



Provision of Technical Platform Services

Guidelines and Explanatory Statement

Statement

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Section 1

Summary

Introduction

- 1.1 This statement and guidelines set out how Ofcom would normally interpret the requirement on Sky to ensure that its terms, conditions and charges for providing access to its technical platform services (“TPS”) are fair, reasonable and non-discriminatory.
- 1.2 Broadcasters and operators of interactive TV services who wish to gain access to viewers using Sky’s digital set top boxes can purchase TPS and Sky is required to provide these services on fair, reasonable and non-discriminatory terms.
- 1.3 In the event of a dispute or complaint about Sky’s TPS terms, conditions and charges, Ofcom would normally expect to follow the guidance in this statement when interpreting the meaning of what is fair, reasonable and non-discriminatory. However, Ofcom cannot legally fetter its discretion in advance and therefore retains the ability to depart from the guidance where the circumstances warrant it.
- 1.4 Ofcom first consulted on this subject in November 2005 (“the first consultation”). Having carefully considered the responses to the first consultation Ofcom developed a draft version of this explanatory statement and guidelines.
- 1.5 Ofcom consulted on the draft explanatory statement and guidelines on April 21 2006 (“the second consultation”). This consultation closed on 16 June 2006. Ofcom has also given careful consideration to the responses to the second consultation in finalising this statement and guidelines.

Summary of the guidelines

- 1.6 The Guidelines (set out in Annex 1) set out Ofcom’s approach to considering in the event of a dispute or complaint whether Sky has complied with the conditions requiring it to provide access to TPS on fair, reasonable and non-discriminatory (FRND) terms (the “Conditions”¹). The Guidelines are formed of two parts. The first part sets out general principles that Ofcom would apply in assessing whether Sky has complied with the Conditions. The second part provides more detail on Ofcom’s normal approach to particular aspects of cost recovery and assessment of benefits received in assessing whether Sky has complied with the Conditions.
- 1.7 The general principles that Ofcom would normally apply when considering whether TPS terms offered by Sky are consistent with the conditions requiring it to provide access on FRND terms are:
 - The costs that Sky should be entitled to recover from TPS customers should be restricted to costs which it reasonably, necessarily and efficiently incurs in the provision of TPS to those customers or in order to develop and operate the DSat platform.

¹ A summary of the Conditions are set out in Annex 2 of this statement.

- Sky should be entitled to recover its allowable costs and make a risk adjusted return on its investment.
 - Costs should only be recovered from those customers that directly cause the costs to be incurred, or that benefit from the costs being incurred.
 - Where costs incurred are of benefit to more than one TPS customer then they should be recovered from each TPS customer in a way that takes due account of the benefits derived by TPS customers from those costs being incurred.
- 1.8 The Guidelines provide further detail on a FRND approach to cost recovery and non-price terms associated with the provision of TPS:
- A potentially reasonable approach to recovering common costs maybe one in which these costs are recovered from each TPS customer in relative proportion, based on a percentage of their incremental benefits derived from using each TPS.
 - Ofcom considers that incremental revenues derived by a TPS customer from using TPS are a reasonable proxy of incremental benefits received.
 - In the interests of practicability, Ofcom considers that a fixed fee for an EPG listing may potentially be a reasonable charging methodology for smaller broadcasters that earn relatively low incremental revenues from being available on DSat.
 - Guidance on how costs might reasonably be recovered over time and how over and under recovery of costs may be adjusted for in later periods.
 - Guidance on non price terms Ofcom considers are necessary to satisfy the FRND requirement. These include lead times for provision of regulated TPS, information relating to the development of new regulated TPS and the need to unbundle TPS where technically feasible.
- 1.9 Sky is required to publish a notice specifying its charges, or specifying the methodology that is to be adopted for determining its TPS charges. It is Ofcom's view that the charging methodology should provide an existing or prospective TPS customer with sufficient information to allow it to determine the TPS charges that it would expect to pay without having to enter into a commercial negotiation with Sky.

Application of the new guidelines

- 1.10 Ofcom considers that for reasons of practicality Sky should be allowed a reasonable period of time to implement any changes to its charges or charge methodology as a consequence of the new guidelines. Therefore, the new guidelines will apply as from 1 January 2007, on which date Sky must either publish its revised charges or its charging methodology.

Section 2

Introduction and background

- 2.1 The Guidelines set out how Ofcom would normally interpret the requirement on Sky to ensure that its terms, conditions and charges for technical platform services (“TPS”) are fair, reasonable and non-discriminatory.
- 2.2 This section explains the different TPS that are covered by the Guidelines, the current regulation that applies to the provision of these services, the rationale for reviewing the previous² guidelines and the status of the Guidelines going forward.

Technical Platform Services (TPS)

- 2.3 Broadcasters and operators of interactive TV services who wish to make their content available on Sky’s digital set top boxes can make use of a number of different technical services relating to encryption, electronic programme guides and use of Sky’s interactive technology and systems. Some of the key services that broadcasters and operators currently make use of are set out below.

Conditional Access

- 2.4 A conditional access (“CA”) service enables a broadcaster to restrict access to content that it has made available on a digital platform only to those customers that have been authorised to access it. CA systems typically employ content scrambling and encryption technologies along with an end user authorisation system and decryption technologies operating within the digital receiver (a digital receiver could be a digital set top box with an active viewing card).
- 2.5 On digital TV platforms, CA services are primarily used to enable subscription and pay per view pay-TV services (“pay-TV CA” services). Access to specific encrypted channels and content is only provided to those users who have paid (or have committed to pay) for the content.

Geographic Masking

- 2.6 Geographic masking is where purchasers of CA services are able to restrict access to content to defined geographic territories by implementing technologies and procedures which seek to restrict and/or record the geographic locations in which each of its digital receivers is installed and used. This technique is used to minimise the number of digital receivers that are able to access specific encrypted channels outside of specific geographic territories, such as the UK.

Electronic Programming Guide listing services

- 2.7 Viewers of digital TV use Electronic Programme Guides (“EPGs”) primarily to navigate between channels, access channels by unique channel numbers, and browse through programming schedules and related data.

² The pricing of conditional access services and related issues – a statement by the Director General of Telecommunications, 8 May 2002 and Terms of supply of conditional access, Ofcom guidelines, 22 October 2002

- 2.8 Some EPG listings do not contain as much programme schedule information as others, for example on Sky DSat EPG viewers have access to less schedule information on radio channels than is available for TV channels.
- 2.9 The EPG listing service involves assigning an EPG channel number to each broadcaster's channel and providing a technical interface by which the broadcaster can deliver and amend programme schedules and related data.

Regionalisation

- 2.10 A broadcaster may want to associate different broadcast channels with the same EPG channel number in different geographic regions. For example, DSat viewers in London receive a different version of ITV1 on channel 103 to viewers in Manchester. Different broadcasters may require different regions to be defined, for example the geographic boundaries of the ITV regions do not necessarily correspond with the geographic boundaries of the BBC regions.

Access Control Services

- 2.11 Access Control ("AC") services involve access to certain application programming interfaces (APIs) and access to the digital broadcaster's remote computer hardware and software systems. Such services allow broadcasters to develop software applications such as interactive TV applications, which can be loaded and executed on the digital receiver. These applications may then establish an on-line connection with the broadcaster's network infrastructure to create a "client server" computing environment.
- 2.12 Other AC services also enable the broadcaster to provide viewers with the ability to identify and access interactive applications. For example, on the DSat platform viewers might access interactive applications by "pressing the red button" whilst watching a TV channel or selecting the service from the "Interactive Main Menu".
- 2.13 The specific AC services currently offered by Sky on its DSat platform are set out at Annex 3.

Current regulation

- 2.14 The obligation to provide CA services on a fair, reasonable and non-discriminatory basis stems from the Advanced Television Standards Directive (95/47/EC – the "Directive"). The Directive was implemented in the UK by the Advanced Television Services Regulations 1996 (SI 1996 No. 3151) and the Advanced Television Services (Amendment) Regulations 1996 (SI 1996 No. 3197). As a result, the predecessor telecommunications regulator, OfTel, regulated the provision of CA services through a class licence first granted by the Secretary of State for Trade and Industry under section 7 of the Telecommunications Act 1984 in January 1997 and replaced by an equivalent new class licence granted in August 2001. The TV platform operators Sky Subscriber Services Limited ("Sky") and ITV Digital registered under this licence.
- 2.15 The licence regime ended in July 2003 and was replaced by new EU regulatory framework for electronic communications networks and services (The EU Communications Directives). The EU Communications Directives were implemented in the UK through the Communications Act 2003.

- 2.16 In July 2003, Oftel imposed certain regulatory conditions (the “Conditions”³). on the digital TV platform operator Sky, the only supplier of TPS in the UK, requiring it to offer third parties access to CA, AC and EPG services on regulated terms.
- 2.17 One of the regulatory conditions imposed on Sky requires it to provide TPS on fair and reasonable terms, conditions and charges. Another condition requires Sky to publish charges or the method for determining charges and provide 90 days notice before amending any conditional access charges, terms and conditions. Ofcom considers that it is important that the published charges or methodology should allow TPS customers to determine what charges they would expect to pay without entering into a negotiation with Sky.
- 2.18 Sky remains the only party regulated under the TPS regulatory provisions.

Rationale for reviewing the guidelines

- 2.19 There are a number of reasons that prompted Ofcom to review and update the previous guidelines:

To provide certainty and transparency to current and future TPS customers

- 2.20 A number of stakeholders and respondents to the first consultation considered that the previous guidelines had not provided sufficient clarity for them to determine whether the TPS terms and conditions they were offered would be considered fair, reasonable and non-discriminatory by Ofcom in the event of a complaint or dispute⁴.
- 2.21 Ofcom has also been concerned that a lack of clarity arising from the previous guidelines introduced uncertainty in the business plans of existing and prospective TPS customers which may in turn have dis-incentivised investment and/or market entry. In Ofcom’s view, predictability, transparency and certainty of pricing are critical to ensuring that potential providers of retail services will actually enter the market.

To address a changing platform moving closer to maturity

- 2.22 The previous guidelines stated that Sky’s published prices were only a starting point for negotiations and should not be rigidly adhered to. Sky was therefore able to negotiate different charges with TPS customers on the basis of their willingness to pay. Where the relative negotiating positions of the parties were balanced or when the costs and benefits of the platform were highly uncertain, it may have been appropriate to adopt this approach to allow some freedom for charges to be determined by commercial negotiation.
- 2.23 In the start up phase of a platform business, negotiations were more likely to be balanced as Sky was dependent on securing attractive content on to its platform in order to stimulate retail customer growth. It was therefore more appropriate to allow TPS charges to be determined through commercial negotiations, which provided the

³ A summary of the Conditions are set out in Annex 2 of this statement.

⁴ A dispute may be brought where s185 of the Communications Act 2003 applies. Ofcom has a defined process for dealing with complaints and disputes, details of which can be found on the Ofcom website: http://www.ofcom.org.uk/bulletins/eu_directives/guidelines.pdf

flexibility for TPS charges to be tailored to the specific needs of broadcasters and interactive service providers.

- 2.24 With 8 million households signed up to Sky's retail platform service, Sky is now in a much stronger negotiating position vis-à-vis TPS customers. For example, by the end of Q3 2003 (shortly after the previous guidelines were published), Sky had 6.7m subscribers compared to 3.3m subscribers to (analogue and digital) cable⁵. The gap in retail subscriber numbers between the two largest retail pay-TV platforms had increased from 3.4m in Q3 2003 to 4.7m in Q1 2006 and although there were also 7.1m DTT only households in Q1 2006, only a limited proportion of these had DTT set top boxes capable of supporting retail pay-TV services.⁶ The relatively higher growth in Sky's retail customer base compared to the next best alternative is likely to have tipped the balance of negotiating strength in favour of Sky.
- 2.25 In order to gain direct access to Sky's 8 million households, TPS customers must agree terms with Sky. This raises the following concerns, which have the potential to lead to consumer detriment:
- the potential for Sky to charge some TPS customers higher charges than others, without this difference in charges being reflective of a differential in the relative benefits received by the TPS customers, leading to potentially discriminatory treatment between TPS customers (including potential discrimination between Sky's own retail business and third party businesses). This in turn may harm the development of new and innovative services and potentially reduce the incentive for third party TPS customers to undertake risky investments; and
 - the potential for consumer detriment in terms of lack of competition, innovation and competitive pricing as a result of the above.
- 2.26 Therefore, while the previous guidelines which afforded Sky greater flexibility were appropriate for regulation of the platform at that time, going forward the means by which fair, reasonable and non-discriminatory charges are achieved should reflect the shift in the balance of negotiations and the change in the risk profile of costs and revenues.
- 2.27 Whilst Ofcom considers that changes were necessary, based on the rationale set out above, the guidelines set out in this document share many of the underlying principles that formed the basis of the previous guidelines. These include the need to ensure costs are reasonably, necessarily and efficiently incurred, recovery of common costs based on willingness to pay (which in turn is related to the benefits received), the use of revenues earned as a proxy of benefits received and guidance on non price terms such as lead times and information relating to new TPS.

Responses to the first consultation

- 2.28 The majority of respondents supported Ofcom's proposal to issue revised guidelines and welcomed increased certainty and transparency of TPS charges, terms and conditions. One respondent disagreed with Ofcom's proposed revision of the guidelines and argued that there is no case for changing the regulatory regime, which has been successful at achieving plurality and range of services.

⁵ Ofcom Digital Television Update – Q3 2003, <http://www.ofcom.org.uk/research/tv/reports/dtv/dtv2003q3/>

⁶ Ofcom Digital Progress Report – Q1 2006, http://www.ofcom.org.uk/research/tv/reports/dtv/dtu_2006_q1/

- 2.29 While Ofcom notes that there are a number of different broadcasters currently present on the DSat platform, Ofcom considers that increased certainty and transparency of TPS charging can allow further development in the types of services that are available to viewers.

Status of the guidelines

- 2.30 When resolving any dispute or investigating any complaint brought to it in relation to Sky's alleged failure to comply with the TPS conditions, Ofcom would normally expect to follow these Guidelines. However, Ofcom cannot legally fetter its discretion in advance and therefore retains the ability to depart from the guidance where the circumstances warrant it.

Application of the new guidelines

- 2.31 Ofcom considers that for reasons of practicality Sky should be allowed a reasonable period of time to implement any changes to its charges or charge methodology as a consequence of the new guidelines. Therefore, the new guidelines will apply as from 1 January 2007, on which date Sky must either publish its revised charges or its charging methodology.

Notification of conditional access charge changes

- 2.32 As set out in the Conditions, Sky is required to provide a 90 day notification period before making changes to its conditional access charges. Given that the review of the TPS guidelines has been ongoing for the past year and broadcasters will in effect have notice from the date this statement is published that their conditional access charges may change, Ofcom proposes to waive this requirement under the Conditions.
- 2.33 A separate consultation document has been published on waiving the 90 day notification period, which can be found on the Ofcom website at <http://www.ofcom.org.uk/consult/condocs/accesscharges/>
- 2.34 Under the Conditions Sky only has to provide one day's notice of changes to EPG listing and AC charges.

Existing contracts

- 2.35 Ofcom is aware that a number of existing contracts between Sky and broadcasters do not expire until after the application of the new guidelines. Ofcom considers that any revised charges/methodology under the new guidelines should apply as from 1 January 2007, and that Sky's TPS charges to broadcasters may as a consequence increase or decrease. Where such revisions do not take effect for the remainder of any contracts, Ofcom would normally consider it FRND for any under or over recovery of charges as from 1 January 2007 to be recovered from the next contractual period.

Market review

- 2.36 It should be noted that, as set out in its 2006/7 Annual Plan⁷, Ofcom has been carrying out work to analyse the degree of competition between different

⁷ http://www.ofcom.org.uk/about/accoun/reports_plans/annual_plan0607/

broadcasting platforms, which will feed into a market review to consider appropriate regulation in this area.

2.37 Ofcom intends to publish a statement announcing the commencement of the market review in early October 2006. The statement will set out the scope of the market review and a detailed timetable.

2.38 In the meantime, for the reasons set out above Ofcom considers that it is appropriate to update and revise the guidelines that set out how it would normally enforce the existing Conditions in the event of a complaint or dispute.

Structure of this document

2.39 The remainder of this statement is set out as follows:

- Section 3 sets out Ofcom's principles of TPS cost recovery;
- Section 4 explains how Ofcom is likely to assess allowable TPS costs in the event of a complaint or dispute;
- Section 5 explains Ofcom's approach to cost recovery in the event of a complaint or dispute;
- Section 6 explains how Ofcom is likely to quantify the incremental benefits received by each TPS customer from being on the DSat platform in the event of a complaint or dispute;
- Section 7 explains how Ofcom is likely to approach FRND non price terms and conditions in the event of a complaint or dispute;
- Section 8 sets out Ofcom's consideration of its duties;
- Annex 1 sets out the Guidelines;
- Annex 2 sets out the legal framework that applies to TPS;
- Annex 3 sets out AC services on the DSat platform;
- Annex 4 sets out Ofcom's approach to a reasonable rate of return; and
- Annex 5 sets out further responses to the consultations.

Section 3

The principles of TPS cost recovery

- 3.1 In order to determine on a dispute or complaint whether TPS charges proposed by Sky are fair, reasonable and non discriminatory (“FRND”) in compliance with the Conditions, Ofcom must decide whether the overall costs Sky recovers are reasonable and whether their recovery from each TPS customer is fair and non-discriminatory.
- 3.2 This section sets out the principles of TPS cost recovery Ofcom would normally apply when assessing whether it was reasonable for particular costs to be recovered through TPS charges and from whom these costs might be recovered.
- 3.3 These principles are similar to those used in other areas of regulation and are recognised as being applicable to a wide range of cost recovery approaches, including FRND.

Fair and reasonable cost recovery

- 3.4 In Ofcom’s view a fair and reasonable pricing regime is one in which the costs which Sky is allowed to recover from TPS customers are restricted to those which it reasonably, necessarily and efficiently incurs in the provision of services to those customers and as a result of the development and operation of the DSat platform and which result in benefits for those customers:
- A “**reasonably**” incurred cost is the cost associated with an input that is required for the provision of a TPS or in order to develop and operate the DSat platform and which results in benefits for TPS customers.
 - A “**necessarily**” incurred cost is the cost associated with an input that is indispensable to the provision of TPS or the development and operation of the DSat platform and which results in benefits for TPS customers.
 - An “**efficiently**” incurred cost is the lowest reasonably achievable cost associated with a reasonable and necessary input, given Sky’s technology. Efficiently incurred costs are those resulting from cost minimisation on the part of Sky.
- 3.5 This principle is consistent with the previous guidelines which state that costs should be “reasonably and necessarily incurred”⁸ and that recovered costs should be “efficiently incurred”⁹

Return on investment

- 3.6 Ofcom considers that it is reasonable for Sky to make a return on the costs incurred in providing TPS and developing and operating the DSat platform that reflects the risk adjusted cost of capital of the investment.
- 3.7 When assessing whether a rate of return is reasonable, Ofcom will take into account the impact on the incentives for companies to invest. Where investments are risky, it is important that an allowable rate of return reflects the degree of risk that companies

⁸ Paragraph 2.2 *Terms of supply of conditional access: Oftel guidelines*, 22 October 2002

⁹ Paragraph 2.3 *Terms of supply of conditional access: Oftel guidelines*, 22 October 2002

face in making investments. It is Ofcom's view that the analytical approach outlined in Ofcom's statement on approach to risk in the assessment of cost of capital¹⁰ should serve as a starting point for Ofcom's approach to risk and return in all sectors that it regulates, including audio-visual broadcasting industries. Further details of Ofcom's approach are set out in Annex 4.

General principles of cost recovery

- 3.8 Ofcom has established six principles of cost recovery that it will apply in assessing how costs could be recovered in any given situation. These principles have previously been successfully applied in a wide range of scenarios and are generally considered to provide an objective and consistent approach to cost recovery:
- cost causation - costs should be recovered from those parties whose actions cause the costs to be incurred at the margin;
 - cost minimisation - the mechanism for cost recovery should ensure that there are strong incentives to minimise costs;
 - distribution of benefits - costs should be recovered from beneficiaries, especially where there are externalities;
 - effect on competition - the mechanism for cost recovery should not undermine or weaken the pressures for effective competition;
 - reciprocity - where services are provided reciprocally, charges should also be reciprocal; and
 - practicability - the mechanism for cost recovery needs to be practicable and relatively easy to implement.
- 3.9 In the case of TPS charges, there are common costs to be recovered as well as incremental costs relating to service provision to individual customers (common costs are costs which are not directly attributable to a particular TPS customer). Ofcom therefore considers that the cost recovery principles of cost causation and distribution of benefits would normally be of most relevance when determining FRND TPS charges.

Cost causation

- 3.10 In general, Ofcom will apply cost causation first and greater reliance is given to it, on the grounds that economic efficiency is enhanced by requiring parties to pay for those costs which they directly cause.
- 3.11 Where specific costs can be identified as being caused solely by a particular service or an additional customer, the principle of cost causation is generally recognised as appropriate as it promotes an economically efficient allocation of resources by ensuring that each user of a service pays for the additional costs incurred in providing that service. Using this principle, incremental costs incurred by the Sky in providing a new service or a service to a new customer would reasonably be expected to be wholly recovered from users of that particular service or from that particular customer.

¹⁰ Ofcom's approach to risk in the assessment of the cost of capital, 18 August 2005 (see: http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/final.pdf)

Distribution of benefits

- 3.12 Ofcom considers that a key principle in relation to the recovery of common costs via TPS charges is that such costs should be recovered in a way that (to the extent reasonable and practicable) takes due account of the benefits derived by TPS customers from those costs being incurred. Further guidance on the methods that Ofcom considers may conform to this principle is provided in section 5.
- 3.13 Ofcom considers that when costs incurred do not benefit a particular TPS customer it would not normally be reasonable for any of these costs to be recovered from that customer

Responses to the first consultation

- 3.14 Ofcom's proposal in the consultation document that customer acquisition costs should be recovered from TPS customers in proportion to the benefits they receive was met with broad agreement from respondents. However, one respondent did not consider that benefits received was an appropriate approach and that another allocation methodology should be considered. After further consideration, and given the weight of support from other respondents, Ofcom maintains its view that the recovery of significant common costs should be based on the benefits that customers receive.

Responses to the second consultation

- 3.15 One free to air broadcaster put forward arguments that Sky should only be able to recover the incremental costs of providing TPS to a customer from that customer (and that no common costs should be recoverable from TPS customers). The respondent also proposed that, if common costs were to be recovered from third party TPS customers, that it would be inconsistent with competition law and regulatory precedent. Another free to air broadcaster also considered that only the administrative costs of providing an EPG listing should be recoverable through TPS charges.
- 3.16 Ofcom has considered the points presented by the respondents but does not agree that they are valid in this case. A charging methodology which only allowed Sky to recover the incremental costs of providing TPS would not allow Sky to recover the legitimate common costs it had incurred in developing the platform.

Application of the principles

- 3.17 A consequence of these Guidelines is that Ofcom would expect Sky to objectively apply the principles when determining its TPS charges and be in a position to justify to Ofcom its charges in light of these principles in the event of a dispute or complaint.
- 3.18 In the event of a dispute or complaint Ofcom may request that Sky provide Ofcom with the basis on which it calculated its charges. Ofcom intends to share this information with the other party in the complaint or dispute, subject to legitimate claims of confidentiality.

Section 4

Allowable costs

- 4.1 In order to determine on a dispute or complaint whether TPS charges proposed by Sky are FRND in compliance with the Conditions Ofcom must decide whether the costs Sky recovers are reasonable.
- 4.2 As set out in Section 3, one of the principles of TPS cost recovery is that Sky should only recover costs from TPS customers which it reasonably, necessarily and efficiently incurs as a result of the provision of services to those customers or as a result of the development and operation of the DSat platform and from which TPS customers derive a benefit. In this section guidance is provided on how Ofcom would normally expect to apply this principle to different categories of cost that Sky incurs.

Types of costs

- 4.3 TPS costs can broadly be categorised as costs specific to a particular TPS (or group of TPS), referred to below as “TPS costs” or “platform costs” which are incurred in the development and operation of the DSat platform.
- 4.4 Ofcom considers that Sky should only recover costs from TPS customers which it reasonably, necessarily and efficiently incurs as a result of the provision of services to those customers and/or as a result of the development and operation of the DSat platform and from which TPS customers derive a benefit.
- 4.5 To ensure TPS customers are not required to contribute towards the recovery of costs from which they do not derive a benefit, Ofcom considers that each item of allowable cost should be identified as one of the following:
- an incremental cost associated with a specific TPS customer;
 - a TPS specific common cost;
 - a TPS cost which is common to more than one TPS;
 - a customer specific platform cost, or;
 - a platform common cost.

These categories of costs are described further below.

TPS costs

- 4.6 Ofcom considers that it would normally be reasonable for Sky to recover reasonably, efficiently and necessarily incurred costs associated with the provision of TPS from customers of those TPS. These costs are likely to include:

TPS specific common costs

- 4.7 TPS specific common costs are those costs that are incurred by Sky in the provision of a particular TPS and from which all customers of that service derive a benefit. For example, if Sky did not offer EPG listings it would not incur the cost of transponder capacity required to broadcast the EPG schedule data.

Incremental costs of service provision

- 4.8 The incremental costs of service provision are the costs incurred by Sky in the provision of a TPS to an individual TPS customer. For example, a new TPS customer taking an EPG listing may result in Sky incurring costs in implementing a technical interface to the customer's scheduling system.

Costs common to more than one TPS

- 4.9 Some costs incurred by Sky may be common to the provision of more than one TPS. Ofcom considers that it may be necessary for Sky to define a number of different TPS common cost "pools" to ensure TPS customers are not required to contribute to the recovery of TPS common costs from which they do not derive a benefit.

Platform costs

- 4.10 In addition to the costs associated with providing individual TPS, Sky may incur other "platform costs" that are incurred in developing and operating the DSat platform as a whole.
- 4.11 Ofcom considers that it would normally be reasonable for Sky to recover reasonably, efficiently and necessarily incurred platform costs. These cost can be sub-categorised as:

Customer specific platform costs

- 4.12 Customer specific platform costs are those allowable costs incurred by Sky in developing and operating the DSat platform which are not directly attributable to a TPS and for which it is reasonably practicable to attribute them to one or more TPS customers. Ofcom considers that it may be necessary for Sky to define a number of different platform cost "pools" to ensure TPS customers are not required to contribute to the recovery of platform costs from which they do not derive a benefit

Platform common costs

- 4.13 Platform common costs are those allowable costs incurred by Sky in developing and operating the DSat platform that are not directly attributable to a TPS and which benefit all TPS customers.

Examples of costs

- 4.14 Guidance on which of the costs incurred by Sky Ofcom considers might reasonably be recovered through TPS charges is provided below. However, this does not represent an exhaustive list of costs that might be recovered.

Marketing Costs

- 4.15 Sky may choose to undertake marketing (e.g. advertising) to promote the benefits of the platform and to encourage its take up and use.
- 4.16 Ofcom considers that marketing of the general benefits of the DSat platform which stimulates take up and increases the platform customer base is likely to benefit most TPS customers, although there may be customers who do not benefit. It would therefore be reasonable for Sky to recover these costs through TPS charges levied on those customers who benefit.

- 4.17 To ensure TPS customers are not being required to contribute towards efficiently incurred costs from which they do not benefit, in the event of a dispute or complaint to Ofcom, Ofcom would expect Sky to justify any marketing spend recovered via TPS charges, and in particular demonstrate to Ofcom that third party TPS customers have not contributed to the marketing of Sky's own retail business.
- 4.18 Several respondents to both consultations suggested that all of Sky's marketing is undertaken purely for the benefit of its own retail pay-TV business. It was also suggested by one respondent that even the marketing of the Sky "Freesat" service has been undertaken with the sole intention of encouraging these customers to upgrade to a Sky pay-TV package. Some respondents concluded that none of Sky's marketing costs should be recovered through TPS charges.
- 4.19 Whilst Ofcom notes the views expressed by some of the respondents, Ofcom does not consider it proportionate or reasonable that these costs should be dis-allowed in their entirety and Ofcom considers that Sky should reasonably be able to recover costs that benefit other TPS customers. Consequently, in the event of a complaint or dispute, Ofcom is likely to request information from Sky on the benefits that relevant TPS customers received from marketing costs being incurred. Ofcom intends to share this information with the other party to the complaint or dispute, subject to legitimate claims of confidentiality.

Customer retention marketing

- 4.20 Where Sky undertakes marketing that encourages households not to churn from its platform, it would normally be reasonable for these costs to be recovered through TPS charges to those customers who benefit. However, Ofcom would not normally consider it reasonable for costs incurred in the prevention of churn from Sky's retail services to be recovered through TPS charges.

Customer equipment subsidies

- 4.21 Sky may choose to subsidise customer equipment to promote the benefits of the platform and to encourage its take up and use. Where such subsidies benefit TPS customers, Ofcom considers that it may be reasonable for Sky to recover efficiently incurred subsidies through TPS charges levied on those customers that benefit.
- 4.22 However, where subsidies are provided subject to a customer entering into a Sky retail contract (a contractual tie), Ofcom considers that it is likely that Sky receives more benefits from the subsidy than other TPS customers. Ofcom considers that any additional benefits that Sky receives from that tie should be considered when assessing the benefits that each TPS customer receives.

Past losses

- 4.23 It is Ofcom's understanding that, to date, Sky's costs of providing TPS and developing and operating the DSat platform (including a reasonable rate of return on capital employed) have exceeded the revenues received from TPS customers (including those from Sky's own retail business). Ofcom considers that it is fair and reasonable for losses incurred in the past to be recovered through TPS charges.
- 4.24 However, it is unlikely to be appropriate for Sky to start recovering costs which were incurred in the past which have not previously been recovered via TPS charges. For example, Ofcom would not expect a TPS customer to contribute to costs incurred in

the past that it would not reasonably have expected to contribute to at the time the costs were incurred.

Platform operational costs

- 4.25 Ofcom considers it would normally be reasonable that operational costs associated with the platform can be recovered through TPS charges provided that third party TPS customers were not being required to contribute to the costs incurred in operating Sky's own retail business. For example, Ofcom would normally only expect call centre costs incurred in answering general queries about the use of the platform, such as advice on technical issues, to be recoverable through TPS charges and not costs associated with the provision of specific retail packages.

Further responses to the consultations

- 4.26 Some respondents to the first consultation claimed that Sky only provides equipment subsidies to benefit its own pay-TV business and that third party TPS customers should not therefore be expected to contribute to the recovery of these costs.
- 4.27 Three respondents whose channels are available on other platforms claimed that they did not benefit when Sky provided equipment subsidies that resulted in homes which already had access to their channels becoming equipped to receive DSat transmissions. Consequently, these broadcasters did not believe that they should contribute to the recovery of these costs.
- 4.28 As set out above, Ofcom considers that some TPS customers benefit from an increased number of homes being able to receive their services via Sky DSat and therefore it would normally be reasonable for Sky to recover these costs through appropriate TPS charges. However, the additional benefit that Sky receives from tied subsidies should be addressed when assessing benefits (see section 6).
- 4.29 A number of respondents to the first and second consultations highlighted the need to "disaggregate" costs wherever possible, such as identifying the costs of individual components of a set top box, in order that the costs of the individual components are only recovered from those that benefit from the particular components. For example, the PSTN modem in a set top box may not benefit all TPS customers.
- 4.30 Ofcom considers that, where reasonably practicable, Sky should disaggregate costs wherever possible with a view to ensuring that TPS customers only contribute to the recovery of costs from which they derive a benefit. For example, if it were reasonably practicable to disaggregate the costs associated with set top boxes such that TPS customers are only required to contribute towards those cost from which they derive a benefit, Ofcom would expect Sky to do this. In the event of a dispute or complaint Ofcom may assess whether Sky has made reasonable efforts to disaggregate costs and will consider the extent to which further disaggregation might be practicable.
- 4.31 In their responses to the second consultation, four free to air broadcasters stated that it would aid their assessment of whether the TPS charges Sky proposed were FRND if Sky were to publish a list of the cost categories that it sought to recover from different groups of TPS customers. Two respondents suggested that it would be beneficial if Sky were to publish a justification for any changes to the costs it sought to recover through TPS charges. These respondents considered that the increased transparency that these types of publication would provide would help TPS customers to assess whether charges were FRND and would therefore be likely to reduce the number of complaints.

- 4.32 Ofcom would welcome any initiative by Sky to increase transparency of how TPS charges are derived but recognises that a balance is required between the level of detail that is published and Sky's legitimate need to maintain the confidentiality of certain cost related data. In the event of a dispute or complaint Ofcom is likely to request information from Sky on how it has calculated TPS charges. Ofcom intends to share this information with the other party to the complaint or dispute, subject to legitimate claims of confidentiality.

Section 5

Approach to cost recovery

- 5.1 In order to determine on a dispute or complaint whether TPS charges proposed by Sky are FRND in compliance with the TPS conditions Ofcom must decide whether allowable costs have been, or will be, recovered from TPS customers fairly and reasonably.
- 5.2 This section applies the cost recovery principles set out in section 3 and considers which TPS customers the allowable costs might fairly and reasonably be recovered from, in what proportions and over what time period. It sets out a cost recovery methodology that Ofcom would normally apply when determining whether TPS charges were FRND in the event of a complaint or dispute.

Recovery of incremental costs

- 5.3 Ofcom would normally expect that incremental costs which are incurred in providing a specific service to a specific TPS customer (and only benefit that customer) would normally be recovered from that TPS customer.

Recovery of common costs

- 5.4 Ofcom would normally expect that incurred costs that benefit more than one TPS customer or not directly attributable to a particular TPS would be recovered from those customers which benefit from the costs being incurred on a basis that takes due account of the benefits each customer receives
- 5.5 Ofcom considers that this principle could be met by recovering common costs in equal proportion to the relative incremental benefits each customer receives from those costs being incurred.
- 5.6 This principle could also be met by an approach in which TPS charges are set for particular TPS Customers (or categories of TPS customers whose services have common characteristics) such that (a) revenues forecast to be generated from those TPS charges are anticipated to recover the relevant common costs over time, and (b) the charges set for each TPS customer (or category of TPS customer) were based on reasonable estimates of the levels of incremental benefits anticipated to be derived by those particular TPS customers (or categories of TPS customers) from the costs being incurred, such that there was comparability, as far as reasonably practical, between those benefits and the proportion of relevant common cost expected to be recovered from each TPS customer (or category of TPS customer) at the time that the charges were so derived. In such an approach Ofcom would normally expect that Sky would be able to objectively justify the approach that it had adopted to estimate the level and proportion of benefits.
- 5.7 In all cases, in the event of a dispute or complaint about TPS charges in assessing whether Sky had taken due account of the benefits derived by those who benefit from costs being incurred, Ofcom would have regard both to the practicability of measuring benefits (including incremental benefits) and proportionality in the application of this principle. Ofcom recognises that it may be difficult for Sky to calculate benefits with a high degree of accuracy on an ex ante basis.

- 5.8 Ofcom would normally expect that an approach such as either of those set out above would be applied to the recovery of all categories of allowable common cost - i.e. TPS specific common costs, costs common to more than one TPS, customer specific platform costs and platform common costs.

Recovery of TPS common costs

- 5.9 As described in section 4, “TPS specific common costs” are those costs incurred in the provision of a particular TPS and from which all customers of that service derive a benefit. Other costs associated with provision of TPS may be common to one or more TPS.
- 5.10 Ofcom would normally expect that only the benefits that a TPS customer derives from using a particular TPS should be considered when determining the TPS customer’s contribution toward the recovery of those costs. For example, if a TPS customer operated both pay-TV and interactive services, and therefore purchased both CA and AC services, Ofcom would normally expect that only the benefits the customer derives from using AC services should be considered when determining the customer’s contribution towards AC common costs, and not the benefits they derive from using CA services.
- 5.11 To recover TPS specific common costs based on incremental benefits received it is necessary to associate different incremental benefits with different TPS. The table below presents some of the incremental benefits Ofcom consider broadcasters are able to derive from using the various TPS available on the Sky DSat platform. This list is non exhaustive and provided for guidance purposes only. Incremental benefits are considered further in section 6.

Examples of incremental benefits derived from using different TPS

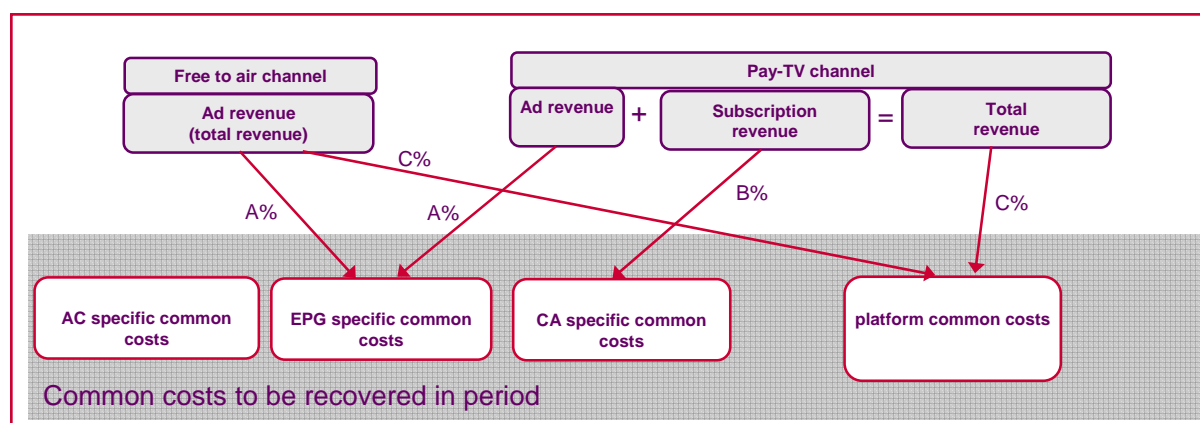
TPS	Potential incremental benefits received by TPS customer (non exhaustive)
EPG Listing	Incremental advertising, sponsorship, retail (home shopping) and PRTS revenues
Regionalisation	Incremental regional advertising revenues
Geographic masking	Reduced cost of broadcast rights
Pay –TV CA	Incremental subscription and PPV revenues
AC	Incremental on-line retail, PRTS, betting, interactive advertising

Recovery of customer specific platform costs and platform common costs

- 5.12 As described in section 4, platform common costs are those costs incurred by Sky in developing and operating the platform which benefit all TPS customers. Customer specific platform costs benefit one or more TPS customers, but not all TPS customers.
- 5.13 Ofcom would normally expect that the total incremental benefits that a TPS customer derives from using its chosen mix of TPS should be considered when determining the TPS customer’s contribution toward the recovery of platform common costs.

- 5.14 Ofcom would normally expect that only the benefits a TPS customer derives from customer specific platform costs being incurred should be considered when determining the TPS customer’s contribution toward the recovery of these costs.
- 5.15 The simplified diagram below is an example of how common costs might be recovered from TPS customers in proportion to the benefits they derive from the costs being incurred. It shows how two different TPS customers would be expected to contribute a percentage of their incremental revenues that are associated with the TPS they use towards the recovery of the common costs of those TPS and also a percentage of the overall incremental revenues they earn towards the platform common costs. In the example a free to air channel only uses the EPG listing TPS (which enables it to earn incremental advertising revenue), whilst the pay-TV channel uses both the EPG Listing and pay-TV CA TPS (which enables it to earn both incremental advertising revenues and subscription revenues). Incremental revenues earned have been used as proxies of incremental benefits.

Simplified example of benefits based common cost recovery



Appropriate time periods over which costs may reasonably be recovered

- 5.16 In addition to considering which costs it might be allowable for Sky to recover, from whom and in what proportion it is also necessary to consider how these costs might be recovered over time. The appropriate period over which costs should be recovered is likely to be different for ongoing operational expenditure and significant sums of capital expenditure or investment.

Appropriate time period for the recovery of significant sums of capital expenditure or investment

- 5.17 The appropriate time period over which significant sums of capital expenditure or other investment (such as customer acquisition costs) are recovered is an important issue since cash costs incurred in one period might bestow benefits upon platform users and TPS customers in other, later periods. For example, a set top box purchased by Sky in 2000 might have to be paid for in the same year. However, the returns generated from that expenditure are likely to extend over a number of years into the future. Therefore Ofcom considers that it would not be appropriate to recover the costs of the set top box from TPS customers present only in the year of box acquisition, since TPS customers present in future years also benefit from the expenditure.
- 5.18 Ofcom considers that a fair and reasonable pricing regime might seek, so far as possible, to spread recovery of capital costs over a realistic time period over which

the items acquired would yield benefits to TPS customers. To provide greater certainty of TPS charges and consistency over time, Ofcom would generally expect Sky not only to recover these costs over a reasonable time period but also not to revise the path of recovery in later periods without objective justification.

Appropriate time period for recovery of ongoing operational expenditure

- 5.19 Ofcom's view is that a fair and reasonable pricing regime might use short term forward looking forecasts in relation to estimating operational expenditure over the period for which the charge would apply. Generally, operational expenditure incurred in a period should be recovered within the same period. Forecast expenditure for the period would likely be rooted in historical expenditure, with observations adjusted to reflect anticipated expenditure over the forthcoming period.

Appropriate time period for the setting of charges

- 5.20 Ofcom considers that under normal circumstances the minimum period for which a TPS charge should be set is twelve months. Charges should normally be set on a forward looking basis for the period of the charges. However, Ofcom considers that, it may be reasonable to fix the level of TPS charges for the period of the TPS contract without materially discriminating between TPS customers. For example, it might be reasonable for Sky to set the period over which charges are set and the period of a standard TPS contract to 3 years.

Over and under recovery of charges

- 5.21 Because a charging regime involves some degree of forecasting, Sky may over or under recover charges in aggregate during any given charging period and in relation to any given service.
- 5.22 If during a charging period, due to forecasting error or unforeseen events, Sky experiences an over or under recovery of costs then Ofcom would expect that under a fair and reasonable pricing regime, this should be taken into account (and adjusted for) when setting tariffs for following periods.
- 5.23 Under a fair and reasonable pricing regime, consideration should be given as to whether such an under (or over) recovery should be spread over several time periods or recovered in the immediately following period. Ofcom considers that under a fair and reasonable pricing regime this decision will be balanced between the size of the under (or over) recovery and the desire to maintain stability in pricing for platform users. However, in general, Ofcom considers that under a fair and reasonable pricing regime recovery of such amounts should be, to the extent practicable, gained from (or rebated to) the same users or same types of users of the services which were causal to the costs being recovered.

Responses to the consultations

- 5.24 One respondent to the first consultation expressed concern that a cost recovery methodology which required costs to be recovered in defined periods might lead to frequent and unpredictable re-setting of charges.
- 5.25 Ofcom has reconsidered the approach set out in the first consultation document which proposed a financial accounting method. Because the majority of costs recovered in each charging period relate to historic and future capital investment, rather than short term operational expenditure, Ofcom does not consider that the

short term variability of charges would be as severe as the respondent suggested. However, in order to facilitate the appropriate setting of charges in respect of short term variability in operational expenditure, the approach outlined above sets out a modified method in which long term capital expenditure and investment in customer acquisition costs and shorter term operational expenditure are treated differently for the purposes of cost recovery. Ofcom considers that this modification to the approach, including the ability to forecast forward on a short term basis in respect of operational expenditure, should increase the opportunity to set charging periods and tariffs which ensure recovery of costs whilst providing TPS customers increased certainty of how costs will be recovered over time.

- 5.26 In responding to the second consultation, one free to air broadcaster commented that it would prefer a charging method in which charges were fixed throughout the duration of its contract with Sky. Ofcom recognises that a balance must be found between fixing the level of charges for long periods with the need to reflect ongoing changes in the cost base and number of TPS customers from which these costs are recovered. Ofcom considers that, in order to provide certainty, it may be reasonable to fix the level of TPS charges for the period of the contract in cases where this would not result in material discrimination between TPS customers. For example, it might be reasonable for Sky to set the period over which charges are set and the period of a standard TPS contract to 3 years.

Section 6

Quantifying incremental benefits received

- 6.1 In section 5, Ofcom provided guidance on, amongst other things, how it would normally expect allowable costs to be recovered from TPS customers when considering whether access charges are FRND.
- 6.2 In this section Ofcom provides guidance on how incremental benefits might be measured and presents different potential proxies for incremental benefits received that Ofcom would normally consider as a reasonable basis for a TPS charging methodology were it faced with a dispute or complaint in relation to whether TPS charges are FRND. However, Sky may choose to adopt different methods for assessing incremental benefits and characterisation of the cost of various TPS which Ofcom may also consider to be consistent with the Conditions.

Incremental benefits

- 6.3 Ofcom considers that the incremental benefit that a TPS customer receives from using its chosen mix of TPS is the benefit that it would not receive if it did not use those TPS.

The use of proxies for measuring incremental benefits received

- 6.4 Ofcom considers that the closest measure of the incremental benefits received by a TPS customer from using TPS is the incremental profit that the customer earns and which they would not have earned if they did not use TPS. However, measuring incremental profit is complex and calculating TPS charges based on profits would require the TPS customer to divulge business sensitive information relating to its cost base. This would be of particular concern if a TPS customer was in competition with Sky's retail pay-TV business. For these reasons, Ofcom considers that a TPS charging methodology based on a TPS customer having to reveal data relating to profits earned may not be reasonable.
- 6.5 Whilst it is a less accurate proxy of incremental benefit, incremental revenue is more transparent and one which TPS customers may be more willing to divulge. Ofcom therefore considers that a TPS charging methodology based on relative incremental revenues earned by TPS customers would normally be considered reasonable.
- 6.6 However, Ofcom recognises that while it is often the case that an increase in revenue translates into an increase in profit, this may not hold, for example, where unit costs increase with volume supplied. Moreover, where the cost base varies significantly from one TPS user to another, similar levels of revenue generated by two TPS customers may not reflect similar underlying profit levels. Ofcom has considered these shortfalls and continues to consider that, short of measuring actual profit levels, revenues represent the most accurate proxy of benefits received from using TPS and hence are a reasonable proxy on which to base a FRND cost recovery regime. However, where it can be objectively shown that different groups of TPS customers operate with different levels of profitability it might be reasonable to take this into consideration when setting TPS charges.
- 6.7 The use of revenues as a proxy of benefits received is broadly consistent with the previous guidelines and does not therefore represent a significant change in approach.

Responses to the second consultation

- 6.8 Three free to view broadcasters commented that how Sky measured the benefits it considered different TPS customers derive from using TPS was important in deciding whether the resulting TPS charges proposed by Sky were FRND. These respondents suggested that Sky be required to disclose this information in the event of a complaint or dispute. Ofcom agrees that the assessment of benefits is an important factor when determining FRND TPS charges and Ofcom is likely to request information from Sky relating to how it has assessed benefits in the event of a complaint or dispute. This information may subsequently be shared with the complainant, subject to confidentiality considerations.
- 6.9 Another respondent suggested that it would increase transparency if Sky published the list of proxies it used to calculate TPS charges along with the criteria that it would apply when determining which proxies to apply for each TPS customer. Ofcom agrees that the publication of this information would assist TPS customers to understand if their charges are FRND.

Incremental benefits derived from using the pay-TV CA services

- 6.10 The pay-TV CA TPS is used by TPS customers who provide subscription TV and pay per view (“PPV”) TV services on the DSat platform. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared.
- 6.11 Ofcom considers that the actual subscription and PPV revenues that each TPS customer earns from subscribers on the DSat platform are a reasonable proxy for the incremental benefits each receives from using this TPS and consequently allocation of common costs on this basis would normally be considered FRND. Ofcom considers that such a proxy would be reasonable for both residential and commercial revenues.
- 6.12 Use of incremental pay-TV revenues as a proxy of incremental benefits received is broadly consistent with the previous guidelines and therefore does not represent a significant change in approach.
- 6.13 Having estimated the incremental benefit each TPS customer derives from using pay-TV CA services Ofcom would expect Sky to apply the approach to common cost recovery set out in section 5 when determining each TPS customer’s contribution towards the relevant common costs¹¹.

Incremental benefits derived from using the EPG listing service

- 6.14 The EPG listing TPS is used by TPS customers primarily to provide end users access to their channels by unique channel numbers and to browse programming schedules and related data. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared.

¹¹ Ofcom notes that given the current retail price of one of Sky’s premium packages and the per subscriber CA charge published by Sky as a starting point for negotiation, this CA charge would represent 8.8% of the retail price of the package. Similarly, for the entry level package the published CA charge represents 15.7% of the retail price. (Sports and Movies 6 Mix @ £42.50/month, CA charge @ £3.20 ex-VAT/month. Basic only, 2 Mix @ £15/month, CA charge @ £2.00 ex-VAT/month)

- 6.15 To date, TPS customers using only the EPG listing service on the DSat platform have paid a fixed “per channel” charge for this service. This has resulted in small free to air channels paying the same TPS charge as channels with significant viewing share and home shopping channels which derive retail revenues from being available on the EPG.
- 6.16 Unlike pay-TV where there is a single, clearly identifiable revenue stream associated with using CA services (i.e. subscription and PPV revenue), broadcasters who have an EPG listing are able to derive various revenue streams. The most significant of which include the following:
- Advertising;
 - Programme sponsorship;
 - Premium rate telephony, for example, voting, chat, quizzes, information lines; and
 - Home shopping.
- 6.17 Ofcom considers that a TPS charging methodology which requires each individual incremental revenue stream to be measured directly may be impractical to implement and operate. In circumstances where a TPS customer is unable or not willing to divulge data to Sky on incremental revenues, Ofcom would normally consider it reasonable that Sky might use more transparent proxies to measure the relative benefits customers of this service receive.
- 6.18 In the first consultation document, Ofcom proposed that the share of viewing that a channel achieves from using the EPG listing service would broadly reflect the incremental revenues the channels earns. However, some respondents claimed that only the incremental viewing a channel achieves from using the EPG listing service should be considered when attempting to measure the incremental benefit derived. For example one public service broadcaster suggested that the reduction in viewing of its channel in DSat homes from no longer using the EPG listing service on DSat would be small and hence the incremental benefit it derives from using this TPS is small.
- 6.19 Ofcom acknowledges that for channels that are available on more than one distribution platform, the actual share of viewing (and resulting revenues) within a DSat home might not be wholly attributed to the channel’s availability on the Sky EPG. Ofcom agrees that a more accurate proxy of incremental benefit received may be the incremental viewing the channel achieves in DSat homes compared to that which it would achieve if it were not to use the EPG listing service.
- 6.20 In assessing the incremental viewing a channel receives from using the EPG Listing TPS Ofcom may consider various factors:
- The availability of the channel on other platforms and alternate methods of accessing the channels;
 - The normal level of viewing of the channel via the platform; and
 - The propensity of viewers to switch between platforms, particularly when multiple platforms are accessible within a home.
- 6.21 Due to the universal availability of the PSB channels via analogue terrestrial Ofcom might expect the relative incremental viewing derived from using the Sky EPG to be lowest on these channels. However, Ofcom acknowledges this position will change as the analogue signal is switched off from 2008 onwards but notes that it is also

likely that the number of homes with access to these and other channels via DTT as well as DSat is likely to become more significant going forward.

- 6.22 For the reasons set out above, assessing the incremental benefit these channels receive from being listed on the Sky EPG may be complex. However, Ofcom believes that objective and quantitative analysis can be undertaken by Sky to establish what the benefit might be. In the event of a dispute or complaint Ofcom would be likely to request information from Sky and the TPS customer on how each had assessed the incremental benefit from using this TPS. In coming to a decision, Ofcom might conduct its own primary research to validate the claims made by each party on how consumers choose to access a particular channel and how this behaviour might change if the channel were not listed on the Sky EPG.
- 6.23 Ofcom is aware that for some channels incremental viewing share may not be an accurate proxy of the benefit the channels receive from having an EPG listing. For example, a channel dedicated to home shopping may earn higher revenues for a given share of viewing compared to an advertising funded channel.
- 6.24 It should be noted that incremental viewing share simply represents an alternate proxy of benefit to using incremental revenues, which in turn is attempting to proxy incremental profits. For particular types of TPS customers like home shopping channels where the application of a single proxy of benefits might lead to a material distortion in the FRND recovery of costs Ofcom would normally consider it reasonable for Sky to use different, transparent, proxies or weighted proxies, as a measure of the incremental revenues earned. In the event of a dispute or complaint Ofcom would seek justification for the use of a particular proxy for determining charges to a particular customer. Similarly it would be open to a particular channel to bring a complaint or dispute, if it felt that the viewing share proxy did not adequately take due account of its benefits received.
- 6.25 As proposed in the first consultation document, for channels that have a very small incremental viewing share or revenue it may be reasonable for Sky to use one or more simple “per EPG listing” charges to approximate the incremental benefits these channels receive.
- 6.26 Such an approach may be appropriate for channels with viewing shares that are too small to measure accurately and provide small start up channels increased certainty of charges in their early stages of growth. The simple approach may also reduce the administrative costs associated with calculating and collecting charges.
- 6.27 If such an approach were adopted, Ofcom would expect Sky to use transparent and objective criteria in deciding which channels were charged a particular fixed charge and which were charged based on using a suitable proxy. In the event of a dispute or complaint Ofcom would require Sky to provide evidence that this differentiation did not lead to undue discrimination for the purposes of the Conditions.
- 6.28 Having estimated the incremental benefit of using the EPG listing service Ofcom would expect Sky to apply the approach to common cost recovery set out in section 5 when determining each TPS customer’s contribution toward the relevant common costs.

Responses to the first consultation

- 6.29 Various respondents claimed that the level of revenues generated by home shopping channel per percent of viewing share was significantly higher than the revenues

generated by channels primarily funded through advertising and that a proxy which was based on viewing share would lead to significant distortions in contribution to common costs and under recovery from home shopping channels at the expense of other channels. Ofcom has recognised this issue above.

- 6.30 Two respondents highlighted the reduced functionality currently offered to radio channels compared to TV channels on the DSat platform. Ofcom notes that the costs Sky incurs in providing EPG listings for radio channels may be lower than those incurred to provide listings for TV channels. Similarly, the incremental benefits radio stations derive from having an EPG listing may differ from those received by TV channels. Given the principle of TPS cost recovery set out in Section 3 Ofcom would expect any such differences to be reflected in the TPS charges for radio channels.

Responses to the second consultation

- 6.31 One free to air broadcaster highlighted the need to ensure that there was no “step change” in charges between those small channels that paid a fixed fee for an EPG listing and those slightly larger channels which were required to pay a variable fee based on a suitable proxy. Ofcom recognises that the charging methodology should seek to avoid a situation in which a broadcaster’s profits reduce as their channel makes the transition between the two charging methods. A reasonable approach maybe to have several tiers of fixed charges to smooth the transition between the two charging methods.
- 6.32 A free to air broadcaster pointed out that some pay-TV operators include channels provided by third parties within their retail packages. In some instances the pay-TV operator allows the providers of these channels to retain all advertising revenue earned whilst the pay-TV operator retains all (or part) of the subscription revenue. As only the pay-TV operator is a TPS customer, and under a charging methodology which only considers the revenues earned by TPS customers (and not upstream suppliers), these advertising revenues might be over looked when calculating the appropriate TPS charge. In such a case Ofcom may consider it appropriate when investigating a complaint or dispute to factor this into its assessment of the benefits received by the TPS customer

Incremental benefits derived from using Regionalisation services

- 6.33 The regionalisation service is used by TPS customers to associate different broadcast channels with the same EPG channel number in different geographic locations. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared
- 6.34 Whilst regionalisation utilises the same underlying technologies that are used for providing pay-TV CA services, the benefits broadcasters derive from regionalisation (over and above those derived from a simple EPG listing) are of a significantly different nature.
- 6.35 The regionalisation service is primarily used by BBC1, BBC2, ITV1 and Channel 4 to replicate the regional programming (and advertising) that these channels provide via terrestrial transmission. However, it is also used to provide UK and the Republic of Ireland versions of Sky News on EPG channel 501 and S4C on channel 104 in Wales.
- 6.36 In determining the incremental benefits TPS customers derive from using the Regionalisation TPS, Ofcom would normally consider it reasonable for Sky to

undertake an objective assessment of the revenues that those TPS customers would not earn if they did not use this service. In Ofcom's view this is likely to encompass the specific incremental regional advertising revenues received from taking this service.

- 6.37 Ofcom would expect Sky to apply the approach to common cost recovery set out in section 5 when determining each TPS customer's contribution toward the relevant common costs. However, where the costs to be recovered are relatively small compared to those recovered via other TPS charges, Ofcom considers that it may be reasonable for Sky to use a simple and transparent charging method such as a fixed "charge per region".

Responses to the consultation

- 6.38 A respondent to the first consultation who uses regionalisation services suggested that using components of the Sky CA system to implement the technical solution was inefficient and resulted in an unnecessarily large amount of common costs being recovered through this service. They argued that users of this TPS should only be required to contribute to costs which were equivalent to those that would be incurred in developing an efficient "stand alone" solution and that this could be accomplished with a relatively simple change to the EPG software that ran on the Sky set top box. As set out in the first consultation (paragraph 7.5), in the event of a dispute Ofcom may take into account the costs of using alternative technologies or any benchmark costs in order to assess whether or not the allocation of costs was reasonable and the costs were efficiently incurred.

Incremental benefits derived from using the Geographic Masking TPS

- 6.39 The geographic masking TPS is used by some free to view broadcasters to prevent rights spillage into Ireland and mainland Europe. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared.
- 6.40 Whilst geographic masking TPS utilises the same underlying technologies that are used for providing pay-TV CA services, the benefits of taking the service can be considered as either a cost saving from not having to compensate rights holders for lost earnings due to rights spillage or increased revenues earned from being able to broadcast programming which they would not otherwise be able to broadcast due to rights restrictions.
- 6.41 In determining the incremental benefits TPS customers derive from using the geographic masking TPS, Ofcom would normally consider it reasonable for Sky to undertake an objective assessment of the revenues that those TPS customers would not earn if they did not use this service
- 6.42 Ofcom would expect Sky to apply the approach to common cost recovery set out in section 5 when determining each TPS customer's contribution toward the relevant common costs. However, where the costs to be recovered are relatively small compared to those recovered via other TPS charges, Ofcom considers that it may be reasonable for Sky to use a simple and transparent charging method such as a fixed "charge per channel".

Responses to the second consultation

- 6.43 One free to air customer suggested that estimating the benefits of using the geographic masking service was very complex and that a fixed fee per channel was a more appropriate approach. As set out above, Ofcom considers that a fixed fee per channel may be reasonable approach if costs are relatively low.

Incremental benefits derived from using the access control services

- 6.44 Operators of interactive TV services are able to derive a very wide range of benefits from using AC services. Ofcom considers that, due to the relative immaturity of these services and the potential for new and innovative services supporting different business models to develop, it would be inappropriate to propose a limited set of proxies of benefits received for these services at this time. A limited set of proxies of benefits received might disincentivise investment in these new services.
- 6.45 On the Sky DSat platform, Sky already publishes a schedule of charges for different types of services and transactions which on the whole are closely linked to the retail revenues generated (or benefits received) by each service. However, in the event of a dispute or complaint Ofcom would consider whether charges for AC services were FRND and in compliance with the Conditions.

Adjustment to proxies

Incremental benefits received by Sky as a result of subsidies tied to a retail service

- 6.46 Most TPS customers benefit from an increased number of homes which are able to receive their services. Consequently, efficiently incurred subsidies provided by Sky to increase take up of the platform may be reasonably recovered via TPS charges from those TPS customers who benefit from this increase.
- 6.47 However, when Sky provides subsidies to a consumer on the condition that the consumer signs up to its own retail services then Sky may enjoy additional benefits compared to other TPS customers. For example:
- Sky may get more retail customers than it would get absent the tied subsidy. These additional revenues can be attributed to the tie.
 - A tied subsidy may provide a “first mover” advantage for Sky. This may be particularly important where third parties provide substitutable services: a consumer may choose to take Sky’s retail service in order to take advantage of the subsidies which were not available if they took the third party retail service instead and, where Sky’s retail service and third party retail services are substitutable, the consumer may be less likely to take both. Other factors that may be relevant in assessing the importance of any first mover advantage for Sky include the scope of Sky’s retail service (e.g. the number and range of channels within Sky’s retail service) and the degree of complementarity between Sky’s retail service and third party retail services.

Therefore, while most TPS customers benefit from gaining access to an additional household once that household decides to take up the platform, Sky may receive a larger proportion of the benefits compared to third party TPS customers.

- 6.48 Where such a tie exists Ofcom considers that these additional benefits should be taken into account when setting TPS charges for Sky's own retail business, through an objective analysis and quantification of these benefits.
- 6.49 In the second consultation (paragraph 6.41) Ofcom explained how it had been unable to procure a "free" set top box from Sky without entering into a subscription contract with Sky's pay-TV business. Ofcom has subsequently been informed by Sky that this was potentially due to Sky's call centre personnel confusing this offer with the Sky Freesat offer and that this situation had since been addressed.
- 6.50 Ofcom considers it important that consumers and TPS customers are made aware that there is no requirement for retail customers to subscribe to Sky's retail service to acquire a free set top box (subject to terms and conditions). Ofcom intends to monitor this situation going forward.
- 6.51 One respondent to the second consultation commented that it would be beneficial to them in assessing whether proposed charges were FRND if Sky were more transparent about how it measured any unique benefits it derives from tied subsidies. Specifically, they suggested that Sky be required to disclose how it had assessed this benefit in the event of a complaint or dispute. Another respondent suggested that Sky should provide details of the subsidies that it sought to recover from third parties. Ofcom agrees that the assessment of these benefits is important and Ofcom is likely to request information from Sky relating to how it has assessed such benefits in the event of a complaint or dispute. This information may subsequently be shared with the complainant, subject to confidentiality considerations.

Benefits received from advanced consumer equipment

- 6.52 Where TPS customers earn incremental revenues due to the availability of consumer equipment with advanced functionality, for example Sky+, Ofcom would normally consider it reasonable for Sky to recover any incremental costs (e.g. equipment subsidies) associated with providing this equipment (over and above subsidies incurred to provide basic consumer equipment) through TPS charges levied on these TPS customers. Ofcom would expect Sky to apply the approach to common cost recovery set out in section 5 when determining each TPS customer's contribution toward the relevant common costs.
- 6.53 Where costs are incurred by Sky in upgrading existing customer equipment in a home with more advanced equipment, Ofcom would not normally expect these costs to be recovered from TPS customers who do not benefit from the upgrade.

Total incremental benefits received

- 6.54 Ofcom consider that the total incremental benefit is the benefit each TPS customer derives from using their chosen mix of TPS. For example, a pay-TV channel with an interactive voting application may derive three different revenue streams, the sum of which would represent the total benefits received:
- Advertising revenues (incremental revenues associated with taking an EPG listing service);
 - Pay-TV subscription revenues (incremental revenues associated with using CA services); and
 - Premium rate telephony revenues (incremental revenues associated with using the AC services).

- 6.55 Having estimated the incremental benefit of using TPS Ofcom would expect Sky to apply the approach to common cost recovery set out in section 5 when determining each TPS customer's contribution toward the platform common costs.

Net Benefits

- 6.56 Where the Sky DSat platform derives a benefit from providing TPS to a particular TPS customer, e.g. making a particularly attractive service available on its platform which encourages the take up of the platform, Ofcom might expect that this benefit be "netted off" against the benefit that this TPS customer derives from using TPS.
- 6.57 However, Ofcom may also consider it FRND for Sky to exclude these effects when establishing its charging methodology due to the complexity involved in assessing the magnitude of the impact of individual TPS customer's services on, for example, the take up of the platform or churn from the platform. If Sky were to adopt such an approach Ofcom would expect Sky to exclude the effects when deriving the TPS charges for all TPS customers (and not selectively exclude the effects from particular TPS customers or TPS customer groups).

Responses to the second consultation

- 6.58 One respondent to the second consultation requested clarity on whether Ofcom would expect Sky to consider the benefits TPS customers bring to the platform when determining TPS charges. It is Ofcom view that it may be reasonable, in order to ensure transparency and practicability of charging, for Sky not to consider the benefits that TPS customer bring to the platform. If such an approach were to be adopted by Sky Ofcom would expect that it would be applied to all TPS customers and not limited to specific customers.

Risk sharing

- 6.59 Ofcom is aware that in the past some TPS customers were offered lower TPS pricing on the basis that this reflected the risk that they had undertaken as an early entrant on a new and unproven digital platform.
- 6.60 Under a charging methodology in which capital costs associated with a new platform development are recovered over a number of charging periods Ofcom considers that it may be reasonable to recover a relatively small amount of these costs in early periods as the service becomes established. This can reduce the burden on TPS customers who have taken the risk of providing services on an unproven platform and defer recovery of these costs to a point when there is less risk and potentially more TPS customers from which to recover the costs.
- 6.61 However, Ofcom would normally expect that all TPS customers would pay charges determined by the prevailing published charging methodology (or published charges) in each charging period to ensure there was no undue discrimination in charges between those TPS customers who had joined the platform when charges were lower and those that joined when charges had increased.

Economies of Scale

- 6.62 Ofcom acknowledges that the incremental costs incurred by Sky in providing multiple instances of a service to a customer may benefit from economies of scale. For

example, the cost to Sky of providing incremental equipment to support encryption services for a new pay-TV broadcaster may be the same irrespective of whether the broadcaster is encrypting one channel or five channels. In such an instance Ofcom would normally expect any economies of scale to be passed onto the TPS customer.

- 6.63 However, Ofcom would not normally expect that a TPS customer who used multiple instances of a service e.g. multiple EPG listings, to be offered a “bulk” discount on their contribution to common costs.

Section 7

Non price terms and conditions

- 7.1 The conditions require Sky to provide TPS in effect on fair and reasonable terms, conditions and charges. The previous sections focus on guidance as to what Ofcom believes would constitute fair and reasonable access charges.
- 7.2 This section sets out guidance as to how Ofcom would normally consider whether certain other terms and conditions for TPS are FRND in accordance with the TPS conditions. In this context Ofcom has also taken into account the fact that Sky is required under the conditions not to unduly discriminate against particular TPS customers or particular groups of TPS customers in relation to the provision of TPS.
- 7.3 Several respondents to the first consultation highlighted concerns with the length of time it took to get access to the DSat platform and the process that had been implemented by Sky. A number of respondents also raised concerns relating to Sky's control over technical developments. For example, one respondent suggested that Sky should be required to give advance public notice of its intention to implement or use new TPS, so that broadcasters will be in the same position as Sky's pay-TV business to take advantage of any new TPS. Another respondent considered that innovations by broadcasters may have been hindered by Sky's control over the development of existing technology and the bundling of services.
- 7.4 Ofcom recognises that in certain circumstances the terms and conditions on which TPS are provided could be contrary to the condition for provision of TPS on FRND terms. In particular, for example, it may be important that third parties are given access to TPS on similar terms as Sky's own pay-TV business.
- 7.5 Non-price terms and conditions which Ofcom believes would be relevant in assessing whether access has been provided on FRND terms include, but are not limited to:
- Lead times associated with the provision of a regulated TPS;
 - Information relating to the development of new regulated TPS and changes to existing regulated TPS
 - Support levels, availability and performance of the regulated TPS;
 - Appropriate processes to ensure that requests for new regulated TPS or changes to existing regulated TPS are handled in a consistent, transparent and objective manner; and
 - Bundling of regulated TPS services such that TPS customers are forced to purchase a TPS that they do not require in order to gain access to services they do require.

Section 8

Ofcom's duties

8.1 This section sets out the statutory duties Ofcom has had regard to in drafting the Guidelines.

Ofcom's statutory duties

8.2 Section 3(1) of the Communications Act 2003 ('the Act') states that Ofcom's principal duty in carrying out its functions is to further the interests of citizens in relation to communications matters; and, to further the interests of consumers in relevant markets, where appropriate by promoting competition.

8.3 Sections 3(2) of the Act states that, in carrying out its functions, Ofcom is required to secure amongst other things:

- a) the availability of a wide range of electronic communications services throughout the United Kingdom (s3(2)(b));
- b) a wide range of television and radio services to be available (duty to secure range) which (taken as a whole) are both of high quality and calculated to appeal to a variety of tastes and interests (s3(2)(c)) (duty to secure high quality and appeal); and
- c) the maintenance of a sufficient plurality of providers of different television and radio services (s3(2)(d)) (duty to maintain sufficient plurality).

8.4 In performing those duties, Ofcom must also have regard to, amongst other things:

- a) the desirability of promoting the fulfilment of the purposes of public service television broadcasting in the United Kingdom (s3(4)(a) of the Act);
- b) the desirability of promoting competition in the relevant markets (s3(4)(b) of the Act); and
- c) the desirability of encouraging investment and innovation in relevant markets (s3(4)(d) of the Act).

8.5 Section 4 of the Act requires Ofcom to act in accordance with the six European Community requirements of Article 8 of the Framework Directive. In summary these requirements are to:

- a) promote competition in the provision of electronic communications networks and services, associated facilities and the supply of directories (s4(3) of the Act);
- b) contribute to the development of the European internal market (s4(4) of the Act);
- c) promote the interests of all persons who are citizens of the European Union (s4(5) of the Act);
- d) not favour one form of or means of providing electronic communications networks or services, i.e. to be technologically neutral (s4(6) of the Act);
- e) to encourage the provision of network access and service interoperability for the purpose of securing (s4(7) and (8) of the Act):
 - i) efficient and sustainable competition; and
 - ii) the maximum benefit for customers of communications providers;

- f) to encourage compliance with certain standards in order to facilitate service interoperability and secure freedom of choice for the customers of communications providers (s4(9) of the Act).
- 8.6 In performing its duties Ofcom must have regard to the extent to which its activities are transparent and proportionate (s 3(3)(a) of the Act) and do not impose burdens on stakeholders that are unnecessary (s6(1) (a) of the Act).

Consideration of relevant duties

- 8.7 In drafting the Guidelines, Ofcom has in particular considered its duties in carrying out its functions to secure a wide range of services, which are of high quality and appeal, and to maintain sufficient plurality. Ofcom has considered its duties in respect of the application of the Guidelines to Sky and the DSat platform, given that they only apply in this respect.
- 8.8 Ofcom considers that it is necessary to ensure that TPS are provided on FRND terms to ensure that broadcasters and interactive service providers are able to access and provide services to viewers on the DSat platform. This is likely to ensure that a wide range of services, of potentially high quality and appeal, are provided on the DSat platform.
- 8.9 The responses to the consultations and previous discussions with TPS customers have highlighted that transparency of pricing and pricing methodologies and the predictability of charges are important to TPS customers in assessing whether TPS terms are FRND and to provide them with certainty when business planning. Ofcom considers that transparency and predictability of both price and non-price terms are critical to ensure that potential providers of retail services will start, and existing TPS customers will continue, to provide retail services to viewers on the DSat platform. TPS terms which are transparent and predictable will therefore assist in securing the widest range, quality and appeal of television and radio services and maintaining sufficient plurality on the DSat platform.
- 8.10 In order to ensure that the Guidelines are transparent and proportionate and do not impose burdens on stakeholders that are unnecessary, Ofcom has sought to minimise the burden imposed on stakeholders by ensuring that the Guidelines are practical to apply.
- 8.11 Transparency and predictability of TPS terms and practicability are the key outcomes that Ofcom has considered in respect of its relevant duties.

Transparency

- 8.12 Transparent pricing provides TPS customers with an understanding of how prices are derived and the costs that are being recovered. In addition, guidelines that make clear how Ofcom would normally interpret FRND in the event of a dispute or complaint allow TPS customers to assess whether the prices that are being charged are fair and reasonable. Further, transparency better enables customers to compare the charges applied to different TPS customers and allows them to judge whether the terms they are offered are non-discriminatory.

- 8.13 The previous guidelines supported a pricing regime based on negotiation that allowed Sky flexibility to charge a potentially very wide range of prices for its TPS¹², although the guidelines set out certain restrictions such as costs should not be over recovered and there should not be discrimination between comparable services provided to comparable customers at a comparable time.
- 8.14 For the reasons set out in Section 2, Ofcom no longer considers that negotiated charges are appropriate. Negotiated charges will not result in sufficient transparency for TPS customers to establish whether the terms they are offered are FRND. The Guidelines set out that, in accordance with its Conditions, Sky should publish charges or methodology by which charges are determined. The Guidelines also provide clarity as to how Ofcom is likely to interpret FRND in the event of a dispute.

Predictability

- 8.15 TPS customers require predictability of pricing to enable short and long term business planning. Lack of predictability may dis-incentivise investment in content rights and/or lead to increased business risk and cost of capital. As a result, the range and plurality of service providers may be less than it might otherwise be.
- 8.16 The Guidelines make clear that, in accordance with the Conditions, Sky should publish a rate card or methodology by which charges are determined, that charges should apply for a period of a minimum of a year and that Sky should give TPS customers three months notice before changing its prices. This should provide TPS customers with more predictability of pricing.

Practicability

- 8.17 Ofcom has considered the costs that are likely to be incurred by stakeholders as a result of the Guidelines as well as the overall benefits.
- 8.18 Generally, where there are alternative approaches which provide a similar outcome, Ofcom will prefer the most practicable approach, in terms of cost, simplicity and ease of implementation. For example, when assessing benefits, profit information is unlikely to be practicable to obtain. Therefore, the Guidelines identify revenue or viewing share as more appropriate proxies.

¹² <http://www.ofcom.org.uk/static/archive/oftel/publications/broadcasting/2002/cagu1002.htm> section 3.5

Annex 1

The Guidelines

A1.1 These guidelines (the “Guidelines”) set out Ofcom’s normal approach to considering in the event of a dispute or complaint whether Sky has complied with the conditions that require it to provide conditional access (“CA”), access control (“AC”) and/or electronic programme guide (“EPG”) services on fair, reasonable and non-discriminatory (“FRND”) terms, conditions and charges. Details of the conditions that apply to the supply of these Technical Platform Services (“TPS”) are set out in Annex 2 of this statement (the “Conditions”).

Publication of charges and/or methodology

A1.2 Under the Conditions, Sky is required to publish a notice specifying its TPS charges or specifying the methodology that is to be adopted for determining its TPS charges.

A1.3 It is Ofcom’s view that such a notice should provide an existing or prospective TPS customer with sufficient information to allow it to determine the TPS charges that it would expect to pay without having to enter into a commercial negotiation with Sky. This would be achieved were Sky to publish a methodology with sufficient detail for a prospective TPS customer to determine their charges without negotiating with Sky, or through the publication of a rate card setting out Sky’s TPS charges.

A1.4 In practice different TPS customers may have different business models and Sky’s published charges or charging methodology should reflect this. Consequently, it may be necessary for Sky to revise its published charges or charging methodology in order to ensure the charges applying to a new prospective TPS customer with a different business model are FRND.

Application of the guidelines

A1.5 SSSL and BSkyB shall together be referred to as “Sky” in these Guidelines. Sky is currently the only supplier required to provide access to EPG, CA and AC services in the UK on regulated terms.

A1.6 If other operators were to be designated as regulated suppliers of TPS in the future, Ofcom would need to consider the appropriate guidelines to apply given the specific circumstances of the designated provider. Therefore these guidelines currently only apply to Sky’s provision of regulated TPS on the DSat platform.

Status

A1.7 When resolving any dispute or investigating any complaint brought to it in relation to Sky’s alleged failure to comply with the Conditions, Ofcom would normally expect to follow these Guidelines. However, Ofcom cannot legally fetter its discretion in advance and therefore retains the ability to depart from the Guidelines where the circumstances warrant it.

Resolution of complaints or disputes

A1.8 Ofcom’s primary reason for issuing guidelines is to assist Sky and TPS customers to better understand how Ofcom would normally interpret the Conditions and

therefore whether TPS terms are consistent with Ofcom's interpretation of the Conditions.

A1.9 In the event that there is a disagreement between the parties as to whether the TPS terms are consistent with the Conditions a complaint or dispute¹³ may be raised with Ofcom.

A1.10 Ofcom has a defined process for dealing with complaints and disputes, details of which can be found on the Ofcom website:

http://www.ofcom.org.uk/bulletins/eu_directives/guidelines.pdf

Structure of the Guidelines

A1.11 These Guidelines are formed of two parts. The first part sets out general principles that Ofcom would apply in assessing whether Sky has complied with the Conditions. The second part provides more detail on Ofcom's normal approach to particular aspects of cost recovery and assessment of benefits received in assessing whether Sky has complied with the Conditions.

Technical Platform Services (TPS)

A1.12 Broadcasters and operators of interactive TV services who wish to make their content available on Sky's digital set top boxes can make use of a number of different technical services relating to encryption, electronic programme guides and use of Sky's interactive technology and systems. Some of the key services that broadcasters and operators currently make use of are set out below.

Conditional Access

A1.13 A conditional access ("CA") service enables a broadcaster to restrict access to content that it has made available on a digital platform only to those customers that have been authorised to access it. CA systems typically employ content scrambling and encryption technologies along with an end user authorisation system and decryption technologies operating within the digital receiver (a digital receiver could be a digital set top box with an active viewing card).

A1.14 On digital TV platforms, CA services are primarily used to enable subscription and pay per view pay-TV services ("pay-TV CA" services). Access to specific encrypted channels and content is only provided to those users who have paid (or have committed to pay) for the content.

Geographic Masking

A1.15 Geographic masking is where purchasers of CA services are able to restrict access to content to defined geographic territories by implementing technologies and procedures which seek to restrict and/or record the geographic locations in which each of its digital receivers is installed and used. This technique is used to minimise the number of digital receivers that are able to access specific encrypted channels outside of specific geographic territories, such as the UK.

¹³ A dispute may be brought where s185 of the Communications Act 2003 applies.

Electronic Programming Guide listing services

- A1.16 Viewers of digital TV use Electronic Programme Guides (“EPGs”) primarily to navigate between channels, access channels by unique channel numbers, and browse through programming schedules and related data.
- A1.17 The EPG listing service involves assigning an EPG channel number to each broadcaster’s channel and providing a technical interface by which the broadcaster can deliver and amend programme schedules and related data.

Regionalisation

- A1.18 A broadcaster may want to associate different broadcast channels with the same EPG channel number in different geographic regions. For example, DSat viewers in London receive a different version of ITV1 on channel 103 to viewers in Manchester. Different broadcasters may require different regions to be defined, for example the geographic boundaries of the ITV regions do not necessarily correspond with the geographic boundaries of the BBC regions.

Access Control Services

- A1.19 Access Control (“AC”) services involve access to certain application programming interfaces (APIs) and access to the digital broadcaster’s remote computer hardware and software systems. Such services allow broadcasters to develop software applications, such as interactive TV applications, which can be loaded and executed on the digital receiver. These applications may then establish an on-line connection with the broadcaster’s network infrastructure to create a “client server” computing environment.
- A1.20 Other AC services also enable the broadcaster to provide viewers with the ability to identify and access interactive applications. For example, on the DSat platform viewers might access interactive applications by “pressing the red button” whilst watching a TV channel or selecting the service from the “Interactive Main Menu”.

Part 1: The principles of TPS cost recovery

- A1.21 In order to determine in the event of a complaint or dispute whether TPS charges proposed by Sky are fair, reasonable and non discriminatory (“FRND”) in compliance with the Conditions, Ofcom would normally consider, amongst other things, whether the overall costs Sky recovers are reasonable and whether their recovery from each TPS customer is fair and non-discriminatory.
- A1.22 This section sets out the principles of TPS cost recovery Ofcom would normally apply when assessing whether it was reasonable for particular costs to be recovered through TPS charges and from whom these costs might be recovered.

Fair and reasonable cost recovery

- A1.23 In Ofcom’s view a fair and reasonable pricing regime is one in which the costs which Sky is allowed to recover from TPS customers are restricted to those which it

reasonably, necessarily and efficiently incurs in the provision of services to those customers and as a result of the development and operation of the DSat platform and which result in benefits for those customers:

- A “**reasonably**” incurred cost is the cost associated with an input that is required for the provision of a TPS or in order to develop and operate the DSat platform and which results in benefits for TPS customers.
- A “**necessarily**” incurred cost is the cost associated with an input that is indispensable to the provision of TPS or the development and operation of the DSat platform and which results in benefits for TPS customers.
- An “**efficiently**” incurred cost is the lowest reasonably achievable cost associated with a reasonable and necessary input, given Sky’s technology. Efficiently incurred costs are those resulting from cost minimisation on the part of Sky.

Return on investment

A1.24 Ofcom considers that it is reasonable for Sky to make a return on the costs incurred in providing TPS and developing and operating the DSat platform that reflects the risk adjusted cost of capital of the investment.

A1.25 When assessing whether a rate of return is reasonable, Ofcom will take into account the impact on the incentives for companies to invest. Where investments are risky, it is important that an allowable rate of return reflects the degree of risk that companies face in making investments. It is Ofcom’s view that the analytical approach outlined in Ofcom’s statement on approach to risk in the assessment of cost of capital¹⁴ should serve as a starting point for Ofcom’s approach to risk and return in all sectors that it regulates, including audio-visual broadcasting industries. Further details of Ofcom’s approach are set out in Annex 4 of this statement.

General principles of cost recovery

A1.26 Ofcom has established six principles of cost recovery that it will apply in assessing how costs could be recovered in any given situation. These principles have previously been successfully applied in a wide range of scenarios and are generally considered to provide an objective and consistent approach to cost recovery:

- cost causation - costs should be recovered from those parties whose actions cause the costs to be incurred at the margin;
- cost minimisation - the mechanism for cost recovery should ensure that there are strong incentives to minimise costs;
- distribution of benefits - costs should be recovered from beneficiaries, especially where there are externalities;
- effect on competition - the mechanism for cost recovery should not undermine or weaken the pressures for effective competition;
- reciprocity - where services are provided reciprocally, charges should also be reciprocal; and

¹⁴ Ofcom’s approach to risk in the assessment of the cost of capital, 18 August 2005 (see: http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/final.pdf)

- practicability - the mechanism for cost recovery needs to be practicable and relatively easy to implement.

A1.27 In the case of TPS charges, there are common costs to be recovered as well as incremental costs relating to service provision to individual customers (common costs are costs which are not directly attributable to a particular TPS customer). Ofcom therefore considers that the cost recovery principles of cost causation and distribution of benefits would normally be of most relevance when determining FRND TPS charges.

Cost causation

A1.28 In general, Ofcom will apply cost causation first and greater reliance is given to it, on the grounds that economic efficiency is enhanced by requiring parties to pay for those costs which they directly cause.

A1.29 Where specific costs can be identified as being caused solely by a particular service or an additional customer, the principle of cost causation is generally recognised as appropriate as it promotes an economically efficient allocation of resources by ensuring that each user of a service pays for the additional costs incurred in providing that service. Using this principle, incremental costs incurred by the Sky in providing a new service or a service to a new customer would reasonably be expected to be wholly recovered from users of that particular service or from that particular customer.

Distribution of benefits

A1.30 Ofcom considers that a key principle in relation to the recovery of common costs via TPS charges is that such costs should be recovered in a way that (to the extent reasonable and practicable) takes due account of the benefits derived by TPS customers from those costs being incurred. Further guidance on the methods that Ofcom considers may conform to this principle is provided in part 2.

A1.31 Ofcom considers that when costs incurred do not benefit a particular TPS customer it would not normally be reasonable for any of these costs to be recovered from that customer.

Application of the principles

A1.32 A consequence of these Guidelines is that Ofcom would expect Sky to apply objectively the principles when determining its TPS charges and be in a position to justify to Ofcom its charges in light of these principles in the event of a dispute or complaint.

Part 2: Further Guidance

A1.33 Part 2 provides further guidance on how Ofcom would normally expect to interpret the Conditions when assessing whether terms offered by Sky for TPS are FRND.

Allowable Costs

A1.34 Ofcom considers that Sky should only recover costs from TPS customers which it reasonably, necessarily and efficiently incurs as a result of the provision of services to those customers or as a result of the development and operation of the DSat platform and from which TPS customers derive a benefit.

A1.35 To ensure TPS customers are not required to contribute towards the recovery of costs from which they do not derive a benefit, Ofcom considers that each item of allowable cost should be identified as one of the following:

- an incremental cost associated with a specific TPS customer;
- a TPS specific common cost;
- a TPS cost which is common to more than one TPS;
- a customer specific platform cost, or;
- a platform common cost.

These categories of costs are described further below.

A1.36 Ofcom considers that, where reasonably practicable, Sky should disaggregate costs wherever possible with a view to ensuring that TPS customers only contribute to the recovery of costs from which they derive a benefit. For example, if it were reasonably practicable to disaggregate the costs associated set top boxes such that TPS customers are only required to contribute towards those costs from which they derive a benefit, Ofcom would expect Sky to do this.

TPS costs

A1.37 Ofcom considers that it would normally be reasonable for Sky to recover reasonably, efficiently and necessarily incurred costs associated with the provision of TPS from customers of those TPS. These costs are likely to include:

- **TPS specific common costs:** Costs that are incurred by Sky in the provision of a particular TPS and from which all customers of that service derive a benefit. For example, if Sky did not offer EPG listings it would not incur the cost of transponder capacity required to broadcast the EPG schedule data.
- **Incremental costs of service provision:** The incremental costs of service provision are the costs incurred by Sky in the provision of a TPS to an individual TPS customer. For example, a new TPS customer taking an EPG listing may result in Sky incurring costs in implementing a technical interface to the customer's scheduling system.
- **Costs common to more than one TPS:** Some costs incurred by Sky may be common to the provision of more than one TPS. Ofcom considers that it may be necessary for Sky to define a number of different TPS common cost "pools" to ensure TPS customers are not required to contribute to the recovery of TPS common costs from which they do not derive a benefit.

Platform costs

A1.38 Ofcom considers that it would normally be reasonable for Sky to recover reasonably, efficiently and necessarily incurred costs associated with the development and operation of the DSat platform as a whole. These cost can be sub-categorised as:

- **Customer specific platform costs:** Allowable costs incurred by Sky in developing and operating the DSat platform which are not directly attributable to a TPS and for which it is reasonably practicable to attribute them to one or more TPS customers. Ofcom considers that it may be necessary for Sky to define a number of different platform cost "pools" to ensure TPS customers are not

required to contribute to the recovery of platform costs from which they do not derive a benefit.

- **Platform common costs:** Allowable costs incurred by Sky in developing and operating the DSat platform that are not attributable to a TPS and which benefit all TPS customers.

A1.39 Guidance on which of the costs incurred by Sky Ofcom considers might reasonably be recovered through TPS charges is provided below. However, this does not represent an exhaustive list of costs that might be recovered. In deciding which costs might be reasonably recovered through TPS charges, Ofcom would expect Sky to objectively apply the principles set out in Part 1 of these Guidelines.

Marketing costs

A1.40 Sky may choose to undertake marketing (e.g. advertising) to promote the benefits of the platform and to encourage its take up and use.

A1.41 Ofcom considers that marketing of the general benefits of the DSat platform which stimulates take up and increases the platform customer base is likely to benefit most TPS customers, although there may be customers who do not benefit. It would therefore be reasonable for Sky to recover these costs through TPS charges levied on those customers who benefit.

A1.42 To ensure TPS customers are not being required to contribute towards efficiently incurred costs from which they do not benefit, in the event of a dispute or complaint to Ofcom, Ofcom would expect Sky to justify any marketing spend recovered via TPS charges, and in particular demonstrate to Ofcom that third party TPS customers have not contributed to the marketing of Sky's own retail business.

Customer retention marketing

A1.43 Where Sky undertakes marketing that encourages households not to churn from its platform, it would normally be reasonable for these costs to be recovered through TPS charges to those customers who benefit. However, Ofcom would not normally consider it reasonable for costs incurred in the prevention of churn from Sky's retail services to be recovered through TPS charges.

Customer equipment subsidies

A1.44 Sky may choose to subsidise customer equipment to promote the benefits of the platform and to encourage its take up and use. Where such subsidies benefit TPS customers, Ofcom considers that it may be reasonable for Sky to recover efficiently incurred subsidies through TPS charges levied on those customers that benefit.

A1.45 However, where subsidies are provided subject to a customer entering into a Sky retail contract (a contractual tie), Ofcom considers that it is likely that Sky receives more benefits from the subsidy than other TPS customers. Ofcom considers that any additional benefits that Sky receives from that tie should be considered when assessing the benefits that each TPS customer receives.

Platform operational costs

A1.46 Ofcom considers it would normally be reasonable that operational costs associated with the platform can be recovered through TPS charges provided that third party TPS customers were not being required to contribute to the costs incurred in

operating Sky's own retail business. For example, Ofcom would normally only expect call centre costs incurred in answering general queries about the use of the platform, such as advice on technical issues, to be recoverable through TPS charges and not costs associated with the provision of specific retail packages.

Approach to cost recovery

Recovery of incremental costs

A1.47 Ofcom would normally expect that incremental costs which are incurred in providing a specific service to a specific TPS customer (and only benefit that customer) would normally be recovered from that TPS customer.

Recovery of common costs

A1.48 Ofcom would normally expect that incurred costs that benefit more than one TPS customer or not directly attributable to a particular TPS would be recovered from those customers which benefit from the costs being incurred on a basis that takes due account of the benefits each customer receives.

A1.49 Ofcom considers that this principle could be met by recovering common costs in equal proportion to the relative incremental benefits each customer receives from those costs being incurred.

A1.50 This principle could also be met by an approach in which TPS charges are set for particular TPS Customers (or categories of TPS customers whose services have common characteristics) such that (a) revenues forecast to be generated from those TPS charges are anticipated to recover the relevant common costs over time, and (b) the charges set for each TPS customer (or category of TPS customer) were based on reasonable estimates of the levels of incremental benefits anticipated to be derived by those particular TPS customers (or categories of TPS customers) from the costs being incurred, such that there was comparability, as far as reasonably practical, between those benefits and the proportion of relevant common cost expected to be recovered from each TPS customer (or category of TPS customer) at the time that the charges were so derived. In such an approach Ofcom would normally expect that Sky would be able to objectively justify the approach that it had adopted to estimate the level and proportion of benefits.

A1.51 In all cases, in the event of a dispute or complaint about TPS charges in assessing whether Sky had taken due account of the benefits derived by those who benefit from costs being incurred, Ofcom would have regard both to the practicability of measuring benefits (including incremental benefits) and proportionality in the application of this principle. Ofcom recognises that it may be difficult for Sky to calculate benefits with a high degree of accuracy on an ex ante basis.

A1.52 Ofcom would normally expect that an approach such as either of those set out above would be applied to the recovery of all categories of allowable common costs i.e. TPS specific common costs, costs common to more than one TPS, customer specific platform costs and platform common costs.

A1.53 Ofcom would normally expect that only the benefits that a TPS customer derives from using a particular TPS should be considered when determining the TPS customer's contribution toward the recovery of the associated costs. For example, if a TPS customer operated both pay-TV and interactive services, and therefore purchased both CA and AC services, Ofcom would normally expect that only the

benefits the customer derives from using AC services should be considered when determining the customer's contribution towards AC common costs, and not the benefits they derive from using CA services.

Appropriate time periods over which costs may reasonably be recovered

A1.54 Ofcom considers that the appropriate period over which allowable costs should be recovered is likely to be different for ongoing operational expenditure and significant sums of capital expenditure or investment.

Appropriate time period for the recovery of significant sums of capital expenditure or investment

A1.55 The appropriate time period over which significant sums of capital expenditure or other investment (such as customer acquisition costs) are recovered is an important issue since cash costs incurred in one period might bestow benefits upon platform users and TPS customers in other, later periods. For example, a set top box purchased by Sky in 2000 might have to be paid for in the same year. However, the returns generated from that expenditure are likely to extend over a number of years into the future. Therefore Ofcom considers that it would not be appropriate to recover the costs of the set top box from TPS customers present only in the year of box acquisition, since TPS customers present in future years also benefit from the expenditure.

A1.56 Ofcom considers that a fair and reasonable pricing regime might seek, so far as possible, to spread recovery of capital costs over a realistic time period over which the items acquired would yield benefits to TPS customers. To provide greater certainty of TPS charges and consistency over time, Ofcom would generally expect Sky not only to recover these costs over a reasonable time period but also not to revise the path of recovery in later periods without objective justification.

Appropriate time period for recovery of ongoing operational expenditure

A1.57 Ofcom's view is that a fair and reasonable pricing regime might use forward looking forecasts in relation to estimating operational expenditure over the period for which the charge would apply. Generally, operational expenditure incurred in a period should be recovered within the same period. Forecast expenditure for the period would likely be rooted in historical expenditure, with observations adjusted to reflect anticipated expenditure over the forthcoming period.

Appropriate time period for the setting of charges

A1.58 Ofcom considers that under normal circumstances the minimum period for which a TPS charge should be set is twelve months. Charges should normally be set on a forward looking basis for the period of the charges. However, Ofcom considers that, it may be reasonable to fix the level of TPS charges for the period of the TPS contract without materially discriminating between TPS customers. For example, it might be reasonable for Sky to set the period over which charges are set and the period of a standard TPS contract to 3 years.

Over and under recovery of charges

A1.59 Because a charging regime involves some degree of forecasting, Sky may over or under recover charges in aggregate during any given charging period and in relation to any given service.

- A1.60 If during a charging period, due to forecasting error or unforeseen events, Sky experiences an over or under recovery of costs then Ofcom would expect that under a fair and reasonable pricing regime, this should be taken into account (and adjusted for) when setting tariffs for following periods.
- A1.61 Under a fair and reasonable pricing regime, consideration should be given as to whether such an under (or over) recovery should be spread over several time periods or recovered in the immediately following period. Ofcom considers that under a fair and reasonable pricing regime this decision will be balanced between the size of the under (or over) recovery and the desire to maintain stability in pricing for platform users. However, in general, Ofcom considers that under a fair and reasonable pricing regime recovery of such amounts should be, to the extent practicable, gained from (or rebated to) the same users or same types of users of the services which were causal to the costs being recovered.

Past losses

- A1.62 It is Ofcom's understanding that, to date, Sky's costs of providing TPS and developing and operating the DSat platform (including a reasonable rate of return on capital employed) have exceeded the revenues received from TPS customers (including those from Sky's own retail business). Ofcom considers that it is fair and reasonable for losses incurred in the past to be recovered through TPS charges.
- A1.63 However, it is unlikely to be appropriate for Sky to start recovering costs which were incurred in the past which have not previously been recovered via TPS charges. For example, Ofcom would not expect a TPS customer to contribute to costs incurred in the past that it would not reasonably have expected to contribute to at the time the costs were incurred.

Quantifying incremental benefits received

- A1.64 In this section Ofcom provides guidance on different proxies for incremental benefits received that Ofcom would normally consider as a reasonable basis for a TPS charging methodology were it faced with a dispute or complaint in relation to whether TPS charges are FRND. However, Sky may choose to adopt different methods for assessing incremental benefits and characterisation of the cost of various TPS which Ofcom may also consider to be consistent with the Conditions.

Incremental benefits

- A1.65 Ofcom considers that the incremental benefits that a TPS customer receives from using its chosen mix of TPS is the benefit that it would not receive if it did not use those TPS.

Incremental benefits derived from using the pay-TV CA services

- A1.66 The pay-TV CA TPS is used by TPS customers who provide subscription TV and pay per view ("PPV") TV services on the DSat platform. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared.
- A1.67 Ofcom considers that the actual subscription and PPV revenues that each TPS customer earns from subscribers on the DSat platform are a reasonable proxy for the incremental benefits each receives from using this TPS and consequently allocation of common costs on this basis would normally be considered FRND.

Ofcom considers that such a proxy would be reasonable for both residential and commercial revenues.

A1.68 Having estimated the incremental benefit each TPS customer derives from using pay-TV CA services Ofcom would expect Sky to apply the approach to common cost recovery set out in A1.48 to A1.53 when determining each TPS customer's contribution towards the relevant common costs.

Incremental benefits derived from using the EPG listing service

A1.69 The EPG listing TPS is used by TPS customers primarily to provide end users access to their channels by unique channel numbers and to browse programming schedules and related data. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared.

A1.70 Ofcom considers that a reasonable proxy of the benefits derived from using the EPG listing TPS, may be the incremental viewing the channel achieves in DSat homes compared to that which it would achieve if it were not to have a listing on the Sky EPG.

A1.71 In assessing the incremental viewing a channel receives from using the EPG listing TPS, Ofcom may consider various factors:

- The availability of the channel on other platforms and alternate methods of accessing the channels;
- The normal level of viewing of the channel via the platform; and
- The propensity of viewers to switch between platforms, particularly when multiple platforms are accessible within a home.

A1.72 In the event of a dispute or complaint Ofcom would be likely to request information from both Sky and the TPS customer on how each had assessed the incremental benefit from using this TPS. In coming to a decision, Ofcom might conduct its own primary research to validate the claims made by each party on how consumers choose to access a particular channel and how this behaviour might change if the channel were not listed on the Sky EPG.

A1.73 Ofcom is aware that for some channels incremental viewing share may not be an accurate proxy of the benefit the channels receive from having an EPG listing. For example, a channel dedicated to home shopping may earn higher revenues for a given share of viewing compared to an advertising funded channel.

A1.74 It should be noted that incremental viewing share simply represents an alternate proxy of benefit to using incremental revenues, which in turn is attempting to proxy incremental profits. For particular types of TPS customers like home shopping channels where the application of a single proxy of benefits might lead to a material distortion in the FRND recovery of costs, Ofcom would normally consider it reasonable for Sky to use different, transparent, proxies or weighted proxies, as a measure of the incremental revenues earned. In the event of a dispute or complaint Ofcom would seek justification for the use of a particular proxy for determining charges to a particular customer. Similarly it would be open to a particular channel to bring a complaint or dispute, if it felt that the viewing share proxy did not adequately take due account of its benefits received.

- A1.75 For channels that have a very small incremental viewing share or revenue it may be reasonable for Sky to use one or more simple “per EPG listing” charges to approximate the incremental benefits these channels receive. Such an approach might reduce the administrative costs associated with calculating and collecting charges.
- A1.76 If such an approach were adopted, Ofcom would expect Sky to use transparent and objective criteria in deciding which channels were charged a particular fixed charge and which were charged based on using a suitable proxy and in the event of a dispute or complaint Ofcom may require Sky to provide evidence that this differentiation did not lead to undue discrimination for the purposes of the Conditions.
- A1.77 Some pay-TV operators include channels provided by third parties within their retail packages. In some instances the pay-TV operator allows the providers of these channels to retain all advertising revenue earned whilst the pay-TV operator retains all (or part) of the subscription revenue. As only the pay-TV operator is a TPS customer, and under a charging methodology which only considers the revenues earned by TPS customers (and not upstream suppliers), these advertising revenues might be overlooked when calculating the appropriate TPS charge. In such a case Ofcom may consider it appropriate when investigating a complaint or dispute to factor this into its assessment of the benefits received by the TPS customer.
- A1.78 Having estimated the incremental benefit of using the EPG listing service Ofcom would expect Sky to apply the approach to common cost recovery set out in A1.48 to A1.53 when determining each TPS customer’s contribution toward the relevant common costs.

Incremental benefits derived from using Regionalisation services

- A1.79 The regionalisation service is used by TPS customers to associate different broadcast channels with the same EPG channel number in different geographic locations. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared.
- A1.80 Whilst regionalisation utilises the same underlying technologies that are used for providing pay-TV CA services, the benefits broadcasters derive from regionalisation (over and above those derived from a simple EPG listing) are of a significantly different nature.
- A1.81 In determining the incremental benefits TPS customers derive from using the Regionalisation TPS, Ofcom would normally consider it reasonable for Sky to undertake an objective assessment of the revenues that those TPS customers would not earn if they did not use this service. In Ofcom’s view, this is likely to encompass the specific incremental regional advertising revenues received from taking this service.
- A1.82 Ofcom would expect Sky to apply the approach to common cost recovery set out in A1.48 to A1.53 when determining each TPS customer’s contribution toward the relevant common costs. However, where the costs to be recovered are relatively small compared to those recovered via other TPS charges, Ofcom considers that it may be reasonable for Sky to use a simple and transparent charging method such as a fixed “charge per region”.

Incremental benefits derived from using the Geographic Masking TPS

- A1.83 The geographic masking TPS is used by some free to view broadcasters to prevent rights spillage into Ireland and mainland Europe. In order to allocate the common costs associated with providing this TPS the relative benefits received by users of this TPS should be compared.
- A1.84 Whilst geographic masking TPS utilises the same underlying technologies that are used for providing pay-TV CA services, the benefits of taking the service can be considered as either a cost saving from not having to compensate rights holders for lost earnings due to rights spillage or increased revenues earned from being able to broadcast programming which they would not otherwise be able to broadcast due to rights restrictions.
- A1.85 In determining the incremental benefits TPS customers derive from using the geographic masking TPS, Ofcom would normally consider it reasonable for Sky to undertake an objective assessment of the revenues that those TPS customers would not earn if they did not use this service
- A1.86 Ofcom would expect Sky to apply the approach to common cost recovery set out in A1.48 to A1.53 when determining each TPS customer's contribution toward the relevant common costs. However, where the costs to be recovered are relatively small compared to those recovered via other TPS charges, Ofcom considers that it may be reasonable for Sky to use a simple and transparent charging method such as a fixed "charge per channel".

Incremental benefits derived from using the access control services

- A1.87 Operators of interactive TV services are able to derive a very wide range of benefits from using AC services. Ofcom considers that, due to the relative immaturity of these services and the potential for new and innovative services supporting different business models to develop, it would be inappropriate to propose a limited set of proxies of benefits received for these services at this time. A limited set of proxies of benefits received might disincentivise investment in these new services.
- A1.88 On the Sky DSat platform, Sky already publishes a schedule of charges for different types of services and transactions which on the whole are closely linked to the retail revenues generated (or benefits received) by each service. However, in the event of a dispute or complaint Ofcom would consider whether charges for AC services were FRND and in compliance with the Conditions.

Incremental benefits received by Sky as a result of subsidies tied to a retail service

- A1.89 Most TPS customers benefit from an increased number of homes which are able to receive their services. Consequently, efficiently incurred subsidies provided by Sky to increase take up of the platform may be reasonably recovered via TPS charges from those TPS customers who benefit from this increase.
- A1.90 However, when Sky provides subsidies to a consumer on the condition that the consumer signs up to its own retail services then Sky may enjoy additional benefits compared to other TPS customers. For example:
- Sky may get more retail customers than it would get absent the tied subsidy. These additional revenues can be attributed to the tie.

- A tied subsidy may provide a “first mover” advantage for Sky. This may be particularly important where third parties provide substitutable services: a consumer may choose to take Sky’s retail service in order to take advantage of the subsidies which were not available if they took the third party retail service instead and, where Sky’s retail service and third party retail services are substitutable, the consumer may be less likely to take both. Other factors that may be relevant in assessing the importance of any first mover advantage for Sky include the scope of Sky’s retail service (e.g. the number and range of channels within Sky’s retail service) and the degree of complementarity between Sky’s retail service and third party retail services.

Therefore, while most TPS customers benefit from gaining access to an additional household once that household decides to take up the platform, Sky may receive a larger proportion of the benefits compared to third party TPS customers.

- A1.91 Where such a tie exists Ofcom considers that these additional benefits should be taken into account when setting TPS charges for Sky’s own retail business, through an objective analysis and quantification of these benefits.

Incremental benefits received from advanced consumer equipment

- A1.92 Where TPS customers earn incremental revenues due to the availability of consumer equipment with advanced functionality, for example Sky+, Ofcom would normally consider it reasonable for Sky to recover any incremental costs (e.g. equipment subsidies) associated with providing this equipment (over and above subsidies incurred to provide basic consumer equipment) through TPS charges levied on these TPS customers. Ofcom would expect Sky to apply the approach to common cost recovery set out in A1.48 to A1.53 when determining each TPS customer’s contribution toward the relevant common costs.

- A1.93 Where costs are incurred by Sky in upgrading existing customer equipment in a home with more advanced equipment, Ofcom would not normally expect these costs to be recovered from TPS customers who do not benefit from the upgrade.

Total incremental benefits received

- A1.94 When determining the contribution each TPS customer makes towards the platform common costs Ofcom would normally expect Sky to consider the incremental benefits each TPS customer derived from using its chosen mix of TPS.
- A1.95 Having estimated the incremental benefits each TPS customers derives from using its chosen mix of TPS Ofcom would expect Sky to apply the approach to common cost recovery set out in A1.48 to A1.53 when determining each TPS customer’s contribution toward the platform common costs.

Net benefits

- A1.96 Where the Sky DSat platform derives a benefit from providing TPS to a particular TPS customer, e.g. making a particularly attractive service available on its platform which encourages the take up of the platform, Ofcom might expect that this benefit be “netted off” against the benefit that this TPS customer derives from using TPS.
- A1.97 However, Ofcom may also consider it FRND for Sky to exclude these effects when establishing its charging methodology due to the complexity involved in assessing the magnitude of the impact of individual TPS customer’s services on, for example,

the take up of the platform or churn from the platform. If Sky were to adopt such an approach Ofcom would expect Sky to exclude the effects when deriving the TPS charges for all TPS customers (and not selectively exclude the effects from particular TPS customers or TPS customer groups)

Risk sharing

- A1.98 Under a charging methodology in which capital costs associated with a new platform development are recovered over a number of charging periods, Ofcom considers that it may be reasonable to recover a relatively small amount of these costs in early periods as the service becomes established. This can reduce the burden on TPS customers who have taken the risk of providing services on an unproven platform and defer recovery of these costs to a point when there is less risk and potentially more TPS customers from which to recover the costs.
- A1.99 However, Ofcom would normally expect that all TPS customers would pay charges determined by the prevailing published charging methodology (or published charges) in each charging period to ensure there was no undue discrimination in charges between those TPS customers who had joined the platform when charges were lower and those that joined when charges had increased.

Economies of Scale

- A1.100 Ofcom acknowledges that the incremental costs incurred by Sky in providing multiple instances of a service to a customer may benefit from economies of scale. For example, the cost to Sky of providing incremental equipment to support encryption services for a new pay-TV broadcaster may be the same irrespective of whether the broadcaster is encrypting one channel or five channels. In such an instance Ofcom would normally expect any economies of scale to be passed onto the TPS customer.
- A1.101 However, Ofcom would not normally expect that a TPS customer who used multiple instances of a service e.g. multiple EPG listings, to be offered a “bulk” discount on their contribution to common costs.

Non price terms and conditions

- A1.102 Ofcom considers that in certain circumstances the terms and conditions on which TPS are provided could be contrary to the Condition for provision of regulated TPS on fair and reasonable terms. In particular it may be important that third parties are given access to regulated TPS on similar terms as Sky’s own pay-TV business.
- A1.103 Non-price terms and conditions which Ofcom believes would be relevant in assessing whether regulated TPS have been provided on FRND terms include, but are not limited to:
- Lead times associated with the provision of a regulated TPS;
 - Information relating to the development of new regulated TPS and changes to existing regulated TPS
 - Support levels, availability and performance of the regulated TPS;
 - Appropriate processes to ensure that requests for new regulated TPS or changes to existing regulated TPS are handled in a consistent, transparent and objective manner; and

- Bundling of regulated TPS services such that TPS customers are forced to purchase a TPS that they do not require in order to gain access to services they do require.

Annex 2

The legal framework

A2.1 This Annex provides a summary of the legislation relevant to TPS.

Conditional Access

Conditional Access Framework

A2.2 The regulation of CA services is harmonised at the EU level through the Access Directive¹⁵. Article 6 of the Access Directive provides as follows:

“1. Member States shall ensure that, in relation to conditional access to digital television and radio services broadcast to viewers and listeners in the Community, irrespective of the means of transmission, the conditions laid down in Annex I, Part I apply.

2. In the light of market and technological developments, Annex I may be amended in accordance with the procedure referred to in Article 14(3).

3. Notwithstanding the provisions of paragraph 1, Member States may permit their national regulatory authority, as soon as possible after the entry into force of this Directive and periodically thereafter, to review the conditions applied in accordance with this Article, by undertaking a market analysis in accordance with the first paragraph of Article 16 of Directive 2002/21/EC (Framework Directive) to determine whether to maintain, amend or withdraw the conditions applied.

Where, as a result of this market analysis, a national regulatory authority finds that one or more operators do not have significant market power on the relevant market, it may amend or withdraw the conditions with respect to those operators, in accordance with the procedures referred to in Articles 6 and 7 of Directive 2002/21/EC (Framework Directive), only to the extent that:

(a) accessibility for end-users to radio and television broadcasts and broadcasting channels and services specified in accordance with Article 31 of Directive 2002/22/EC (Universal Service Directive) would not be adversely affected by such amendment or withdrawal, and

(b) the prospects for effective competition in the markets for:

(i) retail digital television and radio broadcasting services, and

(ii) conditional access systems and other associated facilities,

would not be adversely affected by such amendment or withdrawal.

¹⁵ Directive 2002/19/EC.

An appropriate period of notice shall be given to parties affected by such amendment or withdrawal of conditions.

4. Conditions applied in accordance with this Article are without prejudice to the ability of Member States to impose obligations in relation to the presentational aspect of electronic programme guides and similar listing and navigation facilities.”

A2.3 Article 6 (1) of the Access Directive specifically requires Member States to ensure that, in relation to conditional access to digital television broadcast to viewers, the conditions laid down in Annex I, Part I of that Directive apply.

A2.4 Specifically, Annex I (b), Part 1 Access Directive states that:

“(b) all operators of conditional access services, irrespective of the means of transmission, who provide access services to digital television and radio services and whose access services broadcasters depend on to reach any group of potential viewers or listeners are to: offer to all broadcasters, on fair, reasonable and non-discriminatory basis compatible with Community competition law, technical services enabling the broadcasters’ digitally-transmitted services to be received by viewers or listeners authorised by means of decoders administered by the service operators, and comply with Community competition law.”

A2.5 These provisions of the Access Directive set out above have been implemented in the UK by sections 45(5), 73(5), 75(2) and 76 of the Act. Section 45 of the Act generally allows Ofcom to set ex ante conditions on various persons, including ‘access-related’ conditions, which, pursuant to subsection (5), are conditions authorised by section 73. Section 73(5) of the Act provides that an access related condition may be one which is set under section 75(2) of the Act.

A2.6 Section 75(2) of the Act imposes a duty on Ofcom:

“to ensure:

(a) that access-related conditions are applied to every person who provides a conditional access system in relation to a protected programme service¹⁶.”

A2.7 A protected programme service is defined as:

“a programme service the programmes included in which cannot be viewed or listened to in an intelligible form except by the use of a conditional access system¹⁷.”

A2.8 A conditional access system is defined as:

“any system, facility, arrangements or technical measure under or by means of which access to programme services requires -

¹⁶ Section 75 (2) (a) of the Communications Act 2003.

¹⁷ Section 75 (3) of the Communications Act 2003.

(a) a subscription to the service or to a service that includes that service; or

(b) an authorisation to view it, or to listen to it, on a particular occasion,¹⁸

A2.9 In order to fulfil the duty imposed by section 75 of the Act, the Director General of Telecommunications determined under section 45 of the Act in his conditional access conditions notification (the 'Conditional Access Notification') that various conditional access conditions ('CA Conditions') applied only to Sky Subscriber Services Limited ('SSSL').¹⁹

Relevant Conditional Access Conditions

Provision of access on fair and reasonable terms

A2.10 **CA Condition 1** requires the Provider to provide to a Broadcaster a CA service in relation to Protected Programme Services²⁰:

"1.1 Where a Broadcaster reasonably requests in writing Conditional Access Services in relation to the provision of Protected Programme Services, the Provider shall provide those Conditional Access Services. The Provider shall also provide such Conditional Access Services in relation to the provision of Protected Programme Services as the Director may from time to time direct.

1.2 The provision of Conditional Access Services in accordance with paragraph 1 shall occur as soon as reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as the Director may from time to time direct.

1.3 The Provider shall comply with any direction the Director may make from time to time under this Condition."

Not to unduly discriminate

A2.11 **CA Condition 5** imposes on the Provider a specific prohibition not to unduly discriminate in matters connected with the provision of CA services to Broadcasters:

"5.1 The Provider shall not unduly discriminate against particular persons or against a particular description of persons, in relation to matters connected with the provision of Conditional Access Services.

¹⁸ Section 75 (3) of the Communications Act 2003.

¹⁹ The regulation of conditional access: setting of regulatory conditions, explanatory statement and formal notification pursuant Section 48 (1) of the Communications Act 2003 published by Ofcom on 24 July 2003, www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/condac0703.pdf.

²⁰ A 'Broadcaster' is defined as, including the British Broadcasting Corporation, "any person to whom a licence has been granted to provide, deliver or diffuse television services under one or more of the Wireless Telegraphy Act 1949, Cable and Broadcasting Act 1984 (and continued in force by the Broadcasting Act 1990), Broadcasting Act 1990, Broadcasting Act 1996, or any person acting on behalf of such a person."

5.2 In this Condition, the Provider shall be unduly discriminating where the discrimination has a material adverse effect on competition and has no objective justification.”

Publication of charges

A2.12 The Provider is obliged to publish its charges or the method for determining its charges, terms and conditions as set out by **CA Condition 6** and to ‘do those things’ set out in Condition 6 (a) (i) to (iii) (e.g. provide CA services) at the charges and on the other terms and conditions so published:

“6.1 The Provider shall except in so far as the Director may otherwise consent in writing:

(a) publish in the manner and at all times specified in paragraph 6.2(a) a notice specifying, or specifying the method that is to be adopted for determining, the charges and other terms and condition on which it offers:

(i) to provide each Conditional Access Service, or package of such Services;

(ii) to connect to any part of the Conditional Access System in accordance with an obligation imposed by or under these conditions; or

(iii) to grant permission to connect Electronic Communications Networks to or to provide Conditional Access Services by means of any of the Conditional Access Systems; and

(b) where it does any of the things mentioned in paragraph 6.1(a)(i) to 6.1(a)(iii), do those things at the charges and on the other terms and conditions so published.

6.2 Publication of the notice shall be effected in the following way:

(a) where the Provider is providing Conditional Access System on 25 July 2003, by sending a copy thereof to the Director not later than 25 August 2003; or

(b) where the Provider provide a Conditional Access System after 25 July 2003, by sending a copy thereof to the Director no later than 28 days after the Provider first provides a Conditional Access System; and

(c) thereafter, 90 days before the date on which any proposal to amend any charge, term or conditions or the method of determining the same is to become effective

and, in any and all of these circumstances, by:

(d) placing a copy of the said notice on any relevant website operated or controlled by the Provider; and

(e) sending a copy thereof to any person who may request such a copy at that person's written request (or such parts which have been requested).”

Keeping of financial accounts

A2.13 The Provider is obliged to keep separate financial accounts regarding its activities as a provider of CA services as set out in **CA Condition 3**:

“3.1 Except in so far as the Director may consent otherwise in writing, the Provider shall keep separate financial accounts regarding its activities as a provider of Conditional Access Services in the manner set out below. [...]

3.5 The Provider shall comply with Conditions 3.6 to 3.18 from 24 December 2003 as appropriate.

3.6 The Provider shall ensure that its accounting and reporting arrangements (including Accounting Separation Systems) are sufficient to enable the Provider, at all times, to be capable of preparing in relation to any period a financial statement in accordance with the Accounting Documents. These accounting and reporting arrangements shall be, in the opinion of the Director, suitable and sufficiently transparent to demonstrate at any, or over, time and in relation to any period that the Provider's charges for Conditional Access Services are, or have been, non discriminatory, fair and reasonable.

3.7 The Provider shall maintain a separation for accounting purposes of Accounting Separation Activities from other activities, so as to:

(a) identify all elements of revenue, cost, assets and liabilities, with the basis of their calculation and the Detailed Attribution Methods used, related to the Accounting Separation Activities including an itemised breakdown of fixed assets; and

(b) ensure that Accounting Separation Activities are identified and are recorded at an appropriate amount in accordance with the Accounting Documents.

3.8 The Provider shall maintain accounting records in a form which, on a historic cost basis and on a current cost basis:

(a) enables each of the Accounting Separation Activities to be separately identified and the revenues, costs, assets and liabilities of the Accounting Separation Activities to be separately attributable; and

(b) which shows and explains the transactions of each of the Accounting Separation Activities.

3.9 The accounting records referred to in paragraph 3.8 and all associated documentation shall be:

(a) maintained in accordance with the Accounting Documents;

- (b) maintained in order to ensure compliance with this Condition;
 - (c) sufficient to enable the Financial Statements to have expressed upon them a Standard Audit Opinion; and
 - (d) sufficient to ensure that charges for Conditional Access Services can be shown to be fair and reasonable and not to be unduly discriminatory.
- [...]"

A2.14 For further text and definitions, see the full text of the CA Conditions and defined terms at:
www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/cont0903.pdf

The Electronic Programme Guide and Access Control Conditions

Electronic Programme Guide and Access Control Services Framework

A2.15 Article 5 of the Access Directive makes specific provision for the regulation of EPG and AC services as follows:

"1. National regulatory authorities shall [...], encourage and where appropriate ensure, in accordance with the provisions of this Directive, adequate access and interconnection, interoperability of services, exercising their responsibility in a way that promotes efficiency, sustainable competition, and gives the maximum benefit to end-users.

In particular, [...] national regulatory authorities shall be able to impose [...]:

(a) to the extent that is necessary to ensure end-to-end connectivity, obligations on undertakings that control access to end-users, including in justified cases the obligation to interconnect their networks where this is not already the case;

(b) to the extent necessary to ensure accessibility for end-users to digital radio and television broadcasting services specified by the Member State, obligations on operators to provide access to the other facilities referred to in Annex I, Part II on fair, reasonable and non-discriminatory terms."

A2.16 The facilities referred to in Article 5 (1) (b) at Annex I, Part II of the Access Directive are:

"(a) Access to application program interfaces (APIs);

(b) Access to electronic programme guides (EPGs)."

A2.17 Article 5(1)(b) of the Access Directive is implemented in the UK by Sections 73(2) and 74(2) of the Act. Section 45 of the Act allows Ofcom to set different types of conditions, including access-related conditions. Section 45(5) provides that an access-related condition is one that is authorised by Section 73, and Section 74(2)

states that the conditions that may be set under Section 73(2) includes those conditions set out in Section 74(2) of the Act.

A2.18 Section 74(2) of the Act enables Ofcom to impose:

“[...] conditions imposing obligations on a person providing facilities for the use of application programme interfaces or electronic programme guides as OFCOM consider to be necessary for securing:

(a) that persons are able to have access to such programme services provided in digital form as OFCOM may determine; and

(b) that the facility for using those interfaces or guides is provided on terms which –

(i) are fair and reasonable; and

(ii) do not involve, or tend to give rise to, any undue discrimination against any person or description of persons²¹.”

A2.19 An application programme interface is defined in Section 74 (3) and (4) of the Act as:

“[...] a facility for allowing software to make use, in connection with any of the matters mentioned [below], of facilities contained in other software”;

The matters mentioned [above], in the definition of "application programme interface", are-

(a) allowing a person to have access to programme services;

(b) allowing a person, other than a communications provider or a person who makes associated facilities available, to make use of an electronic communications network by means of which a programme service is broadcast or otherwise transmitted;

(c) allowing a person to become the end-user of a description of public electronic communications service.”

A2.20 An EPG is defined in s 74 (3) of the Act as:

“a facility by means of which a person has access to any service which consists of-

(a) the listing or promotion, or both the listing and the promotion, of some or all of the programmes included in any one or more programme services; and

(b) a facility for obtaining access, in whole or in part, to the programme service or services listed or promoted in the guide;”

²¹ Section 74 (2) of the Communications Act 2003.

A2.21 The Director duly imposed on SSSL a number of regulatory conditions relating to the provision of EPG (the 'EPG Conditions') and AC (the 'AC Conditions') services, which were carried over by means of "continuation notices" from the regulatory regime that was in place until 24 July 2003²². The Director further explained in a statement in September 2003, his reasons for continuing the licence conditions after 25 July 2003, (see specifically paragraphs 3.121 and 3.122).²³ For the purpose of this Annex, the continuation notices are referred to as the EPG Continuation Notice²⁴ and the AC Continuation Notice.²⁵

Relevant Electronic Programme Guide Conditions

A2.22 The following paragraphs set out the application of the EPG Conditions relevant to this consultation:

Provision of access on fair reasonable and non-discriminatory basis

A2.23 EPG **Condition 1** requires the Licensee (i.e. currently SSSL) to provide an EPG service to Third Parties in respect of decoders administered by it on a fair reasonable and non-discriminatory basis.²⁶

"1.1 Where a Third Party requires the provision of an Electronic Programme Guide Service in respect of decoders administered by the Licensee, the Licensee shall offer that Service to that person on a fair reasonable and non-discriminatory basis. [...]"

A2.24 An EPG service is defined in the Conditions as:

"a service which consists of -

²² Continuation notice to a class of persons defined as the licensee for the purposes of the provision of electronic programme guide services under paragraph 9 of schedule 18 to the communications act 2003, 23 July 2003, which continued certain provisions of the class licence to run telecommunications systems for the provision of conditional access services granted by the Secretary of State for Trade and Industry on 1 August 2001 under section 7 of the Telecommunications Act 1984.

²³ Continuing Licence Conditions after 25 July, 10 September 2003,

http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/cont0903.pdf.

²⁴ Continuation Notice to a class of persons defined as the licensee for the purposes of the provision of electronic programme guide services under paragraph 9 of schedule 18 to the Communications Act 2003, 23 July 2003.

http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/index.htm.

²⁵ Continuation Notice to a class of persons defined as the licensee for the purposes of the provision of access control services under paragraph 9 of schedule 18 to the Communications Act 2003, 23 July 2003.

http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/acs_class.pdf.

²⁶ A 'Third Party' is defined as "a Broadcaster". A 'Broadcaster' is defined as, including the British Broadcasting Corporation, "any person to whom a licence has been granted to provide, deliver or diffuse television services under one or more of the Wireless Telegraphy Act 1949, Cable and Broadcasting Act 1984 (and continued in force by the Broadcasting Act 1990), Broadcasting Act 1990, Broadcasting Act 1996, or any person acting on behalf of such a person, and any person providing Digital Television Services.". 'Digital Television Services' has the same meaning as in Directive 95/47/EC on the use of standards for the transmission of television signals which was in force prior to its repeal by the Framework Directive.

(a) the listing or promotion, or both the listing and promotion, of some or all of the programmes included in any more or more programme services the providers of which are or include persons other than the provider of the guide; and

(b) a facility for obtaining access, in whole or part, to the programme service or services listed or promoted in the guide²⁷.”

Not show undue preference or exercise undue discrimination

A2.25 In addition, EPG **Condition 11** imposes on the Licensee a specific prohibition on undue preference or discrimination in the provision of EPG services to third parties:

“11.1 The Licensee shall not (whether in respect of the charges or other terms or conditions applied or otherwise) show undue preference to or exercise undue discrimination against particular persons or persons of any class or description as respects:

(a) the provision of any Electronic Programme Guide Services, or

(b) the connection to any of the Applicable Systems of any other Conditional Access System or Transmission System which is not and is not to be comprised in any of the Applicable Systems.

11.2 The Licensee shall be deemed to have shown such undue preference or to have exercised such undue discrimination if it unfairly favours to a material extent a business carried on by it in relation to the doing of any of the things mentioned in paragraph 11.1 so as to place at a significant competitive disadvantage persons competing with that business.

11.3 Any question relating to whether any act done or course of conduct pursued by the Licensee amounts to such undue preference or such undue discrimination shall be determined by the Director, but nothing done in any manner by the Licensee shall be regarded as undue preference or undue discrimination if and to the extent that the Licensee is required or expressly permitted to do such thing in that manner by or under any provision of this Licence.”

Publication of Charges

A2.26 The Licensee is obliged to publish its charges or the method for determining its charges, terms and conditions as set out by EPG **Condition 14** and to do those things mentioned in Condition 14.1(a) (i) to 14.1(a) (iii) (e.g. to provide EPG Services) at the charges and on the other terms and conditions so published.

“14.1 The Licensee shall except in so far as the Director may otherwise consent in writing:

(a) publish in the manner and at the times specified in paragraph 14.2(a) a notice specifying, or specifying the method that is to be

²⁷ Schedule 1, EPG Conditions.

adopted for determining, the charges and other terms and condition on which it offers:

(i) to provide each Electronic Programme Guide Service, or package of such services:

(ii) to connect to any of the Applicable Systems any other telecommunication system (which is not and not to be comprised in any of the Applicable Systems) in accordance with an obligation imposed by or under this Licence: or

(iii) to grant permission to connect other telecommunication systems to or to provide Electronic Programme Guide Services by means of any of the Applicable Systems:

and

(b) where it does any of the things mentioned in paragraph 14.1(a)(i) to 14.1(a)(iii) do those things at the charges and on the other terms and conditions so published.

and

14.2 Publication of the notice shall be effected by:

(a) sending a copy thereof to the Director not more than 28 days after the date on which the Licensee first runs and Applicable System and, thereafter, not later than the last working day before the date on which any proposal to amend any change, term or condition or the method of determining the same is to become effective;

(b) placing as soon as practicable thereafter a copy thereof in a publicly accessible part of the Major Office of the Licensee in such a manner and in such a place that is readily available for inspection free of charge by members of the general public during normal office hours: and

(c) sending a copy thereof or such part or parts thereof as are appropriate to any person who may request such a copy.”

A2.27 For further text and definitions, see the full text of the EPG Conditions and defined terms at:

www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/epg_cl ass.pdf

Relevant Access Control Conditions

A2.28 The following paragraphs set out the application of the AC Conditions relevant to this consultation:

Provision of access on fair and reasonable terms

A2.29 AC **Condition 10** requires that where the “Licensee is a Regulated Supplier” (i.e. currently SSSL) it must provide an AC service to any Third Party who requests it.²⁸

“10.1 [...] at the request of any Third Party who requires Access Control Services in order to supply a Relevant Other Telecommunication Service of any description, the Licensee shall supply such Access Control Services to that Third Party on fair and reasonable terms. [...]”

A2.30 AC services are defined as:

“telecommunication services, other than Network Services, Electronic Programme Guide Services or Conditional Access Services, by means of which the supply to end-users of a Relevant Other Telecommunication Service is controlled and which are provided to any person, including the Licensee, providing telecommunication services and without prejudice to the generality of the foregoing includes:

(i) Message Processing Services, that is to say any encryption, scrambling or other processing of Messages associated with or incorporated in a Relevant Other Telecommunication Service of any description prior to a transmission to an Access Device;

(ii) Authentication Services, that is to say either or both of:

(A) services which identify an end-user or an Access Device in order to permit or deny access of that end-user or access device to a Relevant Other Telecommunication Service; or

(B) services which identify a Relevant Other Telecommunication Service in order to permit it to operate with an Access Device;

(iii) Access Device Management Services, that is to say the actuation, control or operation, or the remote actuation, control or operation of Access Devices;

(iv) Selection Services, that is to say the processing by an Access Device or the preparation and transmission to an Access Device of Messages which allow an end-user to initiate access to a Relevant Other Telecommunication Service or to select from a number of Relevant Other Telecommunication Services;

(v) Subscriber Management Services, that is to say either or both of:

(A) the preparation of and the preparation and supply, adaptation of, or adaptation and supply to end-users of Essential Components; or

²⁸ “Third Party” is defined as “a person who provides Relevant Other Telecommunications Services”. For a definition of a Relevant Other Telecommunications Services, see paragraph A2.31 of this annex.

(B) the preparation and transmission to Access Devices of Messages giving effect to end-users' decisions to subscribe to a Relevant Other Telecommunication Service;"

A2.31 Relevant Other Telecommunications Services are defined as:

"telecommunication services, whether supplied by the Licensee or any other party, but not including:

(i) any of the services specified in Section 72(2)(a) to (f), of the Broadcasting Act 1990 other than licensable programme services specified in Section 46(1) of that Act which are conveyed for reception at different times in response to requests made by different users of the service;

(ii) Digital Television Services; or

(iii) Network Services;"

Not unduly discriminate or show undue preference

A2.32 In addition, AC **Condition 14** imposes on the Licensee a specific prohibition on undue preference or discrimination in the provision of EPG Services to Third Parties.

"14.1 The Licensee shall not unduly discriminate or show undue preference in the manner set out below:

(a) the Licensee shall not (whether in respect of the charges or other terms or conditions applied or otherwise) show undue preference to, or exercise undue discrimination against, particular persons or persons of any class or description (in any market) as respects:

(i) the provision by means of the Applicable Systems of any Access Control Service provided by the Licensee (including offers of terms on which such services are to be provided) in the market determined by the Director for the purposes of the Regulated Supplier Determination;

(ii) the maintenance, adjustment, repair or replacement of any apparatus comprised in the Applicable Systems which is used for the provision of any Access Control Service in the market determined by the Director for the purposes of Regulated Supplier Determination;

(b) the Licensee may be deemed to have shown such undue preference or to have exercised such undue discrimination if it unfairly favours to a material extent a business carried on by it in relation to the provision of any Access Control Service referred to in paragraph 14.1(a) above so as to place at a significant competitive disadvantage persons competing with that business; and

(c) any question relating to whether any act done or course of conduct pursued by the Licensee amounts to such undue preference or such undue discrimination shall be determined by the Director, but nothing done in any manner by the Licensee shall be regarded as undue preference or undue discrimination if and to the extent that the

Licensee is required or permitted to do such thing in that manner by or under any provision of this Licence.”

Publication of charges

A2.33 The Licensee is obliged to publish its charges or the method for determining its charges, terms and conditions set out by AC **Condition 15.2** and not to depart from the published charges, terms and conditions (except as set out in Condition 15.4 which sets out Notice periods for changing charges, terms and conditions).

“15.1 The Licensee shall, except in so far as the Director may otherwise consent in writing, publish prices and act in the manner set out below.

15.2 Within 28 days after the date the Director has made the Regulated Supplier Determination above, the Licensee shall send to the Director a notice specifying, or specifying the method that is to be adopted, for determining the charges, terms and conditions on which it offers to:

(a) provide each description of Access Control Service in the market determined by the Director for the purposes of the Regulated Supplier Determination above;

(b) maintain, adjust, repair or replace any apparatus comprised in the Applicable Systems which is used in the provision of any telecommunication service comprised in such a specified Access Control Service.

15.3 The Licensee shall provide the services referred to in paragraph 15.2 above at the charges, terms and conditions so published, and shall not depart there from except in the circumstances set out in paragraph 15.4 below.

15.4 the Licensee shall send to the Director:

(a) a notice of any amendment to any charge, term or condition, or method of determining the same, referred to in the notice described in paragraph 15.2 above; and

(b) a notice specifying, or specifying the method that is to be adopted, for determining the charges, terms and conditions on which it offers each description of Access Control Service specified in the Regulated Supplier Determination above which materially different from any Access Control Service to which the notice under paragraph 15.2 refers not less than one day before the amendment referred to in sub-paragraph 15.4(a) above is to come into effect, or the Licensee first provides the telecommunications service referred to in sub-paragraph 15.4(b) above.

15.5 The Licensee shall, as soon as practicable after sending to the Director each notice referred to in paragraphs 15.2 and 15.4 above, place a copy of such notice in a publicly accessible part of every Major Office of the Licensee in such manner and in such place that it

is readily available for inspection free of charge by members of the general public during normal office hours.

15.6 The Licensee shall send a copy of any notice referred to in paragraph 15.2 and 15.4 above to any person at that person's request (or such parts which have been requested)"

Keeping of financial accounts

A2.34 The Licensee is obliged to keep separate financial accounts regarding its operation of AC services as set out in CA **Condition 12**.

12.1 [...] the Licensee shall keep separate financial accounts regarding its operation of Access Control Services save that where the Licensee also runs a Conditional Access System it shall not be obliged by this Condition to keep accounts in respect of Access Control Services separate from those in respect of Conditional Access Services provided by means of a Conditional Access System.

12.2 The Licensee shall maintain such accounting records dealing separately with its Access Control Services Business as will enable it to show separately and explain, in response to any request from the Director under paragraph 12.5, all the transactions to which paragraph 12.3 refers.

12.3 This paragraph refers to all transactions between the Licensee's Access Control Services Business and:

(a) any other business carried on by the Licensee whether in the United Kingdom or elsewhere;

(b) the business of any Associated Person whether in the United Kingdom or elsewhere;

(c) the business of any Third Party; and

(d) any other person or class of persons notified to the Licensee by the Director.

12.4 The Licensee shall update the accounting records referred to in paragraph 12.1 no less frequently than six monthly and those records shall include in particular the costs (including capital costs), revenue and a reasonable assessment of assets employed in and liabilities attributable to the Access Control Services Business, and separately, the amount of any material item of revenue, cost, asset or liability which has been either:

(a) charged from or to any other business of the Licensee or the business of an Associated Person or Third Party together with a description of the basis of the value on which the charge was made; or

(b) determined by apportionment or attribution from an activity common to the business and any other business of the Licensee or

any Associated Person and, if not otherwise disclosed, the basis of the apportionment or attribution. [...]"

A2.35 For further text and definitions, see the full text of the AC Conditions and defined terms at:

http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/cont_notices/acs_class.pdf

Annex 3

Access Control services

A3.1 The AC services currently offered by Sky on its DSat platform include:

<p>Application Signing Services</p>	<p>The Sky set top box will only recognise and execute interactive applications that have been digitally “signed” with certificates issued by Sky. The provision of these certificates, use of the “red button” technology, procedures relating to testing of the applications and conditions relating to the visual and functional design of the applications form the basis of the Application Signing service.</p>
<p>Authentication Services</p>	<p>Interactive applications which connect to the broadcaster’s online infrastructure using the STB modem must do so via an “authentication server” provided as part of the Authentication Service. The processing capacity and level of reliability of this server is determined for each Authentication Service customer to match their expected connection volumes and peak connection rate (i.e. connections per second). Consequently the direct cost of providing this service varies between customers.</p>
<p>Customer Data Sets</p>	<p>Sky holds name and address data relating to customers who received subsidised set top boxes. Third parties can procure this information to use in conjunction with an interactive TV service. For example, to reduce the burden on a TV viewer, an interactive application operator may pre-populate a customer registration screen within its service with the address data it has procured from Sky.</p>

New Access Control services

Given the evolving nature of interactive TV services and the Sky DSat platform, Ofcom considers it possible that other technical services may be introduced that fall within the definition of AC services.

Annex 4

Reasonable rate of return

- A4.1 Investors are assumed to be risk averse. Therefore, where the outcome of a project is uncertain, investors require a higher expected rate of return on that investment in order to compensate them for this higher risk on returns.²⁹ The relevant risk is the systematic (or undiversifiable) risk associated with the company's equity that can not be diversified by assembling a market portfolio of equities.
- A4.2 The level of compensation required by investors is commonly referred to as the company's cost of equity. A company's weighted average cost of capital ('WACC') is simply the weighted average (with weights based on the proportion of its total financing that is accounted for by equity and debt capital respectively) of its cost of equity and cost of debt. The level of a company's cost of capital is equal to the expected return that could be gained from an alternative investment opportunity of equivalent risk that is available in the capital market, i.e. it is an opportunity cost.
- A4.3 The allowable risk-adjusted rate of return on an investment should be compared with the mean expected value of the cash flows from the investment. This is because, separately from the issue of the scale of the appropriate reward for bearing risk, the investor requires a "fair bet". This would be the case even in the case of a risk neutral investor who was happy to bear risk for no reward. A fair bet is one where, if the bet were repeated a sufficiently large number of times, the investors (or gamblers) would on average cover their cost (or stake). At the point where a risky project is undertaken, there are a range of outcomes that may arise, each with an associated probability. A project may, for example, have two outcomes, success or failure. An investor would form an *ex ante* view on the expected return of this project, based on the return in each possible state and the probability associated with each state arising. A fair bet in the case of a new investment would be one where this *ex ante* expected return covers the cost of investment, including the cost of capital.
- A4.4 Where a successful outcome arises, the observed return derived in this state is likely to be higher than the *ex ante* expected return and in particular, higher than the cost of capital. Such a return may still however be reasonable. This is because when the investment was undertaken, there was an *ex ante* probability of failure and a lower return associated with this outcome. This probability of failure is likely to be greater initially but may diminish over time with respect to future tranches of investment.
- A4.5 Therefore, when comparing the return achieved on a project in a successful state with the cost of capital of the project, an allowance should be made to reflect the fact that for a return to be deemed reasonable, it is the *ex ante* expected return, and not the successful state return, that should reflect the cost of capital.
- A4.6 Where a project consists of multiple tranches of investment, in evaluating the reasonableness of the return achieved, it is important to differentiate the *ex ante*

²⁹ Ofcom's approach to calculating the rate of return that investors require for bearing systematic risk is, in line with the other UK economic regulators and the Competition Commission (CC), to use the CAPM.

expected return on each individual tranche of investment. As noted above, in the case of a new start up project the initial investment is likely to be among the most risky tranches of investment and therefore the observed return on a successful tranche of early investment might be particularly high, when compared to the cost of capital. Incremental tranches of investment in the same, successful project would be likely to have a lower ex ante risk of failure and therefore the variation of the observed return from the cost of capital on an incremental tranche of investment would also be likely to be lower. Therefore, the amount of return associated with the payoff resulting from a successful outcome to a fair bet would be expected to decline with each additional tranche of investment

- A4.7 In assessing overall DSat platform cost recovery against the cost of capital of the DSat platform investment, it is Ofcom's view that a reasonable approach would be for Sky to earn a level of return that is consistent with the ex ante return that would have been anticipated at the time of each tranche of investment, having taken into account the extent to which any variation from the cost of capital could be attributed to the outcomes resulting from participation in a "fair bet".
- A4.8 Ofcom's statement on approach to risk in the assessment of cost of capital sets out other considerations that Ofcom would normally take into account when assessing a company's cost of capital.
- A4.9 Ofcom believes that, under certain circumstances, it may be appropriate to reflect differences in risk within corporate groups in its financial analysis. In the context of systematic risk, the reflection of differences in risk would mean allowing different costs of capital on different projects to reflect variations in systematic risk between different investments. One way to achieve this in practice would be to disaggregate the company's equity beta, the parameter that reflects the systematic risk of a particular company according to the CAPM.³⁰
- A4.10 Ofcom has considered whether these circumstances apply to evaluation of the reasonable rate of return in the case of Sky's DSat platform and has concluded that it would not be appropriate to estimate a disaggregated cost of capital in this case. This is for three primary reasons.
- A4.11 First, Ofcom has no a priori reason to believe that the variability of returns and level of systematic risk are likely to be materially different between the platform and retail elements of BSkyB's business. This appears particularly true given the extent to which each side of the business is dependent on the other for successful operation and the linkages in business drivers that this implies. For example, the commercial success of both elements of BSkyB's business is likely to be positively driven by the size of BSkyB's retail customer base.
- A4.12 Second, in the event that such a disaggregation were to be undertaken, there would be a need to consider the appropriate cost of capital for two businesses. The first would be the cost of capital for a TPS provider which does not have an associated pay-TV business. The second would be the cost of capital for a pay-TV business which does not have a TPS platform business. The pay-TV business in each of these circumstances would need to be similar in nature and profile to the Sky pay-TV business, including an appropriate mix of content and market share. Ofcom does not believe that there are appropriate benchmarks which can currently

³⁰ Para 1.13, Ofcom's approach to risk in the assessment of the cost of capital, 18 August 2005

be observed or utilised for these businesses, either in the UK or abroad, and therefore considers that estimation of the appropriate cost of capital would be problematic

- A4.13 Third, Ofcom questions whether the calculation of such a disaggregation would be likely to be a significant or material factor in the calculation of an appropriate cost of capital in any case, particularly considering the two points above and the likely greater material impact of other relevant estimates and adjustments, compared with the materiality of the impact which could be associated with disaggregation of the cost of capital.

Annex 5

Further responses to the consultations

- A5.1 This section addresses further points raised by stakeholders during the consultation process and Ofcom's response to them.
- A5.2 In total Ofcom received sixteen responses to the first consultation: fourteen from companies/organisations and two from individual members of the public. Many of the respondents focused on certain key issues, rather than commenting on all the specific questions posed by Ofcom.
- A5.3 Ofcom received 9 responses to the second consultation all of which were marked confidential in their entirety. Subject to ensuring confidentiality is maintained, Ofcom has reflected comments received during the second consultation within the main statement.
- A5.4 Ofcom has not provided details of the names of the companies, organisations and individuals who provided confidential responses to the consultation.
- A5.5 Ofcom has grouped the responses under the following headings:
- Transitional arrangements
 - Market review
 - Further consultation
 - Equipment costs
 - Marketing costs
 - Pricing small broadcasters off the platform
 - Benefits approach to cost allocation
 - Rate card vs. negotiation
 - Financial accounts based approach to the assessment of cost recovery
 - Other TPS platforms
 - Other TPS issues

Transitional arrangements

- A5.6 Three respondents generally wanted the new guidelines to come into force in the near future and seven respondents who suggested that there should be a transitional period before the new guidelines come into effect. However, there were many different views on the appropriate length of time for transitional arrangements.
- A5.7 Two respondents considered that that Ofcom should make clear that the new guidelines will apply retrospectively to any disputes about existing contracts on the basis that the underlying principles are the same as those contained in the previous guidelines.
- A5.8 Section 2 provides further information on implementation of the new guidelines.

- A5.9 Where Ofcom has the power to, it will consider the appropriateness of retrospection on a case by case basis.

Market review

- A5.10 One respondent considered that the market for satellite TV is seriously distorted and that that a fundamental review of the regulatory environment is required.
- A5.11 As set out above in Section 2, Ofcom intends to conduct a market review and will begin the preliminary analysis for this later this year.

Equipment costs

- A5.12 Five respondents agreed that it was not appropriate to mandate that equipment costs must be recovered directly from consumers. One respondent argued that any upgrade from basic equipment to more advanced equipment, e.g. Sky+ and Sky HD, should be funded by the consumer. This argument was further developed by other respondents who considered that these costs should not be recovered from TPS customers who did not benefit from the upgrade.
- A5.13 One respondent, whilst agreeing that consumer subsidies benefited Sky and other broadcasters and that they should be recovered from TPS customers, did not agree that this should be based on the benefits received by these customers.
- A5.14 A respondent claimed that the PSB channels that are also available on analogue terrestrial do not benefit from the growth of the DSat platform as these channels are already universally available in all homes. They therefore argued that these channels should not contribute to the subsidies for customer equipment.
- A5.15 Ofcom considers that the views expressed by respondents are broadly reflected in the benefits based approach set out in the guidelines (sections 4 “Allowable costs” and 6 “Quantifying incremental benefits received”). Ofcom considers that all TPS customers are likely to benefit from having a presence on the DSat platform in a DSat household and it may therefore be reasonable that a proportion of these costs should be recovered from third party TPS Customers.
- A5.16 It is Ofcom’s view that a benefit based cost recovery mechanism would address the concerns raised by stakeholders that costs should not be recovered from TPS Customers who do not benefit from them and that cost recovery should take due account of benefits received.
- A5.17 Ofcom has acknowledged the point raised by the respondent who claims channels which broadcast via analogue terrestrial may receive smaller incremental benefit from the growth of the digital satellite platform than some other channels. Ofcom considers that this issue is addressed in the Guidelines. Ofcom disagrees with the respondent who did not consider that TPS charges should reflect the benefits a TPS Customer derived from using TPS. Ofcom considers a benefits based recovery approach is the most appropriate for FRND recovery of common costs.
- A5.18 It is Ofcom’s continued view that recovery of customer equipment subsidies using a benefit based cost recovery approach is the most appropriate for a FRND pricing regime. Furthermore, Ofcom consider that the incremental benefits received by each TPS Customer should be objectively assessed to derive TPS charges rather than determining them through negotiation.

- A5.19 Ofcom's Guidelines also seek to address the concerns expressed with regard to customer equipment subsidies being linked to pay-TV subscriptions. This information is contained in section 4.
- A5.20 In addition, it is Ofcom's view that the benefits based cost recovery mechanism will also ensure that only those TPS customers who benefit from more advanced functionality such as Sky+ or HD services would be required to contribute towards the associated costs. This issue is covered in section 6.

Marketing costs

- A5.21 One respondent considered that Ofcom's proposal did not clearly set out how costs should be allocated to different broadcasters. This respondent also suggested that a clear distinction should be made between costs which relate to customer acquisition and retention, and argued that retention costs should not be recovered from TPS customers.
- A5.22 One respondent suggested that free-to-view broadcasters benefit more from marketing than small pay-TV broadcasters, due to the fact that they are available on the Sky platform without a subscription, and that Ofcom's approach should take this into account.
- A5.23 One respondent highlighted concerns with the possibility that marketing associated with Sky+ equipment and HD services may be charged to the TPS customers.
- A5.24 One respondent considers that third parties obtain benefits from marketing and other investments which attract new customers to the platform and therefore third parties should contribute towards the recovery of these costs.
- A5.25 Ofcom consider that these concerns have been adequately addressed in the guidelines in so far that only those marketing costs that can be shown to promote the generic benefits of the platform should be recovered via TPS charges. This is set out in Section 4 "Allowable costs".
- A5.26 Ofcom also considers that the guidelines seek to address concerns relating to the allocation of customer retention costs. As is outlined in section 4 of the Explanatory Statement, it would not normally be allowable for Sky to recover marketing and retention costs associated with its pay-TV business from TPS customers.
- A5.27 It is also Ofcom's view that the benefits based cost recovery mechanism will also ensure that only those TPS customers who benefit from more advanced functionality such as Sky+ or HD services would be required to contribute towards the associated costs. This issue is set out in section 6.

Pricing small broadcasters off the platform

- A5.28 One respondent suggested that charges should take into account the number of subscribers/viewers of each broadcaster, as well as size of the broadcaster's business and financial strength to bear costs.
- A5.29 Another respondent disagreed with the view that the current charging arrangements for EPG listings appear to promote range or plurality. This respondent considered that the UK EPG arrangements are designed as a means of market control and are radically different from those of most European DSat/pay-TV platforms. The

respondent also claimed that there is evidence that several prospective new entrants have abandoned their entry plans as a result of EPG charges.

- A5.30 One respondent considered that charges for EPG services should be capped at £1000 per month and that any additional fees should be linked to either qualifying revenue or measured audience size.
- A5.31 Ofcom considers that these concerns are addressed by the benefits based cost recovery approach Ofcom has set out in the statement and guidelines.

Benefits approach to cost allocation

Conditional Access

- A5.32 One respondent considered that for geographical masking services a benefits based approach would be too complex and burdensome on broadcasters, and therefore supported Ofcom's proposal of a per channel charge.
- A5.33 Another respondent considered that pay-TV broadcasters receive a significant proportion of the benefits from using CA services. This respondent considered that conditional access services mainly benefit pay-TV broadcasters because the 'pay-TV' business model relies on channels being encrypted. In comparison, this respondent considered that encryption for geographical masking provides little or no benefit for free-to-view broadcasters. This service is not essential for such channels to operate, but has been used by free-to-view broadcasters to comply with rights agreements. The respondent also highlighted that a number of channels have started to broadcast "in the clear".
- A5.34 Ofcom consider that the guidelines address the concerns raised by these respondents. The Explanatory Statement and Guidelines highlight that Ofcom would normally expect the charges for this TPS to be determined based on an assessment of the incremental benefits that the TPS customer derives from using the service. Therefore Ofcom would expect TPS charges to reflect the benefits TPS customers receive. Where benefits can be demonstrated to be low, charges should also be relatively low.

EPG listing

- A5.35 One respondent disagreed with Ofcom's proposed approach for the variable element of charging for EPG listings and suggested that charges should be set at a level which "catches" the Public Service Broadcasters and other broadcasters with equivalent viewing shares. Another respondent was in favour of keeping the current flat rate approach to EPG pricing, but considered that, if a benefits approach were to be adopted by Ofcom, then this should be based on revenue rather than viewing share. This respondent also expressed concerns that a two tier approach could lead to larger broadcasters paying the majority of EPG costs.
- A5.36 Another respondent considered that, due to difficulties in estimating the benefits received from an EPG listing, it is appropriate that a 'per EPG listing' charge is applied to all customers. This broadcaster considered that viewing share is a poor proxy for the benefits of an EPG listing because certain channels are available on other platforms and/or can still be accessed on the Sky platform in the absence of an EPG listing.

- A5.37 One respondent argued that Ofcom's analysis of the benefits derived from being on Sky's platform is flawed and inadequately reasoned. In particular, the respondent argued that no evidence had been provided by Ofcom to support the conclusion that benefits to analogue terrestrial channels are 'particularly low'.
- A5.38 One respondent highlighted that Ofcom's proposal did not take into account the benefits which Sky's platform receives from the presence of the channels operated by the commercial public service broadcasters.
- A5.39 Ofcom consider that a benefits based cost recovery mechanism is most appropriate to achieve FRND TPS pricing. Where possible it is reasonable to use proxies of revenue to avoid actual revenues earned by a TPS customer being revealed to Sky.
- A5.40 Ofcom considers that measuring the benefits a particular TPS customer brings to a platform are very hard to quantify. Whilst TPS charges would ideally be based on the net incremental benefits TPS Customers receive from using TPS in practical terms this may be impractical to measure.
- A5.41 Ofcom has highlighted in its explanatory statement that the criteria used to determine which channels are charged a fix fee for an EPG Listing and which are charged a variable fee should be such that there was no material distortion in the benefits based costs recovery.

Rate card vs. negotiation

- A5.42 Eight respondents preferred a rate card approach and highlighted the importance of predictability of charging for broadcasters' planning and decision making processes. One of these respondents commented that Sky should continue to publish details of its charges, and, in cases where it deviates from those charges, Sky should also be required to publish details of the different charges as well as the objective justifications for doing this.
- A5.43 Three of these respondents claimed that determining TPS charges with Sky through commercial negotiation was no longer appropriate and did not lead to consistent and transparent pricing. Three others claimed that a more transparent charging methodology would benefit their own business.
- A5.44 One respondent generally supported a rate card approach, but considered that Ofcom must take great care in developing charging methodologies. This respondent also considered it was important for flexibility to remain with contractual terms.
- A5.45 One respondent did not support moving from a negotiation approach to charges. This respondent believes that a rate card approach is not appropriate because no single set of charges can be FRND. In addition, the respondent argues that loss of flexibility inherent in a rate card approach could hinder the development of innovative services by broadcasters, and that there is a significant risk that the lack of flexibility of the TPS provider to meet broadcasters' particular demands will result in increased recourse to Ofcom.
- A5.46 Section 2 of the Explanatory Statement and Guidelines explain why Ofcom considers that negotiation is no longer an appropriate approach for determining TPS charges and how a charging methodology that takes due account of benefits can result in FRND charges.

Financial accounts based approach to the assessment of cost recovery

- A5.47 One respondent supported Ofcom's proposal in principle but argued that the approach was flawed in practice because Sky's accounts do not solely relate to its platform business.
- A5.48 Ofcom would like to clarify that it is a requirement of the Conditions that Sky maintains separate accounts for its CA and AC services. Therefore, the view that Sky's accounts do not solely relate to its platform business is incorrect in the case of these services. Ofcom further considers that the application of the principles set out in these Guidelines should result in Sky only recovering costs through TPS charges which relate to the provision of TPS or the development of the DSat platform.

Other TPS platforms

- A5.49 One respondent suggested that Ofcom should apply its proposed cost-based approaches to other TPS providers and, in particular, access control services on digital cable platforms.
- A5.50 The cable platforms are not currently regulated providers of Access Control services. Ofcom considers that this issue is outside the scope of the TPS guidelines but may be considered by Ofcom as part of a full market review.

Other TPS issues

- A5.51 One respondent considered that Ofcom's proposed two-tier charging for EPG listings would result in inconsistencies across different TV platforms and may encourage the listing of EPG slots for channels which the individual user cannot view. Consequently, it may add to the difficulties of digital switchover for vulnerable groups. This respondent therefore recommended that Ofcom takes an approach, particularly on the DTT platform, which ensures that the EPG pricing structure does not encourage a proliferation of EPG slots for channels.
- A5.52 Ofcom's objective in the new guidelines is to set out how it would normally interpret the TPS conditions in the event of a dispute. It is not Ofcom's intention to affect the way in which broadcasters decide to structure their channel listings on an EPG. Also, as was explained in the November consultation document the review of the TPS guidelines does not cover Ofcom's "Code of practice on electronic programme guides".
- A5.53 However, as outlined in Ofcom's Annual plan for 2006/7, there are other Ofcom work programmes which relate to issues connected to digital switchover and vulnerable customer groups. For example Ofcom is working with the Government to ensure that vulnerable consumers receive the necessary support prior to digital switchover. Ofcom's future work programme also includes a review of the "Code of practice on electronic programme guides".