

# CRA Competition Memo



## Sports Rights

### The UK Premier League football case

In recent years arrangements for the sale of broadcast rights to sporting events have attracted increasing attention from the competition authorities. An important reason for this regulatory interest is that these agreements often involve *collectivity* (where rights are sold *en bloc* by a co-ordinating body) and *exclusivity* (where certain rights are allocated to only one broadcaster). A particularly high profile recent case that revolved around these issues was the action brought by the UK Office of Fair Trading against the contracts between the English football Premier League and the broadcasters, BBC and BSkyB. The case was concluded when the UK Restrictive Practices Court ruled that neither the collective selling by the Premier League of rights to broadcast live football matches, nor the exclusive purchase of those rights by BSkyB, acted against the public interest.

The ruling represented a comprehensive victory for the Premier League, BSkyB and the BBC. More generally it served as a timely reminder that judging agreements on their effects requires a detailed economic analysis of the market in question. The OFT lost on every count because it relied on a hypothetical competitive benchmark that focused on the form, not the economic impact, of the agreements.

### The OFT's competitive benchmark

The core of the OFT's case was that markets work best when they resemble the competitive benchmark of a fragmented market with many competing sellers, and where sales are free from contractual restrictions. The OFT correctly pointed out that the arrangements for the sale of rights to televise Premier League football matches departed from this benchmark.

Football clubs in the Premier League do not each sell rights to televise their own games. Instead the Premier League collectively sells rights to all the games played by its members and is the only supplier of broadcasting rights to these games. In the OFT's eyes this collective selling suggested that the Premier League was a monopoly or cartel that would restrict output and raise price above the competitive level.

In addition the OFT pointed out another departure from its competitive benchmark. The Premier League sold the rights to show live matches to a single buyer, BSkyB, under an exclusive contract which prevented the Premier League selling rights to any live matches to any other UK broadcaster. The OFT contended that competition between channels would be damaged if only one channel – BSkyB – showed live Premier League matches.

In objecting to the contracts the OFT relied on the following claims about the damaging effects of departing from the competitive benchmark:

- consumers are best served by competing suppliers rather than collective selling;
- monopoly suppliers restrict output; and
- exclusive agreements restrict competition downstream.

The Court considered each of these propositions. On the basis of detailed evidence about the economic effects of the agreements it rejected each one.<sup>1</sup>

### The benefits of collective selling

The OFT argued that the Premier League was the means by which member clubs co-operated in a cartel. In general co-operation between suppliers is viewed with great suspicion by competition authorities, and often with good reason. In most industries consumers are unlikely to gain when firms co-operate. Firms can generally produce the goods customers want without the help of others who are supplying the same product and consumers can be harmed by co-operation when suppliers agree to compete less fiercely.

However, in the case of the Premier League rights, the Court rejected the OFT's analysis. The Court's decision reflected the special features of the economics of sport. Teams in a sporting league *must* co-operate to some degree with one another to produce the output customers want to buy – exciting games.

At a minimum, clubs must co-operate in arranging fixtures and tournaments. They must also co-operate in ensuring that matches are worth watching. Few people will bother to watch a game if the outcome is certain beforehand. In practice this means a sports league will often need to provide some form of financial support for less successful clubs to help them attract better players and invest in better facilities. The Premier League is able to offer such financial support using the revenues it collects in its role as the collective seller of rights to televise all Premier League matches.

### Monopoly need not restrict output

The second general claim the OFT relied on was that monopoly is harmful because monopoly sellers raise price and restrict output. In general this is true, but

<sup>1</sup> Lexecon gave evidence on behalf of BSkyB.

once again the relevance of this observation to the allocation of Premier League sports rights has to be questioned. Specifically, economic analysis of the market for sports rights showed that the Premier League had no incentive to restrict the number of televised games.

In standard textbook models a monopoly supplier will raise price and restrict output relative to a competitive market outcome. It does so because the textbook monopolist (in the absence of price discrimination) has to charge the same price for each unit sold. If it wants to persuade customers to buy more it must lower the price on the additional sales. These additional sales, *considered alone*, will be profitable so long as the customer is willing to pay more than the cost of production. However the textbook monopolist will also take into account another effect. Because it charges the same price on all units it will have to lower the price not just on the additional sales, but on all *existing* sales as well. This means the monopolist may refuse to sell an additional unit, even though the customer is willing to pay more than the cost of production, because it does not want to lose revenue on its other sales.

In the market for sports rights, however, the Premier League has no incentive to restrict output at all, even though it is the single seller of those rights. The key is that, unlike the monopolist of textbook theory, the Premier League is *not* forced to charge the same price for each match sold. The Premier League sets a price for a bundle of rights taken together rather than setting a fee per game. If the Premier League wanted to sell rights to an additional game it would set a new (higher) price for the new (larger) bundle of games. In this way it could sell the extra game without affecting the income it receives from the existing games in the bundle. As a result the Premier League has an incentive to sell an additional game whenever the additional revenue available makes it worthwhile. There is no restriction in output.

## The benefits of exclusive agreements

The third of the OFT's propositions was that restricting sales of a valuable input to a single downstream customer puts that customer at an advantage and damages downstream competition. There are situations where this will be true. However, on the basis of a detailed analysis of the facts of the case, the Court accepted that the sale of rights to Premier League games on an exclusive basis to one channel promoted rather than harmed competition.

To understand why exclusivity promotes competition between channels one must understand the nature of broadcasting markets. Television programmes are expensive to produce, but cost practically nothing extra to supply to one more person. Broadcasting is the quintessential high fixed cost but low marginal cost industry. Such an industry can *never* operate on a sustainable basis under conditions of intense price competition.

Price competition is intense when customers consider competing channels to be practically identical and

choose between them on the basis of price alone. The key point is that whichever channel has the lowest price gets almost all the customers, and the rest get almost none. Identical competing channels will always have an incentive to undercut each other. They will keep undercutting until the price is so low that revenue from subscribers does little more than cover the marginal cost of delivering content to them. At this point subscribers are no longer valuable, and channels no longer have an incentive to undercut.

Intense price competition, in other words, would mean that channels would have difficulty earning enough subscription revenue to cover the substantial costs of buying or making the content. As a result some of the channels may decide to exit rather than go through another round of heavy spending on content and fierce price competition. Or, anticipating that price competition will be intense, channels may not enter in the first place.

Economists are familiar with the conclusion that intense price competition in markets with high fixed costs and low marginal costs can be unsustainable. They refer to it as the 'Bertrand Paradox'. One way out of the paradox is for channels to compete on factors other than price. If channels are differentiated in some way then each channel will have some customers who will choose it over its competitors even if the price is slightly higher. As a result channels can raise price without losing all of their subscribers, and prices will not be forced down to an unsustainable level. More channels will be able to stay in the market and customers will have more choice.

The solutions suggested by the OFT amounted to attempts to impose a particular outcome on the market. For example one proposal was to require the rights to televised Premier League matches to be divided up between different channels. This would have pushed the market towards one where all channels had some of everything, making it more difficult for channels to differentiate themselves from one another. The OFT was unable to convince the Court that this alternative would make consumers better off.

## Conclusions

The OFT failed to establish that any aspect of the contested commercial arrangements between the sports league and the broadcasters acted against the public interest. The simple lesson is that one cannot just criticise existing market arrangements on the basis that their form departs from some idealised competitive benchmark. One has to show, on the basis of a detailed economic analysis of the particular facts of the market, that there are some other practical arrangements that can perform better. It was the OFT's failure to propose a better solution that proved decisive.

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