UK Film Council

Submission to
Ofcom Pay TV Market investigation

February 29, 2008

1. Introduction & Executive Summary

1.1 The UK Film Council is the Government-backed lead agency for film in the UK. Our goal is to help make the UK a global hub for film in the digital age, with the world's most imaginative, diverse and vibrant film culture, underpinned by a flourishing, competitive film industry.

1.2 The UK Film Council welcomes the opportunity to comment on Ofcom's Consultation on pay TV ("the Consultation").

1.3 Given its remit, the UK Film Council has focused its comments mainly on those aspects of the Consultation which impact upon and relate to premium movie content.

1.4 In summary, the UK Film Council considers that the structure of the UK pay market raises a number of potential competition law issues which merit investigation by Ofcom In particular, the UK Film Council is concerned to learn whether the lack of competitive offerings in the premium content market for film has an adverse effect on consumers possibly by inhibiting new entrants, discouraging innovation and generally dampening competition in pay TV.

Responses to Consultation questions

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

2.1 Yes. We welcome the focus on whether pay TV may deliver consumer benefits in the future and we think that the criteria of choice of platform and content is especially important. The UK film distribution sector clearly believes that the presence of only one significant operator in the pay TV market has been detrimental to consumer choice and sector growth.

2.2 It is argued that the dominance of a single pay operator in the pay TV market has over time, substantially lessened upstream competition for the acquisition of rights for films, including British films (whether distributed by an independent or a studio), and including non-British films distributed by UK independent distributors. Arguably this has lead to a lesser range of films being made available (or being made available at a much higher price) than would have been the case had the market been more competitive. Arguably this has diminished the choice of films available in the pay TV window, resulting in consumer detriment.[1]

[1] See also UK Film Council submission to Ofcom Consultation on Proposed BSkyB Digital Terrestrial Services at: http://www.ukfilmcouncil.org.uk/media/pdf/b/f/Ofcom._BSkyB_Consultation.pdf

2.3 We also agree with the other criteria of "innovation in platform services" (since the ability of consumers to access content in new ways is important) we also agree that "pay TV services [should be] priced competitively and efficiently."

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

3.1 Yes. We agree with the conclusion that "distinct narrow economic markets exist for pay TV subscription channels containing premium sports and movies content at both the wholesale and retail level of the value chain, and that Sky has market power in these markets." (para. 1.25).

3.2 We also agree that:

"Consumers do not appear to regard other forms of content as being readily substitutable for this premium content, nor do they regard premium content distributed by other means (e.g. DVDs, pay per view) as being readily substitutable for premium channels. The price which can be charged for these premium channels is therefore unlikely to be constrained to the competitive level by the availability of other content. (ibid.)."

3.3 In this regard, we note the Ofcom consumer research cited in Annex 13, *Market Definition and Market Power in pay TV,* that:

"Consumers also value not having to pay each time they watch a film, and the convenience of not having to rent a DVD (respectively cited by 63% and 65% of consumers as either 'must have' or 'nice to have' features)." (Annex 13, Paragraph 4.55, third bullet point).

3.4 We would also cite in evidence, the observation in the main Consultation that:

"Over the last few years sales of pay TV packages including premium movies have increased by **[** *excised in original* **]** per annum despite large reductions in the price of DVDs and the rapid growth of DVD sales. This suggests that the retail price of DVDs is not constraining the retail price of pay TV packages including premium movies." (Paragraph 5.40, third bullet point).

3.5 We also agree with the assertion that:

"the way in which competition plays out in practice may depend to a significant extent on whether vertically integrated firms make their premium content available to other retailers, and whether buy-through is enforced at the retail level." (para. 1.43).

3.6 In this respect, it is a legitimate question to ask whether competition in the marketplace is sub-optimal at present, and we note Ofcom's observation:

"in particular that Sky does make its premium content available to one retailer on another platform – Virgin Media on cable, where Sky is not itself present as a retailer – but does not appear to make its premium content available to other retailers on its own satellite platform. Nor has it yet made its premium content available on DTT, where it has announced its desire to launch its own retail operation." (para. 1.49)

Given Sky's current position where it retains exclusive rights to film product, its willingness to license film channels beyond its own retail platform cannot logically be taken for granted.

3.7 The UK Film Council agrees that it is important that Ofcom "takes a forward-looking view of how the market might evolve" (para. 2.9). The advent of new platforms for delivering pay TV services, such as BT and Tiscali/Homechoice is clearly of relevance, as is the advent of new forms of services such as Video-On-Demand. In respect of the latter, we note that content providers typically make their film product available on a non-exclusive basis.

3.8 Nonetheless, established pay TV services continue to retain very large numbers of subscribers by comparison with new platforms and new services such as VOD. Even in an era when take-up of digital services is comparatively rapid, it is likely that these new platforms and new services will take a number of years to build critical mass. It is very difficult to build critical mass without access to premium content. Therefore, notwithstanding these developments, a detailed assessment of the impact on consumer welfare of the existing and distinctly narrow market for pay TV services seems justified and important.

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

Yes, broadly we agree with this framework.

5 **Question 4:** ***Are there any additional comments or evidence which you wish to provide?***

5.1 Yes. We wish to draw attention to an apparent inaccuracy in the Screen Digest data at Annex 11 which has a material impact on a statement in this section of the Consultation. In addition, the UK Film Council notes that Ofcom commissioned a substantial piece of research entitled *Movie Markets in the UK* (Annex 11) from Screen Digest, a commercial consultancy. The UK Film Council is disappointed that Ofcom did not consult with us since we believe we could have contributed to improving the brief and we would be very happy to work with Ofcom going forward to help inform its analysis of matters pertaining to the UK film market.[2]

5.2 In Annex 11, Screen Digest states that:

"The second biggest market is pay TV, which generated an estimated £673m in subscription fees to Premium Movie channels (Sky) in 2006. Cinema comes third, with £649m in 2006 (21 per cent of total spending)." (Para. 3).

5.3 This is not consistent with UK Film Council data, sourced from the Cinema Advertising Association/Nielsen EDI which states that UK box office in 2006 was £762m at the retail level.

5.4 Thus the following paragraph in the main Consultation needs to be adjusted to reflect the fact that pay TV is the third largest retail market for movies in the UK, rather than the second:

"The structure of the various markets for movie products is summarised at Annex 12 [*sic*]. Pay TV subscriptions are the second most important retail market for movies, generating an estimated £673m in retail revenues. This is significantly less than the revenue generated by DVDs (£1,655m) but slightly ahead of the revenue generated by cinemas (£649m). PPV VoD revenues are currently less significant (£84m)." (Paragraph 3.69).

5.5 We would also question the methodology used to arrive at Figures 130 and 131 in Annex 11, which purport to show the "Studio" [but, in fact, show all distributor] market shares and revenues on Sky's Premium Movie Channels for 2006. Screen Digest states in a footnote to Figure 131 that "BSkyB has deals with all the studios and distributors mentioned in this table. The market share have been estimated top-down by applying the box office market share of the same studios one year before (as we know BO performance is a key factor in Premium rights valuation)." In fact, the Figure to which this footnote is appended refers to revenues rather than market share but we assume that the footnote applies to both this Figure (131) and Figure 130 (which shows market share).

5.6 To the best of our knowledge, it is incorrect to assert that BSkyB has "deals with all the studios and distributors mentioned." Most independent film distributors (as opposed to the studios) do not have "deals" with BSkyB and report that they are unable to regularly license their films at all to BSkyB's premium movie channels and are unable to extract prices which, on a like-for-like box-office performance basis, compare with the prices secured by the Hollywood-based studios through their exclusive output deals.

[2] We have drawn attention to an apparent inaccuracy with material consequences for Ofcom's Consultation in Screen Digest's data at Question 4 below.

5.7 If so then it must be misleading to use distributor share of box-office as a proxy for either distributor share of market or revenues as regards Premium movie channels. Indeed, the analysis is inconsistent with Screen Digest's more logical statement that:

"Thanks to their output agreements, it is very likely that the major Studios gain a disproportionately higher share of movie rights spending than independents, as the independents are competing for the leftover slots on the BSkyB film channels and are in a weaker negotiating position." (Annex 11, paragraph 382).

5.8 The Screen Digest analysis at Figures 130 and 131 may well give a misleading picture of the competitive position that the independent distributors have in the pay TV market. As noted (at paragraph 2.1, 2.2, 5.6 above and 13.2 below), the UK film industry has significant concerns about this competitive position and the adverse impact upon the ability of independent distributors to access an important distribution medium (which of course, in turn, reduces consumer choice).

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

6.1 We do not agree with the views expressed with respect to content choice.

6.2 For example, it is stated that:

"The UK compares fairly well to other countries in terms of content choice. Although the number of channels provided through traditional analogue terrestrial television is at the low end of the range, the number of channels currently available across all platforms in the UK is 416, which is second only to the US amongst the comparator countries set out in Figure 24." (paragraph 4.12).

6.3 This paragraph ignores the impact of release windows. Films are released through a sequential series of windows, as set out in Figure 2, Annex 11, *Movie Markets in the UK*. For example, films are released to traditional analogue terrestrial television services at least 12 months after they are released to pay TV. Therefore, to assume that "content choice" compares "fairly well to other countries" based on the number of channels available across all platforms is inaccurate because within one of the release windows, i.e. pay TV, one operator of services dominates the UK market and therefore the choice of content available to consumers in that window is almost wholly dependent on the range of content made available by that operator.

6.4 This misunderstanding of the impact of windows is also apparent at paragraph 4.17 which is concerned with the Figure 27: "Availability of Premium Movie Content by Distribution Technology and Country." It is stated that: "Analogue TV shows movies, but often not the latest blockbusters, as Sky has contracts with the six major Hollywood studios." In fact, analogue TV does show "blockbusters" but not at the same time, or before, Sky simply because analogue TV sits behind pay TV in the traditional sequence of windows.

6.5 Windows are a very important means of enabling content creators and distributors secure optimum economic value from each medium in which a film is to be released. Arguably a detrimental impact on consumer choice may arise if, as is the case with pay TV in the UK, one provider has a dominant position within a given window. In this respect we would argue with the assertion that "for certain types of content the extent of real choice available to consumers is rather more limited,".

6.6 Logically it would be reasonable for Ofcom, when assessing the level of premium movie content choice which is available to pay TV consumers, to first assess the level of choice between pay TV providers competing on the same platform and second, to assess the choice available between pay TV platforms. Only then can Ofcom judge the totality of the levels of competition and choice available to consumers. We would suggest that to compare free-to-air or analogue TV with pay TV is misconceived because of the time differential in the availability of the films.

7. **Question 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?***

We broadly agree with this analysis as summarised at paragraph 4.28.

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

We are not qualified to comment on this Question.

9. **Question 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 are not qualified to comment on this Question.

10. **Question 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?**

We are not qualified to comment on this Question.

11. **Question 10:** ***Are there any other comments or evidence which you wish to provide?***

No.

12. **Question 11:** ***What is your view on our approach to defining markets?***

See answer to Question 12.

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

13.1 We note that Ofcom observes that:

"The primary characteristic of a 'premium movies' pay TV service is that it provides access on a subscription basis to first-run movies from the six major Hollywood studios. The only example of such a service in the UK is Sky Movies, which has exclusive access to this content." [Paragraph 5.36]

13.2 As previously noted in our submission to Ofcom Consultation on Proposed BSkyB Digital Terrestrial Services, we do not agree that the definition of "premium content" should be confined to US films made by the Hollywood majors.[3] While the overwhelming majority of the films shown on Sky Movies are Hollywood films it includes some independently produced and/or distributed British films, such as *Bend it Like Beckham*, *Stormbreaker*; and also films such as *Wallace and Gromit: The Curse of the Were Rabbit* which while distributed to cinemas in the UK by a US-owned distributor (UIP) was produced by Aardman Animations, a Bristol-based company. Both these films were qualifying British films under the Government's "Cultural Test". We believe that Ofcom should expand its definition of "premium content" in order to fully understand the potential impact of the pay TV market upon the consumer. It is inadequate to categorise UK or independently produced/distributed films as being of limited appeal simply because they only have a limited presence in the pay TV film channel schedules. We believe that an important question needs to be addressed as to whether the dominance of a single wholesaler (which is also the dominant pay TV retailer) will, over time, substantially lessen upstream competition for the acquisition of rights for films, including British films (whether distributed by an independent or a studio), as well as non-British films distributed by UK independent distributors. This should be an important consideration because, if proven, this position would arguably lead to a narrowing range and number of films being made available (or perhaps being made available at a much higher price) than would otherwise be the case.

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[3] Ibid.

13.3 With this caveat, we do agree with the analysis from paragraphs 5.36 to 5.44 that concludes that "there is likely to be a narrow retail market for premium movies." (Paragraph 5.45). We also agree that pay-per-view services, DVDs and broadcast services cannot be regarded as close substitutes for pay TV for the reasons set out in paragraphs 5.36-5.44.

13.4 However, we wish to add a qualification to Ofcom's analysis. If films are available via Video-On-Demand services, operating on a subscription basis ("SVOD" services), as opposed to a pay-per view basis, at the same time as they are available in the pay TV window, it may be possible to regard the films on these SVOD services as substitutes for films available on a pay TV service. This is because the consumer preference for paying monthly for pay TV services (Paragraph 5.38) is also operative with regard to such SVOD services. The same would presumably be true for VOD services which operated on an advertising supported basis where the issue of the method of payment is no longer a constraint for the consumer.

13.5 In practice, the ability to set up such SVOD or advertising supported VOD services will depend on the ability to unbundle the SVOD or advertising supported VOD rights from the pay TV rights. In this regard, we note with interest the assertion by British Telecommunications, Virgin Media and other parties in their submission to Ofcom on the need for a market investigation into the pay TV industry that:

"through the bundled acquisition of ancillary rights (including rights such as DSL) on an exclusive basis, Sky denies such rights to innovative new entrants such as BT Vision whilst not fully exploiting these ancillary rights itself. Because of the exclusivity provisions, these rights are not available directly from content owners." [Paragraph 5.5. (b)].[4]

This is a view which also has considerable currency in the UK film industry.

13.6 We also note with interest the accompanying footnote to that paragraph:

The European Commission has noted that: "*Bundling of rights across platforms may represent a restriction which, due to the strong asymmetry of value between the TV rights and the [new media] rights, prevents operators that offer [new media] services from purchasing meaningful rights. The purchasers of bundled rights are most frequently TV operators.*" Paragraph 32 of the European Commission's Concluding Report on the Sector Inquiry into the Provision of Sports Content over Third Generation Mobile Networks (21 September 2005). [5]

[4] http://www.ofcom.org.uk/media/news/2007/03/submission1.pdf
[5] Ibid.

13.7 For the reasons set out in 13.5 and 13.6 above we would encourage Ofcom to investigate and take a view on these assertions. We also note that the Screen Digest study refers to the fact that "There are instances however, where rights deals – especially for major titles – preclude prior, or indeed, simultaneous exploitation in certain windows. Certainly this has been the obstacle for the development of SVOD, in other markets outside the UK where pay TV operators have exclusive rights to content. In the context of the UK it is therefore legitimate to ask whether Sky is using its clout to expand existing deals to include Internet distribution and looking to leverage these rights in a Internet VOD environment through services like Sky Anytime.". If this creates obstacles to the development of SVOD services on a variety of different platforms in the UK there is a risk that innovation will be stifled.

13.8 We note Screen Digest's conclusion:

"Digital rental SVOD is being set at the same time as Premium pay TV as a defensive move from pay TV operators (namely BSkyB) who tend to acquire and hold these rights." (Annex 11, third bullet point, Paragraph 432).

13.9 Therefore the arguments made by British Telecommunications, Virgin Media and the other parties in their submission may be an example of the "dynamic foreclosure" which is identified as a specific risk by Ofcom at paragraph 1.55. Whereby innovation is chilled and the development of a viable competitive constraint is hindered due to the dominance of one operator at both a wholesale and retail level.

13.10 The UK Film Council also agrees with the conclusion that;

"Upstream…there is a narrow wholesale market for premium movies. There is no credible alternative to Sky that would enable a retailer to substitute its demand, and the exclusivity and staggered nature of movie contracts prevents supply-side substitution. Any indirect constraint from the retail level would also be insufficient to suggest broadening the market." (Paragraph 5.46).

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

Since "the assessment of the constraint imposed on basic-tier pay TV by free-to-air TV focuses on stand-alone basic packages – i.e. those that do not include premium sports or movies," (Paragraph 5.47) we will not offer a view on this question.

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

We support with the conclusion that:

"Sky has a share of **[** *excised from original* **]** (well over 80%) in the premium sports content market – Setanta being its only rival – and 100% of the premium movies market. Access to content in both markets represents a very significant barrier to entry, so that there are very limited direct constraints imposed upon Sky. The limited competition in the retail market and the dependence of retailers on Sky for content also suggests that there are very limited indirect constraints on Sky's pricing. Sky is therefore likely to enjoy substantial market power in both the sports and movies markets." (second bullet point at paragraph 5.56)

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

16.1 We broadly agree with the analysis and we have nothing substantial to add.

16.2 However, we want to emphasise the importance of the following statement in understanding how the market for pay TV film rights actually operates:

"We understand that Sky has relationships with the six major Hollywood studios for the subscription pay TV window which go back (at least) several years. The subscription window contracts are not awarded by the studios under a transparent tender process. The contracts do not tend to come up for renewal at the same time, so that they could be contestable only on a staggered basis over the course of the next few years. This creates a potential barrier to entry for a wholesale channel provider wishing to launch a new premium movies channel containing content from more than one or two studios." (second bullet point at paragraph 5.71).

17. **Question 16:** ***Have we correctly captured the role of vertical integration?***

17.1 We broadly agree that vertical integration in the pay TV sector confers the advantages described. We would also highlight Sky's unique position in respect of premium movie content and it may be that consumers suffer in this narrow market segment by obtaining fewer of the benefits that may be generated by vertically integrated companies in the wider pay TV market as a whole.

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

18.1 Yes. In particular we agree with the statement that:

"the tendency for one retailer to emerge as the primary retailer on each platform is likely to be significantly strengthened where premium content is licensed exclusively to one retailer on a given platform. Having sole access to premium content on a platform is likely to confer significant strength of portfolio on such a retailer. In these circumstances platforms may be prone to "tipping" – i.e. once one retailer has emerged as predominant, it is likely to be extremely difficult for a competitor to displace it." (Paragraph 6.22).

18.2 We also disagree with the one aspect of the following statement:

"Much of the aggregation which we observe, especially in relation to premium sports and movie content, occurs at the content production and wholesale channel levels of the value chain." (Paragraph 6.28).

18.3 We would point out that the aggregation, in relation to "movie content" in the UK, occurs at the level of content *acquisition* rather than content *production*, since pay TV services nearly always acquire rather than produce the films at issue.

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

We agree with summary of possible issues relating to premium content. We are not qualified to comment on the summary of possible issues relating to basic content.

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

20.1 Yes we share the four possible concerns identified by Ofcom, namely:

"There may be significant barriers to entry into the market for premium wholesale channels. These are primarily due to the way in which content rights become contestable only on a staggered basis. These barriers to entry may be exacerbated by the presence of a vertically integrated incumbent, which has an incentive to control access to downstream markets, albeit its ability to do so may be restricted by regulation.

Although a vertically integrated incumbent may supply content to established retail competitors, in order to generate wholesale revenues, it may have the ability and incentive to reduce the quality of what it supplies, in order to strengthen its own retail offering relative to its competitors. We acknowledge however that such reductions of quality may also arise naturally, due to technical inter-operability issues.

A vertically integrated incumbent may have the incentive and ability to foreclose potential new retailers by denying them content.

The prevalence of vertical integration between retail and platform operations may cause this problem to extend to foreclosing the possible development of new platforms." [paragraph 6.77]

21. **Question 20:** ***What do you see as the impact of these considerations on consumers?***

We believe that there if these concerns are found to be real through further analysis of the market it is likely that there may be real consumer detriment in the form of reduced choice and the chilling of innovation. In the longer term, left unchanged, it is possible that the structure of the market, particularly the market power arising from the exclusive rights to premium movie content may have a detrimental impact on competition between both retail operators and the platforms themselves. We consider that the lack of adequate competitive constraints for wholesale (and retail) providers of premium content might directly or indirectly discourage future investment in alternative platforms and the likelihood of new entrants emerging, which in turn could result in increased prices for consumers.