening the economic viability of Sky’s competitors on DTT*” (paragraph 3.65). Ofcom considers that this “*might occur within a very short period (possibly a matter of months)*” (paragraph 4.16).
- 5.35 As outlined in paragraphs 5.13 – 5.31 above, these assertions as to effect on competition are not supported by evidence: no meaningful assessment appears to have been undertaken of factors such as comparative growth and churn rates of alternate pay TV retailers, or of comparative prices and packages of content. Ofcom’s assertion over the rapid demise of other pay TV retailers is stated as “*mainly*” relating to Sky’s content being considered “*popular*” (paragraph 3.62). No substantiation is made of its belief that this could take place within “*a matter of months*”. Again, such analysis falls well short of the level required to justify *ex ante* intervention – no attempt has been made to explain how such an outcome is “*more likely than not*” to happen (so quickly), nor how that outcome will materially adversely affect competition as a whole (as opposed to any particular competitor).
- 5.36 As with the inadequacies in Ofcom’s substantive competition analysis, it appears that no assessment has been undertaken of such factors specifically when considering the speed of take-up of Picnic or switching away from other pay TV retailers:
- no assessment has been made of the impact that Picnic’s comparatively limited offering will have on the speed of take-up of Picnic and churn from third party pay TV retailers; nor is any consideration given specifically to demands of DTT viewers, including the availability of Setanta content from existing retailers, and the very high levels of viewing of PSB/sister channels on DTT;
 - Ofcom also makes reference (in footnote 34) to the other channels that will comprise the line up of Picnic channels, *Sky One*, *Discovery* and *Disney*. Yet even Ofcom does not argue that any market power can be attributed to these basic channels (at the wholesale level).

¹⁹ It is not clear what specific “*technological changes*” Ofcom has in mind here.

- 5.37 Overall, the assessment of the need to intervene on an *ex ante* basis due to timing concerns falls well short of the level of standard required. One would reasonably expect this could only be done as part of a full assessment of the likely impact on competition at the retail level; assertions of “popular[ity]” are clearly insufficient. But to do so would create a problem for Ofcom: even based on Ofcom’s (unduly narrow) definition of an cross-platform retail market for pay TV alone, in light of Sky’s subscriber projections for Picnic, its launch could not be considered to have a material effect on competition, given that there are more than 13 million pay TV homes in the UK, across all platforms. On that basis alone, *ex ante* intervention cannot be justified.
- 5.38 It has therefore not been adequately demonstrated that any (material adverse) impact that the launch of Picnic may have on competition generally is more likely than not to be too quick to be dealt with under the CA98, or even using Ofcom’s sectoral competition powers on an *ex post* basis.

Rejection of ex post powers

- 5.39 In paragraph 4.16, Ofcom sets out a number of reasons why it rejects use of its *ex post* powers. It considers use of its sectoral powers on an *ex ante* basis “*more suited*” to dealing with its competition concerns. Yet, the reasons provided only arise as a result of the deficiencies in the analysis that Ofcom has undertaken in this review. Taking each bullet point under paragraph 4.16 in turn:
- **First bullet:** Ofcom considers that its powers under CA98 would not be able to address the “*negative impact on competition and consumers that we have identified*”. As noted above, Ofcom’s analysis fails to meet the requisite standards of likelihood, and materiality; an argument that the CA98 is unable to address purported concerns is therefore not tenable. Further, Ofcom appears to consider that, were it to want to act on an *ex post* basis, only its powers under the CA98 would be at its disposal. This is not the case: there is no reason why, in principle, it could not seek to use its sectoral competition powers under s.316 CA03 to ensure fair and effective competition subsequent to Picnic’s launch, were that to be appropriate;
 - **Second bullet:** Ofcom rightly states that the CA98 can only address infringements of competition law, but its concerns rest with the need for the “*creation of incentives for expansion and entry*”. (We explain in Section 3 of our response to the second pay TV consultation document that s.316 CA03 does not allow the promotion of competition, in the way contemplated by Ofcom.) In any case, Ofcom has not demonstrated that the launch of Picnic is more likely than not to result in some detriment to consumers (through a material adverse effect on competition) such that it would be appropriate for it to invoke its principal duty under s.3(1)(b) CA03 to promote competition;
 - **Third bullet:** Ofcom identifies various perceived deficiencies with the remedies available under CA98. Yet, as noted in the first bullet point above, it pays no consideration to the ability to use its sectoral competition powers once Picnic has launched;

- **Fourth bullet:** as noted in paragraph 5.32 – 5.38 above, Ofcom has not adequately explained why it considers any competition problem is more likely than not to occur “*within a very short period*”.

Conclusion on Access to Content section

- 5.40 By considering pay TV services (particularly on DTT) in a hermetically sealed bubble, rather than recognising that UK consumers are already very well served by a wide range of pay and FTA TV services, Ofcom’s inadequate analysis has led it to resolve any potential conflict between its general duties incorrectly. It underplays the fact that Picnic would bring new impetus to competition (recognised in paragraph A6.17), and effectively ignores the fact that, to the extent that it is able to demonstrate that there would be material competition concerns derived from any wholesale market power, its “*separate*” pay TV review is designed to examine such issues, and is the appropriate place to do so, rather than using the “convenience” of the Picnic Application.
- 5.41 Ofcom’s case about Picnic’s effect at the retail level falls far short of that required to impose any regulatory remedy on an *ex ante* basis; in light of its evidence base and impact assessment, a proper assessment of its general duties cannot reasonably lead Ofcom to conclude that “*Option 2 is most likely to satisfy our regulatory duties*” (paragraph 4.12). Ofcom has a stated “*bias against intervention*” and a regulatory duty only to intervene in cases where action is needed. As Ofcom itself notes, s.317 CA03 also requires Ofcom to consider whether or not it is more appropriate for it to use its powers under CA98 rather than its Broadcasting Act powers for a competition purpose. It would not be appropriate for Ofcom to reach such a decision based on evidence that falls far short of the standard required and would make Ofcom prone to allegations of a manifest legal error. This is the case here: Ofcom has not articulated sufficiently that a material impact on the competitive process is more likely than not to arise as a result of the launch of Picnic; therefore it is unable to reach a properly informed view of the inappropriateness of relying on use of *ex post* enforcement powers.

6. Sky as a retailer of pay TV services on DTT

- 6.1 Ofcom sets out a number of concerns that may be raised as a result of Sky being a retailer of pay TV services on DTT. In all cases, Ofcom accepts that, having assessed “*whether the issues ... would be likely to lead to an adverse effect on competition and/or consumers*” (paragraph 3.82), no *ex ante* intervention is required, as that would be consistent with its duty under section 3(3) CA03 to act proportionately and only in cases in which action is needed. Sky agrees that this is an appropriate approach.
- 6.2 It is also notable that, even though the concerns raised in this section are competition-related, Ofcom considers that it would be appropriate for it to rely on its *ex post* powers under the CA98, were it to consider that any action is required, in contrast to its proposed approach in relation to access to content.
- 6.3 Ofcom will, no doubt, seek to distinguish between the concerns raised in these two sections as justification for the differential approach to the use of *ex ante* and *ex post* powers. A key difference in this regard would appear to be the Ofcom’s belief that prompt action is required in relation to its content-related competition concerns, in contrast to an ability to wait and see whether enforcement under CA98 is merited in

relation to concerns about Sky being a pay TV retailer on DTT. As noted above, the evidence that Ofcom advances in support of the need for *ex ante* intervention falls far short of that required on any reasonable analysis. Without the justification of needing to act promptly, it appears difficult to reconcile Ofcom's approach to *ex ante* regulation in this consultation with its duty to act both proportionately and consistently.

- 6.4 It is also worth noting, specifically in relation to the concerns raised about STB retailers, that Ofcom indicates that its concerns would be addressed by its proposed new compulsory licensing obligations being imposed on Sky. This clearly demonstrates that Ofcom's thinking behind this consultation is very much predicated on such a remedy being in place. No consideration is apparently given to alternative, more proportionate options, that could address any such concerns. Nor has Ofcom given any indication of the materiality of any adverse effect on competition that any such concern would need to have before it considered such action was merited. Without such an indication of materiality, it is impossible to assess whether Ofcom's proposal to impose compulsory licensing obligations on Sky would be an appropriate, proportionate approach to such concerns, or whether a less interventionist solution would be more consistent with Ofcom's duties.

7. Technical Platform Services

- 7.1 In this section of the consultation document, Ofcom raises some concerns about Sky becoming the sole provider of platform services on DTT. Despite noting (in paragraph 3.126) that Picnic would launch at a disadvantage, compared to existing pay TV retailers on DTT, by not having a pre-existing installed base of compatible STBs, Ofcom considers the imposition of compulsory licensing obligations on Sky would remedy any concerns about Sky "*gain[ing] control over DTT in respect of wholesale provision of TPS, simply as a result of its unique market position in other parts of the supply chain*" (paragraph 3.123).
- 7.2 This represents another instance of Ofcom's analysis being predicated on the imposition of compulsory licensing obligations on Sky, rather than considering whether an alternate, less interventionist approach would be more proportionate to the identified concern (which again has not been demonstrated to the required standards).
- 7.3 It is worth reminding Ofcom that Sky has already indicated that it would be willing to provide broadcasters with CA services for the Picnic population of STBs, in circumstances where similar rights of access are available to other DTT platforms. Such an approach in itself would appear to represent an appropriate, and more proportionate, means of addressing Ofcom's platform services-related concerns. Sky would also be willing to enter into simulcrypt arrangements, though subject to any broadcaster's security concerns being satisfactorily addressed by the CA provider in question. Sky welcomes Ofcom's acknowledgement that these concerns are "*genuine*" (paragraph 4.38).
- 7.4 Even if Ofcom does not consider that such commitments would be sufficient to address its concerns, it would seem appropriate and more proportionate (and consistent with its approach to the launch of the Top Up TV and BT Vision DTT platforms) for Ofcom not to impose any platform service-related conditions on Picnic, but rather to consider them in the context of its wholesale digital television broadcasting platforms market review,

which would seem capable of being conducted “*separately*”, yet “*in parallel*” to its Picnic, and pay TV, reviews.

8. Other policy considerations

- 8.1 Sky considers that the approach that Ofcom has taken in this section is appropriate, the restraint that it exercises (for example, in paragraph 3.152, concerning DTVSL) admirable, and agrees with Ofcom’s conclusions that no specific regulation is required to address any of the concerns raised.
- 8.2 In paragraphs 4.56 – 4.62, Ofcom sets out its thinking on transmission and compression technologies. At this stage, Sky reserves its position on these issues, in light of the fact that the Picnic Application does not formally make any request to alter the transmission or compression technology that it would like to use on DTT. Nonetheless, we disagree with Ofcom’s statement (in paragraph 4.58) that changes to MPEG-4 and DVB-T would raise “*material risks*”, particularly in relation to DSO.²⁰ Pay TV retailers are inherently incentivised to ensure that any consumer confusion is minimised and, as Ofcom acknowledges in paragraph 4.58, flexibility is likely to encourage more efficient and quicker adoption of these technologies.

9. Provisional conclusions and ancillary remedies

- 9.1 Ofcom has provisionally concluded that it would be justified in imposing compulsory licensing obligations on Sky, accompanied by a simulcrypt requirement, and ancillary conditions (in paragraph 4.50) to “*focus on delivering our intended outcome for competition and consumers rather than attempt to address a wide range of potential behaviours*” (paragraph 4.47). Although dressed up as part of any approval for Picnic, the possible ancillary conditions include the potential to prevent the launch of Picnic until at least one third party retailer has started to retail Sky channels (potentially needing to reach a certain level of subscriber numbers too).
- 9.2 We do not propose to comment on these conditions in detail, given that the analysis that underpins them falls far short of that required to justify their introduction. Accordingly we reserve our position in this regard. However, we note that the ancillary conditions contemplated are Draconian, in that they would act to prevent making Sky’s channels as widely available as possible on DTT for at least a (as yet undetermined) length of time. Notwithstanding the inadequacies of its evidence base, it is difficult to see how Ofcom could ever reconcile such an outcome with its duties.
- 9.3 Accordingly, we do not consider Ofcom has built a sufficient evidence base, over the course of the last 21 months, to justify doing anything other than implementing its Option 1, and approving the Picnic Application without condition.

Sky

January 2009

²⁰ In fact, Ofcom’s approach to the reorganisation of Mux B capacity is likely to pose a greater “*material risk*”.