ALMR

The Association of Licensed Multiple Retailers *(ALMR)* welcomes the opportunity to comment on OFCOM's consultation document setting out its preliminary views on the pay TV market. These initial conclusions were broadly drafted before the *ALMR* had submitted detailed evidence on the market as it relates to commercial subscribers, and many of the points raised within it are covered in the reports presented to OFCOM in December 2007 and January 2008. We have therefore restricted our comments to any additional points arising. This submission builds on our earlier work and should be read in that context.

1. Do you agree with the criteria against which we propose to assess the functioning of the pay TV sector?

Whilst the *ALMR* is broadly in agreement with the criteria against which OFCOM is proposing to assess the functioning of the market – choice of platform and content, price and innovation – we believe that it will be important to assess separately the interests of domestic and commercial customers. That is not to say that the criteria against which each customer base should be assessed should be different, but rather that the priority accorded to them will be different. Whilst considerations about switching and availability of a broad range of content are clearly pertinent to domestic retail customers, commercial retail customers are only interested in premium sports broadcasting. They presently have no choice of platform and limited choice of content, the main focus of concern for them is therefore price and terms of supply.

We believe it will be vital on each consumer related issue – choice, price, value for money and quality of service - for OFCOM to undertake separate analysis of the domestic and commercial retail customer base. We are in the process of collating the views of commercial customers on these and other issues and will present the findings of this research to OFCOM shortly.

2. Does our overview of the pay TV market fairly reflect the key developments within this market?

Whilst the overview reflects broad developments within the market for pay-tv services in the UK, it does not reflect the specific nuances in respect of supply to commercial customers. These were covered in more detail in our original submission but broadly relate to the decision by cable suppliers to discontinue services to commercial customers because the terms on which BSkyB wholesaled sports broadcasting made their service uneconomic.

It is important that these developments are reflected in any overview of the market, both because they are symptomatic of the structural problems in the market place and also because they help to explain the continuing strong growth in satellite subscribers as compared to cable customers. As the majority of commercial subscribers are only interested in premium sports

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broadcasting, Sky has been able to exploit its position in the market to effectively drive out competition at a commercial retail level.

As a starting point, we believe that OFCOM's analysis of subscriber numbers (para 3.9) should be split between domestic and commercial retail. We have provided information on the historical market for commercial subscribers, the number of total subscribers and the percentage split between cable and satellite in our initial submission to OFCOM and 2003 submission to the OFT. This demonstrated that in 2001 17% of *ALMR* members who subscribed to pay TV used a cable provider but by 2003 that figure had dropped to 9.5% and in 2007, no alternative providers were used.

3. Do you agree with our analytic framework for the pay TV value chain? If not, why not?

We are in agreement with the analytic framework for the pay TV value chain, but believe that the strategic and financial importance of the commercial retail market is under-played within it.

Around half of UK pubs and bars are commercial subscribers and the average Sky subscription for the current year is £8,700 per outlet. A conservative estimate of the revenue generated by these subscriptions would therefore be between £260-300 million per annum. However, given that the largest premises would pay over £30,000 per annum and the majority of *ALMR* members report an £11,000 subscription, a more realistic figure would be between £330-385 million per annum from pubs and bars alone. Members and other working mens' clubs would boost this revenue stream further.

To put these figures into context, in August 2006, Sky agreed to pay £433 million per annum for Premier League football rights. These figures justify the assertion made by the Guardian at the time that "BSkyB recoups its whole outlay for the Premiership TV rights solely from this [commercial] market".

Looking at it a different way, a recent analysts report suggested that Mitchells & Butler's reported pre-tax loss of £391 million (£267 million post tax) was equivalent to 2 years' turnover from its 2000 managed outlets. It is also 0.025% of GDP.

4. Are there any additional comments or evidence which you wish to provide?

Paragraph 3.61 refers to the role of content in decisions to subscribe to pay tv. As with other consumer research in the document, this appears to relate to the views of domestic subscribers rather than all customers. We believe that there would be merit in asking the same questions of commercial customers, and we are in the process of collating this. Where possible we will replicate the research questions used by OFCOM for figures 12, 13 and 16 and assess consumer satisfaction levels.

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In 2003, the *ALMR* carried out a survey of members looking at the reasons behind satellite subscriptions. A full copy of the results is attached as an appendix, but in summary 62% of members said that their primary motivation for subscribing initially was the need to provide comprehensive sports coverage. Other reasons cited include the need to respond to competitors providing a similar service, customer demand and the desire to provide entertainment.

Content is also important to a pubs' customers. 86% of operators said live sports was the prime reason customers visited those premises. Half said between 15-30% of customers would go elsewhere if a pub could not show a popular match.

5. Do you agree with the views we have expressed as to the level of platform and content choice available?

Because this preliminary analysis does not deal separately with domestic and commercial retail subscribers, it does not adequately reflect the level of platform and content choice available to the former. Paragraph 4.14 states that Sky's premium content is available on Virgin Media's cable platform. Paragraph 4.24 states that just under 50% of consumers have a choice of digital platforms.

This is not the case for commercial customers. Whilst theoretically there is a choice of broadcast platforms for all pay tv services, in reality there is no choice available to pub and club subscribers. For this segment of the market, premium sports are exclusively available through one platform and one provider. We note that in contrast, largely due to regulatory intervention, in the US all major sporting events are available through a wide range of platforms.

There is no choice of platform available to commercial subscribers because of BSkyB's policy on wholesale pricing for commercial services – and in particular premium sports broadcasting - to competing platforms. Sub-economic pricing has seen the exit of cable competitors from the commercial market. Moreover, Setanta Sports is only available to commercial subscribers as a buy-through from Sky's basic tier service. We believe that this is only the case for commercial subscribers, but the pub and club agreement makes clear that sourcing Setanta via another route will be in breach of the contract.

Content choice is less of an issue for commercial subscribers. For pubs and clubs, the only reason to subscribe is access to premium sports broadcasting, the range of other channels available is largely irrelevant to their decision. The key point here is the availability at a wholesale rather than retail level of a choice of premium content.

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6. **Do you agree with our analysis of innovation levels in UK pay TV? Do you agree with our assessment of what has driven innovation in the past, and what will drive it in the future?**

Again, the analysis refers almost exclusively to innovations of interest and value to domestic retail consumers rather than commercial ones. The main drivers in the market at present appear to be DVRs and VOD services as well as interactivity. Neither of these are of particular value to a commercial subscriber. The development of HD services and PPV are of far greater importance – the former as a means of differentiating oneself from the competition and the latter as a means of tailoring your purchase to your needs. However, HD requires significant additional investment in hardware and BSkyB shows no sign of providing access to HD services at a wholesale level. Equally, we see no appetite at a wholesale or retail level to offer PPV for premium sporting events.

7. **Do you agree with our analysis of pricing structures in UK pay TV? Do current pricing structures act in the aggregate interests of consumers?**

Before considering OFCOM's analysis of pricing structures, we would like to clarify that Setanta's premium sports service is not available on a stand-alone basis to commercial customers. It is only available as a buy through from the basic Sky service.

The summary of pricing structures of the main retail packages does not include any analysis of commercial pricing and services. Details of these have been provided in our original submission. We have tried to access information about the cost of commercial subscriptions in other European countries, but have not been able to ascertain these precisely. As far as we understand it, a pub or club wishing to subscribe to a pay tv service for premium sports broadcasting, would pay an equivalent amount to a domestic retail subscriber. If this is indeed the case, then the average revenue per subscriber would be far higher in the UK than in any other country for satellite services. We believe that this is largely as a result of the absence of any competition in the commercial market.

8. **Do you agree with our assessment that there is currently insufficient evidence to support a conclusion that prices in the UK are excessive?**

We do not agree with this initial assessment. We believe that there would be merit in exploring this further and in particular in respect of the commercial retail market where prices are significantly higher. We refer to the evidence provided in our original submission to OFCOM and the 2003 submission to the OFT which suggests that prices for commercial customers are higher than they would otherwise be in a truly competitive market. The *ALMR* believes that they already exceed a competitive level and that BSkyB is extracting greater value from its customers as a result.

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9. Do you agree with our initial assessment that there is not convincing evidence to support the claim that the industry is earning excessive profits? Is there evidence to support the suggestion that Sky is pursuing objectives other than short term profitability?

The *ALMR* is not able to make a direct comparison between the prices charged and BSkyB's cost structure in order to determine whether the industry is earning excessive profits. We note, however, that recent investment by BSkyB has been in developing its multi-product services rather than pay tv per se, and that operating margin has held up well in the pay tv market. Pay TV generates 91% of the company's revenue and retail subscriptions are £82.5% of that amount. Moreover, programming costs both as an absolute headline figure and as a percentage of expenditure have declined significantly since 2005

We also refer to the evidence collated by the *ALMR* and presented to the OFT in 2003. Section 3 of this report argues that with Sky having now recouped the cost of its investment in digital, with no additional significant capital expenditure planned and having agreed to pay a reduced amount for increased match coverage and enhanced internet and reselling rights[1] for the period 2005-2007, the relationship between prices and costs is becoming less strong.

In fact, there is evidence to suggest that the cost to BSkyB of supplying its service had fallen across the board in real terms At the same time, prices have gone up significantly and are credited with dramatically improving the revenue per user. BSkyB announced record ARPU of £421 at its interim results presentation for the 6 months ending December 2007. It went on to say that increases in TV pricing and a reduction in the level of viewing package discounts had helped the company to squeeze more value out of its retail subscriptions.

Taking into account the fact that Sky faces almost no competition for subscribers and controls two of the key drivers to the market, it is clear that the company operates on a very low risk market. This has been reflected in pricing decisions in the domestic sector, but the commercial retail sector has seen successive swingeing price increases imposed year on year. There appears little direct relationship between Sky's costs and prices charged to commercial retail customers. Full details of this are provided in our initial submission to OFCOM.

10. Are there any other comments or evidence which you wish to provide?

We believe there is evidence to suggest that BSkyB has pursued a commercial strategy designed to deliver a strong and unassailable position in

[1] *Goldman Sachs 14 August 2003 – the contract for 2002-2004 was £1212 million and that for 2005-07 was £1024 million*

the market at the expense of short term profitability. The recent interim results statement concluded that Sky had now grown from a scratch start up to Europe's most valuable Pay TV company, reaching 1 in 3 households. The company has clearly pursued a strategy designed to develop, sustain and enhance this strong market position.

The OFT noted in its 1996 inquiry that BSkyB's unfettered ability to increase retail and wholesale prices was one reason why it could afford to outbid all rivals for broadcasting rights without fear of price competition at a retail level. Sky's investment in high quality programming and sports rights in particular, is explicitly designed to reinforce its position in the market and to prevent other operators achieving sufficient content to become real competitor. There is considerable anecdotal evidence that Sky will seek to outbid rivals for sports events in which it has no real commercial interest, purely to ensure that it remains viewed as the home of live premium sports broadcasting.

Commenting on the 2001 OnDigital football package, Sky stated that it would retain its ability to choose the most attractive games ahead of any broadcaster and ensure that these are the ones drawing the biggest pub audiences. The company has clearly been willing to invest heavily in high quality content – even sacrificing operating profit and strong shareholder returns in order to maintain exclusive control over key content. This has been used to drive retail subscriptions, which in turn give it a strong base to continue to outbid rivals. The effects of this are clear in the company's interim trading statement for 2007/08. In December 2007, the company reported a 12% increase in sports broadcasting costs and a lower pay tv operating margin as a result of this and the disagreement between it and cable companies. Yet retail subscriber revenue increased by 13% to more than cover this and because the company controlled key content, churn was lower.

We believe that BSkyB has used its strong subscriber base and willingness to report lower operating profits in order to invest in high quality content. It has sought to develop a comprehensive sports offering and attracted subscribers through initial low prices and discounts. It has then used it pricing structure to price competitors out of the market, resulting in effect on captive customers. A simple analysis of profitability is not of itself sufficient to determine that market position has not been abused. Nor should it be taken as indicating that there are no structural or competition problems within the market.

Previous inquiries have concluded that the possession of exclusive rights is the main driver of subscriptions to pay TV and had enabled BSkyB to establish themselves in, and profit from, the retail market.

11. What is your view on our approach to defining markets

The *ALMR* supports OFCOM's approach to defining markets and in particular the adoption of a broad analytical framework to consider the market as a whole. We believe the analysis to be robust and reliable.

12. **Do you agree with our definitions of premium content markets?**

The *ALMR* agrees with the preliminary conclusion that there are separate retail and wholesale markets for the supply of premium sport and movie content. In respect of the retail market, we believe that the retail supply of channels containing sports content is no wider than content that is unique to pay TV. In light of the differences between them, we believe that the retail market can be further divided between supply to commercial premises and domestic subscribers.

Our 2003 submission to the OFT provides further information on the market, demand and supply side substitutability. This argues that those businesses subscribing to pay TV services clearly saw sports broadcasting and pay-to-view TV generally as a driver of business and customer footfall. Just under 80% said that other forms of pub entertainment were not a substitute for those services.

We note the suggestion that the market for premium sports channels should include both Sky Sports and Setanta. We would remind OFCOM that in the commercial retail market these are not separate channels and that there is only one retail provider. Setanta is only available as a buy-through from Sky Sports and is not available as a stand alone alternative – unlike for domestic retail customers.

13. **Do you agree with our preliminary conclusions on basic/free to air markets?**

We agree with the conclusions on basic/free to air markets. Given that there is no close substitute for live Premier League Football, basic/free to air services provide no constraint on premium pay tv providers.

14. **Do you agree with our assessment of market power?**

We agree with the assessment of market power but believe it would be helpful for the analysis of markets and market power to deal separately with commercial and domestic retail subscribers.

It is clear from only a cursory assessment of the market that BSkyB enjoys a position of considerable market power at a retail and wholesale level. At a commercial retail level, it is a monopoly provider. BSkyB's dominant position is further reinforced by the total absence of buyer power in the market. In contrast to all other major suppliers to the pub trade, BSkyB refuses to negotiate at a group level and in effect contracts with an individual outlet. This means that even major purchasers exercise no constraint over its ability to set prices.

15. **Have we identified the correct set of intrinsic market characteristics? Are there any that you would add?**

In respect of the commercial retail market, we believe that the availability of substitutable products and alternative suppliers is a key feature not adequately reflected in OFCOM's analysis. For commercial subscribers, the product they are purchasing is live Premiership Football, for which, it is acknowledged, there is no substitute. The absence of a directly substitutable or competing product is a further barrier to switching.

Questions about switching between retail service provider and platforms are therefore only relevant to domestic retail subscribers. The analysis in paragraphs 5.103-5.113 needs to reflect the unique position within which commercial retail subscribers find themselves. There is no alternative platform or retail provider available and the choice is therefore between subscribing to BSkyB and not subscribing to pay tv services at all.

It is also worth noting in this context that BSkyB's contract terms for multiple operators make it very difficult for them to exercise their right to cancel their subscription. Further information about this is provided in our original submission to OFCOM and 2003 submission to the OFT.

16. Have we correctly captured the role of vertical integration?

The vertically integrated nature of BSkyB's businesses and their control over the exclusive broadcasting rights reinforced their dominance in the market for the supply of such channels and gives it considerable independence in setting prices.

There is little dispute over the conclusion that BSkyB's vertically integrated nature has resulted in it becoming the gatekeeper for key content in the market. Experience in the commercial sector suggests that it has used this to directly and indirectly restrict competitors' access to key content – either by refusing to supply or supplying on sub-economic terms.

BSkyB's dominance on the wholesale market enables to do business on very favourable terms in the related retail market and supply to commercial premises. The wholesale market is defined and driven by the demands of retail consumers, be they domestic or commercial. Indeed, the product is exactly the same in both markets. BSkyB provides exactly the same product at a wholesale level as it does to its own retail customers. BSkyB's complete monopoly in the wholesale supply of premium pay TV sports channels is also relevant to any assessment of intrinsic links between the two markets.

17. Do you agree with our assessment of the effects of content aggregation on retail competition?

Whilst the analysis of content aggregation on retail competition may be relevant to the domestic retail market, it does not accurately reflect the needs and drivers of commercial retail subscription. Here there are a few specific

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items of content which are highly valued by large numbers of consumers – namely live Premier League Football – and a large amount of other premium content which will be highly valued by small groups of customers.

However, we agree with the suggestion that content aggregation can be used as a means of monopolising certain categories of content, and believe this to be the case in respect of premium sports broadcasting to commercial customers. In the case of an established operator such as BSkyB, it allows it extract significantly more value out of marginal content than other operators would be able to.

For example, the agreement between Sky and Setanta to aggregate their content for commercial subscribers has clearly reduced the potential for competition in this lucrative market. It has also allowed BSkyB to further increase prices for its basic and buy through services, above a competitive level.

18. Do you agree with our summary of the possible issues relating to the short-run operation of the market?

The illustrations provided at 6.27 accurately capture what has in fact occurred in respect of the pay tv market supplying commercial premises. At a wholesale level, BSkyB has favoured its own retail arm – by restricting access to premium content both directly and indirectly by means of pricing policy - in order to build a strong commercial retail subscriber base, which it has then exploited to eliminate competitors at a retail, wholesale and broadcast level. Whilst Sky has made its premium content available to other platforms, it has done so on terms which mean that it is uneconomic for competing platforms to provide a commercial service. As Sky has been able to control both the retail and the wholesale price, it has been able to determine its competitors' margins. Moreover, it has also supplied reduced quality services eg HD.

We also agree with the preliminary conclusion that buy-throughs can have an exclusionary effect. This is clearly the case in respect of the agreement with Setanta as it is prevented a potential competitor establishing a relationship with commercial subscribers, reinforced Sky’s position as the only source of premium sports broadcasting. We readily acknowledge that stand-alone content in this instance may not deliver benefits to subscribers, but that does not negate the fact that the effect of the agreement is to restrict competition and prevent competition emerging in the future.

19. Do you share our possible concerns over the long-run operation of the market?

The *ALMR* believes that there is both downstream and upstream foreclosure in the pay tv market. We do not agree with Sky’s assertion that it has strong incentives to distribute content and open access. If this was indeed the case, then competing platforms would exist on the commercial retail market and commercial subscribers would have a genuine choice of provider.

The experience of Setanta clearly demonstrates the significant barriers to entry which new entrants face and the important first-mover advantages enjoyed by BSkyB which enable them both to prevent access to content by out-bidding and control or restrict access to the retail market. There is little doubt that BSkyB is better placed to outbid and accumulate more rights. Even if those rights are of little commercial value to them as a broadcaster, strategically it prevents a competitor from establishing a rival portfolio. They are also better able to extract more value from sports rights.

20. What do you see as the impact of these considerations on consumers?

The effects of this lack of competition are felt at the retail level and also by pub customers. Commercial subscribers themselves feel the effects in basic service levels, poor customer service and strict contract terms. Because BSkyB does not need to compete with another provider for the subscription, it has no incentive to provide a better deal. This is reflected in the absence of value-added bundled services and deals which have characterized the domestic retail market in recent years.

The principal effect, however, is on the prices charged for the product. These have risen exponentially in recent year. Prices of beer and food have not dramatically changed over recent years and the competitive position of many pubs has worsened as a result of increased costs from legislation. This has led to a squeeze on margins. The average operational costs of running a pub are now around 54% of turnover. This rises to 64% for rented premises.

In some cases, the increase in trade as a result of subscribing to BSkyB is insufficient to cover the cost of the subscription. 70% of our members subscribing to pay tv services found that their trade can increase by 10-20% on popular match days, but this in itself may not be enough to cover the cost of a service going up by 11-17% year on year. Operators are faced with a decision to continue with an uneconomic subscription or cancel the service. Both of these impact adversely on consumers.

An operator deciding to maintain the subscription will either have to put up prices to cover the costs or cut other expenditure in order to maintain margins. For example, investment in additional services, staff or décor may be sacrificed.

Deciding to do without the service because of price increases is a commercial risk, and the effects of this will only be seen in the longer term. Those outlets not subscribing to sports broadcasting do report an appreciable drop in custom when a popular match or event was shown elsewhere. It would be reasonable to assume that a pub canceling a subscription would see a similar dip in trade on match days. However, this could translate into a longer term decline in trade if previous regulars found a new local.

As more and more pubs switch off – there was a net decline of 2000 commercial subscribers in 2006/7 - ultimately it is the customer who suffers, as pubs are one of the few 'free' points of access for premiere sporting events.

A recent survey of *ALMR* members found that 60% of existing commercial subscribers said that they would increase the coverage of the service if the commercial deal was better – one by as much as 70%; and a significant number said that they would extend coverage to all their outlets. This suggests that there are a large number of potential subscribers currently being priced off the platform.