



Provision of Technical Platform Services

Consultation on draft guidelines and explanatory
statement

Consultation

Publication date:

21 April 2006

Closing Date for Responses:

16 June 2006

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Section 1

Summary

- 1.1 This consultation invites stakeholders to comment on the draft explanatory statement and revised Technical Platform Services (“TPS”) guidelines which explain how Ofcom would normally interpret the regulatory conditions placed on Sky Subscriber Services Limited (“Sky”) to offer Conditional Access, Access Control and Electronic Programme Guide services on fair, reasonable and non-discriminatory (FRND) terms.
- 1.2 Ofcom consulted on its proposals for the Guidelines in November 2005¹. The consultation closed in February 2006 and Ofcom has considered the responses to the consultation carefully and taken them into account in drafting the explanatory statement and revised guidelines.
- 1.3 Ofcom considers that this is an important subject and in the interests of regulatory transparency is seeking comments on the revised guidelines before they are published.
- 1.4 Ofcom welcomes comments from stakeholders by 16 June 2006.

¹ <http://www.ofcom.org.uk/consult/condocs/tps/>

Section 2

Consultation on draft guidelines

Background

- 2.1 In November 2005, Ofcom published a consultation on the “Provision of Technical Platform Services” in which it proposed revised guidance on interpreting the regulatory conditions placed on Sky to offer Conditional Access, Access Control and Electronic Programme Guide services on fair, reasonable and non-discriminatory (“FRND”) terms.
- 2.2 The consultation closed in February 2006 and Ofcom has considered the responses to the consultation carefully and taken them into account in drafting the explanatory statement and guidelines.

Purpose of this consultation

- 2.3 Ofcom considers that this is an important subject and in the interests of regulatory transparency has decided to conduct a short consultation on the draft explanatory statement and guidelines to provide stakeholders with an additional opportunity to comment before publication.
- 2.4 The draft explanatory statement and guidelines are set out at Annex 4.

Ofcom’s duties

- 2.5 In developing the explanatory statement and guidelines and in deciding to undertake a further stage of consultation, Ofcom has had due regard to its duties as set out in the Communications Act 2003. These are set out in Section 8 of the attached explanatory statement.

Responding to this consultation

- 2.6 Details of how to respond to this consultation are provided in Annex 1.

Annex 1

Responding to this consultation

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 16 June 2006**.
- A1.2 Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Section 5), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.
- A1.3 Please can you send your response to richard.moore@ofcom.org.uk.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Richard Moore
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7981 3333
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Also note that Ofcom will not routinely acknowledge receipt of responses.
- A1.6 It would help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Richard Moore on 020 7981 3537.

Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt (when respondents confirm on their response coversheet that this is acceptable).
- A1.9 All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Any claim for confidentiality will need to be fully justified. Ofcom has a strong preference that responses should not be marked confidential wherever possible. Please place any confidential parts of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.

- A1.10 Ofcom reserves its power to disclose any information it receives where this is required to facilitate the carrying out of its statutory functions.
- A1.11 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use in order to meet its legal requirements. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

Next steps

- A1.12 Following the end of the consultation period, and subject to any comments received, Ofcom intends to publish revised guidelines by the end of June 2006.
- A1.13 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

- A1.14 Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 2) which it seeks to follow, including on the length of consultations.
- A1.15 Ofcom has previously consulted on the options for revising the TPS guidelines and is now seeking comments for a further 28 day period on its draft explanatory statement and guidelines.
- A1.16 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.
- A1.17 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email: vicki.nash@ofcom.org.uk

Annex 2

Ofcom's consultation principles

- A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

- A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

- A2.3 We will be clear about who we are consulting, why, on what questions and for how long.
- A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.
- A2.5 We will normally allow ten weeks for responses to consultations on issues of general interest.
- A2.6 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organizations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.
- A2.7 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

After the consultation

- A2.8 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency, we will publish all consultation responses in full on our website, www.ofcom.org.uk, unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed coversheets confidential.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A3.5 Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your coversheet only so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Nothing

☐

Name/contact details/job title

☐

Whole response

☐

Organisation

☐

Part of the response

☐

If there is no separate annex, which parts?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

☐

Name

Signed (if hard copy)

Annex 4

Draft guidelines and explanatory statement



Provision of Technical Platform Services

Draft Guidelines and Explanatory Statement

Draft statement for consultation

Publication date: 21 April 2006

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Section 1

Summary

Introduction

- 1.1 This draft statement and guidelines sets 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.
- 1.2 Broadcasters and operators of interactive TV services who wish to gain access to viewers using Sky's digital set top boxes must 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.

Summary of the new guidelines

- 1.4 Ofcom's revised draft guidelines 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 on fair, reasonable and non-discriminatory (FRND) terms. The draft guidelines are formed of two parts. The first sets out general principles that we would normally apply in assessing whether Sky has complied with the FRND conditions. The second part provides more detail on Ofcom's approach to particular aspects of cost recovery and assessment of benefits received in assessing whether Sky has complied with the FRND conditions.
- 1.5 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 services to those customers.
 - Sky should be entitled to recover its 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 proportion to the relative incremental benefits each TPS customer receives from the costs being incurred.
 - Where costs incurred by Sky benefit its vertically integrated business exclusively or disproportionately, these costs should be recovered exclusively or proportionately from Sky rather than from third party TPS customers.
- 1.6 The revised draft guidelines provide further detail on Ofcom's approach to what costs are reasonable for Sky to recover through TPS charges. These include the following:

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- A reasonable approach to recovering common costs is 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 be a reasonable charging methodology for smaller broadcasters that earn relatively low incremental revenues from being available on DSat.
 - Guidelines on how costs might reasonably be recovered over time and how over and under recovery of costs may be adjusted for in later periods.
 - Guidelines on non price terms Ofcom considers are necessary to satisfy the FRND requirement. These include lead times for provision of services, product information and the need to unbundle TPS where technically feasible.
- 1.7 In addition to these guidelines, under the TPS Conditions, 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.

Section 2

Introduction and background

- 2.1 This draft statement and guidelines sets 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 new guidelines, the current regulation that applies to the provision of these services, the rationale for reviewing the 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 make use of a number of different technical services relating to encryption, electronic programme guides and use of Sky’s interactive technology and systems. Below we set out some of the key services that broadcasters and operators currently make use of.

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.
- 2.8 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.

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- 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. Without an EPG listing, very few viewers would be aware that a channel was available and they would find it hard to navigate to it.

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 supply 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 a set of general and specific conditions under a new EU regulatory framework for electronic communications networks and services. The EU Communications Directives were implemented in the UK through the Communications Act 2003.
- 2.16 In July 2003, Oftel imposed certain regulatory conditions on the digital TV platform operator Sky, the only supplier of TPS in the UK following the demise of ITV Digital in

May 2002, requiring it to offer third parties access to CA, geographic masking, EPG listing, regionalisation and AC 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. Ofcom considers that this is an important condition and 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.

Publication of charges and/or methodology

- 2.19 As set out above, under the TPS regulatory conditions, Sky is required to publish a notice specifying its charges, or specifying the methodology that is to be adopted for determining its charges.
- 2.20 In the consultation document Ofcom proposed that transparency and predictability of TPS charges were important objectives of a FRND charging methodology and that commercial negotiations did not necessarily meet these objectives. The majority of TPS customers that responded to the consultation endorsed this position.
- 2.21 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.
- 2.22 In practice different types of TPS customers have different business models and Sky's published charges or charging methodology should reflect this. Consequently, published charges that are only applicable to a specific business model might not represent charges that are FRND for a TPS customer with a different business model. Ofcom considers that a charging methodology which uses various objectively measurable proxies which reflect the benefits that different types of TPS customers receive from using TPS would be a reasonable methodology and appropriate to ensure that a published pricing methodology produced FRND charges for a wide range of TPS customers and business models.
- 2.23 However, in exceptional circumstances, where the application of the methodology might result in a particular TPS Customer being "priced off" the DSat platform (discussed later in this document) then Ofcom may consider that a TPS charge which was different from the published charges, or charges that were determined by the published charging methodology, may be appropriate.

Rationale for reviewing the guidelines

- 2.24 There are a number of reasons that have prompted Ofcom to review and update the existing guidelines:

To reflect different regulatory duties

- 2.25 The regulatory regime under which the existing guidelines were set in place, namely the Telecommunications Act 1984¹, has been replaced by the EC Communications Directives and the Communications Act 2003, under which Ofcom has different duties to consider when exercising its functions. A summary of Ofcom's duties are set out in section 8.

To provide certainty and transparency to current and future TPS customers

- 2.26 A number of stakeholders and respondents to the consultation consider that the existing guidelines have not provided sufficient clarity for them to determine whether the TPS terms and conditions they are offered would be considered fair, reasonable and non-discriminatory by Ofcom in the event of a complaint or dispute.
- 2.27 Ofcom has also been concerned that a lack of clarity arising from the existing guidelines introduces uncertainty in the business plans of existing and prospective TPS customers which may in turn dis-incentivise investment and/or market entry. Predictability, transparency and certainty of pricing are critical to ensuring that potential providers of retail services will actually enter the market. This issue is particularly acute when it comes to bidding for important and expensive content rights.

To address a changing platform moving closer to maturity

- 2.28 The existing guidelines state that Sky's published prices are only a starting point for negotiations and should not be rigidly adhered to. Sky is 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 are balanced or where the costs and benefits of the platform are highly uncertain, it may be appropriate to adopt this approach to allow some freedom for charges to be determined by commercial negotiation.
- 2.29 In the start up phase of a platform business, negotiations are more likely to be balanced as the TPS provider is dependent on securing attractive content on to its platform in order to stimulate retail customer growth. It is therefore more appropriate to allow TPS charges to be determined through commercial negotiations, which provides the flexibility for TPS charges to be tailored to the specific needs of broadcasters and interactive service providers.
- 2.30 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 and is sufficiently established that the risk of regulatory requirements leading to an inability to make a reasonable return is lessened. In order to gain direct access to Sky set top boxes, TPS customers are required to 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

¹ See "The pricing of conditional access services and related issues" (8 May 2002) paragraph 1.2

development of new and innovative services and potentially reduces 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.

2.31 Therefore, while the existing 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 prices are achieved should reflect the shift in the balance of negotiations and the change in the risk profile of costs and revenues.

2.32 While we believe that changes are necessary, based on the rationale set out above, the revised draft guidelines set out in this document share many of the principles that form the basis of the existing guidelines. These include 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 new product information.

Responses to the consultation

2.33 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.

2.34 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 new guidelines and implementation

2.35 Following the receipt of any comments on the revised draft guidelines and having taken into account any such comments Ofcom intends to publish new guidelines by the end of June 2006. These new guidelines will replace the existing guidelines² which will be superseded.

2.36 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 the new 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. For the avoidance of doubt, in the event that a dispute or complaint is brought to Ofcom after publication of this document but prior to implementation of the new guidelines Ofcom considers that it will normally be appropriate to take account of the new guidelines.

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, Oftel guidelines, 22 October 2002

Market review

- 2.37 It should be noted that, as set out in its 2006/7 Annual Plan³, Ofcom intends to carry out work to analyse the degree of competition between different broadcasting platforms, which will feed into a future market review to consider the TPS conditions. This work is likely to be complex and may take some time to complete.
- 2.38 In the meantime, for the reasons set out above Ofcom considers that it is appropriate to update and revise the guidelines as to how it would normally enforce the existing TPS conditions in the event of a 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 dispute;
 - Section 5 explains Ofcom's approach to cost recovery in the event of a dispute;
 - Section 6 explains how Ofcom is likely to quantify the incremental benefits received by each broadcaster from being on the DSat platform in the event of a dispute;
 - Section 7 explains how Ofcom is likely to approach FRND non price terms and conditions in the event of a dispute;
 - Section 8 sets out Ofcom's consideration of its duties;
 - Annex 1 sets out the New 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;
 - Annex 5 sets out further responses to the consultation;

³ http://www.ofcom.org.uk/about/accoun/reports_plans/annual_plan0607/

Section 3

The principles of TPS cost recovery

- 3.1 In order to determine on a dispute whether TPS charges proposed by Sky are fair, reasonable and non discriminatory (“FRND”) in compliance with the TPS 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 Ofcom considers that in a fair and reasonable pricing regime 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:
- A “**reasonably**” incurred cost is the cost associated with an input that is required for the provision of a service of “reasonable” standard/quality.
 - A “**necessarily**” incurred cost is the cost associated with an input that is indispensable to the provision of a service to a customer (or an appropriate share of the cost associated with an input common to two or more services that is indispensable to the provision of those services to a customer). Not incurring this cost would preclude the service from being provided.
 - An “**efficiently**” incurred cost is the lowest possible cost associated with a reasonable and necessary input, given the TPS provider’s technology and position on its cost function. Efficiently incurred costs are those resulting from cost minimisation on the part of the TPS Provider.
- 3.5 This principle is consistent with the existing guidelines which state that costs should be “reasonably and necessarily incurred”⁴ and that recovered costs should be “efficiently incurred”⁵

Return on investment

- 3.6 Ofcom considers that it is reasonable for Sky to make a return on the costs incurred in providing TPS 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 face in making investments. It is Ofcom’s view that the analytical approach outlined

⁴ Paragraph 2.2 *Terms of supply of conditional access: Oftel guidelines*, 22 October 2002

⁵ Paragraph 2.3 *Terms of supply of conditional access: Oftel guidelines*, 22 October 2002

in Ofcom's statement on approach to risk in the assessment of cost of capital⁶ 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 reflect benefits received;
 - 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 general, cost causation is applied 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. In the case of TPS charges, there are significant common costs to be recovered as well as incremental costs relating to service provision to individual customers. Therefore, Ofcom considers that cost recovery based on distribution of benefits is a key principle for the FRND recovery of TPS costs.

Cost causation

- 3.10 Where specific costs can be identified as being caused solely by a particular new service or 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 supplier 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

- 3.11 Ofcom considers that where costs incurred are of benefit to more than one TPS customer then these "common costs" should normally be recovered from each TPS customer in proportion to the relative incremental benefits each TPS customer receives from the costs being incurred.

⁶ 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)

- 3.12 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 consultation

- 3.13 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 respondents, Ofcom maintains its view that the recovery of significant common costs should be based on the benefits that customers receive.

Pricing off

- 3.14 One respondent to the consultation expressed concern that smaller operators may be "priced off" the DSat platform if they were unable to pay the contribution to common costs expected under the published charging methodology.
- 3.15 Ofcom considers that it is economically efficient that any TPS customer who is able to pay the incremental costs associated with taking TPS and also make a contribution to common costs should be given access to TPS. Ofcom would therefore not normally expect any TPS customer who was able to pay for the incremental costs of the TPS it used and a contribution to common costs to be refused access. Ofcom considers that a charging methodology which reflects benefits received would result in FRND charges for the large majority of TPS customers without having to deviate from this methodology.

Application of the principles

- 3.16 Application of the cost recovery principles set out above should be performed on a case by case basis. A consequence of these guidelines is that Sky would be expected to objectively apply the principles when determining its TPS charges and be in a position to justify its charges in light of these principles in the event of a dispute or complaint.

Section 4

Allowable costs

- 4.1 In order to determine on a dispute whether TPS charges proposed by Sky are fair, reasonable and non discriminatory (“FRND”) in compliance with the TPS 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 in the provision of services to those customers. In this section guidance is provided on how Ofcom would normally expect to apply this principle to different items of cost that Sky incurs.

Types of costs

- 4.3 Sky should only recover costs from TPS customers which it reasonably, necessarily and efficiently incurs in the provision of services to those customers. These costs can broadly be categorised as being costs specific to a particular TPS (or group of TPS), referred to below as “TPS specific costs” or costs that are common to the platform or “platform common costs”.

TPS specific costs

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

TPS specific common costs

- 4.5 Costs that are incurred 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 an EPG Listing TPS it would not incur the cost of transponder capacity required to broadcast the EPG schedule data.

Incremental costs of service provision

- 4.6 The incremental costs of service provision are the costs incurred by Sky in the provision of an existing 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.

Platform common costs

- 4.7 In addition to the costs associated with providing individual TPS, Sky may incur other “platform common costs” that are necessary in order to provide TPS. For example, where Sky undertakes general marketing of the benefits of its platform or provides subsidies to consumers to encourage take up of its platform it may be reasonable for Sky to recover a proportion of these costs through TPS charges.

Marketing costs

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

Provision of Technical Platform Services

- 4.9 Marketing of the general benefits of the DSat platform which stimulates take up and increases the platform customer base potentially benefits all TPS customers and it would therefore be reasonable for Sky to recover the relevant proportion of these costs through TPS charges.
- 4.10 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, Sky would be expected to justify any marketing spend recovered via TPS charges, and in particular demonstrate that third party TPS customers have not contributed to the marketing of Sky's own retail business.

Responses to the consultation

- 4.11 Several respondents to the consultation 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.
- 4.12 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 that Sky should reasonably be able to recover costs that can be demonstrably shown to benefit other TPS customers. Consequently, in the event of a complaint or dispute, Sky would be expected to demonstrate the benefits that the relevant TPS customers have received from its marketing activities where the costs of such activities are being recovered through TPS charges.

Customer retention marketing

- 4.13 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, as some TPS customers will benefit from this marketing and customer retention on the DSat platform. However, Ofcom would not normally consider it reasonable for costs incurred in the prevention of churn from Sky's retail business to be recovered through TPS charges.

Customer equipment subsidies

- 4.14 Sky may choose to subsidise customer equipment or installations to promote take up of the platform. Where such subsidies can be shown to benefit third party TPS customers, Ofcom considers that it may be reasonable for Sky to recover efficiently incurred subsidies through TPS charges.
- 4.15 However, where subsidies are provided subject to a customer entering into a Sky retail contract (a contractual tie), it is likely that Sky receives more benefits from the subsidy than other TPS customers. Any additional benefits that Sky receives from that tie would be considered by Ofcom when assessing the benefits that each TPS customer receives. This is discussed further in section 6.
- 4.16 The existing Oftel guidelines state that:
- "...in certain cases, recovery of subsidy via conditional access or access control charges may have anti-competitive effects. In such cases, recovery would not be permitted. Each case would be examined on its merits. However, one example where

Of tel would have serious concerns is where the granting of subsidy was tied to a requirement to subscribe to a retail service of a vertically integrated supplier”⁷

Ofcom considers that the tying of a subsidy to a requirement to subscribe to Sky’s retail service may, in certain cases, raise a concern on competition grounds. An assessment of the potential anti-competitive effects of such a practice would need to be carried out on a case by case basis, outside of this guidelines process.

- 4.17 To the extent that costs associated with subsidies may be recovered going forward where such subsidies can be shown to benefit third party TPS customers, it is unlikely to be appropriate for those historic subsidies that have yet to be recovered, to be recovered through TPS charges. Given the legitimate expectations of both Sky and TPS customers about the recovery of these costs, Ofcom would not expect the treatment of historically incurred costs to be adjusted retrospectively by Sky. For example, Ofcom would not expect a TPS customer to contribute to the recovery of costs incurred by Sky in the past that it did not reasonably expect to contribute to at the time the costs were incurred. Equally, Ofcom would not normally expect to retrospectively disallow costs Sky had incurred in the past with a reasonable expectation that they could be recovered through TPS charges.

Responses to the consultation

- 4.18 Some respondents to the 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.
- 4.19 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 TPS charges. However, the additional benefit that Sky receives from tied subsidies should be addressed when assessing benefits (see section 6).

Platform operational costs

- 4.20 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.

⁷ Para. 3.11, Terms of supply of conditional access: Of tel guidelines, 22 October 2002.

Section 5

Approach to cost recovery

- 5.1 In order to determine on a dispute whether TPS charges proposed by Sky are fair, reasonable and non discriminatory (FRND) in compliance with the TPS conditions Ofcom must decide whether allowable costs have been recovered from TPS customer 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 presents a cost recovery methodology that Ofcom would normally apply when determining whether TPS charges were FRND in the event of a 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 As set out in section 3, where incurred costs provide a benefit to multiple TPS customers, Ofcom considers that the most economically efficient and least distortive method for recovering these “common costs” is to recover them from TPS customers in proportion to the relative incremental benefit each customer receives from the costs being incurred. For example, if TPS Customer A derives twice the incremental benefit from using a particular TPS than TPS Customer B then Customer A’s contribution to the TPS common costs would normally be expected to be twice as large as Customer B’s.
- 5.5 In a FRND pricing regime, Ofcom would normally expect that, in order to ensure that each TPS customer makes a fair contribution, they would contribute an equal proportion of the incremental benefits they derive from the common costs being incurred to the recovery of those costs.
- 5.6 Guidance on how “incremental benefits” might be measured in practice is provided in section 6.

Recovery of TPS specific common costs

- 5.7 As described in section 4, “TPS specific common costs” are those costs which are efficiently incurred in the provision of a particular TPS (and would not have been incurred if that TPS were not offered) and that cannot be attributed to a single customer of that service.
- 5.8 Ofcom would normally expect all TPS customers to contribute an equal percentage of the incremental benefits they derive from using the TPS towards the recovery of TPS specific common 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.

- 5.9 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.

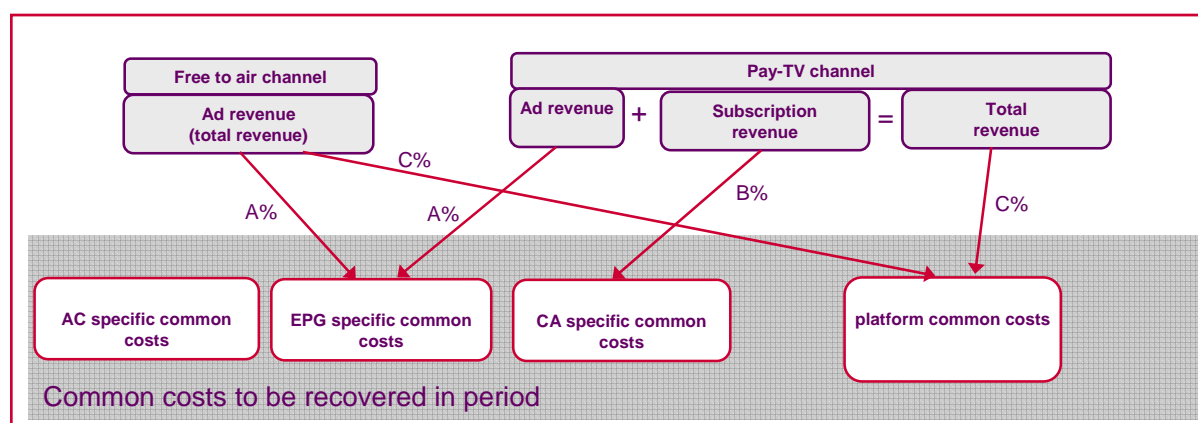
Examples of incremental benefits derived from using different TPS

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 platform common costs

- 5.10 As described in section 4, platform common costs are those costs incurred by Sky that benefit users of all TPS.
- 5.11 Ofcom would normally expect all TPS customers to contribute an equal proportion of the total incremental benefits they derive from using TPS towards the recovery of platform common costs.
- 5.12 Where proxies have been used for incremental revenues earned (as described in section 6), e.g. incremental viewing share for revenues earned from having an EPG listing, an estimate of the total incremental revenues associated with this TPS would need to be made by Sky so that platform common costs can be recovered from each TPS in proportion to the incremental benefits received. Ofcom would expect the estimate of total incremental revenues earned to be objectively derived, for example using historic data with forward looking adjustments.
- 5.13 The simplified diagram below 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).

Simplified example of benefits based common cost recovery



Allocation of costs

5.14 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 can be identified as one of the following:

- an incremental cost associated with a specific TPS customer;
- a TPS specific common cost;
- a cost common to more than one TPS, but not all TPS; or
- a platform common cost i.e. a cost common to all TPS.

5.15 Consideration should also be given to the common costs incurred when defining the TPS that are offered to TPS customers. For example, if two customers used similar underlying technologies but Sky incurred significantly different costs in providing services to the two customers it may be appropriate to define two separate TPS with different incremental costs or with different common cost pools.

Responses to the consultation

5.16 A number of respondents to the consultation 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.

5.17 Ofcom considers that, where disaggregating set top box costs is practicable, Sky should attempt to do this and ensure that TPS customers only contribute to the recovery of costs from which they derive a benefit.

Appropriate time periods over which it is reasonable to recover costs

5.18 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 significant sums of capital expenditure or investment

- 5.19 The appropriate time period for significant sums of capital expenditure or other investment (such as customer acquisition costs) 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 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.
- 5.20 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 good reason.

Appropriate time period for recovery of ongoing operational expenditure

- 5.21 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.
- 5.22 Therefore, operational expenditure would be forecast on a short term basis, whilst substantial capital expenditure and investment would need to be considered more broadly, on a longer term perspective.

Appropriate time period for the setting of charges

- 5.23 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.
- 5.24 Ofcom considers that a twelve month period is a reasonable time horizon for short term forecasts to be made.

Ofcom also considers that any purchaser of TPS should be entitled to a reasonable period of notice of variations in charges for the next charging period, that the duration of this period of notice should be publicised, and that it should generally not be revised without justification; subject always to complying with any regulated notice period given⁸.

⁸ Condition 6 of the CA Conditions requires Sky to give a 90 day notice where it proposes to change its charges

Over and under recovery of charges

- 5.25 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.
- 5.26 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.
- 5.27 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 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 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 consultation

- 5.28 One respondent to the 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.
- 5.29 Ofcom has reconsidered the approach set out in the 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.
- 5.30 Ofcom recognises that fixing cost recovery to discrete periods might result in changes to tariffs at the end of each period. However, where cost recovery profiles are relatively stable or predictable Ofcom considers that these changes will be relatively predictable. In addition, tariffs linked to incremental revenues will reflect increases in derived benefits.

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 in proportion to the incremental benefits they received from the costs being incurred when considering whether access charges are fair, reasonable and non-discriminatory ("FRND").
- 6.2 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 access charges are FRND.

Incremental benefit

- 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 are generally 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. This limitation of revenue as a proxy for benefit was highlighted by one respondent to the consultation who claimed that using this proxy may lead to TPS charges that were not FRND. Ofcom has considered these arguments and has concluded 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.
- 6.7 The use of revenues as proxies of benefits received is consistent with the current guidelines and does not therefore represent a significant change in approach.

Proxies for revenues derived from using the pay-TV CA services

- 6.8 In order to allocate the common costs associated with providing the pay-TV CA service the relative benefits received by users of this TPS should be compared.
- 6.9 Ofcom considers that the actual subscription and pay per view revenues (“PPV”) that each TPS customer earns from the 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.
- 6.10 Use of incremental pay-TV revenues as a proxy of incremental benefits received is consistent with the current guidelines and therefore does not represent a significant change in approach.
- 6.11 Ofcom would normally expect that under an FRND charging regime users of the pay-TV CA service would contribute the same percentage of their pay-TV revenues towards the recovery of the common costs associated with CA.
- 6.12 Ofcom notes that given the current retail price of one of Sky’s premium packages and the per subscriber CA charge published by SSSL as a starting point for negotiation, this CA charge would represent 7.5%⁹ of the retail price of the package. Similarly, for the entry level package the published CA charge represents 13.3%¹⁰ of the retail price. Ofcom further notes that CA charges are currently negotiated such that they also reflect non subscription revenues and benefits and therefore no firm conclusions can be drawn from this analysis. However, under Ofcom’s FRND cost recovery methodology all TPS customers would expect to pay CA charges which represented the same percentage of their pay-TV revenues.

Proxies for revenues derived from using the EPG listing service

- 6.13 TPS customers using only the EPG listing service on the DSat platform currently pay 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 significant retail revenues from being available on the EPG. Ofcom notes that in a FRND pricing regime TPS customers would normally be expected to contribute to common costs in proportion to the incremental benefit they receive and that the current EPG charging mechanism for TPS customers does not appear to reflect this.
- 6.14 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;

⁹ Sports and Movies 6 Mix @ £42.50/month, CA charge @ £3.20/month

¹⁰ Basic only, 2 Mix @ £15/month, CA charge @ £2.00/month

Provision of Technical Platform Services

- Premium rate telephony, for example, voting, chat, quizzes, information lines; and
 - Home shopping.
- 6.15 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.
- 6.16 In the 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.
- 6.17 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 would 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.
- 6.18 In assessing the incremental viewing a channel receives from using the EPG Listing TPS Ofcom would 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.
- 6.19 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.
- 6.20 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 both Sky and the TPS customer to establish what the benefit might be. In the event of a dispute 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.

- 6.21 When reaching a decision Ofcom may use techniques such as pendulum arbitration to encourage the two parties to reach agreement absent a dispute.
- 6.22 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 significantly higher revenues for a given share of viewing compared to an advertising funded channel.
- 6.23 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 Ofcom would seek justification for the use of a particular proxy for determining charges to a particular customer and demonstration of how this proxy more accurately reflected the incremental benefits that this customer received from having an EPG listing. Similarly it would be open to a particular channel to provide Sky with evidence, or alternatively to bring a dispute, if it felt that the viewing share proxy did not adequately reflect its benefits received.
- 6.24 As proposed in the consultation document, for channels that have a very small incremental viewing share or revenue it may be reasonable for Sky to use a simple “per EPG listing charge” to approximate the incremental benefits these channels receive.
- 6.25 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.
- 6.26 If such an approach were adopted by Sky, transparent and objective criteria should be used in deciding which channels were charged a fixed fee and which were charged based on using a suitable proxy. In the event of a dispute Ofcom may require Sky to demonstrate that this differentiation did not lead to material discrimination between TPS customers.

Responses to the consultation

- 6.27 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.
- 6.28 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 EPG listings for radio channels.

Proxies for revenues derived from using Regionalisation services

- 6.29 Whilst regionalisation utilises some of the same technologies that are used for providing the CA services, the benefits broadcasters derive from regionalisation are of a significantly different nature.
- 6.30 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.
- 6.31 In determining the incremental benefits TPS customers derive from using this TPS, Ofcom would 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.
- 6.32 Ofcom would normally expect that the user of this service contributes an equal percentage of the incremental revenues it derives from using the service towards the common costs associated with providing it. However, where the costs to be recovered are relatively small compared to those recovered via other TPS, Ofcom considers that it may be reasonable for Sky to use a simple and transparent proxy for these incremental revenues, such as a fixed "charge per region".

Responses to the consultation

- 6.33 A respondent to the 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 consultation (paragraph 7.5), in the event of a dispute Ofcom would normally 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.

Proxies for benefits derived from using the Geographic Masking TPS

- 6.34 The geographic masking service on the Sky DSat platform is used by some free to view broadcasters to prevent rights spillage into Ireland and mainland Europe. 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 an absolute necessity to securing certain rights e.g. due to restrictions placed on rights holders from existing contracts in other territories.
- 6.35 Due to the potentially unique nature of the benefits different TPS customers derive from using this service, Ofcom considers it reasonable that the charges be agreed on a case by case basis but that each TPS customer is charged the same percentage of

incremental benefit they derive from using this service to recover the common costs associated with providing it. However, where the costs to be recovered are relatively small compared to those recovered via other TPS Ofcom considers that it may be reasonable for Sky to use a simple and transparent proxy for these incremental revenues, such as a fixed “charge per channel”.

Proxies for revenues derived from using the access control services

- 6.36 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 dis-incentivise investment in these new services.
- 6.37 On the Sky DSat platform, Sky already publishes a rate card 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 Ofcom would apply the principles of TPS cost recovery set out in these guidelines to determine whether terms offered for AC services were FRND.

Benefits received by vertically integrated TPS Providers as a result of subsidies tied to a retail service

- 6.38 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.
- 6.39 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.

- 6.40 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.

- 6.41 Where subsidies are not tied Ofcom expects that consumers should be made aware of this. For example, currently, according to Sky advertising, consumers should be able to acquire a fully subsidised set top box without having to subscribe to a Sky pay-TV service. However, attempts by Ofcom staff to procure a “free” set top box have indicated that it may not be readily available without signing up to a Sky pay-TV package¹¹. Therefore while in theory similar benefits may be accruing to all TPS users, in practice Sky may be deriving a larger proportion of the benefits.
- 6.42 Ofcom also recognises that Sky will generally adjust the levels of consumer subsidies to maximise the benefit for its own retail business. The control over subsidy levels implicitly proffered to Sky’s retail business may provide unique incremental benefits compared to other TPS customers. Under a FRND charging methodology Ofcom would expect these unique benefits to be taken into account by Sky when determining charges for its own internal TPS charges.

Benefits received from advanced consumer equipment

- 6.43 Where TPS customers earn incremental revenues due to the availability of consumer equipment with advanced functionality, for example Sky+, Ofcom would consider it reasonable for Sky to recover any incremental costs associated with providing this equipment (over and above costs incurred to provide basic consumer equipment) through TPS charges levied on these TPS customers and in proportion to the incremental revenues each of these TPS customers earns as a result of having this functionality.
- 6.44 Where costs are incurred by Sky in replacing existing customer equipment in a home with more advanced equipment, Ofcom would not normally expect these costs to be recovered from TPS customers whose TPS service is unaffected by the change and that consequently do not benefit from the change.

Total Benefits Received

- 6.45 Ofcom would normally consider it reasonable for platform common costs to be recovered from TPS customers in proportion to the total incremental benefits each TPS customer derives from using its 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).
- 6.46 As stated previously in section 5, in a FRND pricing regime, Ofcom would normally expect all TPS customers to contribute the same percentage of the total incremental

¹¹ It is not clear whether the £150 “Freesat from Sky” offer includes a fully subsidised set top box. However, as there is no requirement to sign the “interactive discount contract” normally associated with the provision of a free set top box when taking “Freesat” then it would indicate that it does not

revenues they derive from using TPS towards the recovery of platform common costs.

Net Benefits

- 6.47 Where Sky 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 would normally expect that this benefit be “netted off” against the benefit that this TPS customer derives from using TPS.
- 6.48 However, Ofcom recognises that objectively quantifying these benefits is very complex. Additionally, Ofcom considers that these benefits may be less material on a well established platform than they are on a platform in its early stages of growth. Consequently, in order to establish a TPS charging methodology which is both transparent and predictable Ofcom considers that it may be reasonable for a TPS to exclude these effects when establishing its charging methodology.

Risk sharing

- 6.49 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.
- 6.50 Under a charging methodology in which capital costs associated with a new platform development are recovered over a number of charging periods 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.
- 6.51 However, Ofcom would normally expect that all TPS customers would contribute the same proportion of the incremental benefits they receive from having access to the new platform in each charging period. Therefore, in later charging periods Ofcom would normally expect that both an early entrant and a new entrant would pay charges which represented the same percentage of the benefits they each receive during that charging period.

Economies of Scale

- 6.52 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.
- 6.53 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 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 fair and reasonable 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 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 services, so that broadcasters will be in the same position as Sky's pay-TV business to take advantage of any new services. 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 services are provided could be contrary to the condition for provision of TPS on fair and reasonable terms. In particular 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 TPS;
 - Product information including knowledge of new product development, changes to existing products, pricing packages or investment plans;
 - Support levels, availability and performance of the TPS;
 - Appropriate processes to ensure that requests for new TPS or changes to existing TPS are handled in a consistent, transparent and objective manner; and
 - Bundling of 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.
- 7.6 This approach was proposed in the consultation document and is also consistent with the existing guidelines.

Non TPS contracts

- 7.7 In addition, Ofcom is aware that some TPS customers must acquire other services from third parties to enable them to operate their service. For example, providers of

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interactive TV services on the DSat platform are required to put in place insurance policies to cover any claims made against them for harm their services might do to the integrity or operation of the platform and pay-TV operators require customer management services to manage subscribers.

- 7.8 In the event of a dispute, Ofcom may consider the charges that TPS customers are required to pay for non TPS services but which are related to TPS. In such circumstances Ofcom may consider whether the terms on which such services are provided are such that customers are dis-incentivised from purchasing TPS services and investing in new television, radio or interactive services.

Section 8

Ofcom's duties

- 8.1 This section sets out the statutory duties Ofcom has had regard to in drafting the revised 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 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;

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- 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 new guidelines, Ofcom has considered its duties 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 new 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 consultation 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 plurality on the DSat platform.
- 8.10 In order to ensure that the new 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 new 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 will interpret FRND in the event of a dispute 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 draft revised guidelines set out that, in accordance with its regulatory conditions, Sky should publish a rate card or methodology by which charges are determined. The revised draft 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 revised draft guidelines make clear that, in accordance with its regulatory conditions, Sky should publish a rate card or methodology by which charges are determined, that charges should apply for a period 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 new 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 a more appropriate proxy.

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

Annex 1

The Guidelines

- A1.1 Ofcom's revised draft guidelines 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 on fair, reasonable and non-discriminatory terms.

Publication of charges and/or methodology

- A1.2 In addition to these guidelines, under the Conditions, Sky is required to publish a notice specifying, 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.
- A1.4 In practice different TPS customers have different business models and Sky's published charges or charging methodology should reflect this. Consequently, published charges that are only applicable to a specific business model might not represent charges that are FRND for a TPS customer with a different business model. Ofcom considers that a charging methodology which uses various objectively measurable proxies which reflect the benefits that different types of TPS customers receive from using TPS would be a reasonable methodology and appropriate to ensure that a published pricing methodology produced FRND charges for a wide range of TPS customers and business models.
- A1.5 However, in exceptional circumstances, where the application of the methodology might result in a particular TPS Customer being "priced off" the DSat platform (see below) then Ofcom may consider that a TPS charge which was different from the published charges, or charges that were determined by the published charging methodology, may be appropriate.

Application of the guidelines

- A1.6 These guidelines only apply to a regulated provider of Technical Platform Services.
- A1.7 SSSL ('Sky') is currently the only supplier required to provide access to Conditional Access ('CA'), Access Control ('AC') and Electronic Programme Guide ('EPG') services in the UK.
- A1.8 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 the TPS on the Sky DSat platform.

Status

- A1.9 These guidelines set out the high level principles Ofcom will be guided by when considering the application of Sky's TPS Conditions. Ofcom would normally expect to follow these guidelines when investigating a dispute. However, Ofcom cannot legally fetter its discretion in advance and therefore it retains the ability to depart

from the guidance where the circumstances warrant it. The Guidelines do not form part of the Conditions and so do not affect the scope of those Conditions.

Dispute Resolution

- A1.10 Ofcom's primary reason for issuing guidelines is to assist Sky and TPS customers to better understand how Ofcom would normally interpret the Conditions such that TPS terms that are consistent with the Conditions can be agreed.
- A1.11 In the event that the parties fail to agree terms which both parties consider are consistent with the Conditions a dispute may be raised with Ofcom.
- A1.12 Ofcom has a defined dispute process, details of which can be found on the Ofcom website: http://www.ofcom.org.uk/bulletins/eu_directives/guidelines.pdf

Structure of the guidelines

- A1.13 The draft guidelines are formed of two parts. The first sets out general principles that we would normally apply in assessing whether Sky has complied with the FRND conditions. The second part provides more detail on Ofcom's approach to particular aspects of cost recovery and assessment of benefits received in assessing whether Sky has complied with the FRND conditions.

Part 1: The principles of TPS cost recovery

- A1.14 In order to determine on a dispute whether TPS charges proposed by Sky are fair, reasonable and non discriminatory (FRND) in compliance with the TPS 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.
- A1.15 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.

Allowable Costs

- A1.16 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:
- A **"reasonably"** incurred cost is the cost associated with an input that is required for the provision of a service of "reasonable" standard/quality.
 - A **"necessarily"** incurred cost is the cost associated with an input that is indispensable to the provision of a service to a customer (or an appropriate share of the cost associated with an input common to two or more services that is indispensable to the provision of those services to a customer). Not incurring this cost would preclude the service from being provided.
 - An **"efficiently"** incurred cost is the lowest possible cost associated with a reasonable and necessary input, given the TPS Provider's technology and position on its cost function. Efficiently incurred costs are those resulting from cost minimisation on the part of the TPS Provider.

Return on investment

- A1.17 Sky can reasonably expect to make a return on the costs incurred in providing TPS that reflect the risk adjusted cost of capital of the investment.
- A1.18 When calculating 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 capital¹³ 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.

General principles of cost recovery

- A1.19 Ofcom has established 6 principles of cost recovery that it will apply in assessing how costs could be recovered in any given situation:
- 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 reflect benefits received;
 - 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.
- A1.20 In general, cost causation is applied 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. In the case of TPS charges, there are significant common costs to be recovered as well as incremental costs relating to service provision to individual customers. Therefore, Ofcom consider that cost recovery based on distribution of benefits is a key principle for the recovery of TPS costs.

Cost causation

- A1.21 Where specific costs can be identified as being caused solely by a particular new service or 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 supplier 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.

¹³ Ofcom's approach to risk in the assessment of the cost of capital, 18th August 2005 (see: http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/final.pdf)

Distribution of benefits

- A1.22 Ofcom considers that where costs incurred are of benefit to more than one TPS customer then these “common costs” should normally be recovered from each TPS customer in proportion to the relative incremental benefits each TPS customer receives from the costs being incurred.
- A1.23 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.

Pricing off

- A1.24 Ofcom considers that it is economically efficient that any TPS customer who is able to pay the incremental costs associated with taking TPS and also make a contribution to common costs should be given access to TPS. Ofcom would therefore not normally expect any TPS customer who was able to pay for the incremental costs of the TPS it used and a contribution to common costs to be refused access. Ofcom considers that a charging methodology which reflects benefits received would result in FRND charges for the large majority of TPS customers without having to deviate from this methodology.

Application of the principles

- A1.25 Application of the cost recovery principles set out above should be performed on a case by case basis. A consequence of these guidelines is that Sky would be expected to objectively apply the principles when determining its TPS charges and be in a position to justify its charges in light of these principles in the event of a dispute or complaint.

Part 2: Further Guidance

This part provides further specific guidance on how Ofcom would normally expect to interpret the conditions when accessing whether terms offered by Sky for TPS were FRND.

Allowable Costs

- A1.26 Sky should only recover costs from TPS customers which it reasonably, necessarily and efficiently incurs in the provision of services to those customers. These costs can broadly be categorised as being costs specific to a particular TPS (or group of TPS) or costs that are common to the platform.

TPS specific costs

- A1.27 Ofcom considers that it would normally be reasonable for Sky to recover reasonably, efficiently and necessarily incurred costs associated with the provision of each TPS from customers of those TPS. These include:
- **TPS Specific Common Cost:** Costs that are incurred 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 an EPG Listing TPS it would not incur the cost of transponder capacity required to broadcast the EPG schedule data.
 - **Incremental costs of service provision:** Incremental costs incurred by Sky in the provision of an existing 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 customers scheduling system.

Platform common costs

- A1.28 In addition to the costs associated with providing individual TPS, Sky may incur other “platform common costs” that are necessary in order to provide TPS. Guidance on which of the costs incurred by Sky it might reasonably recover through TPS charges is provided below. However, this does not represent an exhaustive list of cost 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

- A1.29 Sky may choose to undertake marketing (e.g. advertising) to promote the benefits of the platform to encourage its take up and use.
- A1.30 Marketing of the general benefits of the DSat platform which stimulates take-up and increases the platform customer base potentially benefits third party TPS customers and it would therefore be reasonable for Sky to recover these costs through TPS charges.
- A1.31 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, Sky would be expected to justify any marketing spend recovered via TPS charges, and in particular demonstrate that third party TPS customers have not contributed to the marketing of Sky’s own retail business.

Customer retention marketing

- A1.32 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, as some TPS customers will benefit from this marketing and customer retention on the DSat platform. However, Ofcom would not normally consider it reasonable for costs incurred in the prevention of churn from Sky’s retail business to be recovered through TPS charges.

Customer equipment subsidies

- A1.33 Sky may choose to subsidise customer equipment or installations to promote take-up of the platform. Where such subsidies can be shown to benefit third party TPS customers, Ofcom considers that it may be reasonable for Sky to recover efficiently incurred subsidies through TPS charges.
- A1.34 However, where subsidies are provided subject to a customer entering into a Sky retail contract (a contractual “tie”), it is likely that Sky receives more benefits from the subsidy than other TPS customers. Any additional benefits that Sky receives from that tie should be considered when assessing the benefits that each TPS customer receives.
- A1.35 The existing Oftel guidelines state that:
- “...in certain cases, recovery of subsidy via conditional access or access control charges may have anti-competitive effects. In such cases, recovery would not be

permitted. Each case would be examined on its merits. However, one example where Oftel would have serious concerns is where the granting of subsidy was tied to a requirement to subscribe to a retail service of a vertically integrated supplier”¹⁴

Ofcom considers that the tying of a subsidy to a requirement to subscribe to Sky's retail service may, in certain cases, raise a concern on competition grounds. An assessment of the potential anti-competitive effects of such a practice would need to be carried out on a case by case basis, outside of this guidelines process.

- A1.36 To the extent that costs associated with subsidies may be recovered going forward where such subsidies can be shown to benefit third party TPS customers, it is unlikely to be appropriate for those historic subsidies that have yet to be recovered, to be recovered through TPS charges. Given the legitimate expectations of both Sky and TPS customers about the recovery of these costs, Ofcom would not expect the treatment of historically incurred costs to be adjusted retrospectively by Sky. For example, Ofcom would not expect a TPS customer to contribute to the recovery of costs incurred by Sky in the past that it did not reasonably expect to contribute to at the time the costs were incurred. Equally, Ofcom would not normally expect to retrospectively disallow costs Sky had incurred in the past with a reasonable expectation that they could be recovered through TPS charges.

Platform operational costs

- A1.37 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 provision of specific retail packages.

Approach to cost recovery

Recovery of incremental costs of service provision

- A1.38 In applying the cost recovery principle of “cost causation” 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

- A1.39 In applying the cost recovery principle of “benefits received” Ofcom would normally expect that incurred cost that benefit more than one TPS customer are recovered from these customers in proportion to the relative incremental benefits each customer receives from the costs being incurred.
- A1.40 In a FRND pricing regime, Ofcom would normally expect that, in order to ensure that each TPS customer makes a fair contribution; each customer would contribute an equal proportion of the incremental benefits they derive from the common costs being incurred towards the recovery of those costs.

¹⁴ Para. 3.11, *Terms of supply of conditional access: Oftel guidelines*, 22 October 2002.

Recovery of TPS specific common costs

- A1.41 “TPS specific common costs” are those costs which are efficiently incurred in the provision of a particular TPS (and would not have been incurred if that TPS were not offered) and that cannot be attributed to a single customer of that service.
- A1.42 Ofcom would normally expect all TPS customers to contribute an equal percentage of the incremental benefits they derive from using the TPS towards the recovery of TPS specific common costs. For example, if a TPS customer operated both pay-TV and interactive services, and therefore purchased both CA and AC services, Ofcom considers that a fair and reasonable regime would only consider the benefits the customer derives from using AC when determining the customer’s contribution towards AC common costs, and not the benefits they derive from using CA services.
- A1.43 Where proxies have been used for incremental revenues earned, e.g. incremental viewing share for revenues earned from having an EPG listing, an estimate of the total incremental revenues associated with this TPS would need to be made by Sky so that platform common costs can be recovered from each TPS in proportion to the incremental benefits received. Ofcom would expect the estimate of total incremental revenues earned to be objectively derived, for example using historic data with forward looking adjustments.

Recovery of platform common costs

- A1.44 “Platform common costs” are those costs incurred by Sky that benefit users of all TPS.
- A1.45 Ofcom would normally expect all TPS customers to contribute an equal proportion of the total incremental benefits they derive from using TPS towards the recovery of platform common costs.

Allocation of costs

- A1.46 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 can be identified as one of the following:
- an incremental costs associated with a specific TPS customer;
 - a TPS specific common cost;
 - a cost common to more than one TPS, but not all TPS; or
 - a platform common cost i.e. a cost common to all TPS.
- A1.47 Consideration should also be given to the common costs incurred when defining the TPS that are offered to TPS customers. For example, if two customers used similar underlying technologies but Sky incurred significantly different costs in providing services to the two customers it may be appropriate to define two separate TPS with different incremental costs or with different common cost pools.
- A1.48 Ofcom considers that, where disaggregating set top box costs is practicable, Sky should attempt to do this and ensure that TPS customers only contribute to the recovery of costs from which they derive a benefit.

Appropriate time periods over which costs should be recovered

- A1.49 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 significant sums of capital expenditure or investment

- A1.50 The appropriate time period for significant sums of capital expenditure or investment 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 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.
- A1.51 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 good reason.

Appropriate time period for recovery of ongoing operational expenditure

- A1.52 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. Such forecasts would be rooted in historical expenditure, and would apply to this observation an estimate which reflected anticipated expenditure over the forthcoming period.
- A1.53 Therefore, operational expenditure would be forecast on a short term basis, whilst substantial capital expenditure and investment would need to be considered more broadly, on a longer term perspective.

Appropriate time period for the setting of charges

- A1.54 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.
- A1.55 Ofcom considers that a twelve month period is a reasonable time horizon for forecasts to be made and for charges to be fixed.
- A1.56 Ofcom also considers that any purchaser of TPS should be entitled to a reasonable period of notice of variations in charges for the next charging period, that the duration of this period of notice should be publicised, and that it should generally not be revised without justification; subject always to complying with any regulated notice period given.

Over and under recovery of charges

- A1.57 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.
- A1.58 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.
- A1.59 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 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 gained from (or rebated to) the same users or same types of users of the services which were causal to the costs being recovered.

Quantifying incremental benefits received

Incremental benefit

- A1.60 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

- A1.61 Ofcom considers that a TPS charging methodology based on relative incremental revenues earned by TPS customers would normally be considered reasonable to recover common costs.
- A1.62 In circumstances where incremental revenues are not easily observable or TPS customers are unwilling to share this information with Sky it may be reasonable to base charges on imputed revenues derived from the measurement of other publicly observable proxies of incremental benefit.

Proxies for revenues derived from using the pay-TV CA services

- A1.63 In order to recover the common costs associated with providing the pay-TV CA services the relative benefits received by users of this TPS must be compared.
- A1.64 Ofcom considers that the actual subscription and pay per view revenues that each TPS customer earns from the 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.
- A1.65 Ofcom would normally expect that users of the pay-TV CA service would contribute the same percentage of their pay-TV revenues towards the recovery of the common costs associated with CA to ensure charges are FRND.

Proxies for revenues derived from using the EPG listing service

- A1.66 In order to recover the common costs associated with providing the EPG Listing TPS the relative benefits received by users of this TPS must be compared.
- A1.67 Ofcom considers that a reasonable proxy of the incremental benefits derived from using the EPG Listing TPS is 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.
- A1.68 In assessing the incremental viewing a channel receives from using the EPG Listing TPS Ofcom would 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.
- A1.69 In the event of a dispute 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.
- A1.70 When reaching a decision Ofcom may use techniques such as pendulum arbitration to encourage the two parties to reach agreement absent a dispute.
- A1.71 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 significantly higher revenues for a given share of viewing compared to an advertising funded channel.
- A1.72 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 Ofcom would normally expect Sky to explain why it had used a particular proxy for determining charges to a particular customer and demonstrate how this proxy more accurately reflected the incremental benefits that this customer received from having an EPG listing. Similarly it would be open to a particular channel to provide Sky with evidence, or alternatively to bring a dispute, if it felt that the viewing share proxy did not adequately reflect its benefits received.
- A1.73 For channels that have a very small incremental viewing share or revenue it may be reasonable for Sky to use a simple “per EPG listing charge” to approximate the incremental benefits these channels receive that will reduce the costs associated with the administration of the cost recovery methodology. If such an approach were adopted, Ofcom would expect the use of transparent and objective criteria for

deciding which channels were charged a fixed fee and which were charged based on using a suitable proxy. It would be necessary for Sky to demonstrate that this differentiation did not lead to material discrimination between TPS customers.

Proxies for revenues derived from using Sky's regionalisation service

- A1.74 Whilst regionalisation utilises some of the same technologies that are used for providing the CA services, the benefits broadcasters derive from regionalisation are of a significantly different nature.
- A1.75 Ofcom would normally expect that the user of this service contribute an equal percentage of the incremental revenues they derive from using the service towards the common costs associated with providing it. However, where the costs to be recovered are relatively small compared to those recovered via other TPS, Ofcom considers that it may be reasonable for Sky to use a simple and transparent proxy for these incremental revenues, such as a fixed "charge per region".

Proxies for benefits derived from using the Geographic Masking TPS

- A1.76 The geographic masking service on the Sky DSat platform is used by some free to view broadcasters to prevent rights spillage into Ireland and mainland Europe. 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 an absolute necessity to securing certain rights e.g. due to restrictions placed on rights holders from existing contracts in other territories.
- A1.77 Due to the potentially unique nature of the benefits different TPS customers derive from using this service, Ofcom considers it reasonable that the charges be agreed on a case by case basis but that each TPS customer is charged the same percentage of incremental benefit they derive from using this service to recover the common costs associated with providing it. However, where the costs to be recovered are relatively small compared to those recovered via other TPS Ofcom considers that it may be reasonable for Sky to use a simple and transparent proxy for these incremental revenues, such as a fixed "charge per channel".

Proxies for revenues derived from using the access control services

- A1.78 Operators of interactive TV services are able to derive a very wide range of benefits from using AC services. Ofcom consider that, due to the relative immaturity of these services, it would be inappropriate to propose a limited set of proxies of benefits received for these services at this time.
- A1.79 On the Sky Dsat platform, Sky already publishes a rate card 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 Ofcom would apply the principles of TPS cost recovery set out in these guidelines to determine whether terms offered for AC services were FRND.

Benefits received by vertically integrated TPS Providers as a result of subsidies tied to a retail service

- A1.80 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.

Provision of Technical Platform Services

A1.81 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.

A1.82 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.

A1.83 Ofcom also recognises that Sky will generally adjust the levels of consumer subsidies to maximise the benefit for its own retail business. The control over subsidy levels implicitly proffered to Sky’s retail business may provide unique incremental benefits compared to other TPS customers. Ofcom would expect TPS charges to reflect these additional benefits.

Benefits received from advanced consumer equipment

A1.84 Where TPS customers earn incremental revenues due to the availability of consumer equipment with advanced functionality, for example Sky+, Ofcom would consider it reasonable for Sky to recover any incremental costs associated with providing this equipment (over and above costs incurred to provide basic consumer equipment) through TPS charges levied on these TPS customers and in proportion to the incremental revenues each of these TPS customers earns as a result of having this functionality.

A1.85 Where costs are incurred by Sky in replacing existing customer equipment in a home with more advanced equipment, Ofcom would not normally expect these costs to be recovered from TPS customers whose TPS service is unaffected by the change and that consequently do not benefit from the change.

Total Benefits Received

A1.86 Ofcom would normally consider it reasonable for platform common costs to be recovered from TPS customers in proportion to the total incremental benefits each TPS customer derives from using its chosen mix of TPS. For example, a pay-TV channel with a interactive voting application may derive three different revenue streams, the sum of which would represent the total benefits received:

Provision of Technical Platform Services

- 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).

A1.87 In a FRND pricing regime, Ofcom would normally expect all TPS customers to contribute the same percentage of the total incremental benefits they derive from using TPS towards the recovery of platform common costs.

Net Benefits

A1.88 Where Sky 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 would normally expect that this benefit be “netted off” against the benefit that this TPS customer derives from using TPS.

A1.89 However, Ofcom recognises that objectively quantifying these benefits is very complex. Additionally, Ofcom considers that these benefits may be less material on a well established platform than they are on a platform in its early stages of growth. Consequently, in order to establish a TPS charging methodology which is both transparent and predictable Ofcom considers that it may be reasonable for a TPS to exclude these effects when establishing its charging methodology.

Risk sharing

A1.90 Under a charging methodology in which capital costs associated with a new platform development are recovered over a number of charging periods 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 customer 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 customer from which to recover the costs.

A1.91 Ofcom would not normally expect that a TPS customer who joined the new platform early, when charges were lower, to continue to benefit from these lower prices in later periods when new TPS customers are required to pay the higher prices. Ofcom would normally expect all TPS customers to contribute the same proportion of benefits received in a given charging period towards the costs to be recovered in that period.

Economies of Scale

A1.92 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.

Provision of Technical Platform Services

- A1.93 However, Ofcom would not normally expect that TPS customer who used multiple instances of a service e.g. multiple EPG listings to be offered a discount on their contribution to common costs.

Non price terms and conditions

- A1.94 Ofcom recognises that in certain circumstances the terms and conditions on which TPS services are provided could be contrary to the condition for provision of TPS on fair and reasonable terms. In particular it may be important that third parties are given access to TPS on similar terms as Sky's own pay-TV business.
- A1.95 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 TPS;
 - Product information including knowledge of new product development, changes to existing products, pricing packages or investment plans;
 - Support levels, availability and performance of the TPS;
 - Appropriate processes to ensure that requests for new TPS or changes to existing TPS are handled in a consistent, transparent and objective manner; and
 - Bundling of 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.

Non TPS contracts

- A1.96 Ofcom is aware that some TPS customers must acquire other services from third parties to enable them to operate their service. For example, providers of interactive TV services on the DSat platform are required to put in place insurance policies to cover any claims made against them for harm their services might do to the integrity or operation of the platform and pay-TV operators require customer management services to manage subscribers.
- A1.97 In the event of a dispute, Ofcom may consider the charges that TPS customers are required to pay for non TPS services but which are related to TPS. In such circumstances Ofcom may consider whether the terms on which such services are provided are such that customers are dis-incentivised from purchasing TPS services and investing in new television, radio or interactive services.

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. [...]”

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;”

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

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

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

Relevant Electronic Programme Guide Conditions

A2.22 The following paragraphs consider 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 -

(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:

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.

²⁷ Schedule 1, EPG Conditions.

“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 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. [...]"

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

A2.28 On 15 January 2004, Ofcom proposed new access conditions for providers of EPG Services²⁸. At the time of writing, these new EPG Conditions have not been finalised and the existing EPG Conditions referred to above remain in force.

Relevant Access Control Conditions

A2.29 The following paragraphs consider the application of the AC Conditions relevant to this consultation:

Provision of access on fair and reasonable terms

A2.30 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.²⁹

"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. [...]"

A2.31 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:

²⁸ See *The regulation of Electronic Programme Guides*, published at http://www.ofcom.org.uk/consult/condocs/epg/epg/condoc_150104.pdf

²⁹ "Third Party" is defined as "a person who provides Relevant Other Telecommunications Services". For a definition of a Relevant Other Telecommunications Services, see paragraph A2.32 of this annex.

Provision of Technical Platform Services

(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

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

A2.32 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

A2.33 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

A2.34 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. [...]"

Keeping of financial accounts

A2.35 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. [...]"

A2.36 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

A2.37 On 14 November 2003, Ofcom proposed new access control conditions for providers of AC services³⁰. At the time of writing, these new AC Conditions have not been finalised and the existing AC Conditions referred to above remain in force.

³⁰ See, *The future regulation of access control services*, published at http://www.ofcom.org.uk/consult/condocs/access_control_services/access_control_condoc

Annex 3

Access Control services

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

Application Signing Services	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.
Authentication Services	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.
Customer Data Sets	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.

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.³¹ 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*

³¹ 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.³²
- 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

³² 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 consultation responses

- 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 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 has not provided details of the names of the companies, organisations and individuals who provided confidential responses to the consultation.
- A5.4 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

- A5.5 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.
- A5.6 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.
- A5.7 Section 2 provides further information on implementation of the new guidelines.

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- A5.8 Ofcom will only consider retrospection in exceptional circumstances and this would need to be assessed on a case by case basis.

Market review

- A5.9 One respondent considered that the market for satellite TV is seriously distorted and that that a fundamental review of the regulatory environment is required.
- A5.10 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.

Further consultation

- A5.11 One respondent suggested that Ofcom should re-consult on the new cost allocation proposal, while another respondent considered that Ofcom should re-consult for procedural reasons.
- A5.12 Ofcom has taken on board these comments and has decided to issue a short consultation on its draft explanatory statement and guidelines.

Equipment costs

- A5.13 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.
- A5.14 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.
- A5.15 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.
- A5.16 Ofcom considers that the views expressed by respondents are broadly reflected in the benefits based approach set out in the guidelines (sections 5 “Allowable costs” and 7 “Quantifying incremental benefits received”). Ofcom consider that all TPS customers typically benefit from having a presence on the DSat platform in a DSat household and it is therefore reasonable that a proportion of these costs should be recovered from third party TPS Customers.
- A5.17 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 they should only be recovered in proportion to the benefits they receive.
- A5.18 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 because only incremental benefits that a TPS Customer receives from using TPS should be considered when

calculating contribution towards the recovery of common costs. Ofcom disagrees with the contribution respondent who did not consider that TPS charges should reflect the benefits a TPS Customer derived from using TPS. Ofcom considers a benefit based recovery approach is the most appropriate for FRND recovery of common costs.

- A5.19 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.
- A5.20 Ofcom's new 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 6 of the Explanatory Statement and Guidelines.
- A5.21 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 of the Explanatory Statement and Guidelines.

Marketing costs

- A5.22 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.
- A5.23 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.
- A5.24 One respondent highlighted concerns with the possibility that marketing associated with Sky+ equipment and HD services may be charged to the TPS customers.
- A5.25 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.
- A5.26 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 information is contained in Sections 4 "Allowable costs" and 6 "Quantifying incremental benefits received" of the Explanatory Statement and Guidelines.
- A5.27 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.
- A5.28 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 covered in section 6 of the Explanatory Statement and Guidelines.

Pricing small broadcasters off the platform

- A5.29 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.
- A5.30 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.
- A5.31 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.
- A5.32 Ofcom considers that these concerns are addressed by the benefits based cost recovery Ofcom has set out in the statement and guidelines.

Benefits approach to cost allocation

Conditional Access

- A5.33 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.
- A5.34 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".
- A5.35 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

- A5.36 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.

- A5.37 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.
- A5.38 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'.
- A5.39 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.
- A5.40 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.
- A5.41 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. As it is unclear which TPS customer brings the greatest benefit to a platform it is normally impractical to make an objective adjustment for these benefits when determining TPS charges.
- A5.42 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.
- A5.43 Ofcom has provided guidance on how a threshold for EPG charges might be set. Ofcom considers that a key determinant in setting a threshold is the practicality of calculating charges for each TPS customer, rather than targeting a specific type of broadcaster.

Rate card vs. negotiation

- A5.44 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.
- A5.45 Three of these respondents claimed that determining TPS charges with Sky through commercial negotiation was no longer appropriate and did not lead to consistent

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and transparent pricing. Three others claimed that a more transparent charging methodology would benefit their own business.

- A5.46 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.
- A5.47 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.
- A5.48 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 based on relative benefits can result in FRND charges.

Financial accounts based approach to the assessment of cost recovery

- A5.49 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.
- A5.50 Ofcom would like to clarify that it is a requirement of the Conditions that Sky maintains separate accounts for its notional platform business. Therefore, the view that Sky's accounts do not solely relate to its platform business is incorrect.

Other TPS platforms

- A5.51 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.
- A5.52 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

- A5.53 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.
- A5.54 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

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TPS guidelines does not cover Ofcom's "Code of practice on electronic programme guides".

- A5.55 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".