

EU pay TV: the shifting focus of regulatory intervention

The development of pay TV has brought to light growing concerns over content and competition, an important change in focus from the traditional 'capacity' and network access preoccupations. Adrien Cervera-Jackson, of Charles River Associates, discusses how public regulation is being used to solve the discussion over 'fair and effective competition' in the pay TV sector.

It is widely held that content drives consumer choice in pay television. The already wide choice of pay TV platforms and providers in the UK is expected to grow during 2011-12 with new players entering the market to offer services 'over-the-top' (OTT) via the internet (for example, Google TV and Philips Net TV) or via hybrid broadcast/broadband connected TVs (for example, YouView). With the expansion in distribution capacity on direct-to-home (DTH) satellite (provided by BSkyB), cable (primarily Virgin Media), DTT (Top Up TV) and fibre-optic based Internet Protocol television (IPTV) platforms (TalkTalk TV and, as a hybrid with DTT, BT Vision), regulatory focus in pay TV has shifted from bottlenecks in transmission capacity to concerns over access to content. Historically, concerns over transmission bottlenecks arose because of the limited amount of available analogue terrestrial spectrum, often granted to public service broadcasters. Meanwhile, concerns over access to higher-capacity cable and DTH transmission platforms were addressed via the imposition of platform access regulations¹ and interoperability requirements², at EU-level and in each Member State. In the past few years, platform bottlenecks have eased with the digitisation of DTH and cable systems and the development

of DTT and IPTV platforms, and the focus of regulation has shifted towards conditions of access to certain content rights and channels. In particular, regulators fear that pay TV competition may be inhibited by lack of access to key content which might hinder the development of new platforms, products and modes of distribution. Content regulation has typically intervened at two stages of the market. At the upstream level, regulation has restricted the sale or acquisition of content rights - restrictions on the scope and duration of rights contracts, for example). At the wholesale channel supply level, it has typically involved requirements to supply channels on a non-discriminatory basis to rival retailers - through the imposition of wholesale 'must offer' obligations and sometimes even regulation of wholesale prices. In the UK, Ofcom has recently imposed a wholesale must offer obligation covering BSkyB's premium sports channels.

Ofcom's pay TV statement

After three rounds of consultation spanning three years, Ofcom concluded its pay TV investigation on 31 March 2010³. The investigation was triggered by a joint submission from BT, Top Up TV, Virgin Media and Setanta Sport in 2007⁴, alleging that competition in the pay TV industry was not working effectively. Ofcom's investigation focused on the alleged incentive of BSkyB, as a vertically integrated pay TV retailer, to foreclose rival retailers by withholding or inflating the terms of wholesale supply for its premium sports and movie content. At the conclusion of its investigation, Ofcom imposed a wholesale must offer (WMO) obligation requiring BSkyB to offer its two premium sports channels

(Sky Sports 1 and Sky Sports 2) to rival retailers on non-BSkyB platforms, including those on DTT and IPTV platforms, on regulated terms. Ofcom required the standard definition (SD) versions of Sky Sports 1 and 2 to be offered at regulated wholesale prices set on a retail minus basis, some 10.5% (for the bundle of both channels) to 23.4% (for a single channel) below the rate card price charged to cable operators. Meanwhile, high-definition (HD) versions of the two channels must be offered on fair, reasonable and non-discriminatory terms.

Strictly, Ofcom's regulation fixes the margin between BSkyB's retail and wholesale prices for these channels, rather than the wholesale price *per se*: thus, if BSkyB changes its retail prices, wholesale prices will move in line. The basis for Ofcom's regulated margin is the distribution and retail costs of an efficient but smaller scale competitor with a premium subscriber base of 1.5 million (i.e. smaller than BSkyB's premium subscriber numbers) using DTH transmission. BSkyB has argued that its cable rate card prices were already constrained by the requirement to satisfy a 'margin squeeze' test following an earlier Office of Fair Trading (OFT) abuse of dominance investigation which concluded, in 2002, with a non-infringement decision⁵. By widening the margin beyond this level, Ofcom's approach arguably promotes entry not only by retailers that are 'as efficient' as BSkyB, but also retailers with a different cost structure - such as on DTT and IPTV platforms - which claim they are currently foreclosed by BSkyB. The legal basis for the remedy is Ofcom's *ex ante* sectoral powers under Section 316 of the Communications Act 2003 (rather than its *ex post* competition law powers under the Competition Act

1998). Section 316 gives Ofcom the power to impose licence conditions to ensure 'fair and effective competition in the provision of licensed services': Ofcom's regulation introduces a WMO condition into the channel licences of Sky Sports 1 and 2. Section 317 of the Communications Act requires Ofcom to consider whether it would be more appropriate to proceed under the Competition Act 1998. Ofcom states that it has chosen to proceed under Section 316 'because of the need for a comprehensive solution to a general problem affecting the relevant markets'.

Appeals to the Competition Appeal Tribunal

In the months following Ofcom's pay TV statement, BSkyB, Virgin Media, BT and the FA Premier League (FAPL) all appealed Ofcom's decision to the Competition Appeal Tribunal (CAT), on a variety of grounds⁶. BSkyB opposes the WMO remedy itself and the legal basis for its imposition, Virgin Media and BT request lower regulated wholesale prices and an extension of the WMO remedy to BSkyB's other sports channels (Sky Sports 3 and 4), while the FAPL is concerned about the impact of the WMO remedy on the value of sports broadcasting rights. These appeals will be heard by the CAT between May and July 2011.

BSkyB applied to the CAT for interim relief against Ofcom's decision⁷, attempting to prevent implementation of the WMO obligation pending its substantive appeal. On 29 April 2010, BSkyB and Ofcom reached a settlement agreement and the CAT issued an order suspending certain aspects of Ofcom's decision pending appeal⁸. Under the terms of the settlement agreement, the WMO obligation will initially benefit only the

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existing pay TV operators, BT Vision, Top Up TV and Virgin Media. These retailers will pay the prevailing cable rate card price for Sky Sports 1 and 2, with the difference between that price and the new regulated wholesale price paid into escrow and to be awarded in accordance with the CAT's judgment.

Premium pay TV movies

Although part of the original investigation, Ofcom's WMO obligation does not apply to BSkyB's premium movie channels. Nonetheless, Ofcom expressed concerns about the restricted wholesale distribution of these channels to rival retailers and the limited exploitation by BSkyB of subscription video-on-demand (SVoD) rights to premium movies in the first pay TV window and has referred pay TV movies to the Competition Commission (CC) for a market investigation under the Enterprise Act 2002⁹. In deciding to make a reference to the CC, Ofcom concluded that its sectoral powers under the Communications Act 2003 did not adequately extend to VoD services and that action using its powers under the Competition Act 1998 was unlikely to be effective in addressing its concerns. The CC intends to publish the provisional findings of its investigation in April 2011 and to conclude its inquiry by August 2012¹⁰.

Conclusion

With the expansion in distribution capacity in recent years, regulatory focus has shifted from transmission bottlenecks to access to key content, with concerns that pay TV competition may be inhibited by lack of access to key content, hindering the development of new platforms and products. Ofcom's WMO obligation constitutes an

interventionist approach, which seeks to ensure 'fair and effective competition' in practice by promoting retail entry especially on new platforms (i.e. DTT and IPTV). It remains to be seen whether the regulation will survive the CAT's scrutiny. In addition the rapidly changing pay TV landscape, with new platforms, products and modes of delivery over the internet, makes it difficult to predict the outcome of any regulatory intervention.

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1. Articles 5 and 6 of Directive 2002/19/EC of the EU Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive).
2. Article 18 of Directive 2002/21/EC of the EU Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive).
3. Ofcom, Pay TV Statement, 31 March 2010.
4. British Telecommunications plc, Setanta Sport Holdings Limited, Top Up TV Europe Limited, Virgin Media Limited, Submission to Ofcom on the need for a market investigation into the pay TV industry, 3 July 2007.
5. OFT, Decision of the Director General of Fair Trading No CA98/20/2002 - BSkyB investigation: alleged infringement of the Chapter II prohibition, 12 December 2002.
6. CAT, Notices of appeal under Section 317(6) of the Communications Act 2003, Cases No: 1158/8/3/10, 1156/8/3/10, 1159/8/3/10 & 1157/8/3/10, 8 June 2010.
7. CAT, Summary of application for interim relief under rule 61 of the CAT rules 2003, Case No: 1152/8/3/10 (IR).
8. CAT, Order of the President, Case No: 1152/8/3/10 (IR), 29 April 2010.
9. Ofcom, Premium pay TV movies - Market investigation reference to the CC, 4 August 2010.
10. CC, Market Investigation into Movies on Pay TV - Administrative timetable, 3 September 2010.