Non-confidential

Ofcom's consultation on "Proposed BSkyB Digital Terrestrial Television Services".

Response by Setanta Sport Holdings limited and Top Up TV Europe Limited.

Non-confidential

Ofcom's consultation on "Proposed BSkyB Digital Terrestrial Television Services".

Response by Setanta Sport Holdings Limited and Top Up TV Europe Limited.

Non-confidential

Ofcom's consultation on "Proposed BSkyB Digital Terrestrial Television Services".

Response by Setanta Sport Holdings Limited and Top Up TV Europe Limited.

Executive summary

1. Sky's proposed pay TV service on DTT ("Picnic") should not be regarded as a peripheral activity for Sky. It will, if it is authorised by Ofcom, reinforce and become a material part of Sky's core pay TV activities. (See section 1.)

2. The benefits that are attributed to Picnic by Ofcom either do not arise at all or are not dependent on the implementation of the whole of Picnic. For example, the increased choice in sports programming on the DTT platform could be achieved simply by Sky wholesaling Sky Sports 1 to competing pay TV retailers on DTT so that they can retail that channel on that platform, with consumers benefiting from the inter and intra platform retail price competition for pay TV services (and in particular for Sky Sports 1) which would ensue. (See section 2.)

3. In order to be able properly to assess the impact on competition of Picnic and identify the regulation necessary to foster inter and intra platform competition in pay TV, Ofcom needs first to reach conclusions on the current state of competition in pay TV in the UK and its likely evolution. In broad summary, competition in pay TV in the UK is not working effectively due to certain market features which are currently being considered as part of the market investigation that Ofcom announced on 20 March 2007. It is clear that Sky has both the incentive and the ability to leverage the existing market structure in pay TV so as to marginalise and even foreclose competitors. These are material factors to which Ofcom must have regard when considering Sky's request for Ofcom to authorise Picnic and, in particular, when considering the possible application of *ex ante* rules in the licensing of Picnic so as to ensure fair and effective competition. (See section 3.)

4. In order properly to assess the competition implications of Picnic, it is necessary to disaggregate the Picnic proposal and consider each component in turn. The key components of Sky's Picnic proposal are: (i) the reintroduction of Sky's premium channels to the DTT platform; (ii) the distribution by Sky of DTT set top boxes containing NDS' conditional access technology (for the first time); and (iii) the retailing of pay TV services on DTT by Sky (for the first time). (See section 4.)

5. Whether the reintroduction of Sky's premium channels to the DTT platform will result in an increase in the take up of pay TV services on DTT will depend,

among other things, on the price(s) at which those channels are offered on DTT. As Ofcom has already acknowledged, Sky will, as far as it is able, ensure that any offer of its premium channels on DTT does not cannibalise its hugely profitable satellite subscriber base. In contrast, if the existing pay TV retailers on DTT (including BT Vision, Setanta and TUTV) were to be supplied with Sky's premium channels, they would compete vigorously with Sky's satellite retail prices. Therefore, a requirement for Sky to make its premium channels available on a wholesale basis to third party pay TV retailers for distribution on DTT would benefit consumers as a result of both increased choice and retail price competition. Such wholesale supply would also be consistent with what Sky claims are its "*strong incentives*" to make its channels available via competing platforms and pay TV retailers. (See section 5.)

6. If Sky were to launch a new base of DTT boxes containing NDS conditional access technology, **[Redacted – confidential]**. Sky's pre-entry announcement has already resulted in such an effect as it has deterred retailers from placing orders for Setanta/TUTV DTT boxes. **[Redacted – confidential]**. For reasons outlined below, Ofcom would encounter a number of significant impediments if it were to attempt to regulate Sky's provision of conditional access services on DTT. **[Redacted – confidential]**. (See section 6.)

7. If Sky were permitted to retail its premium channels itself on DTT, **[Redacted – confidential]**. Sky would be able to use its unique and extensive influence over the retail supply chain (and its funding capacity coupled with its unique incentives to develop a strategic position on DTT) in order to ensure that its box/content bundle is promoted ahead of any competing offerings. In this context, the "*safeguards*" proposed by Sky (such as the statement that "*Picnic does not intend to subsidise boxes*") will be easily circumvented. Such an outcome would arise even if Sky were prevented from launching its proposed new base of DTT boxes. (See section 7.)

8. As Ofcom has on a number of occasions confirmed, the competition issues that are raised by Picnic are also being considered in its market investigation. In the context of Picnic, Ofcom is considering, among other things, "*the incentives that might exist for anti-competitive conduct*". In order properly to consider such incentives, Ofcom must address not only Sky's pre-eminent upstream position in respect of premium content but also its control of downstream bottlenecks (as the gatekeeper to the largest pay TV platform in the UK and the controller of the largest base of pay TV subscribers). If Ofcom were to authorise Sky to become a pay TV retailer on DTT, Sky would be able to extend its downstream bottlenecks into the DTT platform and thereby exacerbate the competition issues which are at the heart of the market investigation. In the circumstances, it would at the very least be premature if, prior to the conclusion of the market investigation, Ofcom were to authorise Sky to engage in new pay TV activities which could weaken further the already limited state of pay TV competition in the UK. (See section 8.)

9. If Sky were to become a pay TV retailer on DTT, **[Redacted – confidential]**, there would be a substantial reduction in competition which could not be effectively addressed using *ex post* competition powers. As Ofcom notes, where there is the potential for certain types of behaviour to have a material impact on competition, it should adopt a precautionary approach. (See section 9.)

10. Therefore, if Sky is to be authorised to broadcast its premium channels on DTT, that authorisation must be subject to a condition that Sky wholesales its channels to competing pay TV retailers on the platform. In order to be effective, that wholesale supply obligation will need to be supported by detailed provisions in respect of the wholesale pricing of Sky's channels. As the mere presence of new Sky DTT boxes containing NDS conditional access technology **[Redacted – confidential]**, Sky should be prohibited from making its channels available via such new boxes. Furthermore, the myriad ways in which Sky could exploit a position as a pay TV retailer on DTT in order to **[Redacted – confidential]** would require perpetual prescriptive regulation. In practice, such *ex ante* regulation of the retail market would be both ineffective and an inefficient use of Ofcom's resources. In the circumstances, and not least because of the ongoing market investigation, Ofcom should impose a further condition in the DTT licence for Sky's channels which prohibits Sky, itself, from retailing the channels on a pay TV basis on DTT. (See section 10.)

11. This would not be the first time that a regulator has acted in this way as Sky has, twice before, been prevented from becoming a pay TV retailer on DTT. Ofcom must have regard to those precedents. (See section 11.)

12. In addition, in other European territories where pay DTT operators have become established, e.g. Italy and Scandinavia, the relevant authorities have prevented the pre-eminent pay TV retailers on other platforms from having an interest in pay TV retailing on DTT. (See section 12.)

13. As Ofcom acknowledges, it has a principal duty to promote competition. If Ofcom were to authorise Sky to become a pay TV retailer on DTT, it would be in breach of that duty. **[Redacted – confidential]**. (See section 13.)

14. In light of all the above, and given Ofcom's stated intention "*to focus on fostering an environment that encourages effective competition on the DTT platform and which would also allow for the development of competition between pay TV platforms*", Ofcom should confirm that Sky can broadcast its premium channels on DTT subject to a condition that they are made available on commercially viable wholesale terms to competing pay TV retailers on the platform and subject to a condition which prohibits Sky itself from retailing the channels on DTT. (See section 14.)

Ofcom's consultation on "Proposed BSkyB Digital Terrestrial Television Services".

Response by Setanta Sport Holdings Limited and Top Up TV Europe Limited.

1. Introduction

1.1 Sky's proposed pay TV service on DTT ("Picnic") should not be regarded as a peripheral activity for Sky. In practice it will, if it is authorised by Ofcom, reinforce and become a material part of Sky's core pay TV activities. Indeed, the Financial Times reported on 1 November 2007:

> "*It is not a question of broadband delivery making the satellite platform redundant.* ***BSkyB's answer [James Murdoch] says, will be a "hybrid" of its satellite and digital terrestrial platforms, local storage on its set top boxes and its broadband connections.***" (Emphasis added.)

1.2 In the circumstances, Ofcom must consider very carefully the implications of Sky's Picnic proposal. The supply of Sky's premium channels on DTT would promote retail price competition and thereby benefit consumers, provided those channels are wholesaled to competing pay TV retailers on DTT. Other aspects of the Picnic proposal, in particular the introduction of new DTT boxes containing NDS conditional access technology and Sky becoming a pay TV retailer on DTT for the first time, will however have a very material adverse effect on competition.

1.3 In practice, if Ofcom were to authorise Sky to launch a new base of DTT boxes containing NDS conditional access technology and/or authorise Sky to become a pay TV retailer on DTT, there will be a reduction in competition and consumers would be faced with starkly diminished choice as a result of **[Redacted – confidential]**.[1] In the circumstances, it is clear that in order properly to assess the impact that Picnic would have on competition in pay TV, Ofcom must first reach conclusions on a number of fundamental issues that are being considered as part of the market investigation into pay TV which Ofcom announced on 20 March 2007.

---

1 **[Redacted – confidential]**.

2. Asserted benefits and actual adverse impact of Picnic

2.1 With regard to potential benefits from Picnic, Ofcom asserts in its consultation document that:

> "*The proposal would have* ***an immediate, positive effect on choice and availability of retail pay TV services on the DTT platform****. Consumers would be presented with an increase in choice of sports, movies, factual, children's and general entertainment programming. The increased choice brings with it* ***the potential for more competition on the DTT platform in terms of quality of service, and technical innovation, as well as ensuring [sic] that there is competitive pressure on pricing****, all of which is likely to be to the benefit of consumers at least in the short term.*"[2] (Emphasis added.)

2.2 This somewhat uncritical view of the effects of Picnic is at best misleading: the benefits that are attributed to Picnic by Ofcom either do not arise at all or are not dependent on the implementation of the whole of Picnic. For example, as is explained in sections 4 and 5 below, the increased choice in sports programming on the DTT platform could be achieved simply by Sky wholesaling Sky Sports 1 to competing pay TV retailers on DTT (currently Setanta, TUTV and BT Vision) so that they can retail that channel on that platform, with consumers benefitting from the inter and intra platform retail price competition for pay TV services (and, in particular, inter and intra platform retail price competition for Sky Sports 1) which would ensue. Other aspects of the Picnic proposal (such as the introduction of new DTT boxes containing NDS conditional access technology and Sky becoming a pay TV retailer on DTT for the first time) are not required in order to achieve this increased choice and competition.

2.3 In addition, as Ofcom should be aware, pay TV retailers on DTT compete with pay TV retailers on other platforms, primarily satellite and cable. Accordingly, Sky's pay TV services on satellite already exert competitive pressure on the pricing of pay TV retailers on DTT. (In contrast, due to their relatively limited offerings at present, the pay TV retailers on DTT exert only minimal, if any, competitive pressure on the pricing of Sky's pay TV services on satellite.[3]) Unless Sky is intending to position Picnic so that it offers better value for money than its own satellite services (and thereby cannibalise its own satellite services, which seems highly unlikely), Picnic will not increase the existing

---

2 Paragraph 1.11 of the consultation document.

3 For example, Setanta launched its DTT sports channel (including live FAPL coverage) in March 2007 and it currently retails for a price of £9.99 per month. Setanta's package of channels on satellite is also retailed for a price of £9.99 per month. Notwithstanding this, in September 2007, Sky increased the retail prices for its satellite pay TV services (including those packages containing Sky Sports).

pricing pressure on pay TV retailers on DTT.[4] Sky will, nevertheless, be able to use Picnic **[Redacted – confidential]**.

2.4 Accordingly, as Ofcom notes, the rosy, short-term description of the effect of Picnic (cited in paragraph 2.1 above) needs to be contrasted with the longer term view of the impact on competition of Sky's entry into pay DTT services. In this context, Ofcom states in the consultation document that:

> "*If the NGW/Sky proposal foreclosed the opportunity for a pay TV provider on DTT emerging to compete with providers of pay TV services on other delivery platforms (e.g. satellite and cable), leading instead to* ***the emergence of Sky as the main provider of pay TV services on DTT in addition to the satellite platform****, this* ***might [sic] be the source of significant concern and potential [sic] consumer detriment in the long term****.*"[5] (Emphasis added.)

2.5 The use of the words "*might*" and "*potential*" in this context is misconceived. If Sky did become the main provider of pay TV services on DTT as well as on satellite, it would have eliminated (or at least marginalised) its pay TV competitors on the largest digital TV platform. Sky would also have extended the vicious circle and its downstream bottlenecks, which are being considered as part of Ofcom's market investigation into pay TV, from the satellite platform into DTT. As a consequence, the remaining pay TV competition to Sky would come from Virgin Media in respect of its cable platform which can only be accessed by less than half of UK households.[6] In the circumstances, that would undoubtedly be the source of significant concern and actual consumer detriment in the long term.

2.6 Despite Ofcom's unduly qualified statement about the concern and detriment which would result from Sky emerging as the main provider of pay TV services on DTT, Ofcom concludes that:

> "*On the basis of an initial analysis of the issues raised by this proposal, taking account of Sky's position in the wholesale provision of content and its potential impact on the retailing of pay TV services and access to wholesale platforms,* ***we consider that the proposal does raise competition concerns****.*"[7] (Emphasis added.)

---

4 Ofcom has already expressly noted that any pay TV services which Sky itself offered on DTT would be positioned in such a way as to avoid cannibalising its existing base of satellite pay TV subscribers. Specifically, Ofcom stated that: "*... if it were to change its channels to pay TV, Sky is likely to have an incentive to make them complementary rather than substitutable for Sky's satellite services.* Paragraph 2.28 of Ofcom's Consultation Document of 27 October 2006.

5 Paragraph 1.12 of the consultation document.

6 Given the small scale of pay TV retailers on other platforms (e.g. DSL), they are unable to exert a competitive constraint on Sky.

7 Paragraph 1.14 of the consultation document.

The relevant context within which to analyse these competition concerns is considered in section 3 below.

3. Current state of pay TV competition in the UK

3.1 Ofcom notes that when considering how to address the competition concerns raised by Picnic:

> *"... it is relevant to focus on fostering an environment that encourages effective competition on the DTT platform and which would also allow for the development of competition between pay TV platforms."*[8]

3.2 Thus, in order to be able properly to assess the impact on competition of Picnic and identify the regulation necessary to foster inter and intra platform competition in pay TV, Ofcom needs first to reach conclusions on the current state of competition in pay TV in the UK and its likely evolution.

3.3 In broad summary, competition in pay TV in the UK is not working effectively due to certain market features, which were described in some detail in the joint submission to Ofcom by BT, Setanta, TUTV and Virgin Media dated 3 July 2007. A pivotal aspect of these market features is Sky's control of mutually reinforcing bottlenecks, both upstream and downstream in the pay TV supply chain. Upstream, Sky's firm grasp of the most attractive pay TV content enables it to consolidate and expand further its leadership in pay TV distribution. Downstream, Sky's control of access to the largest pay TV platform and the largest base of pay TV subscribers enable it to outbid competitors for the most attractive content.

3.4 The pay TV supply chain can be divided into three main tiers: (i) the acquisition of content, (ii) the wholesale supply of channels and (iii) the distribution of those channels by platforms/retailers. Among other things, Sky has leading market positions at each of these three tiers of the supply chain in respect of sports and movie content and channels which are widely acknowledged to be the drivers of pay TV.[9] These leading market positions have endured over time due to the existence of the vicious circle described below.[10]

---

8 Paragraph 1.15 of the consultation document.

9 For example, as at July 2007: (a) Sky held approximately 80% (by value) of the sports rights which are broadcast on a pay TV basis in the UK; (b)Sky had a 100% share of premium subscription movie rights; (d) Sky's share of the wholesale supply of sports channels was approximately 96% (by revenue); (e) Sky's share of the wholesale supply of premium subscription movie channels was 100%; and (f) Sky accounted for more than 90% of the retail subscribers to premium channels in the UK.

10 Sky also has a leading market position in what can be regarded as a fourth tier of the pay TV supply chain – the provision at the wholesale level of technical platform services (including conditional access services).

3.5 At each of the three main tiers, the pay TV industry exhibits significant barriers to successful market entry, which are due in large part to the following distinctive features:

(a) a finite pool of key content;

(b) the limited duration of certain contracts for key content;

(c) the staggered availability of key content;

(d) the exclusive licensing and selective distribution of key content;

(e) economies of scale in the distribution of content; and

(f) feedback effects.

3.6 The combination of the six features outlined above distinguishes the pay TV industry from other industries with "feedback effects" and has clear cut implications for competition within it:

(a) The pay TV industry exhibits a tendency for concentration and "increasing dominance" (i.e. leading market positions become entrenched). A firm with access to superior content is able to build a customer base advantage which consolidates its ability to monopolise the acquisition of content and, in turn, achieve a leading position downstream.

(b) Market forces are unable to offset this tendency. Leading market positions become entrenched because consumers will not subscribe (or switch) to new entrants unless their content offerings are sufficiently attractive. But this is not likely because new entrants will face the handicap of having to compete for subscribers with inferior content and to compete for content with fewer subscribers.

3.7 As noted above, Sky holds the leading market positions at the key levels of the supply chain and, in particular, has a firm grasp on the most attractive pay TV content and controls both the largest pay TV platform and the largest base of pay TV subscribers. This control of mutually reinforcing upstream and downstream bottlenecks results in a vicious circle for Sky's competitors, as depicted in Annex 1.

3.8 Against this market background, Sky is able to ensure that its leading position in the acquisition of content upstream is perpetuated by preserving its downstream advantage in pay TV distribution. Sky's past conduct vis à vis its competitors confirms that Sky has both the incentive and the ability to foreclose downstream competition. For example, Sky is able to use its leading position in the acquisition of content upstream to deny key content to competing pay TV retailers and thereby restrict downstream competition for its own retail business.

By refusing to provide third party pay TV retailers with access to its premium channels on economically viable terms and on a non-discriminatory basis as compared with its own downstream distribution arm, Sky can place its downstream competitors at a significant disadvantage which adversely impacts on the prices and choices available to consumers

3.9 Sky is also able to ensure that its leading position downstream in pay TV distribution is perpetuated by preserving its upstream advantage in the acquisition of content. Sky's past conduct vis à vis its competitors confirms that Sky has both the incentive and the ability to foreclose upstream competition. For example, Sky is able to use its leading positions downstream in pay TV distribution to inhibit access to the largest pay TV platform and the largest base of pay TV subscribers in the UK and thereby restrict competitive bids for the most attractive pay TV content.

3.10 In its response to the joint submission (which Ofcom published on 6 December 2007), Sky has sought to argue that the vicious circle does not exist because:

(i) Sky's upstream business has strong incentives to supply competing downstream pay TV retailers and platforms; and

(ii) Sky's downstream business does not confer advantages on Sky's upstream business when it bids for content.

3.11 Specifically Sky states that:

> "*... due to economies of scale at the broadcasting level and consumer preferences to use different platforms, Sky has strong incentives to make its channels available on other platforms, which may be expected, in both theory and practice, to outweigh any potential gains from foreclosure of other retailers*";[11] and

> "*... on any reasonable assumptions, foregoing revenues from potential subscribers on other platforms (whether served directly by Sky's retail division or via a wholesale contract with a third party retailer) implies significant costs, and these do in fact (rather than just "could in principle") provide a strong disincentive for downstream foreclosure. ... [T]here are strong incentives for a channel provider such as Sky, having successfully won "key content", to make its channels available on all efficient platforms in order to reach as many interested consumers as possible.*"[12]

These statements by Sky are flatly contradicted by Sky's past practice, Ofcom's own assessment in its consultation document on Picnic (see for example paragraphs 3.70, 3.71 and 3.72) and international experience.

11 Paragraph 3.4(a) of Part A of Sky's response.

12 Paragraph 6 of Annex 4 to Sky's response.

3.12 As noted above, Sky has also sought to argue that it gains no bidding advantage upstream as a result of its downstream position (i.e. control of access to the largest pay TV platform and control of the largest base of pay TV subscribers).[13] For example, Sky states that:

> "... *an entrant would be able to reach Sky DTH subscribers (which comprise the vast majority of Sky's existing retail base) in one of two ways:*
>
> *(a) by entering into a wholesale arrangement with Sky*[14] *...; or*
>
> *(b) by directly retailing that content to DTH households* ...".[15]
>
> "... *In this sense, Sky's success at the retail level in developing a large scale subscriber base ... facilitates rather than forecloses competition.*"[16]

3.13 Sky's response fails, among other things, to take account of the temporal lag experienced when marketing pay TV services to prospective subscribers. This temporal lag is not experienced by Sky in respect of its existing base of more than 8.7 million subscribers of whom approximately 6 million subscribe to premium channels. Accordingly, Sky's claim that it gains no bidding advantage upstream as a result of its downstream position is self-evidently not correct.

3.14 The parties will, in due course, fully rebut all the arguments put forward by Sky in its response. It would, however, be premature for Ofcom to reach any conclusions on the state of competition in pay TV in the UK and its likely evolution before the parties have had a reasonable opportunity to provide such a rebuttal. In this context, it is noteworthy that the joint submission was provided to Sky in early July 2007 and that Sky did not provide its response until late October 2007 – i.e. Sky was given a period of approximately four months by Ofcom in which to respond to the joint submission. If Ofcom does not provide a corresponding period of time to the parties, it will manifestly be operating an unfair and partial procedure.

3.15 In practice, it is abundantly clear that Sky has both the incentive and the ability to leverage the existing market structure in pay TV so as to marginalise and

---

13 Sky has, for example, described this bidding advantage as "*hypothetical*" in paragraph 3.4(b) of Part A of its response.

14 This clearly assumes that it would be in an entrant's interest to wholesale its channels to Sky and that Sky would actively seek to retail those channels in competition with its own channels. It is notable that, in paragraph 4.20(a) of Part C of its response, Sky puts forward the retailing of Setanta's channels to Sky's commercial customers as an example of a broadcaster entering into a wholesale arrangement with Sky. Sky does not, however, expressly state in this regard that it has positioned Setanta Sports solely as a buy-through from Sky Sports. Hence, commercial customers must subscribe to Sky Sports before they are able to subscribe to Setanta Sports. In this way, Sky limits the number of commercial customers for Setanta Sports and ensures that Setanta Sports does not compete in the commercial sector at the retail level with Sky Sports.

15 Paragraph 4.20 of Part C of Sky's response.

16 Paragraph 4.21 of Part C of Sky's response.

even foreclose competitors. The entrenched nature of the market failure means that any competition or other regulatory remedy aimed at addressing one or other aspect of Sky's conduct will not prevent it from exploiting the existing market structure in other ways. Accordingly, this market failure in pay TV cannot adequately be addressed by piecemeal regulatory intervention which is aimed at addressing individual instances of Sky's conduct.[17] These are material factors to which Ofcom must have regard when considering Sky's request for Ofcom to authorise Picnic and, in particular, when considering the possible application of *ex ante* rules in the licensing of Picnic so as to ensure fair and effective competition.

4. Components of Picnic

4.1 In order properly to assess the competition implications of Picnic, it is necessary to disaggregate the Picnic proposal and consider each component in turn. This is because, for example, the increased choice in sports programming on the DTT platform could be achieved simply by Sky wholesaling Sky Sports 1 to BT Vision, Setanta and TUTV for them to retail on DTT.[18] As is explained below, such an approach would avoid the material reduction in competition which will result from Sky becoming a pay TV retailer on DTT.

4.2 The key components of Sky's Picnic proposal are:

(i) the reintroduction of Sky's premium channels to the DTT platform;

(ii) the distribution by Sky of DTT set top boxes containing NDS' conditional access technology (for the first time); and

(iii) the retailing of pay TV services on DTT by Sky (for the first time).

The competition implications of each component are considered below.

5. Distribution of Sky's premium channels on DTT

5.1 The reintroduction of Sky's premium channels to the DTT platform would increase the attractiveness, and hence should increase the take up, of pay TV services on DTT. Indeed, there is evidence to support such a conclusion. When ONdigital/ITV Digital retailed pay TV services (including Sky's premium channels) on DTT between October 1998 and April 2001, it acquired more than one million subscribers. This is a substantially greater figure than the current aggregate number of pay TV subscribers on the DTT platform, even though there are currently three pay TV retailers competing on DTT, each offering

17 Indeed, previous attempts by competition authorities to address competition problems in the UK pay TV industry and in particular to regulate individual instances of Sky's conduct (for example under the Competition Act) have proved inadequate to deal with the structural features which allow such conduct to occur and the industry-wide market failure which results.

18 Indeed, both TUTV and BT Vision have sought, unsuccessfully, to enter into such a wholesale arrangement with Sky and thereby increase the choice of sports programming available on DTT.

improvements in terms of value for money (e.g. premium sports from Setanta for £9.99 per month) and/or advances in technology (e.g. TUTV's overnight download service and BT Vision's combination of DTT services with DSL on-demand services).

5.2 In practice, however, whether the reintroduction of Sky's premium channels to the DTT platform does result in an increase in the take up of pay TV services on DTT will depend, among other things, on the price(s) at which those channels are offered on DTT. As Ofcom has already acknowledged, Sky will, as far as it is able, ensure that any offer of its premium channels on DTT does not cannibalise its hugely profitable satellite subscriber base.[19]

5.3 When DTT services were first licensed in the UK, the ITC required the winning bidder for the three pay TV multiplex licences, British Digital Broadcasting ("BDB"), to enter into a wholesale arrangement with Sky for access to its premium channels as those channels were part of the core proposals within BDB's winning bid and thus were mandatory parts of the service. At that time, the ITC recognised that, if the entry of BDB was to lead to effective competition in pay TV services, it would need to have wholesale access to Sky's premium channels. Sky agreed to wholesale its channels to BDB as part of the arrangement under which Sky exited BDB (which is described further in section 7 below).

5.4 A key benefit of such a wholesale relationship is its contribution to retail price competition in pay TV and, in particular, retail price competition in respect of Sky's premium channels. Consumers would, therefore, benefit from such a wholesale relationship in respect of Sky's premium channels.

5.5 In the consultation document, Ofcom comments as follows on Sky's incentive to leverage its position as a premium channel supplier into the downstream activity of pay TV retailing:

> *"A key issue is the incentives on Sky to make its content available to third party retailers. ... [W]here a wholesale channel provider is vertically integrated with a retailer the incentive to offer content to rivals may be weakened by the impact on its own downstream retail business: there may be an opportunity cost to wholesaling since the availability of content from the third party retailer will tend to increase the relative attractiveness of that retailer's offering (and therefore reduce the relative attractiveness of the vertically integrated firm's own retail offering). Under certain conditions, licensing channels to a rival retailer may therefore lower the profitability of the wholesale channel provider's own retail business."*[20]
>
> *"These incentives are likely to be strengthened by dominance at the wholesale content provision level: under this argument,* ***any (constructive)***

19 See footnote 4 above.

20 Paragraph 3.70 of the consultation document.

refusal to license content to third parties on the DTT platform could potentially [sic] raise concerns that it was intended to foreclose the emergence of rival players on DTT, enabling Sky to strengthen its position in the overall pay TV market. *We note that Sky already licenses a number of its premium channels to Virgin Media, so in principle we would assume that a wholesale product could be made available on DTT as well, subject to various technical constraints relating to TPS ... .* "[21] (Emphasis added.)

"*The above discussion is intended to highlight the potential [sic] economic incentives on Sky in the DTT market in the absence of regulation. In particular, it outlines ways in which Sky might [sic] have the ability and incentive to foreclose the market. However, it is important to consider the scope of the current competition rules in that, for example, CA98 should provide a deterrent to the sort of conduct highlighted above ... .*"[22]

5.6 This latter comment by Ofcom is a disappointing example of hope triumphing over experience. Despite attempting over a protracted period to gain wholesale access to Sky's premium channels (and in particular Sky Sports 1) two of the existing pay TV retailers on DTT, BT Vision and TUTV, have been unable to gain access to these channels on a wholesale (or indeed any other) basis.[23] Thus, the Competition Act has clearly not deterred Sky from engaging in the conduct highlighted by Ofcom above.

5.7 As is briefly described in section 3 above, it is notable that, in its response to the joint submission, Sky contends that it has a strong incentive to make its channels available on a wholesale basis to competing pay TV retailers. The parties will, in due course, fully respond to these arguments. Nevertheless, for the time being, Ofcom should note that Sky is arguing that it would be better off if it were to wholesale its premium channels to competing retailers on DTT (which would include both Setanta and TUTV) rather than perpetuate the current situation in which its premium channels are not made available on DTT.

5.8 In Annex 4 to Sky's response to the joint submission, CRA states that:

"*We understand that where possible, Sky prefers to retail its sports and movie channels directly on other platforms, rather than by means of a wholesale contract with a third party retailer*".[24]

Whilst this may be Sky's preference, retail price competition would be promoted and consumers would benefit if Sky were to wholesale its channels to competing pay TV retailers on DTT.

---

21 Paragraph 3.71 of the consultation document.

22 Paragraph 3.72 of the consultation document.

23 TUTV approached Sky over the supply of Sky Sports 1 on DTT in autumn 2005, i.e. over two years ago.

24 Paragraph 54 of Annex 4 to Sky's response.

5.9 Furthermore, in various press releases, Sky has sought to emphasise that its objective for Picnic is to increase choice. For example:

> "*By bringing back some of the UK's most popular pay TV content to the DTT platform, Sky aims to create more choice for customers who are interested in upgrading from free to air to pay TV.*"[25]
>
> "*The Picnic service will further contribute to the choice of content, across a range of genres, provided on DTT platform, and so appeal to a wider variety of tastes and interests than are catered for at present.*"[26]
>
> "*Picnic aims to connect viewers to an improved choice of TV content through their aerial.*"[27]

Such an increase in choice would, of course, ensue if Sky were required to wholesale its channels to third party pay TV retailers on DTT. Furthermore, a wholesale relationship would actually result in greater choice than if Sky itself were the retailer of these channels as Sky already retails these channels over its satellite platform.

5.10 In summary, therefore, a requirement for Sky to make its premium channels available on a wholesale basis to third party pay TV retailers for distribution on DTT would benefit consumers as a result of both increased choice and retail price competition in respect of pay TV services (and in particular Sky's premium channels). Such wholesale supply would also be consistent with what Sky claims are its "*strong incentives*" and its stated objective of increasing choice. Accordingly, the authorisation of the broadcasting of Sky's channels on DTT should, as Ofcom has contemplated in the consultation document, be subject to a condition:

> "*... requiring Sky to make ... its channels available to other retailers on a wholesale basis, subject to certain conditions in relation to wholesale pricing.*"[28]

5.11 The pricing and technical conditions that would need to apply in order for such a wholesale supply obligation to be workable are considered in section 10 below. The question of whether Sky should, at the same time, be authorised to retail pay TV services on DTT is considered in sections 6 and 7 below.

---

25 Sky's press release of 8 February 2007 – "*Sky to launch new service on digital terrestrial television*".

26 Paragraph 2.8 of Sky's background information document of 1 October 2007 – "*Picnic: the new entertainment and communications service from Sky*".

27 Sky's press release of 22 November 2007 – "*Disney channel to join Picnic TV service*".

28 Paragraph 1.20 of the consultation document.

6. New DTT boxes containing NDS' conditional access technology

6.1 The second component of Picnic to consider is the proposal to launch a new base of DTT boxes. If Sky were to launch a new base of DTT set top boxes containing NDS' conditional access technology, it would have a material adverse effect on competing pay TV retailers on DTT.

6.2 In the consultation document, Ofcom notes the potential for Sky's new box to have an adverse effect on competition. Specifically, Ofcom states that:

> *"There is an ... argument that the mere fact that Sky announced that it was going to provide pay TV services on the DTT platform has had the effect of "chilling" the market for other providers of pay TV on DTT."*[29]

> *"We also recognise the theoretical [sic] possibility of an impact on competition from Sky's pre-entry announcement. For example, it is possible that retailers of STBs may have been less inclined to stock STBs of competing pay TV service providers as a result of the announcement. ... Therefore, we would wish to see evidence from both pay TV retailers/STB manufacturers that the pre-entry announcement had a significant and sustained impact on their businesses. In particular, it would be necessary to demonstrate that the sales channels affected by the announcement constituted the main routes to market for the affected pay TV retailers/STB manufacturers."*[30]

6.3 Sky's "*pre-entry announcement*" had an actual, rather than merely "theoretical", impact on competition. When Sky pre-announced its proposed new DTT service on 8 February 2007, it confirmed that:

> *"To access the service, customers will buy a new set top box that includes the relevant [NDS] CA software and MPEG 4 decoder."*[31]

Thus, on 8 February 2007, Sky announced that its proposed pay TV service on DTT would not be compatible with existing DTT boxes and that Sky's proposed new DTT box would not be compatible with existing pay TV services on DTT. Thus, the launch by Sky of pay TV services via such an incompatible box would, among other things, penalise Setanta's DTT subscribers who have already purchased boxes which would not receive those services.

6.4 As Ofcom is aware, merely as a result of Sky's initial announcement on 8 February 2007 of its proposed DTT pay TV service, retailers were deterred from placing orders for Setanta/TUTV DTT boxes. This is because of concerns on the part of retailers that Sky's unrivalled premium content offering and its very substantial marketing resources, among other things, would overwhelm any

---

29 Paragraph 3.59 of the consultation document.

30 Paragraph 3.61 of the consultation document.

31 Sky's press release of 8 February 2007.

Setanta/TUTV marketing messages with the result that Setanta/TUTV DTT boxes would remain unsold. Similarly, following Sky's announcement manufacturers were less willing to produce Setanta/TUTV DTT boxes either in significant quantities or even at all, due to the risk of such an outcome. For example, following Sky's announcement **[Redacted – confidential]** withdrew from manufacturing such boxes.

6.5 **[Redacted – confidential]**.

6.6 It should, in this context, be noted that Setanta announced the content and pricing of its new DTT channel on 6 February 2007. Two days later, Sky pre-announced its proposal to launch a pay TV service on DTT using a new base of DTT boxes containing NDS CA technology (even though it was only several months later that Sky was in a position formally to apply to Ofcom for authorisation to launch this service). Despite the need to obtain Ofcom's approval of certain licence variations, Sky asserted that its DTT service would be available in the summer of 2007.

6.7 The timing of Sky's announcement (on 8 February 2007) and the proposed service launch (in summer 2007) were both clearly intended to damage the take up of Setanta's new DTT channel as it commenced live broadcasting of FAPL matches in the UK for the first time. As stated above, following Sky's announcement retailers and manufacturers substantially reduced their support for Setanta DTT boxes. There is a 12 to 16 week lead time for set top boxes. In order for sufficient Setanta boxes to be available to consumers at the start of the FAPL season in August 2007, retailers would need to have ordered boxes by April 2007. **[Redacted – confidential.]**

6.8 In summary, prior to Sky's initial DTT announcement, **[Redacted – confidential]** were forecasting demand for **[Redacted – confidential]** boxes to receive Setanta's DTT channel.[32] Following Sky's announcement, that forecast was cut to **[Redacted – confidential[33]]** and only **[Redacted – confidential]** boxes in total had been ordered by **[Redacted – confidential]** as at 20 June 2007. Thus, by merely making an announcement on 8 February 2007, Sky was able to ensure that there would be very few Setanta boxes available in retailers for the start of Setanta's live coverage on DTT of FAPL matches in August.

6.9 This situation improved to a degree following 26 June 2007, when Ofcom announced that it would consult on Sky's proposed DTT pay TV service. Ofcom expressly noted that:

> "*The applications [by NGW/Sky to replace Sky's free channels with pay TV services on DTT] raise a number of important issues, including a*

---

[32] **[Redacted – confidential]**.

[33] **[Redacted – confidential]**.

> *consideration of how Ofcom can best ensure fair and effective competition for the benefit of consumers.*"[34]

On the issue of timing, Ofcom stated that:

> "*Ofcom expects to issue a consultation document in the autumn, provided that there are no further delays in the conclusion of outstanding technical and commercial issues between the applicants. Ofcom's normal consultation period is ten weeks. This will be followed by a Statement, which Ofcom would hope to publish early next year.*"[35]

6.10 In light of this, retailers and manufacturers were able to ascertain that Picnic would not gain regulatory approval in 2007. As a consequence, retailers' immediate concerns over the launch of Picnic causing them to be left with unsold stocks of Setanta/TUTV DTT boxes were temporarily alleviated. This has enabled Setanta to acquire **[Redacted – confidential]** DTT subscribers as at 30 November 2007.

6.11 Nevertheless, after Ofcom's statement of 26 June 2007, retailers and Setanta were still faced with the 12 to 16 week lead time for set top boxes. As a consequence, there was a shortage of boxes available to retailers at the start of the FAPL season in August. **[Redacted – confidential]** for example, forecast that it would sell **[Redacted – confidential]** Setanta DTT boxes in the period from **[Redacted – confidential]** to **[Redacted – confidential]**. Due to the delay in placing orders, there was a shortage of available Setanta DTT boxes and thus, sales of Setanta DTT boxes during the initial part of the FAPL season were not as high as had been anticipated. As a consequence, in **[Redacted – confidential]** reduced its forecast for sales of Setanta DTT boxes between **[Redacted – confidential]** and **[Redacted – confidential]** from **[Redacted – confidential]** to **[Redacted – confidential]**. In **[Redacted – confidential]**, this forecast was further reduced to **[Redacted – confidential]** Setanta DTT boxes in the period from **[Redacted – confidential]** to **[Redacted – confidential]** because of the manufacturing lead time delaying the supply of Setanta DTT boxes for the Christmas period.

6.12 Furthermore, retailers are aware that Ofcom's consultation on Picnic will close in December 2007 and that Ofcom is due to publish a statement on this issue "*early next year*". As a consequence, the previous concern about Setanta's DTT offering being overwhelmed by a new Sky DTT service has resurfaced and no retailer, **[Redacted – confidential]**, has placed an order for Setanta DTT boxes for any period from 1 January onwards. **[Redacted – confidential.**[36]**]** Thus, having stocked and sold Setanta DTT boxes over the last six months, retailers in

---

34 Ofcom's press release dated 26 June 2007 – "*Ofcom to consult on BSkyB's proposed digital terrestrial television service.*

35 Ofcom's press release dated 26 June 2007 – "*Ofcom to consult on BSkyB's proposed digital terrestrial television service*

36 **[Redacted – confidential]**.

general are now forbearing from such activity as a result of the possibility that Ofcom will authorise Picnic "*early next year*".

6.13 **[Redacted – confidential]**.

6.14 **[Redacted – confidential]**. Sky informed the Culture, Media and Sport Select Committee on 8 May 2007 that it would consider retailing Setanta's channel via its proposed new base of DTT boxes. Thus, in these circumstances, Sky would apparently refuse to provide CA services to Setanta on DTT. **[Redacted – confidential]**.

6.15 The source of Sky's apparent view that it will be able to refuse to provide CA services to Setanta on any DTT platform that it launches can, perhaps, be found in Ofcom's consultation of 15 February 2007 entitled "*The setting of access-related conditions upon Top Up TV Limited*". In this consultation, Ofcom stated that:

> "*In early September 2006, TUTV reached an agreement with Setanta Sports which allows Setanta to broadcast premium content to viewers using TUTV's conditional access system to protect its programming from unauthorised viewing.*"[37]
>
> "*... Therefore Ofcom considers that TUTV is a provider of a conditional access system in relation to protected programme services. As such, Ofcom proposes to set the proposed* Conditions *upon TUTV ...*".[38]

6.16 Thus it appears that Ofcom considers that TUTV is "*a provider of a conditional access system*" and should be subject to access-related conditions under section 75(2) of the Communications Act as a result of TUTV entering into a conditional access services agreement with Setanta. On this basis, any operator of a conditional access system who does not provide conditional access services to a third party broadcaster could be regarded as falling outside the scope of section 75(2) of the Communications Act. If this view were to prevail, Sky could seek to operate a new DTT base of NDS set top boxes in a "closed" manner **[Redacted – confidential]**.

6.17 Even if Ofcom were to seek to impose access-related conditions on a new base of Sky DTT set top boxes containing NDS' conditional access technology, it should be noted that, in its consultation on TUTV, Ofcom stated that:

> "*The 2006 guidelines [entitled "Provision of Technical Platform Services"] reflect the shift in the balance of negotiations between Sky and*

---

37 Paragraph 2.27 of Ofcom's consultation document of 15 February 2007 entitled "*The setting of access-related conditions upon Top Up TV Limited*".

38 Paragraph 2.30 of Ofcom's consultation document of 15 February 2007 entitled "*The setting of access-related conditions upon Top Up TV Limited*".

> *broadcasters (wanting access to the Sky [satellite] platform) as Sky's [satellite] platform moved closer to maturity."*[39]
>
> *"The 2006 guidelines do not apply to TUTV."*[40]
>
> *"[The application of CA regulation to TUTV should] reflect the risk that TUTV, as a platform operator in a relatively early stage of its platform lifecycle, has in developing an emerging platform."*[41]

6.18 Thus, even if Ofcom were to seek to impose access-related conditions on a new base of Sky DTT set top boxes containing NDS' conditional access technology, it would appear that the existing guidelines governing Sky's provision of technical platform services would not apply and Sky's new base of DTT boxes may well be subject to less prescriptive regulation thereby further enabling Sky to prevent, restrict and distort competition.

6.19 **[Redacted – confidential]**.

7. Sky as a pay TV retailer on DTT

7.1 Section 5 above outlines the benefits to both competition and consumers if Ofcom were to require Sky to wholesale its premium channels to third party pay TV retailers on DTT. Section 6 above demonstrates the way that **[Redacted – confidential]**. Sky's unique and extensive influence over the retail supply chain (and its funding capacity and unique incentives to develop a strategic position on DTT) would greatly compound the problems faced by competing DTT pay TV retailers which are described in section 6 above.

7.2 In the consultation document, Ofcom notes Sky's influence over the retail supply chain. Specifically, Ofcom states that:

> *"In relation to the marketing of STBs there is a concern that Sky would have an incentive to influence the market in such a way as to distort competition, for example by incentivising retail outlets such as Dixons and Argos."*[42]
>
> *"Marketing activity is of course not anti-competitive. Investment in marketing could well signal the presence of a healthy competitive environment or be a recognition of the importance of competition for the market. ... Sky will have to persuade the consumer to make an explicit decision to purchase its STBs.* ***We recognise that Sky will have a***

39 Paragraph 5.12 of Ofcom's consultation document of 15 February 2007 entitled "*The setting of access-related conditions upon Top Up TV Limited*".

40 Paragraph 5.13 of Ofcom's consultation document of 15 February 2007 entitled "*The setting of access-related conditions upon Top Up TV Limited*".

41 Paragraph 5.18 of Ofcom's consultation document of 15 February 2007 entitled "*The setting of access-related conditions upon Top Up TV Limited*".

42 Paragraph 3.59 of the consultation document.

particular advantage stemming from its existing relationships with manufacturers for DSat STBs: for instance, it might benefit from economies of scope in terms of STB design or economies of scale in terms of volume of orders. *We would be interested to establish how significant these issues could be in the development of competition for pay TV services on the DTT platform.*"[43] (Emphasis added.)

7.3 In practice, Sky could influence in many different ways the types of DTT boxes that are manufactured and thereby impede the take up of competing pay TV services on DTT. For example, by:

- underwriting manufacturing R&D costs;
- providing "sale or return" support for manufacturers;
- providing "after sales" support for manufacturers;
- inhibiting the inclusion of competitors' components in set top boxes; and
- linking Picnic box prices to DSat box orders.

7.4 In addition, there are myriad ways that Sky could influence high street retailers so as to restrict the take up of competing pay TV services on DTT. These include (but are not limited to) the following:

- subsidising DTT boxes;
- providing marketing support for retailers;
- paying significant retail commissions;
- linking the price of Picnic boxes to subscriptions;
- providing "above the line" advertising support for retailers;
- providing "sale or return" support for retailers;
- making payments for listing and store refits etc.;
- providing "below the line" support (such as point of sale materials, staff training etc.); and
- providing increased financial support for Sky Digital to retailers who promote Picnic.

All of these activities will have the effect of causing retailers to increase their support for Picnic and decrease their support for competing products such as Setanta/TUTV DTT boxes. **[Redacted – confidential]**.

7.5 In an attempt to pre-empt Ofcom's consultation on (and the expression of concern about) Sky's ability to restrict competition through its influence over the retail supply chain, Sky's announcement of 1 October 2007 proposed a number of "*safeguards*". In the consultation document Ofcom stated that:

> *Sky has however made proposals designed to protect the operation of a "horizontal market" for STBs ....*" .[44]

---

[43] Paragraph 3.60 of the consultation document.
[44] Paragraph 3.62 of the consultation document.

> *"Sky has stated its intention to encourage a contestable market for the supply of Sky STBs by any manufacturer that could meet Sky's technical requirements rather than to control the exact specifications and production of Sky STBs."*[45]

It should, of course, be noted that this approach would involve a radical departure from Sky's past practice. In respect of the satellite platform Sky has certainly not sought to encourage a contestable market for the supply of Sky compatible satellite boxes by any manufacturer, rather it has very tightly controlled the exact specifications and production of such boxes.[46] In the circumstances, Sky's assertions about protecting the operation of the horizontal market for DTT set top boxes should be treated with suitable scepticism.

7.6 The specific comments which Sky has made in this regard are set out below together with brief explanations of why these "*safeguards*" would be inadequate and would not prevent Sky from engaging in the practices listed in paragraphs 7.3 and 7.4 above and thereby restricting effective competition.

7.7 In its background information document of 1 October 2007, Sky stated that:

> "*Manufacturers will be responsible for the specification of their boxes and will decide which additional features to include, such as PVR functionality or the ability to receive pay TV services from other providers.*"

Such a "*safeguard*" is, however, easily circumvented. For example, without issuing mandatory specifications for Picnic boxes Sky can still exercise significant influence over which DTT boxes are manufactured by:

- underwriting the R&D costs of its preferred manufacturers **[Redacted – confidential]**;
- providing "*sale or return*" support and underwriting production for its preferred manufacturers **[Redacted – confidential]**;
- managing after-sales support for purchasers of its preferred boxes; and
- ensuring "*loyalty*" on the part of particular manufacturers through the strategic placement of satellite box orders (i.e. a large order for satellite boxes could be implicitly be made subject to a manufacturer not producing DTT boxes which compete with Picnic).

7.8 With regard to the latter point, Sky's most recent quarterly results for Q1 2007/08 confirm that it has an existing base of approximately 8.7 million

---

45 Paragraph 3.60 of the consultation document.

46 Sky has, therefore, brought about a vertical market in respect of satellite set top boxes.

satellite subscribers and an annualised churn rate of 11.3%.[47] Thus, Sky will have to acquire in excess of 980,000 new subscribers in the subsequent 12 months in order simply to stand still (i.e. to maintain the same number of satellite subscribers). Those 980,000 subscribers will need to be supplied with new satellite boxes.[48] Thus, Sky is by far and away the biggest source of set top box orders in the UK. As a consequence of this fact alone, Sky gains substantial influence over both manufacturers and retailers. The placement of significant orders for satellite boxes could undoubtedly be used as a lever in order to achieve lower prices for Picnic boxes from particular manufacturers and/or to deter manufacturers from producing competing boxes.

7.9 **[Redacted – confidential]**.

7.10 In its background information document of 1 October 2007, Sky stated that:

> "... *the "horizontal market" arrangements to be put in place for the supply of reception equipment containing NDS CA technology will not prevent manufacturers incorporating more than one CA system or a common interface (for use with a conditional access module, for example).*"

In practice, however, without expressly proscribing the inclusion of a second conditional access system Sky will, nevertheless, be able to achieve the result of deterring manufacturers from incorporating more than one conditional access system in a DTT box as a result of any or all of the practices described in paragraph 7.7 above. For example, if Sky underwrites the R&D costs incurred by its preferred manufacturer(s) in the production of its preferred boxes, a "*multicrypt*" box (i.e. a box containing two conditional access systems) would be at a cost disadvantage and would thus be less attractive to manufacturers.

7.11 Furthermore, it should be noted that, in a footnote to its background information document of 1 October 2007, Sky stated that:

> *"Picnic does, however, expect manufacturers to ensure that any such equipment is secure in order to minimise/prevent signal theft and internet redistribution of Sky's programming and will work with them accordingly".*

It is clear, therefore, that notwithstanding its statements elsewhere, Sky will seek to influence, inhibit and delay decisions by manufacturers to include competing conditional access systems in Picnic boxes. In addition, even if Sky does not support its preferred manufacturer(s) in the manner described in

---

47 Sky's RNS announcement of 2 November 207 entitled "*Interim Management Statement and Results for the three months ended 30 September 2007*".

48 It should be noted that Sky states its churn figure net of reinstated former subscribers. So none of the 980,000 new subscribers will be "*reinstates*". In addition, it should be noted that this figure of 980,000 does not include replacement boxes for customers whose boxes have failed.

paragraph 7.7 above, a box with two conditional access systems will take longer to produce and be more costly than a DTT box which contains just one (e.g. NDS) conditional access technology. Thus, such a "multicrypt" box will, for these reasons, be less attractive to manufacturers and retailers than Picnic boxes and thus will almost certainly not be ordered or manufactured.

7.12 Ultimately, a key deterrent to manufacturers producing competing DTT boxes will be the absence of orders from retailers. **[Redacted – confidential]** have already shown that they can be deterred from ordering competing boxes simply by a pre-announcement from Sky that it intends to launch a DTT box (section 6 above). The actual launch of a Sky DTT box will further deter retailers from ordering competing boxes. If retailers do not place orders, manufacturers will not produce competing boxes and so they will not be available to prospective subscribers even if competing pay TV retailers are able to stimulate some demand.

7.13 In its background information document of 1 October 2007, Sky also stated that:

> "*Picnic does not intend to subsidise boxes.*"

As Ofcom will appreciate, a statement of intention such as this is not binding and can easily be reversed.[49] In any event, as has been described above, Sky can substantially influence the prices of Picnic boxes without directly subsidising them. For example, Sky can, as stated in paragraph 7.7 above, underwrite R&D costs, provide "*sale or return*" support and/or underwrite production for its preferred manufacturers **[Redacted – confidential]**. The parties understand that Sky argues that such activities do not amount to subsidy of Picnic boxes, even though they necessarily reduce the manufacturer's risk in producing those boxes and thereby reduce the box costs. Ultimately, therefore, a statement that Picnic does not intend to subsidise boxes will not prevent Sky from using its influence over manufacturers and retailers to reduce the price of Picnic boxes and thereby further restrict effective competition in pay TV.

7.14 Specifically, with regard to retailers, Sky stated on 1 October 2007 that:

> "*... retailers will be responsible for setting prices, which will therefore be the same for customers who subscribe at the time of purchase and for those who want the ability to upgrade in the future;" and*
>
> "*... retailers will be responsible for setting their own retail price (and negotiating for the supply of such equipment from manufacturers and/or distributors).*"

In practice, there is no basis for Sky's assertion that box prices "will therefore be the same" for subscribers and non-subscribers. Retailers who are financially incentivised by Sky to sell subscriptions may well be persuaded to reduce the

49 In addition, this is a statement of Picnic's intention – not a statement of Sky's intention.

price of boxes for subscribers. For example, payment of commissions/bonuses to retailers for Picnic subscribers would encourage retailers to discount the boxes for such subscribers.

7.15 Substantial "*above the line*" advertising support by Sky for particular retailers will also influence the prices set by those retailers. Sky's budget for marketing in 2006/07 was £734 million. A budget of this magnitude would enable Sky to engage in substantial cross promotion of particular retailers through, for example, advertising in national news papers when those retailers run specific promotions on Sky/Picnic products. Sky can also influence the prices charged by retailers for Picnic boxes through the other activities listed in paragraph 7.4 above, including:

- payment of per unit staff incentives on Sky's preferred boxes and Picnic subscriptions will also influence which products are actually sold;
- end of year bonuses and even guaranteed bonuses just for stocking Sky's preferred boxes;
- "*sale or return*" support for retailers;
- listing payments (i.e. one-off payments for the initial stocking of Sky's preferred boxes) and make payments for store refits etc.;
- payments for preferred "*in-store*" positions (e.g. display bays, gondola ends, store entrances and window displays);
- guaranteed "*below-the-line*" support (e.g. point of sale materials, merchandising, payments for in-store/windows, staff training, staff road shows);
- significant marketing expenditure on Picnic (which would stimulate demand and thus encourage retailers to promote Picnic so as to capture that demand); and
- increased support for a retailer in respect of Sky Digital if Picnic is stocked (e.g. a bonus on Sky Digital sales if Picnic is stocked by the retailer).[50]

7.16 With regard to the latter point above, Sky could also adopt the converse approach with independent retailers. That is, independent retailers could be threatened with being delisted as Sky Digital outlets (and cease to receive any support from Sky in respect of Sky Digital) if they do not stock Picnic and/or if they do stock competing products. In the consultation document, Ofcom states that:

50 All of the practices described in the first seven bullets above have been undertaken by Sky in the past. They are, therefore, not merely theoretical.

> *"There could be concerns about the impact on competition if there were incentive schemes structured so as to penalise a retailer for sales of other competing STBs, for example if discounts were reduced if the retailer sold competing STBs or if the structure of any discounts clearly incentivised the retailer to only sell one STB."*

In practice, the threats described above would not be written down. Sky could also engage in more subtle techniques, such as causing certain retailers to receive only limited stocks of Sky satellite boxes. In practice, it could simply be made clear to particular independent retailers that the renewal of any support arrangements with Sky would be dependent upon the retailers supporting Picnic and/or not supporting competing products. Such practices would, therefore, be hard to identify and police.

7.17 In conclusion, therefore, it is clear that the "*safeguards*" proposed by Sky for Picnic are essentially cosmetic and will not prevent Sky from using Picnic to restrict further the limited degree of competition which exists today in pay TV in the UK by **[Redacted – confidential]**. This would also be the case if Sky were permitted to retail its premium channels itself over DTT whilst being prevented from launching a new base of DTT boxes, as is explained in Annex 3 (which is confidential to TUTV).

7.18 In the consultation document, Ofcom comments as follows on the implications of Sky becoming the sole pay TV retailer on DTT:

> *"Under the definition of a broader market for retail pay TV (across all platforms), the identity of the single provider of pay TV services on DTT would be critical. Specifically, there could [sic] be a concern if Sky were to emerge as the sole retailer of pay TV services on DTT in that* ***it would be in control of two of the major pay TV platforms in the UK at both the retail and wholesale (platform provision) level.*** *In such a situation* ***there would be an expectation [sic] that inter-platform competition would be weaker than in a world where there was a different provider of pay TV services on DTT."***[51] (Emphasis added.)

7.19 Ofcom's observation that, if Sky were to control pay TV on the two major platforms (satellite and DTT), there would merely be an "*expectation*" that inter platform competition would be weaker is misconceived. There is ample jurisprudence which confirms that competition authorities do not regard intra group contracts as being capable of breaching Article 81 of the EC Treaty (i.e. the jurisprudence recognises that an agreement between two companies in the same corporate group cannot be anti-competitive as between those companies). The reason for this is that companies within the same corporate group do not compete against each other. Thus, they cannot enter into an agreement to restrict competition as there is no competition between them in the first place.

---

[51] Paragraph 3.67 of the consultation document.

In light of this, it is clear that if Sky were to control pay TV on both the satellite and the DTT platforms then effective competition between pay TV services on those two platforms would actually be eliminated.

7.20 Furthermore, as Ofcom goes on to note:

> *"By virtue of its strengthened market position and raising entry barriers,* ***it would be more difficult for other suppliers of retail pay TV channels and platform services to enter the market.*** *While we recognise that dominance in itself is not an abuse, we note that* ***in such a situation Sky might have not only the incentive to exclude new entrants but that going forward it would be better placed to implement such a strategy across multiple platforms and at multiple levels in the value chain.***"[52] (Emphasis added.)

This recognition that the control by Sky of pay TV on both the satellite and DTT platforms would not only eliminate competition between the two platforms but also increase further the barriers to entry into pay TV has already been considered and acted upon by Ofcom's predecessor and the European Commission.

7.21 When DTT services were first licensed in the UK, the ITC, following representations from the Competition Directorate of the European Commission, informed the winning bidder for the three pay TV multiplexes, British Digital Broadcasting ("BDB"), that it would only actually be awarded licences for the three pay TV multiplexes if Sky exited the joint venture. In the circumstances, it is somewhat misleading for Ofcom to state in its consultation document that:

> "*... owing to competition concerns, Sky left the consortium ...*".[53]

Sky did not leave of its own volition – it was required to exit the consortium by the UK sectoral regulator and the EU competition authority. In addition, when the licences for multiplexes B, C and D were re-awarded in 2002, the ITC again made it clear to relevant parties that Sky could not become a pay TV retailer on DTT.

7.22 At the time that Sky was required to exit the BDB consortium in 1997, it had approximately the same number of pay TV subscribers in the UK as the aggregate number of cable subscribers (approximately 3.5 million subscribers on each platform). Since then, the number of cable subscribers has remained largely static. In contrast, Sky's subscriber base has increased to approximately 8.7 million. Sky's market position in pay TV is, therefore, substantially stronger today than it was in 1997 when the then sectoral regulator and the European competition authority determined that Sky could not have a 33% stake in the initial pay TV retailer on DTT.

---

52 Paragraph 3.67 of the consultation document.

53 Paragraph 2.17 of the consultation document.

7.23 If, in the current market circumstances, Ofcom were to authorise Sky to become a pay TV retailer on DTT, it would undoubtedly be in breach of its "*principal duty*" to promote competition.[54] Furthermore, as is stated above, before taking such a decision Ofcom would need to have reached a conclusion as to the current state of competition in pay TV in the UK and its likely evolution. If Ofcom were to reach such a conclusion ahead of the completion of the market investigation into pay TV, it would have pre-judged the outcome of the market investigation.

8. Ofcom's market investigation into pay TV

8.1 In its statement of 20 March 2007, which confirmed that Ofcom was commencing an investigation of the pay TV market in order to determine whether to make a market reference to the Competition Commission, Ofcom expressly noted that:

> "*... BSkyB has announced a proposal to launch a new pay TV service on the DTT platform, based on new set top box specification. ...* ***the implications of the possible entry of BSkyB into the pay DTT market, including impact on consumers and emerging competition, will be part of the market investigation announced today.***" (Emphasis added.)

8.2 This overlap between (i) the consideration of competition issues raised by Picnic and (ii) Ofcom's market investigation into pay TV has also been explicitly recognised by Ofcom in its Picnic consultation document, in which it stated that:

> "*In the longer term the impact on competition [of Picnic] at both the retail and wholesale level depends on expectations for the development of pay TV services on the DTT platform and the nature of competition in the provision of pay TV services more widely.* ***These competition issues are being considered in the broader context of our market investigation into the pay TV industry.***"[55] (Emphasis added)

8.3 In the consultation document Ofcom also stated that:

> "*The outcome in which Sky emerges as the sole retailer of pay TV services on DTT is also a relevant one to consider when addressing the question of how the market evolves. That outcome could arise purely through competition on the merits.* ***We also need to consider the incentives that might exist for anti-competitive conduct. In that context we would need to consider the role of upstream dominance, and in particular whether***

---

54 Section 3(1)(b) of the Communications Act.

55 Paragraph 1.12 of the consultation document.

Sky is dominant at the wholesale level in the provision of content (either premium or premium and basic)."[56] (Emphasis added.)

8.4 Thus, Ofcom has already acknowledged that, in order properly to assess the competition issues raised by Picnic, Ofcom will consider whether Sky is dominant at the wholesale level in the provision of content. Again, this consideration overlaps substantially with the scope of Ofcom's market investigation into pay TV.

8.5 Furthermore, when considering Sky's incentives for anti-competitive conduct, Ofcom must consider not only Sky's upstream position but also its downstream position. For the reasons set out in the joint submission by BT, Setanta, TUTV and Virgin Media of 3 July 2007 (which are briefly summarised in section 3 above), the current lack of effective competition in pay TV in the UK results not merely from Sky's upstream position but from, among other features, the combination of mutually reinforcing bottlenecks that Sky controls both upstream and downstream. Hence, when considering Sky's incentives, Ofcom must also have regard to Sky's existing downstream position (as both the gate keeper to the largest pay TV platform in the UK and the controller of the largest base of pay TV subscribers) . If Ofcom were to authorise Sky to become a pay TV retailer on DTT, Sky would be able to extend its downstream bottlenecks into the DTT platform and thereby exacerbate further the competition issues which are at the heart of the market investigation.

8.6 Section 7 above outlines several practices which Sky could undertake in order to eliminate competing pay TV retailers from the DTT platform. Many of these practices relate to Sky's unique market position. For example, Sky's ability to influence the retail distribution chain is derived from its position as by far the largest pay TV retailer in the UK.

8.7 If a new pay TV retailer were to enter on DTT with a compelling and valuable content proposition (including the retail offering of Sky's premium channels) and were to be exceptionally well funded and prepared to risk a significant investment in order to acquire a DTT subscriber base, then it could arguably match some of these activities by Sky, such as the payment of large retailer commissions. Such a new entrant would, however, not have the same incentives as Sky in this context. The prospective entrant would also face a very significant deterrent which Sky itself does not face – namely, the presence of Sky as both a competitor and an exceptionally well entrenched incumbent.

8.8 By virtue of its unique market position (and its control of mutually reinforcing upstream and downstream bottlenecks) Sky is able to manage competition in pay TV. However, as the DTT platform grows (and there are now more DTT households than satellite households), its potential for supporting competing pay TV retailers also grows. Accordingly, Sky has an incentive (which is entirely

[56] Paragraph 3.69 of the consultation document.

unique to Sky) to extend its downstream bottleneck into DTT so as to reinforce the vicious circle which is described in section 3 above. In this way, Sky will perpetuate its hegemony of pay TV in the UK. No other company, however well resourced it might be, would have a comparable incentive.

8.9 Thus, Ofcom's acknowledgement that, in considering the request to authorise Picnic, it must "*consider the incentives that might exist for anti-competitive conduct*" again confirms the inextricable linkage between the market investigation and Picnic. In order properly to have regard to the incentives for anti-competitive conduct, Ofcom must consider Sky's unique incentives which are derived from (and, indeed, contribute to the) vicious circle in pay TV which is being considered as part of the market investigation.

8.10 In the circumstances, it would at the very least be premature if, prior to the conclusion of the market investigation, Ofcom were to authorise Sky to engage in new pay TV activities which could weaken further the already limited state of pay TV competition in the UK. In fact, for the reasons explained below, such an authorisation would be in breach of both Ofcom's administrative law duties and its principal statutory duty to promote competition.

9. The use of ex post competition powers

9.1 Option 1 for addressing Picnic is described in the consultation document as follows:

> "*In light of the increased choice of programming, including premium sports and movies, and associated consumer benefits identified in the consultation document, one option would be for us to consent to the proposal as it stands without requiring any additional specific conditions to be met. This option would reflect a conclusion that* ***any competition concerns could be effectively addressed under ex post competition powers****.*"[57] (Emphasis added.)

9.2 For the reasons outlined above, a conclusion that "*any competition concerns*" arising from Picnic "*could be effectively addressed under ex post competition powers*" could only be reached following a full assessment of pay TV competition in the UK and its likely evolution, which Ofcom is undertaking in the market investigation that it announced on 20 March 2007. Thus, a decision to implement Option 1 above prior to the conclusion of the market investigation would be outwith Ofcom's powers as it would necessarily entail the failure by Ofcom to take account of material relevant factors (i.e. the eventual conclusions of the market investigation) in reaching such a decision.

9.3 Furthermore, a decision to implement Option 1 would also fail to recognise the material shortcomings with *ex post* competition law. In its consultation document, Ofcom stated that:

57 Paragraph 1.17 of the consultation document.

> *"The extent to which we would be able to rely on ex post enforcement (under either our CA98 or sectoral powers) to remedy any competition issues is a key consideration. An issue identified in the concerns set out above is the possibility that* ***Sky's actions in relation to the retail market could have a material impact on the longer term development of competition at all levels and that it would be difficult to address that after the event. If Sky's entry leads quickly to the exclusion of other retailers, it is unlikely [sic] that ex post measures would be effective in unwinding that position.***"[58] (Emphasis added.)

Again, this is a material understatement by Ofcom.

9.4 The only formal use of the Competition Act to date in respect of Sky was the investigation which the OFT carried out between October 2000 and December 2002 into alleged infringement of the Chapter II prohibition. This investigation followed on directly from a Fair Trading Act investigation into Sky which the OFT commenced in March 2000. Thus, overall, this period of investigation lasted for nearly three years and yet only reached the conclusion that:

> *"... there are insufficient grounds to find that BSkyB has abused its dominant position by exercising a margin squeeze on its premium channel distributors, or by practising anti-competitive mixed bundling in the wholesale provision of channels."* [59]

Thus, after three years, the OFT was unable to establish an infringement, even though it did not expressly conclude that Sky had not infringed the Chapter II prohibition. It is clear, therefore, that whilst the OFT considered that Sky's conduct was preventing, restricting or distorting competition, it was unable to address that conduct using *ex post* measures. Option 1 in the consultation document is, therefore, not viable.

9.5 In the consultation document, Ofcom also states that:

> *"In considering longer term issues, it is also relevant to consider our ability to address competition concerns after the fact. For instance, in the case where Sky has become the de facto monopoly provider of pay TV services on DTT, including at the wholesale TPS level, and where there remain capacity constraints ... ,* ***it could be very difficult [sic] for regulatory intervention to enable a new competitor to enter the market to establish a competing pay TV platform on DTT.***"[60] (Emphasis added.)

9.6 **[Redacted – confidential]**.

---

58 Paragraph 3.73 of the consultation document.

59 Decision of the OFT No. CA98/20/2002, dated 17 December 2002.

60 Paragraph 3.68 of the consultation document.

9.7 In light of this, Ofcom alludes to the correct approach when it states in the consultation document that:

> "***If there is the potential for certain types of behaviour to have a material impact on competition, it may [sic] be relevant to adopt a precautionary principle and put in place ex ante rules to prevent such potential from being exploited.*** *However, any such rules should be a proportionate response to the issue that has been identified.*"[61] (Emphasis added.)

The proportionate conditions which are necessary to ensure fair and effective competition are considered below.

10. Conditions to ensure fair and effective competition

10.1 Option 2, canvassed in the consultation document, would entail:

> "*... consent to the proposal subject to imposing conditions to address the longer term competition issues.*"[62]

10.2 As is noted above, in order properly to assess the competition implications of Picnic, it is necessary to disaggregate the Picnic proposal and consider each component in turn. Similarly, when considering the conditions which Ofcom could impose upon Sky and which are necessary to ensure that Sky/Picnic does not enter into or maintain any arrangements or engage in any practice which would be prejudicial to fair and effective competition, each individual component of Picnic should again be considered in turn.

Wholesale premium channel supply

10.3 For the reasons outlined above, if Sky is to be authorised to broadcast its premium channels on DTT, that authorisation must be made subject to a condition that Sky wholesales its channels to competing pay TV retailers on the platform. In order to be effective, that wholesale supply obligation will need to be supported by detailed provisions in respect of the wholesale pricing for Sky's channels so as to ensure that they are made available at commercially viable rates. Setanta and TUTV briefly consider such a wholesale pricing provision below. In doing this, the parties note Ofcom's comment in the consultation document that:

> "*Imposing additional conditions can lead to further complex issues of detail which would require careful consideration to ensure that the conditions are effective ...* ".[63]

---

61 Paragraph 3.74 of the consultation document.
62 Paragraph 1.18 of the consultation document.
63 Paragraph 1.21 of the consultation document.

In the circumstances, Ofcom would need to consult fully on any proposed conditions before implementing them. In the meantime, certain principles in respect of a wholesale pricing obligation should be noted.

10.4 In the consultation document Ofcom states that:

> "*It is likely [sic] to be necessary to establish a framework for deriving appropriate wholesale prices in order for [a wholesale supply obligation] to be effective. One approach would be to require the adoption of a "retail-minus" approach or "ex ante margin squeeze" rule to help ensure that retail competitors can compete at the retail price level while still recovering efficiently incurred costs including retail distribution costs.*"[64]

10.5 As part of its investigation of Sky between 2000 and 2002, the OFT applied (i) a margin squeeze test in an attempt to ensure that Sky's overall retail distribution business is profitable and (ii) a mixed bundling test in an attempt to ensure that the incremental costs incurred by Sky in supplying an additional premium channel to a subscriber would be covered by the wholesale revenues earned by Sky's broadcasting business (either actually from a third party distributor or notionally from Sky's own distribution business). Thus, whilst the margin squeeze test was applied at the retail level, the mixed bundling test was only applied at the wholesale level.

10.6 As a consequence, in several cases, Sky has been able to set the wholesale charge for a premium channel so that it is higher than the incremental retail revenue that Sky itself earns as a result of distributing that premium channel to an additional subscriber. Sky's distribution business, therefore, often earns a negative gross margin on the incremental sale of an additional premium channel. As Virgin Media (the only current third party distributor of Sky's premium channels) has to pay those wholesale prices whilst still competing with the retail price points set by Sky, this results in Virgin Media having little or no incentive actively to compete with Sky in the retailing of these channels.

10.7 In order to be commercially viable, therefore, the wholesale charges for Sky's premium channels must not only satisfy the OFT's (retail) margin squeeze test and the OFT's (wholesale) mixed bundling test but also a mixed bundling test which is applied at the retail level. This should ensure that Sky's wholesale charges are set at a level which is lower than the incremental retail revenues earned by Sky from the sale of those channels (thereby enabling third party retailers of those channels to compete more effectively with Sky). In this context, it is noteworthy that Sky Italia's incremental wholesale charges for its premium channels are expressly subject to a "*retail minus*" test. The "*minus*" in that case comprises, among other things, the retail distribution cost (including

---

64 Paragraph 5.22 of the consultation document.

marketing, transmission and box costs) which Sky Italia avoids when supplying premium channels to third party distributors.[65]

10.8 The wholesale supply obligation in respect of Sky's premium channels should, subject only to reasonable and demonstrable technical constraints (as a result, for example, of limited capacity on DTT), include access to the same product as that retailed to DTH subscribers (i.e. including associated, enhanced and interactive services) on commercially viable wholesale terms.

10.9 In the consultation document Ofcom states that:

> "*We recognise that a wholesaling requirement on its own may not be workable in practice, if multiple versions of a TV channel need to be broadcast in order to make it available on STBs supporting different CA systems. This is because capacity on the DTT platform is at present significantly constrained .... Conditions relating to TPS may therefore be required in order to implement an effective wholesaling requirement on Sky.*"[66]

10.10 Setanta and TUTV agree that a wholesale supply obligation could be entirely neutered if Sky were able to refuse to make its premium channels available via the existing base of pay TV compatible DTT boxes. Accordingly, the authorisation of Sky's premium channels for DTT distribution should be subject to an obligation on Sky/NGW to ensure that the channels are accessible via such boxes. In this context more generally, it may be appropriate for Sky/NGW to be required to ensure that Sky's premium channels are capable of being decrypted via DTT boxes containing any established and reputable conditional access technology.

New Sky box containing NDS conditional access technology

10.11 For the reasons outlined in sections 6 and 7 above, if Sky were authorised to launch a new DTT box containing NDS conditional access technology, it would be able to deter manufacturers from producing and retailers from stocking and selling competing DTT boxes, even if Sky were to wholesale its channels to competing pay TV retailers on DTT and those channels were, as a consequence, to be made available via competing DTT boxes. Thus, the mere presence of a new Sky DTT box containing NDS conditional access technology would be sufficient **[Redacted – confidential]**.

10.12 An additional factor, which needs to be considered in connection with Sky's proposal to launch a new base of DTT boxes, is why Sky would chose to use a different conditional access technology in preference to the Nagra conditional access technology which is currently operated by TUTV on the DTT platform.

---

65 Paragraph 10.5 of the Commitments given by News Corp. to the European Commission on 13 March 2003.

66 Paragraph 5.23 of the consultation document.

Nagra's technology is the most widely deployed conditional access technology in the World.[67] It can undoubtedly perform all the functions that would be required of conditional access technology by a pay TV retailer on DTT in the UK. Indeed, Nagra's conditional access technology is already used to protect Sky's premium channels on the cable platforms in the UK and Ireland. It is also used to protect News Corp's premium channels in the US.

10.13 In the circumstances, it is clear that any decision by Sky to launch pay TV services on DTT using NDS' conditional access technology rather than the established DTT conditional access technology would necessarily be motivated by the desire to control access to DTT (in the same way that Sky currently controls access to satellite) and thereby further restrict competition.

10.14 Sections 316 to 318 of the Communications Act provide the statutory basis for Ofcom's *ex ante* regulation of competition issues in the broadcasting sector. In particular, section 316 provides for conditions to be inserted into broadcasting licences to deal with competition concerns. Such conditions may be used to secure that a licensee does not enter into any arrangement or engage in any practice which is "*prejudicial to fair and effective competition*".

10.15 Ofcom has confirmed that Option 2 (i.e. consent to the Picnic proposal subject to imposing additional conditions):

> "*... would seek (i) to gain the benefits of bringing new programming content to DTT, providing consumers with a greater choice of premium movies and sports ... but also (ii) to ensure the conditions for competition in pay TV, both on DTT and more widely, to the benefit of consumers in the longer term.*"[68]
>
> "*In balancing these objectives, and consistent with our regulatory principals, we would seek to impose additional conditions which are the least intrusive necessary to achieve the policy objectives effectively.*"[69]

10.16 In practice, both goals (i) and (ii) outlined above would be achieved by Sky wholesaling its premium channels to third party pay retailers on DTT and not, itself, retailing pay TV services on DTT. It is, however, somewhat misleading for Ofcom to state that it should balance these objectives. As previously noted, Ofcom is under a principal statutory duty to promote competition. Accordingly, it should not subjugate that duty to (or seek to offset it against) any other purpose, such as the desire to bring new programming content to DTT.

---

67 In the US, for example, Echostar has built up a base of approximately 14 million subscribers using Nagra's conditional access technology. In France, the operator of the principal pay TV platform, Canal Plus, uses Nagra's conditional access technology. In Scandinavia and Spain, the leading pay TV operators both use Nagra's conditional access technology.

68 Paragraph 1.19 of the consultation document.

69 Paragraph 1.20 of the consultation document.

10.17 As a consequence, Ofcom must ensure (over and above other considerations) that if it is to authorise the broadcasting of Sky's premium channels on DTT, then it imposes such conditions as are both necessary and **sufficient** to ensure that Sky and NGW do not enter into any arrangement or engage in any practice which is prejudicial to fair and effective competition. In this regard, it is worth reiterating, as Ofcom has already acknowledged, that it should adopt a "*precautionary*" approach where there is the potential for a material adverse impact on competition (which is clearly the case in respect of Picnic).[70]

10.18 As the mere presence of a new Sky DTT box (which is not compatible with existing pay TV services on DTT or existing DTT boxes) would be sufficient to **[Redacted – confidential]**, the least intrusive condition in this regard would be to prohibit Sky launching and making its channels available through such a new base of incompatible DTT boxes.

Sky as a pay TV retailer

10.19 In addition to ensuring that **[Redacted – confidential]** as a result of Sky launching new DTT boxes containing NDS conditional access technology, it is necessary for Ofcom separately to consider the impact on competition of Sky becoming a pay TV retailer on DTT for the first time (albeit without launching such a new base of DTT boxes). Section 7 above outlines ways in which Sky, as a pay TV retailer on DTT, could **[Redacted – confidential]**.

10.20 In the consultation document, Ofcom states that:

> "*The outcome in which Sky emerges as the sole retailer of pay TV services on DTT is also a relevant one to consider when addressing the question of how the market evolves. That outcome could arise purely through **competition on the merits**.*"[71] (Emphasis added.)

10.21 The proper way to construe Ofcom's power to impose conditions under section 316 of the Communications Act is to view the words "*fair and effective*" disjunctively.[72] Thus, for example, if a practice is prejudicial to effective competition it will, by definition, be prejudicial to fair and effective competition.

10.22 It would, therefore, be appropriate for Ofcom to preclude an outcome in which Sky emerges as the sole pay TV retailer on the DTT platform even as a result of "*competition on the merits*". This is because that outcome would be prejudicial to effective competition, howsoever it had been reached.

---

70 Paragraph 3.74 of the consultation document.

71 Paragraph 3.69 of the consultation document.

72 By ascribing these powers to Ofcom, Parliament intended to increase its ability to intervene in matters raising competition concerns, rather than restrict that ability. Therefore, in so far as conduct meets only one of the conditions (i.e. it is either unfair or distortive of effective competition) then, logically, Parliament would wish there still to be a power of intervention.

10.23 Whether or not any of the activities described in section 7 above are regarded as "*fair*" competition or "*competition on merits*", they will all manifestly lead to a material adverse impact on "*effective*" competition in pay TV. Therefore, in order to ensure that Sky does not enter into any arrangement or engage in any practice which is prejudicial to fair and effective competition, Ofcom must impose conditions which inhibit, as a minimum, the activities described in section 7 above.

10.24 As noted above, Ofcom would clearly need to consult fully on any proposed conditions before implementing them. In the meantime, however, Setanta and TUTV outline briefly below the conditions that would be needed in order to prevent Sky engaging in the activities described in section 7 and thereby having a materially prejudicial impact on fair and effective competition.

10.25 At the heart of a number of the concerns outlined in section 7 are Sky's ability and incentives to leverage the pay TV market structure and its leading positions elsewhere in the pay TV supply chain in order to restrict competition from third party pay TV retailers on the DTT platform. Thus, in the first place, in order to ensure that Sky does not favour its own retail operations on DTT, Picnic must be established as a separate corporate entity and must operate independently of all other Sky companies and maintain separate accounts for all its activities. In this context, it is noteworthy that such a condition would merely reinforce Sky's assurance of 1 October 2007 that:

> "*It is intended that Picnic is able to operate on a stand-alone basis, and market its services separately from Sky.*"

10.26 In order to ensure that Sky is not able to undermine the purpose of the wholesale supply obligation, Picnic would need to pay the same wholesale rates for Sky's premium channels as third party pay TV retailers.

10.27 Several of the practices described in section 7 relate to Sky's ability to cross subsidise any retail pay TV activities on DTT from the very substantial revenues it earns through its leading positions elsewhere in the pay TV supply chain. Picnic must, therefore, fully bear its operating costs (including the appropriate WACC) from the retail margin it earns supplying channels on DTT. Accordingly, the wholesale revenues which Sky earns when Picnic retails its premium channels must be repatriated upstream within Sky. Those revenues must not be utilised by Picnic.

10.28 Furthermore, in this regard Sky has unique incentives which relate to its current hegemony over pay TV. For example, Sky has incentives to limit the growth of other pay TV retailers not only so as to diminish retail competition downstream but also to restrict competition upstream for premium sports and movie rights. As a consequence, therefore, Sky has unique incentives to develop a strategic position in the retailing of pay TV on DTT and to eliminate competing pay TV retailers from that platform in order to further entrench its incumbent position in pay TV in the UK. No other company, however well funded, either has those incentives or would be likely to risk the substantial sums that are required to secure control over the DTT platform. This is, however, the type of investment that both Sky and its controlling shareholder News Corp have sought to make in the past. As Ofcom will be aware, Sky has a track record of making substantial investments in order to achieve particular strategic positions. For example, Sky's near £1 billion acquisition of 17.9% of ITV; Sky's £1 billion investment in Kirch in Germany; and Sky's very substantial investment in BiB. In light of Sky's funding capacity and unique incentives to extend its downstream gatekeeper status from the satellite platform to DTT, Sky must not be permitted to fund losses in Picnic and hence Picnic must be profitable from its inception. In addition, Sky must be precluded from injecting substantial equity into Picnic to enable it to distort competition by engaging in the practices described in section 7 (such as the payment of large retail commissions) without bearing the costs of those activities from the retail margin it earns.

10.29 Sky could also distort competition and circumvent the financial safeguards described above, if Picnic were to benefit from favourable deals offered by Sky to manufacturers and/or retailers in respect of Sky Digital. In practice, such ancillary benefits to Picnic would be hard to identify and police. Therefore, in order to prevent such arrangements, Picnic must be precluded from ordering DTT boxes from manufacturers who supply boxes to Sky and Picnic boxes must not be made available through retailers who offer Sky Digital. In addition, given that Sky is controlled by News Corp and News Corp's other group companies are responsible for very substantial orders of set top boxes worldwide, Picnic must be precluded from ordering DTT boxes from manufacturers who supply boxes to any News Corp company.

10.30 Picnic and Sky must not inhibit the inclusion of competitors' components in Picnic boxes.

10.31 Picnic must not benefit from Sky's substantial marketing resources. Thus, Sky must not promote Picnic through advertising, field sales staff etc.

10.32 In the consultation document, Ofcom notes that:

> "*A further concern arises if Sky has an incentive to use its position as a purchaser of third party content on the DSat platform to influence the availability of that content on DTT.*"[73]

Accordingly, in order to ensure that Picnic does not obtain favourable access to third party content for distribution on DTT as a result of Sky leveraging its position as the primary pay TV retailer on DTT, Picnic must not procure exclusive DTT rights to third party channels. In addition, Picnic must procure DTT rights for third party channels independently from Sky's acquisition of

[73] Paragraph 3.71 of the consultation document.

satellite rights (and must be able to demonstrate such independent acquisition). If it can be shown that Picnic has acquired non-exclusive rights at preferential rates, Picnic must repay any discount it has received.

10.33 The conditions outlined above are all necessary (but are not necessarily sufficient) to ensure that Sky does not enter into any arrangement or engage in any practice in respect of Picnic which is prejudicial to fair and effective competition. Ofcom has, however, consistently demonstrated a strong preference, when remedying competition issues, to "*fixing*" wholesale markets so as not to require perpetual regulation of retail markets. Yet, if Ofcom does allow Sky to become a pay TV retailer on DTT it will, as the preceding discussion demonstrates, need to engage in perpetual and detailed regulation of the retailing of pay TV services.

10.34 Furthermore, for the reasons outlined briefly in section 3 above, the market failure in pay TV is so endemic that the imposition of conditions by Ofcom on Picnic will not ultimately prevent Sky using its position as a pay TV retailer on DTT **[Redacted – confidential]**. (Indeed, Sky has shown itself to be particularly adept in the past at circumventing regulation, no matter how prescriptive it is.) As a consequence, rather than introduce voluminous regulation of pay TV at the retail level, the far better approach would be for Ofcom not to authorise Sky to become a pay TV retailer on DTT. Such a prohibition on retailing would not, however, deny consumers the benefits of increased choice and, indeed, competition in pay TV services on DTT provided that Sky is authorised to (and does) supply its premium channels on DTT through wholesale arrangements with third party pay TV retailers.

10.35 If, as a consequence of such an approach, Sky were to withdraw its request for authorisation to broadcast its premium channels on DTT, then Sky would have disclosed its true motives for seeking such authorisation. If Sky genuinely wished to increase choice and competition (as it has claimed in its press releases), then it would be willing to make its premium channels available on DTT only on a wholesale basis. If, however, Sky is only willing to make its premium channels available on DTT on the terms outlined in the Picnic proposal, then its objective would clearly not be as benign as it is seeking to represent.

11. Precedent and policy

11.1 In the consultation document, Ofcom states that:

> "*... we note that competition concerns have previously been raised in respect of Sky's involvement with the DTT platform. Most notably, in 1997 regulators and competition authorities had concerns about Sky's role as a shareholder in the BDB consortium (the precursor to ONdigital/ITV Digital) and as a supplier of programmes to BDB [sic]. Ultimately, these concerns were addressed by Sky ceasing to be a*

shareholder in BDB. In 2002, at the time of the re-licensing of the multiplex licenses previously operated by ITV Digital, Sky was limited to participating on DTT as a broadcaster – rather than a multiplex operator – on multiplex C and a number of conditions were attached to the multiplex licence in order to protect fair and effective competition."[74]

11.2 As noted in section 7 above, when DTT services were first licensed in the UK, the ITC required the winning bidder for the three pay TV multiplex licences, BDB, to enter into a wholesale arrangement with Sky for access to its premium channels. At that time, the ITC recognised that, if the entry of BDB was to lead to effective competition in pay TV services, it would need to have wholesale access to Sky's premium channels. The ITC therefore did not (as Ofcom states) have "*concerns about Sky's role ... as a supplier of programmes to BDB*". Instead, the ITC had concerns about Sky not being a supplier of programmes to BDB – i.e. the ITC had concerns about Sky withholding its premium channels. Ultimately, Sky agreed to wholesale its channels to BDB as part of the arrangement under which Sky exited BDB.

11.3 Sky did not, however, leave BDB of its own volition – it was required to exit the consortium by the ITC (which was the UK sectoral regulator at the time) following representations from the Competition Directorate of the European Commission (i.e. the EU competition authority). In addition, when the licences for multiplexes B, C and D were re-awarded in 2002, the ITC again made it clear to relevant parties that Sky could not become a pay TV retailer on DTT and restricted its involvement in the platform.

11.4 In this context, it should also be noted that, at the time that Sky was required to exit the BDB consortium in 1997, it had approximately the same number of pay TV subscribers in the UK as the aggregate number of cable subscribers (approximately 3.5 million subscribers on each platform). Since then, the number of cable subscribers has remained largely static. In contrast, Sky's subscriber base has increased to approximately 8.7 million. Sky's market position in pay TV is, therefore, substantially stronger today than it was in 1997 when the then sectoral regulator and the European competition authority determined that Sky could not have a 33% stake in the initial pay TV retailer on DTT.

11.5 If, in the current market circumstances, Ofcom were to authorise Sky to become a pay TV retailer on DTT, it would undoubtedly be in breach of its "*principal duty*" to promote competition.[75] Furthermore, as is stated above, before taking such a decision Ofcom would need to have reached a conclusion as to the current state of competition in pay TV in the UK and its likely evolution. If Ofcom were to reach such a conclusion ahead of the completion of the market

[74] Paragraph 3.52 of the consultation document.

[75] Section 3(1)(b) of the Communications Act.

investigation into pay TV, it would have pre-judged the outcome of the market investigation.

11.6 There is, therefore, clear precedent in the UK for Sky being prevented, on two previous occasions, from becoming a pay TV retailer on DTT. Furthermore, Ofcom should note that the relevant licensing legislation has not changed since Sky was previously prevented from becoming a pay TV retailer on DTT. (The relevant licensing provisions still arise under the Broadcasting Act 1996.) Since those two previous occasions, Ofcom has been established in order to discharge certain functions and duties which are set out in the Communications Act. Whilst the licensing function, in this respect, is the same as the one exercised by Ofcom's predecessor, the ITC, Ofcom is now subject to a new principal duty to promote competition. That new principal duty should make it more, not less, likely that Ofcom will follow the two precedents and ensure that Sky does not become a pay TV retailer on DTT.

12. Other territories

12.1 The question of whether the leading pay TV broadcaster and satellite pay TV retailer should be allowed to extend its activities into DTT has also already been considered in certain other Member States where pay TV services have been made available on DTT.

12.2 For example, as preconditions to the merger of Telepiu and Stream in Italy in 2003, the resulting merged company, Sky Italia, and News Corp. (its parent company) had to give extensive undertakings to the European Commission. Among other things, the parties were obliged:

- to divest Telepiu's existing terrestrial businesses;
- to commit not to enter into any further DTT activities either as a network operator or pay TV retailer; and
- to undertake to make Sky Italia's sport and movie channels available on a wholesale basis to third party pay TV retailers for distribution on DTT.

12.3 Sweden is one of the few territories in which a pay DTT platform has proved sustainable and successful. This is all the more impressive since Sweden also has well developed cable and satellite platforms. There is one pay TV retailer on DTT in Sweden, Boxer, which is independent of the large cable groups such as ComHem and the established satellite operators such as Canal Digital and Viasat. In fact, at the time that DTT was licensed in Sweden, neither the established cable operators nor the incumbent satellite platform operators were allowed to own part of Boxer or to operate a separate DTT pay TV retailer. The parties understand that premium channels such as Canal +, which was owned by Canal Digital when it was first supplied to Boxer, are supplied to Boxer on a wholesale basis.

12.4 One notable exception, where the established satellite pay TV operator has been sanctioned to retail its services via both satellite and DTT, is Canal Plus in France. Canal Plus started as a purely analogue terrestrial based pay TV operator and subsequently launched its own digital satellite platform in around 1997. Today, the company continues to operate its multi-million subscriber analogue terrestrial and digital satellite platforms. It has also now been licensed by the CSA to launch a DTT platform with the intention of transitioning its large analogue terrestrial subscriber base. It is TUTV's understanding that the CSA has sanctioned Canal Plus as a pay retailer on DTT in addition to satellite in order to encourage the company to accelerate the migration of its highly profitable analogue terrestrial subscriber base to a digital platform and thereby release the analogue frequencies it has traditionally used. In addition, as Ofcom will be aware, French industrial policy frequently seeks to create national champions at the expense of the promotion of competition.

12.5 It is clear, therefore, that absent particular policy issues such as the desire to transition an analogue terrestrial pay TV subscriber base or the (indefensible) desire to create a national champion, licensing authorities in other countries have sought to ensure that there is inter platform competition in pay TV by preventing incumbent satellite pay TV operators from becoming pay TV retailers on DTT.

13. Ofcom's duty to promote competition

13.1 As Ofcom acknowledges in the consultation:

> "*The [Picnic] proposal must be considered in the context of Ofcom's duties. Ofcom has a principal duty to further the interests of ... consumers, where appropriate by promoting competition.*"[76]

13.2 Such a duty to promote competition has applied in the telecommunications sector since it was first liberalised in the UK in the 1980s.[77] The inclusion of this duty in section 3 of the Communications Act was, however, the first time it had been applied to the broadcasting sector.

13.3 A duty to "*promote competition*" clearly extends further than a duty to preserve the existing state of competition and a duty to prevent anti-competitive behaviour. Specifically, the verb "*promote*" is defined as:

> "*further the progress of; support or encourage; ... raise to a higher position or rank; ... increase the activity of ... .*"[78]

---

76 Paragraph 1.2 of the consultation document.

77 See, for example, the Telecommunications Act 1984.

78 Tenth edition of the Concise Oxford English dictionary.

13.4 There can be no doubt that it is "*appropriate*" for Ofcom to further the interests of consumers by promoting competition in respect of the licensing of DTT services.

13.5 As stated above, Sections 316 to 318 of the Communications Act provide the statutory basis for Ofcom's *ex ante* regulation of competition issues in the broadcasting sector. In particular, section 316 provides for conditions to be inserted into broadcasting licences to deal with competition concerns. Such conditions may be used to secure that a licensee does not enter into any arrangement or engage in any practice which is prejudicial to fair and effective competition. **[Redacted – confidential]**.

13.6 **[Redacted – confidential]**.

13.7 **[Redacted – confidential]**.

13.8 **[Redacted – confidential]**.

13.9 **[Redacted – confidential]**.

14. Conclusion

14.1 In the consultation document, Ofcom confirms that:

> "*... it is relevant to focus on* ***fostering an environment that encourages effective competition on the DTT platform and which would also allow for the development of competition between pay TV platforms.***"[79] (Emphasis added.)

14.2 Given the material adverse implications for competition, Ofcom would certainly not be fostering an environment that encourages effective competition on the DTT platform or allowing for the development of competition between pay TV platforms if Ofcom were to authorise Sky to broadcast its premium channels on DTT in the manner contemplated in the Picnic proposal (i.e. those channel being retailed on DTT by Sky itself using new DTT boxes containing NDS conditional access technology).

14.3 In contrast, if Sky were to wholesale its premium channels to competing pay TV retailers on DTT and not, itself, retail those channels on the platform, the following benefits would ensue:

- DTT viewers would have access to these premium channels for the first time since 2001;

[79] Paragraph 1.15 of the consultation document.

- intra platform competition on DTT would be increased as a result of there being three competing retailers of these channels on the DTT platform (BT Vision, Setanta and TUTV);
- inter platform competition would be increased as a result of the strengthening of pay TV offerings on DTT with what is commonly regarded as the key content for pay TV services[80];
- consumers would experience substantially increased retail price competition; and
- Sky would, according to the arguments it has made in its response to the joint submission, be better off than if these channels continued to be withheld from DTT.

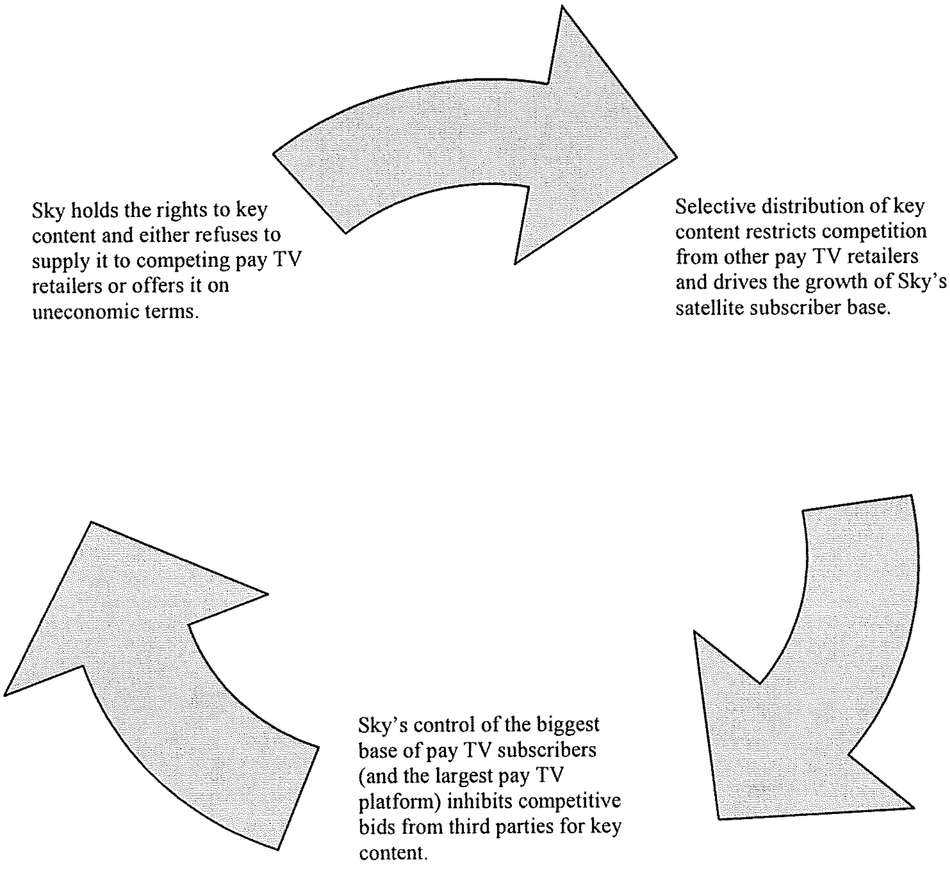
14.4 In light of these significant benefits and the absence of an adverse impact on competition, Ofcom should only authorise Sky to broadcast its premium channels on DTT subject to a condition that it wholesales those channels to competing pay TV retailers on the platform on commercially viable terms and subject to a condition that it does not, itself, retail those channels on DTT.

December 2007

Setanta Sport Holdings Limited
Top Up TV Europe Limited

80 See, for example, the summary of relevant jurisprudence in section 2 of Part 3 of the joint submission of 3 July 2007 by BT, Setanta, TUTV and Virgin Media.

Annex 1: Vicious circle in pay TV in the UK



Annex 2: The important of DTT to Setanta

[Redacted – confidential]

Annex 3: Deployment of Nagra conditional access Technology on DTT in the UK

[Redacted – confidential]