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# WORKING PAPERS

RSCAS 2020/77  
Robert Schuman Centre for Advanced Studies  
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Assessing ten years of intervention in UK Pay TV

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European University Institute

**Robert Schuman Centre for Advanced Studies**

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EUI Working Paper **RSCAS** 2020/77

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ISSN 1028-3625

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Published in December 2020 by the European University Institute.  
Badia Fiesolana, via dei Roccettini 9  
I – 50014 San Domenico di Fiesole (FI)  
Italy

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## **Abstract**

Ofcom identified significant competition concerns in the UK pay TV market and proposed regulatory remedies to address them. For about ten years it tried to get these measure implemented. However, its proposed measures have been repeatedly rejected by appeal bodies and courts. This article critically assesses these interlinked competition decisions disguised as regulatory interventions. It highlights significant issues with the proposed interventions, which have been framed as refusal to supply. It emphasises a failure to properly frame and assess its concerns under a coherent theory of harm, distinguishing and differentiating between premium movies and sport content in terms of what drives consumers' preferences, and whether the chosen remedies would address any potential consumer harm. The latter concern is particularly relevant as in pay TV, even in the presence of market power and consumer harm, it is at best unclear whether access remedies may substantially benefit consumers.

## **Keywords**

UK Pay TV; *ex ante* regulation; refusal to supply; competition; Ofcom





## 1. Introduction\*

This article critically assesses the UK Office of Communications' (Ofcom) main decisions in the pay TV sector focusing on Sky's behaviour in premium sport and movies content. These decisions come under its broadly defined competition powers under Section 316 of the CA03 and the EA02. Ofcom has both *ex ante* regulatory powers stemming from the *Communications Act 2003* (CA03) and *ex post* competition powers from the *Competition Act 1998* (CA98) and the *Enterprise Act 2002* (EA02). Although not all Ofcom's pay TV premium movies content interventions are formally competition decisions, the theory of harm identified is very close to exclusionary concerns, and in particular refusal to supply. Therefore, we have assessed these interventions under a broadly defined refusal to supply approach.

This article is organised as follows:

- Section 2 provides an high level description of the pay TV industry, Ofcom's powers in this sector and Ofcom's three main interventions;
- Section 3 describes and provides a detailed assessment of Ofcom's intervention in premium sport;
- Section 4 separately covers Ofcom's intervention in premium movies;
- Section 5 assesses Ofcom's decision to impose stringent conditions in order to approve Sky's launch of a pay TV service on Digital Terrestrial Television (DTT); and
- Section 6 draws out the main conclusions.

Overall, Ofcom's approach in its pay TV interventions has been formalistic, rarely examining the dominant firm's incentives, never systematically considering whether the practice has or can have any anti-competitive effects and harm consumers and not carefully considering whether the proposed remedies could be effective. Instead, Ofcom's focus was on finding upstream dominance and mandating access remedies. This is probably a reflection of the *ex ante* approach in telecoms that only requires a finding of dominance in order to justify the imposition of *ex ante* remedies, often in the form of access conditions. Ofcom appears to have adopted this approach also when intervening in pay TV. We consider that much more attention should have been given to Sky's behaviour, incentives, its effects on competition and consumers and, critically, whether there were remedies that could be effective in tackling the alleged consumer harm. Critically, Ofcom failed to take into account important differences in the supply and demand features between premium sport and movies content, which, if carefully considered, should have led to different conclusions as to whether there was a concern and, if so, whether it could be remedied. In particular, Ofcom should have considered whether the obligations to supply, it had proposed were likely to reduce the identified consumer harm. This appeared very unlikely for premium movie, and at best uncertain for sport content. This is not to argue that Sky did not have market power in the distribution of premium sport, or pay TV more generally, but there are significant doubts that one could design effective remedies to address this concern.

All Ofcom's decisions were in the end reversed following appeals to the Competition Appeal Tribunal (CAT), references to the CC or led to withdrawals of commercial offers.

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\* I have worked at Ofcom during most of the relevant period – i.e. from 2004 to 2016, with the exception of 2012-13 when I was seconded to the CC. However, I was not involved in decisions assessed in the article. The views and opinions expressed in this paper are the sole responsibility of the author and do not necessarily reflect those of my past, current or future employers. While I have received many helpful suggestions and comments, the responsibility for any remaining errors remains solely with the author.

## 2. Background

### 2.1. The evolution of the UK pay TV sector

The UK pay TV vertical chain has evolved over time reflecting technological change and market evolution. Nonetheless, at its basic it can still be described as follows. The main input is premium content – i.e. content that is valued particularly highly by a proportion of consumers. If the latter are a small group with a particularly high willingness to pay for some type for content, this content is likely be offered as pay TV. By definition premium content is particularly important in driving up take up of pay TV retail subscriptions. There are two key types of premium content with important different features that were relevant at the time of Ofcom’s decisions. Premium sport content usually refers to televised football, like the Premier League (PL) in the UK, and some other live sport events, such as Formula 1. While the value of premium sport content is high when broadcasted live, it drops significantly when it is shown later on. The term premium movies refers to films produced by the seven Hollywood Majors, which are considered the most important producers of films. Unlike premium sport, its value does not decline as rapidly and this allows to price discriminate over time. This way of releasing movies content is known as windowing. In the context of Ofcom’s interventions, premium movies content referred to content, which is first released on pay TV (i.e. the first pay TV window). The main difference between the two types of premium content is that it is extremely difficult to expand the supply of premium sport, but much less so to increase the supply of premium movies content. Wholesalers, such as pay TV operators, acquire the rights to broadcast content, including premium content, and aggregate that into schedules for channels. Content needs then to be delivered to viewers. The number of potential alternative transmission services has grown over time. While in the 90s and the first decade of this century pay TV content could be distributed only via satellite and cable networks, now to some extent DTT and, critically, Internet offer important distribution alternatives. The retailing services include creating retail bundles of channels, customer care and billing.

In the UK after a brief phase of competition between two satellite providers, Sky and BSB, which ended with the merger creating BSkyB (now Sky), the latter only competed with cable operators over the 90s. Several cable operators with non-overlapping franchises gradually consolidated into Virgin Media (VM), which now passes about half of the UK homes. Although VM and Sky had similar subscriber bases in the early 2000, since then Sky has become the dominant pay TV retailer, especially in premium sport content. A critical difference is that Sky had exclusive access to premium content, while cable operators obtained wholesale content from Sky. In recent years, new retailers appeared. BT Vision launched in 2006 and later acquired some relevant premium sport rights, which it distributed over the Internet and DTT. Over The Top (OTT)<sup>1</sup> players, such as Lovefilm and Netflix launched in in December 2011 and January 2012, respectively, mostly focusing instead on movies and TV series.

### 2.2. Ofcom’s relevant power in broadcasting and pay TV interventions

Ofcom has significant powers to intervene in the broadcasting sector including in relation to pay TV. In addition to its concurrent CA98 competition powers,<sup>2</sup> it can also (a) undertake market studies under the

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<sup>1</sup> This article uses the terms OTT an Internet Protocol Television (IPTV) interchangeably. IPTV is generally offered by telecommunication operators over managed network with guaranteed quality of service, while OTT is provided by content owners (such as BBC in the UK, Hulu in the US), or dedicated providers (such as Netflix in the UK and US, or Roku) without the Internet Service Provider (ISP) or network operator being involved either in the control of the content or its access by viewers.

<sup>2</sup> The term concurrency refers primarily to the powers given to the UK regulatory authorities to apply aspects of *ex post* competition law to their industry of competence. Concurrency covers anti-competitive agreements (Chapter I), abuse of dominance (Chapter II) and the power to carry out market studies, which could now lead to a reference to the CMA (and earlier on to the CC) for a full market investigation. Concurrency means that anti-competitive behaviour can be investigated either by the relevant regulatory authority or by the CMA, although the latter has generally agreed to leave the powers to

EA02 and make a reference to the CMA - then Competition Commission (CC) - for a full market investigation or (b) intervene under Section 316 of the CA03. The latter is described as akin to competition powers as it assigns Ofcom the powers to intervene to ensure that broadcasters do not “(a) enter into or maintain any arrangements, or (b) engage in any practice, which Ofcom consider, or would consider, to be prejudicial to fair and effective competition in the provision of licensed services or of connected services.”<sup>3</sup>

The UK pay TV has been the object of several competition policy interventions over the last few decades under the CA98. Sky’s behaviour had been investigated before the creation of Ofcom in 2003 (e.g. OFT, 2002). However, over the 2007-2016 period, a significant number of decisions by Ofcom and various appeal bodies involved Sky, as the dominant pay TV provider in the UK. A joint submission by British Telecom (BT), Setanta, Top Up TV (TUTV) and VM prompted Ofcom’s investigation into the pay TV sector in 2007 (Ofcom, 2010a). This led to two separate decisions on premium sport and movies. Separately, in 2007 Sky announced its proposal to launch a new pay TV service, called *Picnic*, involving the replacement of Sky’s three existing Free To Air (FTA) channels on DTT with a selection of pay TV channels. These triggered a number of investigation and ultimately led to a number of important decisions between 2010 and 2012, which fall neatly into three main areas:

- *Premium sport* - Ofcom 2010 pay TV statement, under Section 316 of the CA03 concluded that Sky had market power in the provision of premium sport channels and imposed a wholesale obligation to supply, known as the “Wholesale Must Offer” (WMO) (Ofcom, 2010a). Ofcom’s decision was appealed to the CAT, which issued its judgement in August 2012 (CAT, 2012) and was subsequently appealed to the Court of Appeal who remitted the case to the CAT. However, in 2015 Ofcom decided to remove the WMO obligation. A decision upheld by the CAT in December 2016 (CAT, 2016);
- *Premium movies* - as Ofcom could not rely on the same legal basis as in premium sport content to address the concern it had identified (Ofcom, 2010c), it referred premium movies to the CC suggesting two remedies, one of which was very similar to that on premium sport. The CC concluded its market investigation in August 2012 (CC, 2012). This was the first, and so far only, market investigation concluding there was no Adverse Effect on Competition (AEC) by the CC and CMA. As a result, the CC did not impose any remedies; and
- *Picnic* - Sky’s pay TV expansion on DTT. Under Section 316 of the CA03 Ofcom approved Sky’s *Picnic* proposal conditional on Sky accepting remedies very similar to those from premium sport and movies (Ofcom, 2010b). In 2008, Sky suspended *Picnic*, which ultimately was never launched.

Although neither Ofcom’s intervention in *Premium sport* and *Premium movies* are formally under the CA98, they have been framed as exclusionary abuses. In particular, Ofcom framed its concerns in *Premium sport* as a pure refusal to supply. The same approach was taken to *Premium movies*, where, in addition, Ofcom claimed that Sky hoarded the rights to Subscription Video on Demand (SVoD). *Picnic* is different as Ofcom was concerned that Sky’s pay TV expansion into DTT would harm competition. We have examined these cases under an ability, incentive, effects and remedies effectiveness framework:

1. Ability - this is reflected in the dominance assessment, as only firms with market power can successfully engage in anti-competitive behaviour and harm consumers. Dominance is, therefore, a critical element in the legal test;

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the relevant regulatory authority. See, for example, *CMA and Ofcom memorandum of understanding*, available at <https://www.gov.uk/government/publications/cma-and-ofcom-memorandum-of-understanding>.

<sup>3</sup> Ofcom could impose conditions requiring compliance to a code approved by or directions from Ofcom. Before exercising its powers under the Section 316, Ofcom must consider if it is more appropriate to rely on the CA98 instead. If it did conclude that the latter was more appropriate, it could not intervene on the same matter also relying on Section 316.

2. Incentives - a dominant firm does not always have incentives to exclude. A good understanding of incentives can help in both deciding whether to open an investigation and how to interpret the available evidence, if and when an investigation is opened;
3. Anti-competitive effects - any attempt by a dominant firm to exclude its rivals must be a concern, if it has an anti-competitive effect and, ultimately, harms consumers; and
4. Remedies effectiveness - remedies addressing refusal to supply concerns tend to focus on imposing obligations to supply. These are intrusive and require constant monitoring. Therefore, it is particularly important that these are likely to be effective in redressing the identified consumer harm. Fumagalli et al. argued that “*competition authorities and courts need to consider the availability and viability of remedies to the behaviour they may try to curtail.*”<sup>4</sup>

### 3. Premium sport interventions

#### 3.1. *When it all began: Ofcom’s 2010 statement*

Ofcom published three consultations as part of its pay TV review, starting in December 2007 and issuing its final statement in March 2010. Although Ofcom’s Final Statement (Ofcom, 2010a) including annexes is over a thousand pages long, its logic can be summarised very succinctly, as Sky having market power in a wholesale market for pay TV packages that includes premium sport, such as PL football, where Sky consistently held a 90% market share. In addition, Ofcom found that access to premium sport content was a barrier to entry and expansion for potential rivals and Sky held the majority of live PL rights packages at the time. Ofcom expected Sky to retain those packages at the following auction. While VM had been a significant retail outlet for Sky’s channels on cable, it was not considered able to exercise sufficient buyer power. Ofcom’s assessment of Sky’s profitability reinforced its overall conclusion that Sky would have remained dominant for the next three to four years.

Ofcom also concluded that Sky had an incentive not to supply its wholesale channels to retail competitors, because if it did, rival retailers may increase their subscriber base and consequently be able to challenge Sky’s dominance by outbidding Sky in future auctions for premium sport rights and, in particular, for the PL rights. According to Ofcom, Sky acted on this incentive and refused to supply its wholesale packages. Ofcom stated that this was its “*key concern*”, as the ability of pay TV retailers to compete effectively depended on access to the wholesale supply of core premium channels. In essence, Ofcom framed Sky’s behaviour as outright refusal to supply, with Sky favouring its retail satellite platform arm.

Ofcom’s core evidence related to several failed negotiations between Sky and other potential platform retailer entrants. Based on a detailed reconstruction of these negotiations, Ofcom concluded that Sky, in its dealings with other retailers, did not engage constructively. Ofcom’s concern extended to the terms of Sky’s only wholesale supply agreement with VM, one of the few wholesale agreements that were in place, although we note that in itself this agreement stems from a prior competition intervention by the OFT. Although Ofcom did not conclude that this agreement amounted to a margin squeeze and the OFT did not either (OFT, 2002), it argued that the terms did not allow VM to compete effectively with Sky at the retail level.

Ofcom expected Sky’s market power and its incentive to refuse to supply wholesale content to be enduring. A concern that, according to Ofcom, could only be remedied by requiring Sky to offer its core premium standard and high definition sport channels (Sport 1 and 2) on a wholesale basis to downstream retailers on competing platforms, at wholesale prices set by Ofcom under the WMO terms. Ofcom’s WMO consisted of a retail-minus approach with two peculiarities. First, the retail costs deducted were

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<sup>4</sup> Fumagalli et al., 2017, 588.

not those of an Equally Efficient Operator (EEO)<sup>5</sup> – i.e. a satellite operator with Sky’s scale – but those of a smaller scale satellite operator expected to reach 1.5 million subscribers in ten years (compared to Sky’s ten million subscribers at the time). Second, the deducted costs included not only the incremental costs, but also a proportion of common costs to account for economies of scope between the two premium sport channels and Sky’s remaining channels. In addition, Ofcom introduced complex restrictions to counter Sky’s incentives to shift premium content from Sport 1 and 2 into other channels and bypass the remedy. Ofcom, therefore, opted for a Reasonably Efficient Operator (REO) approach.<sup>6</sup>

According to Ofcom, its remedy would lead to consumers benefiting from a wider choice of distribution platforms offering premium sport content and new ways of packaging premium channels. It also argued that Sky should benefit in a static sense from the expansion in retail demand and higher wholesale revenues.

### 3.2. On to the CAT

Ofcom’s Final Statement was appealed to the CAT (2012). The CAT’s judgement focused solely on Ofcom’s basic but key factual assumption, which was central to Ofcom’s Final Statement. That is, although the evidence showed that Sky had entered into negotiations to supply wholesale premium content, it had done so without the intention to supply because it was better off not supplying and excluding its competitors. Ofcom took this as the key evidence that Sky had an incentive to and actually refused to supply.

The CAT did not agree: “[t]he Tribunal has concluded that Ofcom’s core competition concern is unfounded.”<sup>7</sup> According to the CAT, “Ofcom has, to a significant extent, misinterpreted the evidence of these negotiations, which does not support Ofcom’s conclusion. We have found a significant number of Ofcom’s pivotal findings of fact in the Statement to be inconsistent with the evidence.”<sup>8</sup> “Ofcom has attributed responsibility for the failure to reach agreement largely to Sky’s failure to engage constructively with its counterparties. However, the evidence shows that Sky did, on the whole, engage constructively. On the other hand its counterparties by no means always did so, and in our view regulatory gaming on the part of some of Sky’s counterparties played a much more important role in the commercial negotiations and their progress (or lack of it) than Ofcom has recognised.”<sup>9</sup> “Although Sky has a strong preference for having the retail role itself when supplying its premium channels to third party platforms (known as “self-retail”) (...) contrary to Ofcom’s findings, Sky has no theological objection to wholesale supply of its premium channels, and is, in principle, willing to do so where self-retail is not open to it.”<sup>10</sup> The CAT’s judgement is scathing about Ofcom’s interpretation of facts related to the negotiations.<sup>11</sup> This culminated in the conclusion that “the nature and extent of our disagreement with Ofcom’s assessment of the facts are such that in general it has not been necessary for us to consider whether, on the basis of Ofcom’s findings, Sky’s alleged conduct in regard to each competition concern would have been such as to prejudice fair and effective competition.”<sup>12</sup>

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<sup>5</sup> The EEO test uses the dominant firm’s own costs to assess whether the dominant firm could trade profitably if it faced the upstream prices it offered to its downstream rivals and the downstream price it charged to its consumers.

<sup>6</sup> Differently from the EEO, described in footnote 5, the REO makes use of the cost of a reasonably efficient rival instead of the dominant firm’s own costs.

<sup>7</sup> CAT, 2012, para 27.

<sup>8</sup> CAT, 2012, para 28.

<sup>9</sup> CAT, 2012, para 29.

<sup>10</sup> CAT, 2012, para 30.

<sup>11</sup> CAT, 2012, paras 824, 825 and 830.

<sup>12</sup> CAT, 2012, para 831.

### 3.3. The final chapter: the removal of the WMO

In parallel to significant further litigation,<sup>13</sup> in 2014 Ofcom commenced a review as to whether the WMO was still required (2014 WMO review)<sup>14</sup> and in November 2015 it concluded that it should be removed (Ofcom, 2015). This was subsequently appealed to the CAT, which upheld Ofcom's decision in December 2016 (CAT, 2016). This marked the end of a ten-year saga of decisions and appeals. The main reason for Ofcom's decision to remove the WMO is that Sky had already been supplying sport (and other) premium content to its downstream rivals outside the WMO. Hence, Ofcom concluded, Sky was no longer refusing to supply.

Ofcom noted that the competitive conditions had substantially changed since 2010. First, Sky's hold on premium sport rights had loosened. BT had won both additional PL rights (previously held by Setanta, a small satellite retailer) and the exclusive rights for the Champions and Europa League matches.<sup>15</sup> Hence, despite Ofcom's conclusion that PL content remained the main driver in consumers' choice, with the Champions League, being important, but secondary,<sup>16</sup> Ofcom noted that Sky's control of premium sport rights had reduced over the relevant period. Ofcom also observed that this increase in competition led to higher overall expenditure on sport rights.<sup>17</sup> Second and linked to the above, existing pay TV providers (not only BT, but also TalkTalk) expanded, new providers entered (e.g. EE) or planned to enter (e.g. Vodafone) and OTT providers (e.g. Netflix, Amazon Prime and Sky's NOW TV) entered and rapidly expanded. Although the latter were not yet focusing on premium sport,<sup>18</sup> Ofcom concluded that increasingly there were options for consumers wishing to access premium sport content via OTTs.<sup>19</sup>

As a result, according to Ofcom premium sport was available to more consumers on a wider range of competing platforms than ever before.<sup>20</sup> This was driven not only by BT's investment in sport rights (£2bn invested in its own platform), but also because Sky had entered into wholesale agreements with several distribution platforms. Despite BT holding a larger share of premium sport content than in 2010, Ofcom concluded that its retail position remained relatively weak. In addition, Ofcom argued that while other suppliers may have substantial customer bases (e.g. BT's nearly eight million broadband subscribers and Vodafone's 18 million mobile subscribers), it was unclear how they could monetise premium sport rights.

In terms of concerns, Ofcom mentioned<sup>21</sup> more clearly than previously, though still very succinctly, that one of its concern related to a dynamic leveraging refusal to supply (or even margin squeeze). Ofcom continued to hold that "*in principle, Sky could have incentives to withhold supply of its important sports content in order to protect its [upstream] market position.*"<sup>22</sup> "*One of the possible strategic benefits to Sky of limited distribution (...) was that [it] could reduce competition for future sports rights. We still consider that platforms with fewer subscribers may be less able to monetise rights and*

<sup>13</sup> The CAT's decision was appealed to the Court of Appeal. In February 2014, the former concluded that the CAT had failed to appreciate the importance of Ofcom's conclusion that Sky's wholesale price and the effect of the penetration discounts that were proposed by Sky gave rise to competition concerns in their own right. As a result, the Court of Appeal remitted the question of whether the WMO obligation was justified to the CAT for further consideration, findings, and conclusions.

<sup>14</sup> The 2014 WMO review was predicated on the statement that the WMO would have been reviewed after three years.

<sup>15</sup> Ofcom, 2015, para 5.42.

<sup>16</sup> Ofcom, 2015, paras 1.12-16.

<sup>17</sup> In the then most recent PL auction (in February 2015), the live rights for the 2016/17-2018/19 football seasons were sold for £5.136bn, which is a 70% increase on the rights for the 2013/14-2015/16 football seasons (sold for £3.018bn). Sky will pay £1.392bn per season and BT will pay £320m per season (Ofcom, 2015, para 3.29).

<sup>18</sup> Ofcom, 2015, paras 1.5 and 3.13.

<sup>19</sup> Ofcom, 2015, para 3.15.

<sup>20</sup> Ofcom, 2015, para 1.6.

<sup>21</sup> Ofcom, 2015, paras 1.17-19.

<sup>22</sup> Ofcom, 2015, paras 1.22-24.

consequently less effective when competing for sports rights.”<sup>23</sup> However, Ofcom also acknowledged that Sky had entered a number of deals with competing distributors and was “currently supplying”, absent a WMO obligation.<sup>24</sup> Therefore, Ofcom no longer raised concerns about either straightforward refusal to supply or about the terms at which Sky supplied its wholesale content to rival platforms.<sup>25</sup>

A new potential concern had emerged. “Sky has said it is willing to wholesale its Premier League content to BT subject to a requirement for reciprocal supply of BT Sport.”<sup>26</sup> Ofcom started by arguing that “in principle, there is potential for concern where a vertically integrated operator in a strong market position such as Sky, makes the supply of its key content subject to a requirement which may condition the way in which its competitor chooses to supply its own content to the detriment of effective competition.”<sup>27</sup> Ofcom did not fully address the issue by concluding that: “on the basis of the current evidence, and the fact that BT and Sky’s negotiations were not concluded, it is not clear that the identified concerns would be borne out in practice. Ofcom has a duty to have regard to the need to act in a manner which is proportionate and targeted only at cases in which action is needed. We do not consider the concerns relating to Sky’s requirement for reciprocal supply warrant the imposition of regulation.”<sup>28</sup>

Overall, Ofcom did “not consider that it would be appropriate to impose regulation in relation to the supply of channels containing key sports content at this time. Whilst there may be concerns in principle given Sky’s strong position in the market, in practice the evidence shows that Sky is supplying widely and we have not seen evidence to show that the terms of this supply amount to practices prejudicial to fair and effective competition which warrant the imposition of regulation. We have therefore decided that it is appropriate to remove the WMO condition from Sky’s broadcast licences.”<sup>29</sup>

### 3.4. Assessment

The investigation into sport premium content lasted almost ten years and despite the lengthy analysis, the many documents published and acrimonious litigation between the parties involved, it would be difficult to conclude that it had a significant impact on the market and, hence, brought benefits to consumers. However, the provision of premium sport and especially movies (Section 4) channels or content witnessed significant changes in the last decade.

We first assess Ofcom original 2010 decision and the CAT judgement as a refusal to supply case. Second, we consider Ofcom’s 2015 decision to remove the WMO altogether. In particular, we consider whether the 2015 decision can provide any lessons for the original 2010 decision.

Sky’s dominance in the supply of wholesale premium content and at the retail level was not in question. Market definition was also relatively straightforward for premium sport, though this was not the case for premium movies (Section 4). It was also evident premium sport content drove consumers’ decisions on pay TV retailers. As per Figure 1, Sky held the majority of premium sport rights, although BT had been increasing its holding of rights.

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<sup>23</sup> Ofcom, 2015, para 6.28.

<sup>24</sup> Ofcom, 2015, paras 6.23-34.

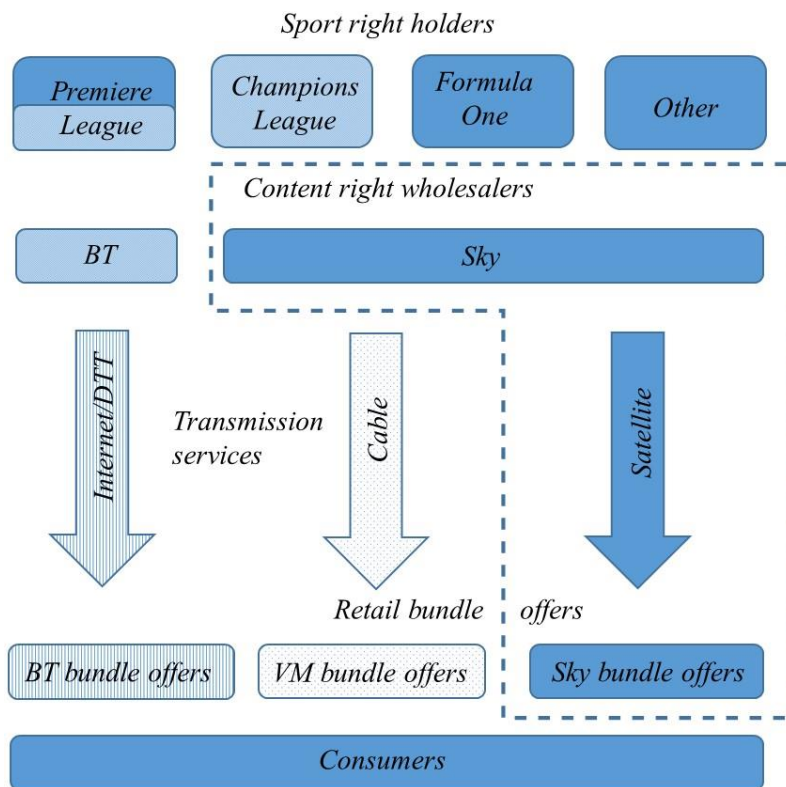
<sup>25</sup> Ofcom, 2015, para 1.27.

<sup>26</sup> Ofcom, 2015, para 1.25.

<sup>27</sup> Ofcom, 2015, para 6.83, but more generally see also paras 6.65-91.

<sup>28</sup> Ofcom, 2015, para 1.33.

<sup>29</sup> Ofcom, 2015, para 1.35.

**Figure 1: Structure of the Premium Sport vertical chain**

Whether Sky had incentives to exclude rivals and had abused its dominant position was, instead, the key point of contention, together with the choice of the appropriate remedy. Although the 2012 CAT's judgement may seem disappointing in confining itself to the interpretation of the facts related to the negotiations between Sky and a number of wholesale buyers, it reveals the unsatisfactory nature of Ofcom's theory of harm. Stripped to its bare minimum and abstracting from the slightly unusual legal grounds to which the case was anchored, this is a straightforward refusal to supply case. The decision hints at this being a dynamic leveraging case, although it never fully assessed in detail and empirically this theory of harm. On this basis, Sky would have had an incentive to engage in exclusionary behaviour when facing retail entry not because it had an incentive to capture profits from competing retailers of premium sport content *per se*. Instead, according to Ofcom, Sky's incentives should be interpreted as a reaction to the risk that competing distribution platforms could gain a sufficiently large retail market share to integrate backwards into wholesale premium sport rights and undermine Sky's main source of market power.

While in theory this could be a credible theory of harm, there are very few dynamic leveraging cases.<sup>30</sup> Ofcom's 2010 pay TV decision neither explores the logic nor provides any evidence or analysis as to why Sky would have preferred to exclude rather than accommodate entry. Weeds (2016) examines the incentives of a vertically integrated pay TV operator to withhold its premium content. She finds that the incentive to refuse to supply could only arise in a dynamic context, where, for example, switching costs can give the incumbent a market share advantage. The incentive to exclude is stronger, the less differentiated are the competing platforms and the more attractive is the programming content. The only

<sup>30</sup> Among these: *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) and European Commission, COMP/C-3/37.792, *Microsoft*, decision of 24/03/2004, available at [http://ec.europa.eu/competition/antitrust/cases/dec\\_docs/37792/37792\\_4177\\_1.pdf](http://ec.europa.eu/competition/antitrust/cases/dec_docs/37792/37792_4177_1.pdf).



evidence Ofcom put forward in the case was that Sky entered negotiations, but never agreed a deal with retailers. This according to Ofcom was the key evidence illustrating that Sky had acted on its incentive to exclude rival retailers. However, relying on outcomes to explain incentives is inconclusive, as there may be several alternative explanations as to why negotiations may have failed in line with the CAT's conclusions. Instead, we consider that Ofcom should have started by considering the necessary conditions for Sky to have strong incentives to engage in dynamic leveraging.

Sky would have incentives to exclude only if, otherwise, retailers could have become a credible threat in bidding for some of the premium sport rights. This depends on a number of conditions. First, Sky's competitors, if successful in bidding for premium sport content, could use it to induce some of their own customers to upgrade<sup>31</sup> or Sky's customers to switch. However, it is unlikely that a large proportion of Sky rivals' existing customers would upgrade, as most are likely to have a low willingness to pay for premium sport. Second and critically, whether Sky's subscribers would switch to rivals depends on whether the latter obtained rights to relatively more valuable content than Sky's and this was sufficiently attractive for consumers to incur the not insignificant switching costs. If, instead, Sky's rival retailers were unlikely to grow their subscriber base to a level that would allow them to challenge Sky's position in an auction for premium sport rights, Sky would be better off supplying rival distributors to increase its wholesale profits. By doing so, it would extend its retail reach to consumers that would otherwise have not subscribed to its satellite platform, but may be willing to pay for its content on another platform.

Although the CAT did not examine other aspects of Ofcom's 2010 Final Statement, the latter departed from established competition policy practice in two important aspects related to remedies. First, it adopted a REO test by adjusting the scale of a satellite's downstream operator. In the consultations preceding Ofcom's 2010 Final Statement, the proposed remedy departed even more drastically by proposing the (higher) costs of a DTT retailer, also with a smaller scale. We are not aware of any price-based abuse of dominance decision that departed from a broad EEO test. Second, the remedy was particularly intrusive and would have required constant monitoring. It included detailed rules to counter Sky's incentive to evade the WMO by shifting content from its Sport 1 and 2 into other channels. In Section 5 we also argue that the WMO remedy was unlikely to benefit consumers.

Overall Ofcom 2010 Final Statement is more akin to a regulatory intervention to impose access obligations than to a competition decision. Most of the decision is concerned with market definition, dominance and remedies. This makes it very much a regulatory decision under the European Framework for regulation of the communications services, where these steps are critical. Instead, there is only limited discussion on defining and testing a credible theory of harm and assessing the effects of Sky's behaviour, which should be key in a refusal to supply case. It is also unusual to opt for remedies that introduce access obligation, especially when these require constant monitoring.

Ofcom's 2015 review raises two additional important issues.

First, Ofcom 2010 decision predicted that an entrant like BT, with no prior strong subscriber base, would have found very difficult to succeed in bidding for premium sport rights against an incumbent with a subscriber base as large as Sky. In 2013, only a few years after this decision, BT without any previous retail pay TV subscriber base successfully challenged Sky and acquired all the rights to the European Champions and Europa League. In 2014 Sky argued that "*the proposition had been fatally undermined*" by BT's success in winning sports rights despite having a relatively small retail base of pay TV subscribers."<sup>32</sup> With respect to the dynamic leveraging theory of harm, Sky had an incentive to engage in refusal to supply if, by doing so, would have made entry in the wholesale market for sport premium rights more difficult. However, BT did not rely on the WMO to enter, hence, refusing to supply may have not had the effect that Ofcom had predicted in 2010. Instead, other operators that relied on

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<sup>31</sup> Although these would not directly reduce Sky's profits, as these consumers did not divert or switch from Sky, they would increase the ability of Sky's rivals to bid more aggressively for premium sport rights.

<sup>32</sup> Ofcom 2015, para 6.18.

Sky's wholesale content, such as VM, which also had a not insignificant subscriber base, did not bid for premium sport rights. This contradicts the logic of Ofcom's 2010 Final Statement.

Second, the concern in Ofcom's 2015 review about Sky's demand for supply reciprocity was new. Ofcom's theory of harm response focused solely on reciprocity as an exclusionary abuse. However, there is an alternative theory of harm, which Ofcom did not explore. Reciprocal wholesale supply could be a tool to soften retail competition. In order for that to be effective, the two right holders would need to agree to sell their respective content to each other at a high price, with a price structure which feeds directly into high retail charges by affecting both firms' marginal costs. For example, this could occur, if they agreed a high reciprocal wholesale price per channel per subscriber. This concern could have been explored further.

## 4. Premium movies

### 4.1. Ofcom's reference to the CC

Following its 2010 Final Statement, Ofcom also referred the market for the rights to show movies from the six Hollywood Major in the first pay TV subscription window (termed "Core Premium Movies") in the UK and the vertically related market for wholesale supply of pay TV packages including Core premium movies to the CC (Ofcom, 2010c). This reference was made under the EA02, which allows sectoral regulators like Ofcom to conduct market studies and to refer the matter to the CC (now the CMA) for a market investigation, if certain conditions are met.

Ofcom defined the relevant market at the retail level as including packages of premium movies channels (i.e. first pay TV window) and Subscription Video on Demand (SVoD). As Sky controlled all these distribution rights at the time, the product market covered Sky's offer. It identified several market features, which, in combination, could lead to an AEC. According to Ofcom, Sky had the ability and incentive to distort competition. Its ability arose from its market power in distribution of movies due to its large subscriber base allowing it exploit market power vis-a-vis the six Hollywood Majors. According to Ofcom, no other distribution platform could outbid Sky in acquiring the relevant rights. This effect was reinforced by the fact that only the six Hollywood Majors supplied premium movies content; rights to the first pay TV window were sold as bundles covering each studio's entire output under exclusivity and the contracts' expiration were staggered.

Ofcom identified three main concerns. It argued that Sky:

- a) could charge high retail prices for premium movies content to consumers,<sup>33</sup>
- b) had market power at the wholesale level and because of its vertical integration it had short-term incentives not to distribute its movies channels to competing distribution platforms other than at a high price; and
- c) had a long-term incentive to purchase, but not fully exploit, the other types of rights to premium movies, such as those for SVoD. Ofcom defined this as its key concern.<sup>34</sup> This is because SVoD were considered likely to become a potential close substitute for subscription pay TV linear channels in the future.<sup>35</sup> If a rival platform acquired them, it could compete with and constraint Sky's retail market power. According to Ofcom cable or Internet Protocol Television (IPTV) operators would have a stronger technical ability than satellite technology to exploit SVoD rights<sup>36</sup> and could have

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<sup>33</sup> Ofcom, 2010c, para A5.7.

<sup>34</sup> Ofcom, 2010c, para A5.6.

<sup>35</sup> Ofcom, 2010c, para 6.33.

<sup>36</sup> Ofcom, 2010c, para 6.6.

launched them much earlier on<sup>37</sup> because there was strong unmet consumer demand for SVoD.<sup>38</sup> Hence, Sky had an incentive to pre-emptively obtain the rights, but not fully exploiting them given that Sky had also limited technical ability to distribute them.<sup>39</sup> The degree of exploitation of SVoD rights by Sky was, however, a disputed fact.<sup>40</sup> A number of competing SVoD providers were mentioned, including LoveFilm, which at the time had the largest film catalogue<sup>41</sup> and Netflix, as an example of a provider not yet active in the UK but supplying SVoD services in the USA.<sup>42</sup>

Ofcom, therefore, put forward two theories of harm. The first is equivalent to Ofcom's refusal to supply for premium sport. The second, although Ofcom did not term it in this way, can be summarised as Sky hoarding SVoD rights in order to increase entry barriers and reduce future competition.

Ofcom opted for a reference under the EA02 because, unlike for premium sport, it did not have the legal powers to intervene under Section 316 of the CA03, which only covers linear programming, but does not extend to SVoD or Video on Demand (VoD) services, while Ofcom considered action under CA98 unlikely to be effective. It identified two possible remedies. The first remedy was to increase competition in the supply of premium movies (e.g. by restricting aggregation of movies by studios). The second remedy required Sky to provide wholesale access to linear and SVoD premium movies content on regulated terms. Ofcom's vision of how this market should evolve was one where consumers could access the (same) content from multiple distribution platforms "*but this will not happen if those operators are denied access to key content.*"<sup>43</sup>

Particularly relevant in the light of the subsequent CC's conclusion and market evolution was Ofcom's belief that "*the features we have identified are likely to persist. We have no reason to believe that, absent regulatory intervention, there will significant new entry of either sellers or purchasers of premium movies rights. In particular, in our Pay TV Statement we have concluded that Sky's market power is likely to continue for the next three to four years.*"<sup>44</sup>

#### 4.2. The CC's Market Investigation

The CC set out its potential theory of harm in a similar way as Ofcom: "*The control by Sky of the acquisition and distribution of movies content on pay TV during the [First Subscription pay TV Window] FSPTW, as a result of its market power in the pay TV retail market, adversely affects competition between pay TV retailers. This adverse effect on competition in the pay TV retail market results in effects both on consumers and/or on the suppliers of pay TV movies rights for the FSPTW (with possible consequential effects on competition between the suppliers of pay TV movies rights for the FSPTW).*"<sup>45</sup>

The CC identified at the start and explored the necessary features for this theory of harm to hold:

- a) Sky must have market power as a pay TV retailer;
- b) pay TV movies content in the FSPTW must be significant to consumers when choosing their pay TV retailer – i.e. there are no close substitutes;

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<sup>37</sup> Ofcom, 2010c, para 6.19.

<sup>38</sup> Ofcom, 2010c, para 6.34.

<sup>39</sup> Ofcom, 2010c, para 6.40.

<sup>40</sup> Ofcom, 2010c, paras 6.23 and 6.30.

<sup>41</sup> Ofcom, 2010c, para A2.45.

<sup>42</sup> Ofcom, 2010c, para A2.47.

<sup>43</sup> Ofcom, 2010c, para A5.33.

<sup>44</sup> Ofcom, 2010c, para A6.26, *emphasis added*.

<sup>45</sup> CC, 2012, para 10.

- c) pay TV retailers competing with Sky could not obtain the rights to sufficient movies content in the FSPTW directly from the studios in order to create movies services which compete effectively with Sky; and
- d) most movies content in the FSPTW on pay TV must be controlled by Sky, and there is limited availability to other pay TV retailers both of movies content in the FSPTW and of Sky's movies products, which include this content.<sup>46</sup>

Critically, the CC argued that, if b) were not met, it would be unlikely that c) and d) would also be met.<sup>47</sup> In other words, if FSPTW content were not a key input for retail competition, then Sky would not be able to exclude its retail competitors.

Therefore, the CC focused on the importance of Sky's control of FSPTW premium movies content for retail competition in the supply of pay TV services, for which FSPTW content is only one small component. This led to a wider retail market definition than that put forward by Ofcom, including, at least, all basic pay TV content, sports, movies pay TV content and SVOD-only services.<sup>48</sup> Second and critically, the CC did not focus on wholesale markets, as it *"did not see a sustainable source of market power arising simply from wholesaling Sky Movies and, therefore, for the purposes of our inquiry, we did not define a total wholesale market comprising both notional and actual wholesale supply of Sky Movies."*<sup>49</sup>

The CC found that Sky had market power in the retail market for providing retail pay TV services. Evidence showed that Sky had both a persistently high market share<sup>50</sup> and enjoyed a high profitability for many years.<sup>51</sup> Nonetheless, in considering whether Sky faced competitive constraints in retailing pay TV, the CC distinguished between pre- and post-entry of OTT providers, Netflix and Lovefilm. These providers entered during the CC market investigation and significantly contributed to change the CC's conclusion on an AEC.

Before the OTTs' entry, the CC concluded that pay TV retailers faced two main barriers to entry. First, competition among pay TV retailers was negatively affected by barriers to consumer switching.<sup>52</sup> Second, there were significant barriers to large scale entry and expansion for a traditional pay TV retailer offering packages of pay TV, including substantial sunk costs. According to the CC: *"together with Sky's large number of existing subscribers deriving from its historical position (Sky's incumbency advantage) and the restricted geographical coverage of Sky's main historical competitor (Virgin Media), it appeared to us that these factors resulted in Sky having market power in the pay TV retail market."*<sup>53</sup> This is a standard theory of harm in pay TV: retail market power leading to inability of rivals to challenge Sky when bidding for premium movies content.<sup>54</sup> The CC concluded that *"traditional pay TV rivals in the past could not rely on being able to circumvent these disadvantages, either by retailing directly to consumers via Sky's DTH satellite platform (due to marketing costs and the disadvantages it*

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<sup>46</sup> CC, 2012, para 11.

<sup>47</sup> CC, 2012, para 3.11.

<sup>48</sup> CC, 2012, para 14. The CC concluded that SVoD services from new OTT entrants were *"closer competitors to each other than to packages of traditional pay TV, and that they were not close substitutes for Sky Movies."* Nonetheless SVoD *"would be regarded as substitutable by some consumers"* and *"closer substitutes than other pay TV movie services previously available, such as BT's Vision Film and PictureBox"* (CC 2012, paras 15 and 4.13). The CC also noted that in the future SVoD services may become closer *"substitutes for more Sky Movies subscribers"* (CC 2012, para 4.45).

<sup>49</sup> CC, 2012, para 4.129.

<sup>50</sup> CC, 2012, para 5.6.

<sup>51</sup> CC, 2012, para 5.113.

<sup>52</sup> CC, 2012, para 19.

<sup>53</sup> CC, 2012, para 19.

<sup>54</sup> CC, 2012, paras 37-38.

would face relative to Sky in being unable to bundle its channel with Sky's other channels and services) or by wholesaling to Sky."<sup>55</sup>

There were two critical aspects leading to the CC's no-AEC finding. First, the CC strongly questioned whether pay TV movies content in the FSPTW was significant in determining consumers' pay TV choices.<sup>56</sup> It concluded that condition b) mentioned above was not met. Second, the CC considered the expected impact of the recent entry by OTTs on competition for retail pay TV services. In this regard, the CC considered two key questions: (1) whether and how far OTT entry was likely to succeed; and (2) the impact of entry on competition in pay TV retailing.<sup>57</sup> This required a difficult judgement given that the evidence was limited at the time.<sup>58</sup> In reaching this judgement, the CC "*had no reason to expect that either Netflix or LOVEFiLM would exit the market in the foreseeable future*" and overall it expected "*at least one OTT supplier to remain in the market in the longer term.*"<sup>59</sup>

The CC concluded that "*although [OTT] services had had a limited impact on demand for traditional pay TV services to date, we expected this constraint to increase over time.*"<sup>60</sup> The CC's conclusion was that, due to a number of technological and demand changes,<sup>61</sup> OTT providers were likely to be an increasing constraint on traditional pay TV retailers, such as Sky. Relative to traditional pay TV retailers, OTT providers faced a number of competitive advantages as entrants. Critically, the consumers' barriers to switching to (and from) an OTT pay TV retailer were likely to be lower than those associated with switching from a traditional pay TV retailer.<sup>62</sup> This was due to the fact that "*OTT services (a) do not require a long-term contractual commitment;*<sup>63</sup> *(b) do not require the installation of infrastructure (e.g. a dish or cable) or the delivery of hardware (e.g. a dedicated STB), meaning that access is quicker and there is no intrusive installation work; and (c) are not bundled with communications products, meaning that they are not affected by any hassle associated in switching broadband or telephony services. We noted that inertia was also likely to be less of a factor in switching away from OTT services as subscriptions could be cancelled online more readily than appeared to be the case in relation to traditional pay TV services.*"<sup>64</sup> As a result, it is not surprising that "*the new OTT services of LOVEFiLM and Netflix had grown very rapidly in comparison with BT's Vision Film service.*"<sup>65</sup> Because of the

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<sup>55</sup> CC, 2012, paras 38 and 5.57.

<sup>56</sup> It concluded that "*overall, the evidence suggested that the availability of Sky Movies was significant to only a relatively small minority of pay TV subscribers in their choice of traditional pay TV retailer and, further, that many consumers within this sub-group placed more weight on other factors than on Sky Movies' FSPTW movies content*" (CC, 2012, para 29; see also paras 6.5, 6.9 and 6.22). In addition, their significance was declining as "*between 2003 and 2010 the number of movie viewings by Sky Movies subscribers declined by more than 30 per cent (...)* Sky Movies accounted for only around 2 per cent of viewing hours by homes with pay TV and just over 1 per cent of viewing hours by all homes" (CC, 2012, para 6.22).

<sup>57</sup> CC, 2012, para 5.71.

<sup>58</sup> CC, 2012, paras 52, 6.123 and 6.170.

<sup>59</sup> CC, 2012, para 5.154.

<sup>60</sup> CC, 2012, para 57.

<sup>61</sup> The CC took into account the following factors point to the competitive pressure from OTTs becoming stronger "*(a) the increasing adoption of Internet-connected TVs and/or STBs (improving convenience and reducing dependence on games consoles as a means of accessing services on households' main TV); (b) the increasing availability of broadband, and faster broadband; (c) an increasing awareness of OTT services among less technologically-aware households, in particular following the launch of services which 'popularize' such services, e.g. YouView; and (d) social factors, including interaction on social media*" (CC, 2012, para 2.162).

<sup>62</sup> CC, 2012, paras 5.72 and 6.121.

<sup>63</sup> While the services of LOVEFiLM and Netflix did not require an initial contractual commitment, traditional pay TV providers such as Sky and VM required initial contracts lasting 12 to 18 months (in order to recover up-front costs associated with installation costs and subsidizing an STB) (CC, 2012, para 6.111).

<sup>64</sup> CC, 2012, para 5.45.

<sup>65</sup> CC, 2012, para 6.120. The CC explained this success as "*not only due to their attractive content but also reflected that they had a different delivery mechanism and business model to traditional pay TV providers, and had been launched at a time*

OTTs' advantages, the prices of their services were much lower,<sup>66</sup> while their service range appeared larger, than Sky's.<sup>67</sup>

On the ability of OTTs to acquire relevant content, the CC argued that "in the past, traditional pay TV retailers faced barriers to acquiring the FSPTW content of major studios. It appeared to us that the key problem was that they were unable to be sufficiently confident of being able to reach enough subscribers to justify a bid greater than Sky's."<sup>68</sup> Despite Ofcom arguing that it did not consider Sky's bidding advantages to have diminished,<sup>69</sup> the CC concluded that there appeared to be no barriers to acquiring content. Lovefilm and/or Netflix were able to maintain their offering, therefore, there was no need to assess it further to reject the theory of harm as set out at the outset.<sup>70</sup> There were several reasons for concluding that barriers to acquisition for OTTs were lower than for traditional pay TV retailers. First, as mentioned above, lower consumers switching costs would make it easier for OTT to monetise content once acquired.<sup>71</sup> Second, six majors (in addition to non-majors) supplied premium movies content. Although the CC concluded that there was some complementarity between the content of the six majors, "for Sky, it seemed likely that complementarities between FSPTW content would be exhausted before all six major studios were aggregated (...) for other types of movies service (e.g. the OTT services of LOVEFiLM or Netflix), it appeared that the point at which FSPTW content ceased to be complementary could be much lower."<sup>72</sup>

Therefore, according to the CC, while "Sky continued to have many more subscribers than either LOVEFiLM or Netflix and, for this reason, in the short term, we expected it to continue to have some advantage when bidding for rights", it believed that "LOVEFiLM and/or Netflix could have an incentive to bid for at least one major studio's FSPTW rights in order to attract additional subscribers and we noted that, as they increased their subscriber numbers, we expected their ability to monetize the value of FSPTW rights to improve further and their risk when bidding to reduce (...). Therefore, we believed that, in the medium to longer term, Sky's bidding advantage was likely to erode."<sup>73</sup> And while the CC "could not be certain of the commercial incentives of any party to participate in any given auction process (...) there was a realistic prospect that, in the future, an OTT pay TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio."<sup>74</sup>

In reaching its finding of no-AEC, the CC also took into account the evidence on Sky's competitive reaction to the OTTs' entry. In July 2012, Sky made Sky Movies available on its own OTT offer (Now TV) unbundled from other content. As a result, the minimum price of accessing Sky Movies declined from £32 to £15, with unmodified content.<sup>75</sup> The CC considered this was a consequence of two factors.

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when technological developments and changes in viewing habits appeared conducive to their success" (CC, 2012, para 6.121).

<sup>66</sup> The monthly subscription prices of LOVEFiLM and Netflix was £4.99 and £5.99 respectively while the incremental price of Sky Movies was £16 for customers who did not take Sky Sports, but was likely to be lower for many customers who did take Sky Sports (CC, 2012, para 6.110).

<sup>67</sup> "As regards the total number of movies available to watch on each service: at the time of our report, Sky Movies offered about 850 movie titles in a month, of which around 600 were available to watch on an on-demand basis via Sky Anytime+ and Sky Go (and Now TV); and LOVEFiLM and Netflix offered approximately 3,500 and 1,000 movies respectively, plus thousands of TV episodes. However, we noted that Sky Movies offered a range of many recent movies from the major studios which were not available on the OTT services of LOVEFiLM and Netflix" (CC, 2012, para 6.110).

<sup>68</sup> CC, 2012, para 7.8.

<sup>69</sup> CC, 2012, para 7.106.

<sup>70</sup> CC, 2012, paras 7.3-4.

<sup>71</sup> CC, 2012, para 7.9.

<sup>72</sup> CC, 2012, paras 7.95.

<sup>73</sup> CC, 2012, paras 7.10 and 7.123, *emphasis added*.

<sup>74</sup> CC, 2012, paras 7.10 and 7.123.

<sup>75</sup> CC, 2012, footnote 51, para 6.129 and App. 4.2.

First, it was consistent with the CC's finding that Sky Movies was not driving the consumers' choice of pay TV retailer and, second, it was a competitive reaction to OTTs' entry. The latter was also consistent with Sky's reducing its wholesale prices for some of its services, which included Sky Movies, and reaching an agreement with TalkTalk to supply Sky Movies on a wholesale basis.<sup>76</sup> Second, by launching Now TV Sky was able to compete with OTTs without cannibalising revenues from its own traditional pay TV subscriber base.<sup>77</sup>

In addition to the above, the CC also disagreed with Ofcom on two concerns that, instead, were critical in Ofcom's reference.

First, Ofcom expected SVoD services to become increasingly important to consumers and it was concerned that Sky's control over these rights could limit future competition. Ofcom described this as its main concern. Indeed, Ofcom justified making a market investigation reference to the CC because its CA03 powers related primarily to linear channels and could not address its key concern on SVoD.<sup>78</sup> The CC *"found that Ofcom's concern that Sky's market power in pay TV might prevent the emergence of competition in SVOD services did not appear to have been realized as new SVOD services offering a broad range of movies (and other) content had entered the market and captured a sizeable subscriber base in a short period of time. Based on the evidence available to us at the time of reaching our findings, we expected competition in relation to SVOD services to be sustained and, consequently, we expected OTT services increasingly to constrain traditional pay TV retailers over time."*<sup>79</sup> In essence, this is due to the impact and growth of OTTs.<sup>80</sup> The CC recognised that *"[Ofcom's] concerns were expressed prior to the entry of Netflix and LOVEFiLM's OTT SVOD services"*, but argued that the CC had to exercise judgement and it *"could not exclude the possibility that circumstances could arise which could limit the development of OTT services in competition with Sky in the future"*. Therefore, the CC argued that *"the conditions of competition should be kept under close review."*<sup>81</sup>

Second, the CC disagreed with Ofcom's conclusion that Sky had an incentive and did exclude rival pay TV retailers by acting on the terms of wholesale supply of Sky's movies. The CC's conclusion follows from its conclusions about the significance of FSPTW content to consumers, which meant *"that it was implausible that the terms of Sky's wholesale supply of Sky Movies could cause Sky's rivals to be at such a disadvantage when competing for pay TV subscribers as to harm competition."*<sup>82</sup> The CC's conclusion on there being evidence of any anti-competitive behaviour was that: *"if there was clear evidence indicating that Sky was seeking to restrict the supply of Sky Movies, in order to constrain its rivals' ability to compete with Sky for pay TV subscribers, this might cast some doubt on the views we had reached on the significance of FSPTW content based on other evidence."*<sup>83</sup> The CC, however, found no evidence of such behaviour.<sup>84</sup> Instead, it *"noted that changes in Sky's wholesale behaviour, both in reducing its wholesale prices for certain of its products which incorporate Sky Movies and in reaching a wholesale agreement with TalkTalk, were consistent with the significance of FSPTW content to consumers in their choice of traditional pay TV retailer having fallen."*<sup>85</sup>

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<sup>76</sup> CC, 2012, paras 4.69 and 6.136-137.

<sup>77</sup> CC, 2012, paras 6.131-2.

<sup>78</sup> CC, 2012, para 1.11.

<sup>79</sup> CC, 2012, para 21.

<sup>80</sup> CC, 2012, para 6.105.

<sup>81</sup> CC, 2012, para 5.159.

<sup>82</sup> CC, 2012, para 41.

<sup>83</sup> CC, 2012, *ibidem*.

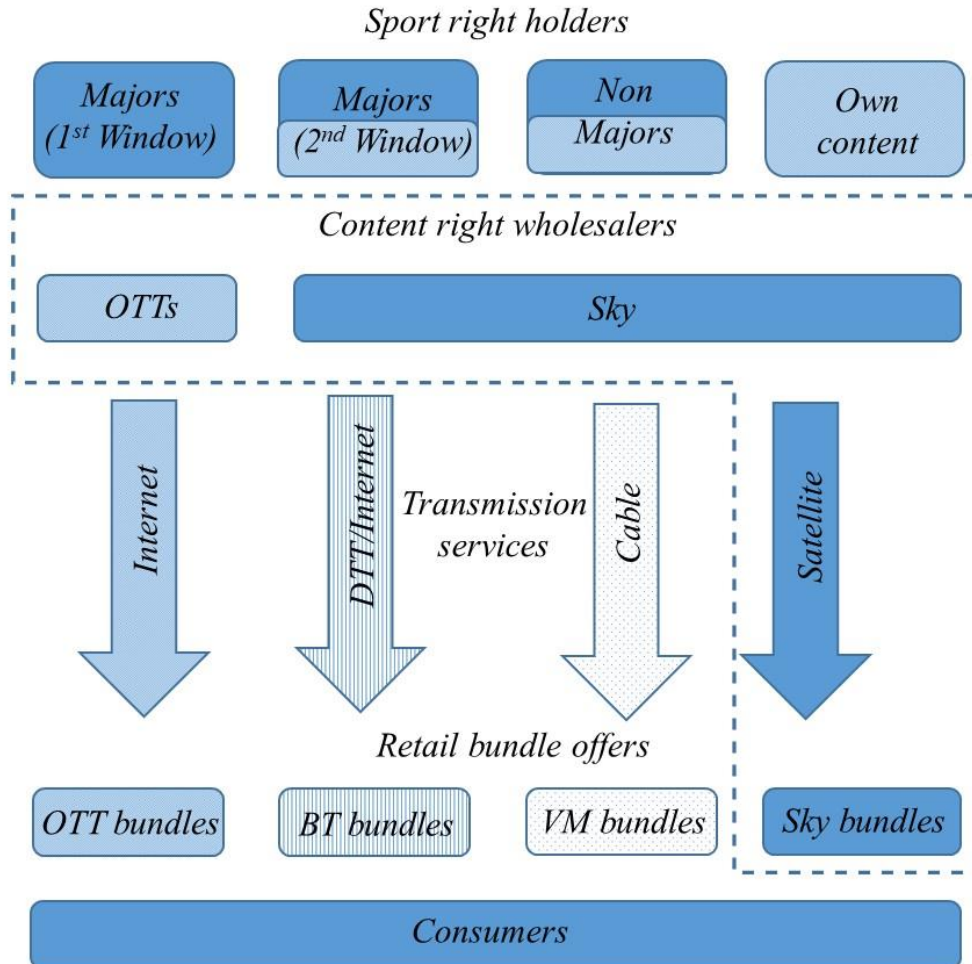
<sup>84</sup> CC, 2012, paras 41 and 8.7.

<sup>85</sup> CC, 2012, paras 42 and 8.7.

4.3. Assessment

Ofcom and the CC agreed only on the fact that Sky had market power in pay TV retailing. Instead, they disagreed on the critical question as to whether Sky’s hold of premium movies rights was the source of its downstream market power (Ofcom) or not (CC) and whether the identified concerns were likely to persist. Figure 2 shows the structure of the Premium Movies vertical chain after the OTTs’ entry.

Figure 2: Structure of the Premium Movies vertical chain



There were many points of disagreement between Ofcom and the CC. The most fundamental one was the focus of competition. Ofcom argued that there was a narrow market for retail provision of pay TV movies for which obtaining access to Sky’s premium movies content was essential. The CC instead considered that premium movies were not an important factor in consumers’ pay TV retail choices. As for premium sport, Ofcom’s approach can be described as “regulatory” in spirit. While Ofcom started from a presumed finding of upstream market power, the CC correctly started from assessing the degree and features of downstream competition. Even if Sky had market power downstream, its control of premium movies rights may not be the source of its market power. To put it differently, according to the CC’s reasoning, even if Ofcom’s remedies were adopted, these would have had no or very limited material impact on Sky’s market power in retailing pay TV. As for premium sport, Ofcom’s approach started from a presumption of upstream market power, not from a competitive assessment that focuses on what drives consumers’ choices downstream.

A useful approach to better understand the differences between Ofcom and the CC, is to consider the three concerns (amounting to two theories of harm) put forward by the Ofcom in its reference to the CC.



First, the CC agreed that Sky had market power in retailing pay TV, though it concluded this was not due to upstream control of premium movies rights. Second, but part of the same theory of harm, the CC disagreed that, even if Sky had upstream market power in a narrowly defined premium movies market, it could and did use this to exclude retail competitors. The CC considered that OTT providers could challenge Sky's market power at both levels because downstream OTT providers faced lower consumer switching barriers and upstream lower barriers to acquire premium movies rights, relative to traditional pay TV retailers. The CC modified its early analysis in the light of market developments following the entry of Lovefilm and Netflix. It is an open and difficult question whether Ofcom could have foreseen such market developments. Nonetheless, Ofcom did not undertake any forward-looking analysis as to whether the features of OTT relative to traditional pay TV services meant that the former could be a stronger competitive constraint on Sky than the latter. Instead, as highlighted in Section 5, Ofcom believed that the most likely entry route was on the DTT rather than OTTs platform. Third, the CC had to reject Ofcom's concern that Sky control of SVoD rights would prevent competitors from entering. Entry by Lovefilm and Netflix directly contradicted Ofcom's main theory of harm.

Although Ofcom, as the sector regulator has significant knowledge and information on the markets on which it has oversight, perhaps it was over-optimistic about its own ability to predict future developments. For example, Ofcom's decision relied to a significant extent on its belief that the features that lead to its own AEC conclusion were likely to persist. For example, Ofcom argued that "*almost all of the features which we have identified, including the release windows structure, staggered availability of content rights, aggregation of rights, Sky's market power, and vertical integration, have already persisted for many years and we have no expectation that these will change in the absence of intervention.*"<sup>86</sup> Ofcom correctly predicted that SVoD would have grown and that OTT providers would be better suited to develop these services.<sup>87</sup> However, it failed to spot that, despite Sky's strong hold on the SVoD, FSPTW premium movies rights from the six majors, OTT providers could still obtain sufficient content to enter. This is a crucial difference between the supply of premium movies and sport content, where the content elasticity of supply is very inelastic (Section 6 discusses this further). As the decision to refer a market to the CC must necessarily rely on an AEC being persistent, Ofcom's approach lacked a strong forward-looking outlook. As a result, it ignored that the OTT distributions platforms, that were being developed and deployed at the time, had substantially different features from traditional pay TV retailers.<sup>88</sup>

## 5. Sky's entry into DTT: Picnic

At the same time of referring premium movies to the CC and issuing its pay TV statement on premium sport, Ofcom also published a third decision under Section 316 of the CA03 (Ofcom, 2010b). Ofcom concluded by allowing Sky to launch a small pay TV package, known as *Picnic*, on DTT, only if it accepted the remedies proposed for premium sport and movies channels. Therefore, this decision is very closely linked to the two above-mentioned decisions.<sup>89</sup>

On April 2007, Arqiva, controlling the relevant DTT transponder capacity, and Sky, supplying its DTT channels on Arqiva transponder capacity, applied to Ofcom to vary their licence. Sky intended to

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<sup>86</sup> Ofcom, 2012c, para 7.46.

<sup>87</sup> "*In terms of movie programming, blockbuster movies are likely to retain their appeal, but the ways in which consumers access movies are likely to evolve*" (Ofcom, 2012c, para A2.61).

<sup>88</sup> An anonymised respondent "*noted that media markets are undergoing a period of change in which creators of content are considering how to benefit from new technologies and means of distribution. In its view, studios will seek to adapt to these changes and continue to sell content rights in a way that furthers their economic interests. [X] argued that studios are likely to take different approaches.*" (Ofcom, 2012c, para 5.12).

<sup>89</sup> The key difference is that this is a request for a licence variation – i.e. a change in the status quo – that Ofcom assessed on the basis of its competition impact.

remove its three FTA channels (Sky News, Sky Sport News and Sky Three) on DTT and replace them with five pay TV channels (Sky Sport 1, Sky Movies Screen 1, Sky One, Discovery Channel and Disney Channel), four of which would only be available only for part of the day. Together these formed Sky's proposed *Picnic* pay TV service, which consumers with already access to DTT could subscribe to by purchasing a new DTT set-top box.

Ofcom noted that "consumers with a preference for platforms other than satellite or cable – such as the ten million households with digital terrestrial television – are currently unable to access Sky's premium channels at all."<sup>90</sup> Therefore, a Sky pay TV *Picnic* service on DTT, offering premium sport and movies, would have an immediate, positive effect on consumers' choice of retail pay TV services on DTT.<sup>91</sup> However, absent remedies Ofcom concluded that the competition concerns it identified<sup>92</sup> outweighed these benefits.

Ofcom first argued that "while DTT provides the best opportunity for scale entry into retailing of pay TV services, given the large installed base of TV aerials and homes relying solely on DTT for multichannel viewing, our concern is not specifically about competition on DTT."<sup>93</sup> It continued: "rather, our concern relates to Sky's market power in the supply of Core Premium channels, and the presence of barriers to market entry or expansion. The critical stage in the development of pay TV on DTT provides an opportunity for a new retailer to enter the market, or an existing one to improve its service. This is therefore an opportunity to challenge Sky's market power at the retail level."<sup>94</sup> Ofcom, therefore, argued that by launching *Picnic* Sky would prevent the most likely entry strategy by a pay TV retailer on DTT. It stated that "absent *Picnic*, we believe that the main entry strategy for most players will be to base their offerings on a limited number of premium sports channels using the DTT capacity which is available."<sup>95</sup>

In essence, Ofcom's concern was that if Sky had launched *Picnic*, it would have enjoyed a first mover advantage and gained a substantial share of pay TV customers on the DTT platform. It argued that "*while there are some switching costs, our view is that these would not be enough to deter new subscribers, or customers of existing pay DTT and FTA DTT content from switching to a significantly more compelling offer (i.e. one with Sky Core Premium content).*"<sup>96</sup> Critically, Ofcom was convinced that the same subscribers "*having taken up a pay TV service on DTT, (...) are likely to be reluctant to switch again unless the alternative is significantly better than their current provider.*"<sup>97</sup> Ofcom's key concern was that "*the strongest competition is likely to take place at the point before the consumer has taken up a pay DTT service, and is deciding which one to choose.*"<sup>98</sup>

Early intervention was required to "ensure that all new or existing pay DTT service providers are subject to fair and effective competition, and that their ability to compete on equal terms is not compromised by restricted access to key content."<sup>99</sup> Therefore according to Ofcom "if *Picnic* were to launch in the absence of the wholesale supply of its Core Premium Sports and Movies channels, no other retailer of pay TV services on DTT would be able to compete effectively with Sky at the retail level."<sup>100</sup>

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<sup>90</sup> Ofcom, 2010b, para 3.37.

<sup>91</sup> Ofcom, 2010b, para 4.22.

<sup>92</sup> Ofcom, 2010b, paras 1.17 and 3.14.

<sup>93</sup> Ofcom, 2010b, para 3.64.

<sup>94</sup> Ofcom, 2010b, para 3.65.

<sup>95</sup> Ofcom, 2010b, para 1.27.

<sup>96</sup> Ofcom, 2010b, para 3.44.

<sup>97</sup> Ofcom, 2010b, para 3.44.

<sup>98</sup> Ofcom, 2010b, para 3.44.

<sup>99</sup> Ofcom, 2010b, para 3.90.

<sup>100</sup> Ofcom, 2010b, para 3.14, *emphasis added*.

Ofcom allowed Sky to launch *Picnic*, but made it conditional on a WMO on Sky Sports 1 and 2 being in place,<sup>101</sup> and on any movies channels included in *Picnic* being offered to other digital terrestrial TV retailers.<sup>102</sup> Ofcom was convinced that its remedy would have significant benefits. It “*also consider[ed] that there is scope for a greater take-up of services including Core Premium channels than Sky forecast for Picnic, if such services are offered by more than one provider, and differentiated by bundling with other services – particularly if one or more provider is independent of Sky and seeks to compete aggressively for Sky’s satellite customers.*”<sup>103</sup>

### 5.1. Assessment

Ofcom’s concern rested on its consideration that in the short term, DTT provided the best opportunity for scale entry into the retailing of pay TV services, given the large installed base of TV aerials and homes relying solely on DTT for multichannel viewing. Ofcom’s concern was that Sky would expand its offer on DTT in order to pre-empt entry by a rival pay TV retailer.

The potential nature of the concern Ofcom raised is not easily classifiable under any of the typical exclusionary concerns. Ofcom did not argue that Sky’s behaviour entailed expanding its capacity and potentially leading to prices below costs, as in a predatory behaviour allegation. Neither did Ofcom argue that Sky launched *Picnic* as anticompetitive reaction to the threat of rival entry on DTT – no rival was planning to do so. Sky also did not engage in hoarding as it already controlled this DTT capacity, which it used for FTA TV and, hence, it could not be an input for a rival entrant pay TV retailer.

Ofcom acknowledged there were significant consumer benefits in Sky expanding its offer on DTT in a timely manner. Instead, the basis for Ofcom’s decision was that consumers would be even better off if providers other than Sky launched a DTT service at the same time as, and in competition with, Sky.

Ofcom believed its remedy would increase competition on the DTT platform and, more broadly, in pay TV. We question whether there was a basis for concluding that the WMO would allow entry by a DTT retailer. The decision suggests,<sup>104</sup> but does not elaborate on, the idea that the WMO would allow an entrant to differentiate its pay TV offer by bundling and adding it to its own services. At the same time, Ofcom hypothesises that such a DTT entrant could compete aggressively with Sky’s satellite offer.<sup>105</sup> We consider that the prospect of entry appeared excessively optimistic and, even if it occurred, may have not significantly benefitted consumers. The first consideration is that the DTT platform was capacity constrained, making it difficult for any new supplier to enter, even if they gained access to premium content. Existing suppliers with DTT FTA channels could have switched to offering pay TV services or offered their capacity to entrants that acquired premium content. However, it is not clear that returns would be higher than continuing to use the capacity to supply FTA channels. This is because competition would have entailed two DTT pay TV providers with identical content, limited ability to differentiate their offering and the entrant obtaining content at retail-minus terms. It is unlikely that entry would have been profitable and, as a result, it may have not occurred. Sky, knowing that its profits may be lower post entry, may have also decided not to offer *Picnic* in the first place. Not only, but offering *Picnic* would have meant that Sky accepted the remedies in Ofcom’s two decisions on premium content.

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<sup>101</sup> *Sky Sports 1* must be sold to consumers by at least one third party retailer not affiliated with Sky, on a DTT platform other than Sky’s DTT platform.

<sup>102</sup> Ofcom, 2010b, para 1.30. *Sky Movies Screen 1* must be sold to consumers by a retailer of pay TV services on DTT that had already entered into an agreement for the wholesale supply of *Sky Sports 1*.

<sup>103</sup> Ofcom, 2010b, para 3.78.

<sup>104</sup> Ofcom, 2010b, para 3.78.

<sup>105</sup> Ofcom, 2010b, para 3.78.

As these matters were, at the time, either appealed to the CAT or referred to the CC, Sky would have had very limited incentives to launch *Picnic* before these cases were decided.<sup>106</sup>

It is not surprising that, given the uncertainty and the above logic, Sky decided to suspend *Picnic*'s launch in 2008 and *Picnic* never materialised. Consumers have certainly lost out from this as no supplier of premium DTT content has so far emerged. Instead, suppose that, following Ofcom's intervention, competition had materialised with two or more pay TV (one being Sky) retailers on DTT. Would consumers have benefitted? Possibly, but any benefit was likely to be very small. Entry would have brought a very limited increase in service variety and very limited price benefits because of the retail minus access terms. In essence, Ofcom sought to achieve what appear very small consumer benefits by promoting competition between pay TV retailers on DTT. However, Ofcom downplayed the risk that its intervention could lead to consumers not being offered any additional pay TV services on DTT. This risk has materialised.

## 6. Conclusions

We can draw two set of conclusions from these pay TV interventions. First, we consider how well the cases examined conform to our "enhanced" ability, incentives and effects framework. Second, we draw some general lessons from Ofcom's decade of interventions in pay TV.

### 6.1. Conformity to an "enhanced" ability, incentives and effect framework

Two of Ofcom's three key decision in pay TV were based on Section 316 of the CA03, while *Premium movies* were referred to the CC under the EA02. We examined all three under our proposed ability, incentives, effects and effective remedies framework described in Section 2. *Premium sport* and *Premium movies* fit clearly a refusal to supply abuse, while *Picnic* is of more difficult characterisation. However, the latter could perhaps be seen as Sky' entering pay TV on DTT and then potentially refusing to supply premium content to rivals. Hence, it could be interpreted as creating the conditions for a "future" refusal to supply case. Therefore, we examined all three cases under the proposed framework.

We have drawn the following conclusions:

- Ability – the picture is mixed. In *Premium Sport*, Sky was found dominant upstream and this was perhaps not too controversial given that there was a strong retail consumer demand for premium sport content and Sky held the majority of the PL's rights. Nonetheless, Sky's upstream dominance had been challenged by BT Vision, when it acquired the rights to the Champions and Europa League as well as some PL football. The CC rejected a very similar preposition Ofcom put forward for *Premium movies*. The CC reasoned that, although Sky may have had a large share on movies rights, consumers based their decision on which pay TV retailer to subscribe to not on quality and price of movies packages. Hence, Sky could have not effectively refused to supply downstream rivals. In *Picnic* there was no discussion of dominance, as Sky had not yet launched its services. This makes this very similar to a regulatory decision. Fumagalli et al. argued that "*one needs something more than mere upstream dominance to intervene, and in this light it may make sense to require that an input is essential as a necessary condition to intervene (...) there must be extremely high and non-transitory barriers to entry*";<sup>107</sup>
- Incentives – In *Premium sport* Ofcom argued that Sky had incentives not to supply content to downstream rivals and that the fact that Sky negotiated with, but never agreed to supply, its downstream rivals was the key evidence that those incentives existed. Ofcom, however, did not examine the factors that may have created that incentive. A priori, a vertically integrated operator

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<sup>106</sup> This covered a five-year period from Sky's application in 2007 to 2012 when the CAT and CC reached their conclusions.

<sup>107</sup> Fumagalli et al., 2017, 549.

may not be always better off by not supplying its downstream rivals. *Premium movies* is less clear cut as Ofcom's main concern was not refusal to supply, but Sky's alleged hoarding SVoD rights. Sky may have had incentives to do so, but as the entry of OTTs during the CC's market investigation proved, it was not able to prevent entry. Ofcom failed to consider that supply of premium movies content could expand while that of sport is significantly less likely to do so. There is limited or no discussion of incentives in *Picnic*. Ofcom simply assumed that, if Sky had launched *Picnic*, it would have not supplied premium movies and sport content;

- Effects – effects are difficult to assess in refusal to supply cases, where the incumbent supplied as a result of an intervention such as the OFT's remedy for Sky to supply cable operators. Nonetheless, it is helpful to recap what happened during Ofcom's investigations in the light of the statement that Sky's retail rivals would have not been able to enter in the absence of an obligation to supply imposed on Sky. In *Premium sport* BT was able to obtain an increasing proportion of rights in the absence of any obligation to supply, even though Sky retained control of most of PL rights. In *Premium movies* OTTs were able to enter in the absence of any remedy during the CC's market investigation, significantly influencing its final no AEC decision. Hence, Sky's alleged hoarding was ineffective at preventing entry. In *Picnic* Ofcom's attempt to balance the benefits of pay TV on DTT and increased competition in retailing pay TV on DTT resulted in the worse outcome for consumers, no pay TV on DTT by any provider; and
- Effective remedies – this is probably the weakest part of Ofcom's analysis, as absence of remedies, which could reduce any consumer harm identified, makes any intervention ineffective. *Premium sport* is where remedies may have perhaps been most effective, given Sky's likely and persistent upstream dominance, despite BT Vision's challenge. However, access remedies for pay TV content are notoriously difficult to implement as content could be modified and transferred away from the key channels (i.e. Sky Sport 1 and 2). Hence, there is a need for complementary obligations, increasing complexity. The CC's conclusion in *Premium movies* that consumers' retail choices were not affected by the packages' movies content means that Ofcom's proposed remedies would have been at best ineffective. In *Picnic* there were serious concerns that the remedy proposed would have led to Sky not launching its service. This is what happened making consumers undoubtedly worse off by Ofcom's intervention.

**Table 1: Summary of pay TV cases**

	<b>1 – Ability</b>	<b>2 - Incentives</b>	<b>3 – Effects</b>	<b>4 - Effective remedies</b>
<i>Premium Sport</i> (2007-16)	Yes (Sky was dominant in the supply of premium sport content)	Yes (However, Ofcom did not explore the factors that affected Sky's incentives. It simply argued it had incentives to refuse to supply were proven by failed negotiations)	Unclear (According to Ofcom, Sky's rivals could only challenge Sky's upstream dominance if they were able to acquire a retail base. BT Vision's entry partially disproved this)	No (Ofcom's access remedies were complex and at risk of being bypassed by shifting content across channels. Critically though it is unclear consumers could have benefitted much from a retail minus access charge)
<i>Premium Movies</i> (2007-12)	No (Sky had a large share of the supply of premium movies content, but this could not confer dominance, as control of those rights was not indispensable for retail competition)	No (Ofcom treated premium movies like premium sport. However, suppliers of premium movies content could expand supply much more easily than those of premium sport)	Unclear (As the CC concluded that premium movies did not drive consumers retail pay TV choices, a refusal to supply was highly unlikely to have any effects for consumers)	No (Access remedies were significantly more difficult to justify than for sport, especially given that the supply of premium movies content was elastic)
<i>Picnic</i> (2007-2010)	Unclear (As Ofcom did not claim that Sky was dominant in any market)	Unclear (Picnic's launch was not an anticompetitive reaction against an entry threat)	Unclear (There was no clear harm from Sky's expansion as the counterfactual may have not seen any entry by Sky's rivals)	No (As above given that Picnic covered both premium movies and sport)

## 6.2. What can we learn from Ofcom's ten-year interventions in pay TV?

Although all Ofcom's decisions in pay TV are formally under its broadly defined competition law powers, they are conceptually and in spirit closer to *ex ante* regulatory decisions. They all start with a finding of upstream market power, followed by a formalistic refusal to supply exclusionary abuse to conclude with standard *ex ante* access remedies. The emphasis is on the first and third components. This is the approach that Ofcom has for a long time successfully applied to the telecom sector in imposing *ex ante* remedies to open up contestable service element of the value chain to competition. Critically the *ex ante* framework allows to impose remedies based on dominance - termed Significant Market Power (SMP) - with no need to find an abuse. Ofcom's three pay TV decisions are particularly weak in three areas: 1) defining the relevant theory of harm; 2) failing to distinguish between the features of premium sport and movies content; and 3) assessing whether the proposed remedies could be effective at reducing the harm to consumers.

### 6.2.1. The theory of harm

The underlying exclusionary theory of harm is often not clearly and fully spelled-out and tested relative to Ofcom's assessment of dominance and remedies. Ofcom's pay TV decisions, therefore, appear like regulatory decisions to impose open access *ex ante* remedies rather than competition decisions.

First, there is a need for a robust theory of harm and for understanding why refusal to supply may be a credible strategy. As Fumagalli et al. put it: “[i]t may be that the buyer and the seller are not agreeing on the price of the input, and in that case one should be careful not to allow a party to seek antitrust

*intervention in relation to what is essentially a standard commercial negotiation or disagreement*".<sup>108</sup> The CAT judgement on *Premium sport* raised substantial doubts as to whether the negotiations with Sky reflected the outcome of standard commercial negotiations. Fumagalli et al. also remark that "*an incentive to engage in anti-competitive vertical foreclosure may arise due to either for two main reasons: the incumbent's inability to extract a sufficient level of economic rent from the downstream rival or entrant; and the incumbent's desire to protect or transfer its market power in the future.*"<sup>109</sup> All Ofcom's pay TV decisions relate to the latter, a form of dynamic leveraging. However, Ofcom's theory of harm is barely sketched, its analysis is limited and evidence is scant. A model that Ofcom should follow in the future is that adopted by the CC in its approach to *premium movies*.

Second, specifically in relation to dynamic leveraging, it is important to consider the expected evolution of the market when analysing incentives for exclusionary behaviour.<sup>110</sup> However, this can be controversial, as it could lead to interventions based on speculative assessments. Several aspects of Ofcom's pay TV decisions relied on beliefs on how the market may have evolved, which in retrospect proved wrong. While it is always easy to put forward this argument with the benefit of hindsight, it is striking how consistently events panned out differently from Ofcom's predictions. As an example, Ofcom believed that absent intervention and imposition of an access type of remedies, such as the WMO, Sky's market power in premium sport and movies would have persisted. It may be briefly worth recounting some events. Ofcom predicted that the best route for any entrant to break into the pay TV market was by reselling Sky's rights and distribute them on the DTT platform. This was based on Ofcom's belief that DTT's addressable base of ten millions of customers with no access to pay TV would be the easiest entry route. However, this lacked credibility even at the time, given that consumers that opted for DTT, did so because they were either not particularly interested in or willing to pay for pay TV services. Hence, DTT's potential addressable base may have appeared deceptively large. Critically and perhaps surprisingly given its sectoral expertise, Ofcom failed to predict that the best distribution channel for TV services would have been via an OTT platform. At the time of Ofcom's key pay TV decisions, there were already significant signs of an evolution in that direction. Indeed, BT entered the pay TV market in 2006 with BT Vision and obtained the rights to show some PL football for the 2007-08 season. BT gradually added further premium content, and especially sport premium content via an OTT offer, which also complemented its DTT content. The potential customer base accessible via OTT was much larger and affluent than that on DTT, there were none of the absolute capacity constraints that, instead, affected DTT, and consumers did not face switching costs, such as the need for a new set-top-box. Just over one year after Ofcom's decision to refer premium movies to the CC, Netflix launched in the UK with a range of movies and TV series content. At the time Netflix's CEO was well aware of the challenges he faced, stating that: "*the big competitor in the UK for us is Sky Movies and Sky Atlantic. Lovefilm is mostly DVD by post... and we're both really competing with Sky.*"<sup>111</sup> Indeed, the prospect of entry from OTT suppliers was what steered the CC towards a no-AEC finding.

Third, any dynamic leveraging theory of harm "*is based on a precise mechanism, and for it to be convincing, one would have to verify that the facts of the case are consistent with such a theory. First, scale economies need to be important in one of the vertically related markets and the rival active in that market (or seeking to enter than market) needs to achieve a critical scale so as to be successful. Second, future entry must be a material threat.*"<sup>112</sup> Ofcom predicted that its WMO offer was required for competition to be possible. Whether Sky's alleged refusal to supply prevented rival distributors to grow and reduced their likelihood to enter upstream is, however, unclear. Entry took place largely without the

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<sup>108</sup> Fumagalli et al., 2017, 550.

<sup>109</sup> Fumagalli et al., 2017, 550.

<sup>110</sup> Fumagalli et al., 2017, 488.

<sup>111</sup> See "Netflix launches UK film and TV streaming service", 8 March 2012, available at <http://www.bbc.co.uk/news/technology-16467432>.

<sup>112</sup> Fumagalli et al., 2017, 533

WMO. Netflix and Amazon (the latter took over LoveFilm) procured and produced their own content and acquired content first from non-majors and later from some of the majors. Ofcom defined premium sport content to include PL football rights. Previous interventions by the European Commission resulted in the UK Football Association (FA) having to sell their rights as separate lots to ensure against the risk that a single provider obtained all the rights. BT Vision won rights to the PL at the auction for the 2007-08 season. Critically and, in addition, BT Vision also won the exclusive rights to broadcast a close substitute, the Champions and Europa League football. Furthermore, the entrants did not have large established customer bases when they won their rights. OTT entrants had no base, apart from LoveFilm, and BT had very few pay TV customers when it acquired premium sport rights.

### 6.2.2. Premium sport and movies content have very different features

Ofcom's failed to distinguish between the key relevant features of the supply of upstream rights between movies and sport. There is a striking similarity in the implicit theory of harm, analysis and remedies that Ofcom designed. In essence, this can be summarised as follows: (a) Sky controlled all or most of the upstream rights; (b) the latter are essential to attract customers downstream; (c) hence, Sky has strong incentives to exclude; and (d) refuses to supply to downstream rival distributor, which, otherwise, would be able to more easily compete in rights acquisition upstream. The logic is simple and reflects a dynamic leveraging theory of harm. Yet, there are two crucial differences between sport and movies, which Ofcom overlooked entirely. First, the supply of premium sport cannot easily expand or it is inelastic – i.e. it is very unlikely that a second PL would be viable or that the PL would increase the number of league's matches in response to higher prices for the broadcasting rights. This is because there are significant scale economies in the organisation and running of sport events and there have no credible attempts to set up new leagues in Europe (Drewes, 2003). Hence, when competition for upstream rights increases following entry, supply is unlikely to expand in reaction to increases in the price or content rights. Increasing competition leads to rights' price inflation. Competition may not lead to retail price increases for consumers, but certainly does not lead to lower prices and increases the right acquisition costs. Instead, supply of premium movies content is elastic and can expand in reaction to a price increase. This means that entry does not necessarily lead to higher rights prices. Critically, even if this were not to lead to lower prices, consumers will benefit from an increase in competition in the form of additional content and variety. As Fels (2013, 375) summarises "*where upstream markets are competitive, and not inelastic in supply, it is extremely unlikely a downstream buyer could profitably monopolise these services.*" This is not the case in premium sport where the same rights may either be split across different retailers or the latter may supply the same content, as would have been the effect of imposing the WMO. In other words, while premium sport rights are a scarce resource, premium movies rights are not. It should be unsurprising, therefore, that OTT have been particularly successful in supplying movies and TV content relative to sport content.

Furthermore, Ofcom ignored that there are strong complementarities in how consumers value watching football – i.e. it is likely that most consumers value watching half of the matches less than being able to watching the entire PL. This is unlikely to be the case for movies where, as noted by the CC, there may be scale effects, but these are likely to get exhausted at a low level of output. It is, therefore, more likely that downstream competition in distribution may be viable for premium movies but not for premium sport. This may suggest that the CC was right in reaching a no-AEC finding, while intervention in sport was in principle more justifiable, if a viable remedy existed. As mentioned below, there are though some doubts whether a remedy that can benefit consumers in the long run could be devised. To conclude, as Fels (2013, 375) warns "*in short, competition concerns in content markets certainly cannot be ruled out as a matter of economics. However, any assessment of the likelihood of those issues arising depends on a complex, and often counterintuitive, analysis of market structure and conduct in both the upstream and downstream market.*"



### 6.2.3. Are there viable remedies?

While remedies were formally available and potentially viable, Ofcom's remedy choices were particularly complex and intrusive. Critically, the impact of such remedies on consumers is far from clear, as we explain below.

Assume that premium content right holders have market power, rights are sold under exclusivity, premium content drive consumers' choices and a retailer, such as Sky, has market power from their large installed subscriber base. Consumers are likely to suffer harm in the form of high prices and lower service quality. However, the key question is whether there are remedies capable of addressing that harm and benefit consumers. We first focus on premium sport content to illustrate some of the difficulties in designing appropriate remedies. All past interventions aimed at making the bidding for the rights more contestable for potential bidders with alternative distribution network, but no or a small(er) subscriber base. To facilitate entry: (a) the duration of the rights exclusivity was reduced; (b) the rights were sometimes auctioned separately by distribution network - i.e. the right to broadcast on satellite were sold separately from those on cable or over the Internet -; and (c) for a given distribution channel, the rights were often broken down with restrictions on any one bidder acquiring more than a given proportion of the entire set of rights. This is usually expressed in terms of number and quality of matches to be televised. These measures increased the opportunities for bidders and, as a result, increased the ability of the rights holders to extract more surplus. The latter is a clear benefit to the rights holder, but whether consumers would benefit is, at best, unclear. They may not be harmed, but may not benefit. Right acquisition is a sunk cost and, hence, rights inflation is unlikely to translate into higher consumer prices. Ironically, though the higher the fixed costs, such as the costs of acquiring TV rights, the fewer the suppliers the market could sustain. Hence, if bidders expect rising rights' inflation, fewer may be willing to bid which is the opposite of what the measure was intended to achieve.

Assuming that increased competition for the rights and higher costs for acquiring content did not increase prices for consumers, breaking down the rights into separate lots, each containing a subset of PL matches, means that different bidders may end-up holding the rights to different matches. This is not a concern as long as consumers do not see these services as complementary - e.g. when consumers may only be interested in watching their favourite team's matches. However, consumers are likely to lose out, if their preferences do not match the partition of rights across suppliers or if most rights are complementary - e.g. they have an interest in watching a wider range of matches than those supplied by a single distributor. To possibly limit this harm, either consumers need to subscribe to multiple platforms or suppliers, or alternatively providers will have to cross-sell their respective rights to each other. The former may carry substantial costs for consumers - e.g. they may need to subscribe to two separate services. Cross-selling, instead, offers an opportunity for providers to soften competition by agreeing to sell the right to each other at high wholesale prices, as alluded to in Section 3.3. These are likely to feed into the suppliers' prices, if they are structured in a way that raises their respective marginal costs.

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With the support of the  
Erasmus+ Programme  
of the European Union

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