OFFICE OF FAIR TRADING

Competition Act 1998

Decision of the Director General of Fair Trading

No CA98/20/2002

BSkyB investigation: alleged infringement of the Chapter II prohibition*

17 December 2002

Case CP 01916-00

Following investigation under the Competition Act 1998, the Director General of Fair Trading has found that BSkyB is dominant within the meaning of the Chapter II prohibition on two markets, namely the wholesale provision of TV channels carrying sports content that will only appear on premium pay TV sports channels (currently identified as live Football Association Premier League football) and premium pay TV film channels.

He considers that there are insufficient grounds to find that BSkyB has abused its dominant position by exercising a margin squeeze on its premium channel distributors, or by practising anticompetitive mixed bundling in the wholesale provision of such channels. He further considers that BSkyB has not infringed the Chapter II prohibition by offering the discounts set out in its Pay to Basic or Premium Pay Unit ratecard.

* Confidential information and data have been redacted. Redactions are indicated by […], or by italic text in square brackets eg [*more than 10%*].

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PART ONE BACKGROUND AND PROCEDURE

I. THE 1996 REVIEW

1. In 1996, the Director General of Fair Trading (the 'Director') conducted a review (the '1996 Review'), under the Fair Trading Act 1973 (the '1973 Act'), of the wholesale Pay TV market in the UK.[1] The review followed complaints regarding British Sky Broadcasting Limited ('BSkyB') from some cable operators and their request to the Secretary of State for Trade and Industry for a ministerial reference to the then Monopolies and Mergers Commission (the 'MMC'). The Director concluded that premium programming rights gave BSkyB a powerful position in the wholesale Pay TV market and that BSkyB's acquisition of premium programming had created a barrier to entry into the market.[2] The Director also concluded that BSkyB was dominant in the supply of sports channels in the UK Pay TV market.[3] To meet the Director's concerns, BSkyB gave the Director non-statutory undertakings (as amended, the '1996 Undertakings') in July 1996 regarding the terms it offered to cable operators for supplying its channels and his requirement for accounting information regarding BSkyB's business. These non-statutory undertakings did not prevent the Competition Act 1998 (the 'Act') applying to BSkyB in the ordinary way in this case once it came into force on 1 March 2000: see Annex 1. The key elements of the 1996 Undertakings were as follows:

   - In Part I, BSkyB undertook to supply certain channels separately, and to publish a ratecard showing its wholesale prices for cable companies, with a discount structure approved in advance by the Director. Absolute price levels were not approved.

   - Part II related to BSkyB's conduct as holder of proprietary rights in the UK industry-standard encryption technology for analogue satellite TV, by detailing the terms on which it undertook to grant broadcasters access to its analogue encryption services.

   - In Part III, BSkyB undertook to submit to the Director accounts separated between its wholesale and retail businesses (dubbed 'BroadCo' and 'Disco', respectively). In particular, BSkyB agreed to show in the accounts a notional charge for the supply of its channels to Disco, to allow the Director to determine if Disco made a reasonable profit when 'purchasing' channels on the terms of the ratecard.

2. The 1996 Undertakings were amended in February 1999, with retrospective effect from October 1998. The amendments principally reflected the Director's agreement to the removal from the wholesale ratecard of four of BSkyB's basic channels, which were considered not to

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[1] 'The Director General's Review of BSkyB's Position in the Wholesale Pay TV Market', published December 1996.

[2] 1996 Review, Appendix A.

[3] 1996 Review, paragraph 2.19.

have or to confer market power on BSkyB (Sky News, Sky Soap, Sky Travel and [.tv]).

3. The 1996 Review envisaged a further review of BSkyB's position and the appropriateness of the 1996 Undertakings in 1998. This was delayed, principally pending conclusion of the *Premier League* case.[4] Clause 8 of the 1996 Undertakings provided for the Director to consider, whenever he so decided or following a reasonable request from BSkyB, whether BSkyB could be released from the 1996 Undertakings, or whether they should be varied, or superseded by new undertakings.

II. THE 2000 REVIEW

4. The Director began a further review (the '2000 Review') on 1 March 2000 with the publication of an issues paper inviting the views of interested parties on BSkyB's activities in relevant markets.[5] This request was part of his general duties to review commercial activities under section 2 of the 1973 Act. He indicated that the review might lead to further investigation or action under Chapter II of the Act and that he would consider whether any agreements that came to light during the review might infringe Chapter I of the Act.

5. The Director received substantial comments from 13 parties (including BSkyB) and reached conclusions on certain of the 1996 Undertakings. Clause 1(1)(a) of Part I (referred to in paragraph 1 above) related to BSkyB's scope to impose minimum carriage requirements ('MCRs') on cable companies. The undertaking had been largely overtaken by the Independent Television Commission's ('ITC') decision to prohibit MCRs on Pay TV channels from 1 January 2000. The Director accepted that BSkyB need no longer observe this undertaking on 5 December 2000. At the same time the Director noted that Part II would become redundant as soon as BSkyB ceased to broadcast in analogue and so would cease to have effect at that time. The Director General of Telecommunications and his office, OFTEL, regulate encryption technology for digital satellite TV.

6. On 2 April 2001, the Director notified BSkyB that it need not observe two further undertakings. First, BSkyB's basic channel, Sky One, was among the channels BSkyB undertook in Part I to place on the company's wholesale ratecard. The Director concluded that Sky One did not have or confer a dominant position and could therefore be removed from the ratecard. Second, Part III was considered by the Director to be unnecessary as he could use his powers under the Act to obtain relevant accounting information.

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[4] *Re an agreement between the Football Association Premier League Ltd and others and an agreement relating to the supply of services facilitating the broadcasting on TV of Premier League football matches*, [1999] UKCLR 258.

[5] 'BSkyB Review: Issues', published 1 March 2000.

III. COMPETITION ACT INVESTIGATION

7. The responses to the 2000 Review gave the Director reasonable grounds under section 25 of the Act to suspect that BSkyB had infringed the Chapter I and Chapter II prohibitions. Accordingly the Director launched an investigation under the Act on 5 December 2000. The investigation was into conduct falling both within and outside the scope of the 1996 Undertakings.

8. The Director obtained information during the investigation from: BSkyB, ntl Group Limited ('NTL'), Telewest Communications plc ('Telewest'), ITV Digital plc ('ITV Digital', formerly OnDigital plc), the British Broadcasting Corporation ('BBC'), ITV Network Limited ('ITV'), the Film Four Channel ('Film Four'), The Racing Channel, the Independent Television Network ('ITN'), Atlantic Telecom ('Atlantic'), the Football Association Premier League ('FAPL'), OFTEL, and the ITC.

IV. THE OFTEL REVIEW

9. The Director transferred certain matters relating to technical services for satellite TV and interactive digital TV to OFTEL to consider under its concurrent powers pursuant to the Act or its specific regulatory powers. On 15 January 2001, OFTEL wrote to BSkyB to explain that, having read and noted the concerns, OFTEL would not be opening an official complaint investigation and that it was closing the case.

10. In October 2001, OFTEL published a consultation document on conditional access ('CA') pricing,[6] and issued a statement on 8 May 2002 on the pricing of conditional access and related issues.[7] This lead to revision of its guidelines on CA charges.[8]

V. THE RULE 14 NOTICE

11. Following investigation under the Act, the Director proposed to make a decision concluding that BSkyB had infringed the Chapter II prohibition and issued a Rule 14 notice to BSkyB on 17 December 2001 (the 'Rule 14 Notice').

12. BSkyB informed the OFT on 11 January 2002 that it intended to amend its wholesale pricing of its premium channels having completed a preliminary review of the Rule 14 Notice.

13. A redacted version of the Rule 14 Notice was disclosed to ITV Digital, NTL, and Telewest on 10 January 2002. BSkyB responded to the Rule 14 Notice with written representations on 30 April 2002 (the 'Response') and oral representations on 27 May 2002.

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6 http://www.oftel.gov.uk/publications/broadcasting/2001/caco1001.htm

7 http://www.oftel.gov.uk/publications/broadcasting/2002/cast0502.htm

8 http://www.oftel.gov.uk/publications/broadcasting/2002/cagu1002.htm

PART TWO THE FACTS

I. THE UNDERTAKING

14. Brisitsh Sky Broadcasting plc is listed on both the London and New York Stock markets. However, the majority of it activities take place in the UK through its subsidiary BSkyB, as does the generation of most of its annual turnover. In the year ending 30 June 2002, its parent British Sky Broadcasting Group plc had turnover of £2,776 million.[9]

15. BSkyB has several subsidiaries with activities connected to television broadcasting in the UK and Ireland. Their activities comprise: (i) the creation of channels broadcast via digital satellite ('DSat') and offered for redistribution via cable and digital terrestrial TV ('DTT'); (ii) the distribution via DSat of wholly owned, joint venture and third party channels and pay per view ('PPV') services; (iii) the provision of conditional access, access control and customer management services to broadcasters and interactive services providers on the DSat platform; (iv) the operation of a website and an internet service provider and the provision of website design and management services and media agency services; (v) the provision of fixed-odds betting services; and (vi) the provision of interactive services on BSkyB's DSat platform.

II. THE COMPLAINTS

16. The Director has investigated the terms on which BSkyB supplies its premium sports and film channels, namely Sky Sports 1, Sky Sports 2, Sky Premier, and Sky Moviemax, as these were the principal focus of concerns raised in responses to the 2000 Review.

17. The period investigated was from 1 March 2000 until 30 June 2001.

18. In the Rule 14 Notice, the Director proposed to find that three elements of BSkyB's wholesale pricing of its premium sports and film channels infringed the Chapter II prohibition of the Act:

    (i) BSkyB had exercised a margin squeeze on its premium channel distributors. The margin offered between the prices charged to distributors and the retail price charged to subscribers was not enough for a normal profit to be made had the distributors been as efficient as BSkyB's own distribution business.

    (ii) BSkyB's mixed bundling had been applied to an abusive degree.

    (iii) BSkyB had offered discounts to its distributors on its pay to basic ratecard ('PBR'), which either foreclosed or had the potential to foreclose entry to other providers of the premium channels, and distort the competitive conduct of these distributors.

[9] Brisitsh Sky Broadcasting plc, Annual Report and Accounts, 2002.

PART THREE THE PAY TV SUPPLY CHAIN

19. The conduct investigated relates to the conditions on which BSkyB supplied certain channels (namely its premium sports and film channels) to third party distributors. This Part describes the pay TV supply chain, and identifies the relevant channels and their position within this supply chain.

I. DISTRIBUTION PLATFORMS

20. All UK TV viewers must obtain a TV set and licence. In most regions, this enables consumers to view five free-to-air analogue channels (BBC1&2, ITV1, Channel 4, Channel 5). The viewer seeking access to additional channels must obtain an additional TV platform. There were three principal UK platforms supplying additional channels during the period investigated: direct to home satellite ('DTH'), DTT, and cable.[10] Access typically comprised subscription to a platform operator (BSkyB for DTH, ITV Digital for DTT (since insolvent), and NTL or Telewest for most cable subscribers), although certain additional free-to-air digital channels could be accessed via DTH or DTT by obtaining the necessary equipment (i.e., dish plus set top box for DTH, or set top box for DTT), without contracting with any platform operator.

II. BASIC AND PREMIUM CHANNELS

21. Subscription to a platform gave access to a package of channels. Pay TV providers offer several such packages, at varying prices. The cheaper packages are known as 'basic packages' and contain those channels referred to as 'basic'. Platform operators offer additional channels, known as premium channels, only to those who have subscribed to a basic package. Premium channels tend to contain the more desirable content able to justify a premium, in particular, certain sports and recently released films. BSkyB's premium sports channels are Sky Sports 1 and Sky Sports 2,[11] and its premium film channels are Sky Premier and Sky MovieMax.

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[10] In the future, the Internet and asymmetric digital subscriber line ('ADSL') may provide additional methods of viewing television programmes. ADSL is currently at pilot stage, with schemes offered by Kingston Communications in Hull, Yes TV in West London, and Video Networks Ltd's 'Homechoice' service in North West London. Third generation mobile telephony may also offer moving images in due course.

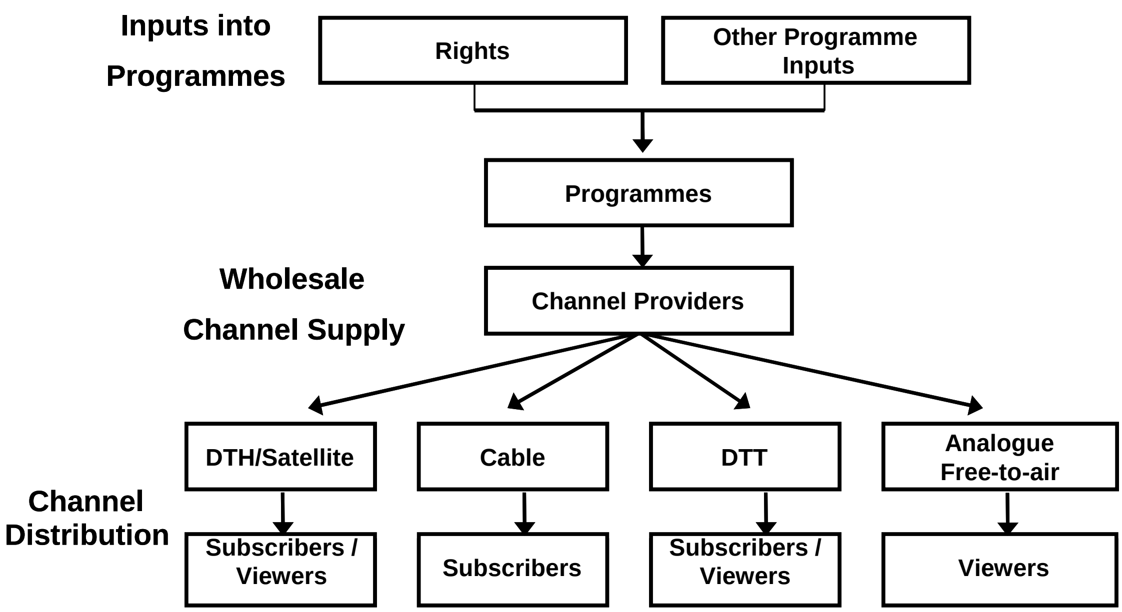
[11] Sky Sports 3 and Sky Sports Extra are bonus channels. Sky Sports 3 is available without extra cost to subscribers of Sky Sports 1 or Sky Sports 2. Sky Sports Extra is an enhanced channel offering interactive football and cricket. This channel is free to residential subscribers of both Sky Sports 1 and 2.

III. CHANNEL SUPPLY

22. The channels distributed by platform operators are supplied by channel providers, which must obtain programming to package into channels. Major channel providers include the BBC, BSkyB, Telewest (which merged with Flextech, a basic channel provider) and ITV. Programming in turn is supplied by content providers. Provision of content might require assembling the inputs necessary for a comedy, drama, or game show, or acquiring the rights to exhibit a film or sporting event.

23. The pay TV supply chain therefore comprises a hierarchy, set out below.

The TV Supply Chain



PART FOUR THE CHAPTER II PROHIBITION AND THE RELEVANT MARKET

I. THE CHAPTER II PROHIBITION

24. Section 18(1) of the Act prohibits conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market, if it may affect trade within the UK.[12] Accordingly, to find an infringement of the Chapter II prohibition, the Director must find first, that BSkyB holds a dominant position, second, that it has abused such position, and third, that such abuse may affect trade within the UK.

25. Under section 60 of the Act, the Director is required to ensure that so far as is possible questions arising in relation to competition within the UK are dealt with in a manner consistent with the treatment of corresponding questions arising in EC competition law. In particular, when interpreting the Act, the Director must act (so far as is compatible with the provisions of the Act) with a view to securing that there is no inconsistency with either the principles laid down by the EC Treaty and the European Court or any relevant decision of the European Court.[13] The Director must also have regard to any relevant decision or statement of the European Commission.

26. The Chapter II prohibition came into force on 1 March 2000.[14] It has no retrospective effect and therefore only applies to abusive conduct on or after 1 March 2000. This decision relates to conduct within the period from 1 March 2000 until 30 June 2001 inclusive.

II. DEFINITION OF DOMINANCE

27. The European Court has defined a dominant position as:

> 'a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers.'[15]

It also considers that:

> 'such a position does not preclude some competition … but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under

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[12] Under section 18(3) of the Act, 'dominant position' means a dominant position within the UK and 'United Kingdom' means the UK, or any part of it.

[13] The European Court is defined as the Court of Justice of the European Communities and includes the Court of First Instance (section 59(1) of the Act).

[14] Competition Act 1998 (Commencement No. 5) Order 2000, SI 2000/344.

[15] Case 27/76 *United Brands v European Commission* [1978] ECR 207, paragraph 65 of the judgment.

which competition will develop, and in any case to act largely in disregard of it so long as such conduct does not act to its detriment.'[16]

28. In assessing dominance, the Director considers whether and to what extent an undertaking faces constraints on its ability to behave independently. Those constraints might be:

(i) existing competitors, according to their strength in the relevant market: one indicator is market share;

(ii) potential competitors. This constraint may be shown by a lack of significant entry barriers and the existence of other undertakings which might easily enter the relevant markets; and

(iii) other constraints, such as significant buyer power exercised by the undertaking's customers.

These possible constraints on BSkyB are assessed in turn below.

III. INTRODUCTION TO MARKET DEFINITION

29. The prohibition in Chapter II of the Act is designed primarily to prevent undertakings using market power anticompetitively. Such power may be assessed within the market relevant to the activities of the undertaking concerned, both product and geographic. Accordingly, following the OFT Guideline on Market Definition,[17] to determine the relevant product and geographic market or markets, the Director has assessed the competitive constraints on BSkyB's activities where it is alleged to have abused a dominant position, i.e., BSkyB's wholesale supply of its premium sports and film channels.

30. UK and EC competition authorities have examined the provision of pay TV on several occasions, frequently finding that Pay TV is in a market separate from free-to-air TV, and noting the importance of premium film and sports content (see Annex 2). The Director is alert to his duties under section 60 of the Act, but equally notes BSkyB's criticisms of the cases cited. Accordingly, while he regards the decisions of the European Commission as important precedents, he has conducted a fresh market analysis, in line with the judgment of the European Court in *TCCC and CCE v European Commission*.[18]

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[16] Case 85/76 *Hoffman-La Roche v European Commission* [1979] ECR 461, paragraph 39.

[17] OFT Guideline 403 of March 1999 at paragraph 3.1. It also explains why and how the Director defines markets for the purposes of the Act.

[18] Joined Cases T-125/97 and T-127/97, *The Coca-Cola Company and Coca-Cola Enterprises Inc v European Commission* [2000] ECR-II 1733 at paragraph 82.

PART FIVE **THE RELEVANT MARKETS**

I. STRUCTURE OF THE DIRECTOR'S ASSESSMENT OF THE MARKETS RELEVANT TO THE PROVISION OF PREMIUM SPORTS AND FILM CHANNELS

31. The Director has assessed the market or markets relevant to the wholesale supply of BSkyB's premium television channels (Sky Sports 1, Sky Sports 2, Sky Premier, Sky MovieMax), as complaints focussed on this supply. The Director has considered sports channels and film channels separately in the following market definition analysis and concluded on the relevant market appropriate to each.

32. The Competition Commission Appeal Tribunal ('CCAT') has summarised those broader factors that may be taken into account in defining relevant markets,[19] and the Director has considered such factors accordingly.

33. The Director's consideration of market definition has four parts. First, he sets out in more detail the structure of the supply of TV channels, both free-to-air and pay, and considers what comprises a TV channel (Part Five, Sections I and II).

34. Second, the Director has defined more closely what the 'relevant products' are, following a detailed description of BSkyB's premium channels. This step has been necessary in this investigation since he considers that any TV channel is simply a bundle of content, and he has to decide whether such a bundle is a relevant product which he can analyse from a competition perspective (Parts Six, Section I and II, and Part Seven, Section I.).

35. Third, having defined the relevant products, the Director has considered the difficulties in this case of applying traditional methods of analysis in defining relevant markets, in particular in applying the 'hypothetical monopolist test' Part Six, Section III).

36. Fourth, the Director considers the available evidence and data to determine which other products may be close substitutes for the relevant products, and so fall within the same relevant market (Part Six, Sections V to X and Part Seven, Section III).

37. This process is repeated (to the extent that separate analysis is needed, avoiding unnecessary duplication) for each of sports and film channels. He concludes that the relevant markets are the supply of channel packages containing content unique to premium sports pay TV channels

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19 In Case 1005/1/1/01 *Aberdeen Journals Ltd v Director General of Fair Trading*, judgment of 19 March 2002 at paragraph 96, objective characteristics, the degree of substitutability, competitive conditions, the structure of supply and demand and the attitudes of consumers and users were identified as relevant factors. http://www.competition-commission.org.uk/ appeals/ judge10.pdf. BSkyB stated that the Director had not taken adequate account of these broader factors relevant to market definition: Response, Part 3, Section A(III).

(currently identified as live FAPL football), and the supply of packages containing premium film channels.

38. Finally he has assessed the geographic market relevant to both types of premium channel, and concluded that it is the UK (Part Eight).

II. GENERAL CHARACTERISTICS OF TELEVISION CHANNELS

39. TV channels are streamed supplies of audio-visual content that can be distributed over the platforms described above (paragraph 20).

1. Free-to-air channels

40. Free-to-air channels are those available to viewers with the appropriate reception equipment and a TV licence. No subscription is needed. There were five free-to-air analogue terrestrial channels during the period investigated, which were available to almost all households in the UK, with the exception of Channel 5 which reached approximately 80% of the UK population.[20] Further free-to-air digital channels were available on DTT and DTH platforms. These include five channels produced by the BBC and one produced by ITV. Most of the free-to-air channels on DTT and DTH were theme channels, with specific examples covering classic movies, 'extreme' sports, children's programming and news.

2. Pay TV channels

41. As noted, subscribers desiring further channels had to subscribe to a pay TV platform. Pay TV was typically retailed to consumers as offerings of 'basic' channels and 'premium' channels.

2.1 Basic channels

42. There were 74 basic channels available in the UK,[21] which were retailed in bundles. Consumers were offered a number of bundles or packages consisting of up to 65 basic channels. They were cheaper than packages containing premium channels. BSkyB's smallest basic package was the 6 channel 'Value Pack' costing £10 per month, the largest basic package was the 65 channel 'Family Pack' costing £16 per month.[22] Basic channels covered a wide range of genres, including sports and films, classic repeat programmes, children's programming, documentaries, natural history and music.

2.2 Premium channels

43. Subscribers to basic packages might then in addition purchase premium channels: premium channels were available only as an addition to a package of basic channels. 'Premium' in this context therefore means no

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[20] http://www.channel5.co.uk

[21] As at April 2002, according to Response, Part 4 paragraphs 143-144.

[22] Response, Part 4, paragraph 144.

more than signifying that a channel may be chosen additionally and individually, for a given price, by a basic package subscriber. BSkyB required distributors of its premium channels to make those channels available only in this way (the 'buy through' requirement),[23] and each distributor active during this investigation retailed channels on this basis.

44. Since BSkyB's premium channels were available only bundled with basic channels, they had no individual retail price distinct from the package price. However, BSkyB's premium package prices ranged from £24 per month to £37 per month.[24] Other premium channels (such as FilmFour) did have an individual set retail price. BSkyB provided packages (at wholesale and retail level) of premium channels at prices discounted from the sum of the individual list price of each premium channel when chosen as the sole premium channel in a package. (See Part Twelve below).

45. The most popular premium channels tend to feature sports and films although there are several premium channels that offer other genres of programming such as the *Disney Channel*, *Music Choice Extra* and *Artsworld*. In total there were 11 premium channels available in the UK on DTH.

46. At the wholesale level, distributors purchase premium channels and basic channels for retail to final subscribers. BSkyB had a sliding scale wholesale per channel charge for its premium channels depending on whether one, two, three or four premium channels are taken by a subscriber.

47. Pay TV has been established in the UK for 11 years and during that time has been purchased by 44% of households,[25] and attracted approximately 20% of the viewer hours spent watching television.[26] The five free-to-air terrestrial channels attract almost 80% of the viewer hours across all households and approximately 60% of the viewer hours in multi-channel households (households with pay TV).[27] The six most popular pay television channels in terms of viewer hours attracted are: Sky One, UK Gold, Sky Sports 1, Sky Premier, Sky Sports 2 and Sky MovieMax.[28] Four of these six channels are premium channels and five of them are produced by BSkyB.

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[23] However, BSkyB did not require that its premium channels were bought through a package containing BSkyB basic channels.

[24] Response, Part 4, Annex 1, page 69.

[25] ITC Annual Report, 2001.

[26] Response, Part 4, paragraph 60.

[27] Response, Part 4, paragraph 60, Chart 5 and Chart 6.

[28] Ibid.

III. DESCRIPTION OF TELEVISION CONTENT

48. Channel assembly requires the acquisition of programming and packaging it to appeal to consumers. In the case of advertiser-supported TV, channel assembly also typically involves the insertion of advertising, for which the channel supplier collects advertising revenue. The channel supplier may also leave 'availabilities' for advertising to be inserted by distributors.[29] These characteristics are common to all TV channels, whether free-to-air, basic or premium.

49. Channel providers can purchase programmes either from independent producers or produce them in-house. In the area of sports programming it is customary for a television provider to licence the rights to the event from the rights holder and then turn the rights into a programme. With regard to films, most are licensed from the major Hollywood studios, but there are some limited examples of television providers commissioning their own films, as both the BBC[30] and Channel Four[31] have done.

50. TV content tends to be exclusive to the channel on which it appears. Programmes made in-house or bought from independent producers are protected by copyright from exploitation on other channels. Similarly, films or sports rights are usually licensed on an exclusive basis to a particular channel provider. Typically this exclusivity extends only to a particular territory. Many of the more expensive productions such as natural histories and costume dramas are produced jointly by two channel providers from different countries, with the exclusive rights in each country awarded accordingly.

51. The exclusivity associated with most programming means that television channels are differentiated products. No two channels show identical programming and so when choosing between channels, the potential subscriber must consider factors other than price, such as content, that a channel will provide. Accordingly, channel providers aim to differentiate their channels so that they are both interesting to potential subscribers and sufficiently different from other channels, to prevent any profit margin they might earn being eroded by identical or similar channels.

52. This market structure is important for the Director's consideration of market definition. The Director must consider the extent to which the prices of one channel are constrained by the existence of substitutes for that channel.

53. The Director is also aware that a channel's interest to a potential subscriber derives from its content and that, because channels bundle

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29 BSkyB submission dated 19 May 2000, 'Television Markets and the Market Power of BSkyB' by William B. Shew.

30 The feature film making arm of the BBC co-produces approximately 8 films a year. See http://www.bbc.co.uk/bbcfilms/info/index.html.

31 FilmFour invested £31 million in production and development of films in 2001 and participated in films with a production value of £112 million. See http://www.channel4.com/about_C4.html

content together, the content that makes a channel attractive to one subscriber may be different to that which attracts another. A subscriber to a given pay TV channel, (or package), does not necessarily want to watch all the programmes the package provides.

54. In terms of market definition, this implies that a channel will have few close substitutes if its content has few close substitutes. Given that channels comprise bundles of content, even if only certain of that content has no close substitutes, this may differentiate the whole channel sufficiently from possible rivals, so that those rival channels may not to be in the same economic market.

55. In conclusion, the Director finds that television channels are characterised by the bundling of content, not all of which attracts each subscriber equally to that channel. Differences between channels are protected by copyright just as differences between the work of recording artists or authors is protected by copyright. This means that the market for television channels bears some similarities to the market for recorded music or books. Although different artists and authors may compete with each other for sales to the record and book purchasing consumer they do not compete on price alone. Equally, different channels do not compete only on price. Market definition for television channels therefore needs to consider the content carried.

PART SIX RELEVANT MARKET FOR PREMIUM SPORTS CHANNELS

56. In this section, the Director considers the market in which BSkyB's premium sports channels (one of the products to which complaints received in response to the March 2000 review related) compete. The Director's assessment covers both the relevant wholesale and retail markets.

57. He describes the channels, considers if they carry a type of content unavailable on other types of channel or means of distribution, before considering how to analyse the constraints BSkyB may face in their supply, and then analysing such constraints.

I. DESCRIPTION OF BSKYB'S PREMIUM SPORTS CHANNELS

58. BSkyB provided a description of its premium sports channels.[32] According to BSkyB, Sky Sports 1 and Sky Sports 2 broadcast a mix of live and recorded programming from a wide variety of different sports including: football, cricket, rugby union, rugby league, Australian Rules football, wrestling, tennis, golf, horseracing, greyhound racing, darts, pool, motor racing, squash, ice-hockey, baseball, American football, surfing, bowls and angling.

59. While each channel broadcast a mix of sports events and competitions, certain events and competitions were specific to each channel. Sky Sports 1 broadcast, among other things, English and Scottish Premier League football, domestic cricket matches (including Test matches), European golf tournaments, boxing, WWF, NFL, domestic and Great British rugby league, and non-UK rugby (such as the Tri-Nations and Super 12 series).

60. Sky Sports 2 broadcast, among other things, England international and FA Cup football matches, Australian rugby league, international golf tournaments, tennis, snooker and pool, NFL Europe, motor racing, darts, Australian Rules football, bowls, and angling.

61. On average, Sky Sports 1 and Sky Sports 2 each broadcast for 148 hours per week. Each channel had a small share of the overall audience of TV viewers, even in multichannel households. Like all television channels, viewing was unevenly distributed over the week. In the case of BSkyB's sports channels, relatively large audiences (i.e., relative to audience numbers for these channels at other times) tended to be attracted by key events, typically live broadcasts, with small audiences the rest of the time. In 2001, Sky Sports 1 had an average viewing share in multichannel households of 1.84%, with an average daily audience of 72,000 viewers.[33] Peak viewing was during live Football Association

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32 Response, Part 4, paragraphs 67 – 45.

33 Source: BARB viewing figures for January 2001 – December 2001.

Premier League ('FAPL') matches on Sunday afternoons. Such events tended to draw audiences of between 850,000 and 950,000 viewers.[34]

62. In 2001, Sky Sports 2 had an average daily audience of 31,000 viewers and an average viewing share in multichannel households of 0.79%.[35] Peak viewing tended to be during live England football matches on Wednesday evenings and England Six Nations rugby matches. In 2001, the five England international football matches shown live on Sky Sports 2 on Wednesdays had an average audience of 1.26 million viewers,[36] while three England Six Nations rugby matches broadcast had an average audience of 533,000 viewers.

63. In 2001, BSkyB's sports channels had a combined average audience of fewer than 250,000 viewers during 82.1% of the hours in which they were broadcast, and fewer than 500,000 viewers during 96.4% of the hours in which they were broadcast, out of a total potential audience of about 13.3 million viewers.[37] If the analysis was limited to weekends and evenings there were fewer than 250,000 viewers during 62.8% of the hours in which they are broadcast, and fewer than 500,000 viewers during about 92.3% of the broadcast hours.[38]

II. DEFINING THE RELEVANT PRODUCTS WITH REGARDS TO BSKYB'S PREMIUM SPORTS CHANNELS

64. The Director accepts BSkyB's description of the its premium sports channels set out above (paragraphs 58 to 63). The Director considers, however, that this description overlooks certain important characteristics relevant to market definition, discussed below. In particular, given the funding characteristics of premium sports channels, the Director considers that certain sports content will only appear on such channels, and, for purposes of this investigation, he considers that such content includes in particular live FAPL football.

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34 This is the approximate range of viewing figures for FAPL matches broadcast during the 2000/2001 football season. Source: BARB viewing figures. BSkyB put these viewing figures in context, stating that in multichannel homes a programme such as Coronation Street typically achieves around 5.4 million viewers per episode and has an average audience share of 51.4%; Antiques Roadshow typically achieves around 2.7 million viewers per episode with an average audience share of 25.8%; and episodes of The Simpsons, shown on Sky One, achieve an average of 521,000 viewers with an average audience share of 5.4%.

35 Source: BARB viewing figures for January 2001 – December 2001.

36 BSkyB broadcast three other England international football matches in 2001. Two of these were on Saturdays and were broadcast on Sky Sports 1. In both cases, the matches were shown simultaneously on BBC1. The other match was on a Friday evening and broadcast on Sky Sports 2.

37 This figure is derived by multiplying the average number of households subscribing to one or more of BSkyB's sports channels in 2001 by the BARB estimate of the number of people per household during 2001 of 2.66. Viewing figures are based on BARB viewing data for January 2001 - December 2001.

38 Paragraphs 37 to 48 of Section B, Part 4 of the Response set out the figures.

1. TV channels are differentiated products

65. With regard to subscription channels, in order to compete other than just on price, channels seek to differentiate themselves, and the more differentiated and attractive the channel, potentially the greater the price that can be charged as other channels are progressively poorer substitutes.

66. The key to channel differentiation lies in the content carried. Accordingly, the Director has, in the following sections, confirmed that premium sports channels contain content that is appreciably differentiated from that carried on other channels. This is relevant to assessing which other services may constrain the prices of channels containing that specific content: only those channels not substantially differentiated from premium sports channels are likely to constrain their prices to the competitive level.

67. As noted, most content is available exclusively to particular channels so no two channels are identical. If a channel can carry content that is so different that rival channels cannot constrain its price to a competitive level, that channel is not competing in the same economic market.

2. Content unique to pay TV sports channels

68. A premium sports channel is transmitted by the same technology over the same networks as other TV channels. Non premium channels can and do carry attractive sports content, and can and do attract higher audiences than premium sports channels.[39]

69. However, for the reasons given in paragraphs 70 to 83 below, the Director considers that at least some of the content on premium sports channels will not be available elsewhere, including on basic pay channels and free-to-air channels. His analysis subsequently focuses on whether customers regard alternative content as a genuine substitute for such content, to determine if the prices of premium sports channels carrying such content are constrained to competitive levels by content available elsewhere.

3. Pay TV versus free-to-air funding characteristics

70. Channel providers may exploit content by the various methods of financing and distributing channels, which generate differing revenues. The Director considers that pay TV channel providers may accordingly value content differently from free-to-air channel providers as a result of these differing revenues. Pay TV channel providers levy subscriptions, so that they can charge individually and directly for access to any given channel, pricing according to their estimation of consumers' willingness to pay for a given channel. Further, they realise value from channels by selling advertising. In contrast, free-to-air channel providers are funded

39 Response, Part 4, Section C(I), Charts 5 and 6.

only indirectly by advertising or, effectively, by taxation (i.e., the licence fee).

71. Accordingly, the value that pay TV channel providers place on specific content is driven by:

- the value of the subscriptions of those subscribers who would not have subscribed to the channel if that content was not shown, plus the additional amount that the retailer can add to the subscription fee ('the season ticket effect') due to the content's presence on the channel;[40]

- advertising revenue derived from the content. This is typically lower than free-to-air TV providers may earn from similar content due to the lower viewing figures achieved by pay TV channels (although the audiences of premium sports channels are particularly attractive to advertisers);[41]

- whether the content is 'listed'. No UK broadcaster can acquire the exclusive live rights to broadcast certain events designated (i.e., 'listed') by the Secretary of State for Culture, Media and Sport, without prior consent by the ITC (see Annex 3);

- the desire of certain rights holders to reach the broader audience that only free-to-air broadcasters can deliver, leading them to forgo the possibly increased revenues that premium or other pay sports channels might provide (and therefore decline to licence a premium channel provider).

4. Bundling

72. Pay TV channel providers can earn additional revenues in ways closed to free-to-air providers, by bundling events into channels and by bundling channels into packages, which permits some price discrimination according to consumers' 'willingness to pay'.

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[40] This season ticket effect may be illustrated by the following example. Assuming that a provider can offer 15 events per annum at £10 each and, at these prices, the average subscriber would wish to purchase five events (but these five may differ between subscribers and the provider cannot identify these preferences) then the provider's average revenue per person would be £50 per annum. But if subscribers derive some pleasure from the other 10 events, for example with a valuation of £2.50 per event, they may be attracted to purchasing a season ticket for £75. In contrast, to persuade all subscribers to take all 15 events separately, the provider would have to lower the single event price to £2.50, yielding revenue of just £37.50 per person. This is a form of price discrimination where the seller is unable to identify buyers' willingness to pay.

[41] ITV submission dated 26 January 2001, question 1; also Commission Decision 2001/478/EC *UEFA's broadcasting regulations* [2001] OJ L-171/12, paragraphs 39-40.

4.1 Event bundling

73. Pay TV providers can package content within a bundle (i.e., a channel) to which customers subscribe. This produces a higher return than selling events on an individual basis, since the channel contains events that the subscriber would not buy individually, as well as those s/he would (i.e., the 'season ticket' effect).

4.2 Channel bundling

74. Pay TV channel providers can price channels according to customers' willingness to pay, by bundling them into packages. All pay TV distributors offer mixed bundle discounts at retail level on packages including premium channels (see Part Twelve), so that packages including progressively more premium channels become progressively cheaper on a per channel or per premium channel basis.[42]

75. This means that a sports fan willing to pay highly for sports channels, in effect pays for the sports channel at the price set for the single sports channel package and then is offered the opportunity to purchase a film channel at a low incremental price. Equally the film fan willing to pay highly for film channels is offered the opportunity to purchase sports at a low incremental price. Other subscribers have intermediate preferences, but a willingness to pay that matches or exceeds the package price, although potentially less than the total of individual single premium channel package prices.[43]

76. Accordingly, pay TV channel providers can capture more consumer surplus than free-to-air providers, as they are able to extract revenue from viewers with a wide range of preferences by this form of second degree price discrimination.[44]

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[42] See, for example, http://www1.sky.com/skydigital/PremiumPackage.html

[43] For BSkyB's justification of its mixed bundling practice, see paragraphs 562 to 565.

[44] The season ticket example in footnote 40 above considering events within channels, can be used illustratively across channels. In this example, if all potential purchasers of premium channel X valued the channel at between £8-£10, the provider may maximise revenue by charging a single price within the range £8-£10 for all customers. The same provider: (i) has 20 other 'basic' channels whose valuation ranges from £1 to £5; (ii) knows that on average each customer values two channels at £5 and the remaining 18 at £1; but (iii) does not know for any one customer what the two favourite channels are. The provider could sell all 20 channels as 'premium' channels at £5 and receive revenue of just £10 per customer or sell them as £1 'premium' channels and receive £20 per customer. In fact, the profit maximising strategy would be to charge £27 per package of 20 channels (i.e., sell as a basic package). Each customer's valuation of the package is (2*5) + (18*1) = £28 and would thus be attracted to buying the package. If it were profitable to extract a channel from this package so that it could be sold individually (on the basis that it received a consistently high valuation across a high number of customers), then by definition, this becomes a premium channel.

5. Funding and capacity of free-to-air broadcasting

77. Free-to-air commercial broadcasters do not levy subscription fees and must rely on advertising revenue alone. The bundling advantages of subscription fees cannot be applied to advertising fees, since advertisers (usually) only purchase time on events individually.[45]

78. The BBC enjoys licence fee revenues, but the level of this fee is very inflexible in relation to the decision to bid for particular rights: the attraction of content offered by the BBC does not directly affect its revenues.

79. Further, the Director considers that free-to-air providers' opportunity cost of allocating analogue terrestrial time to any given sports event is higher than for a pay TV provider seeking sufficient content to fill one or more dedicated channels. Accordingly, they cannot offer a terrestrial analogue product equivalent to a dedicated sports channel.

6. Consequence of differing channel funding characteristics: content unique to premium sports channels

80. The funding of pay TV providers does not imply that (absent listing and rights holder choice) all sporting events will be shown exclusively on premium sports channels. Certain high profile events, particularly those which are single events or which do not occur sufficiently regularly to provide foundations for a sports channel, might earn more revenue from free-to-air advertisers than is available in total to a pay TV sports channel.[46] Several such events are in any event 'listed'. However, the Director considers that certain content will only appear on premium sports channels, due to their inherent funding characteristics.

81. These characteristics mean that a premium channel provider can pay more (since it can earn more revenue from such content) than anyone seeking to exploit such content in other ways. The greater consumers' willingness to pay for content, and the larger the numbers of actual or potential subscribers who wish to view it, the more likely that a pay TV sports channel provider can outbid a free-to-air competitor to obtain the relevant rights.

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[45] ITV submission dated 26 January 2001, question 4, confirmed that the only advertising 'bundling' is for specific tournaments, such as the World Cup 1998. Otherwise advertisers are able to advertise around specific events in the month ahead. The fact that advertisers buy time in bulk and in packages is different from the bundling inherent in subscription fees, as advertisers can place a value on, and negotiate prices for, time around specific events or collections of slots.

[46] The Olympics and World Cup football illustrate this. ITV owns the rights to UEFA Champions League, but (i) this does not feature regularly, (ii) the relatively low number of total matches means that the total cost is substantially less than the FAPL rights cost and (iii) the rights were shared with ITV Digital, a pay TV broadcaster, prior to its insolvency.

82. BSkyB presented a worked example of the value of a hypothetical sports right to illustrate this point, to show that whether a sport right is more valuable to a pay television channel or a free-to-air channel depends on the conditions of demand.[47] BSkyB also stated in the Response that:

> 'the relative advantage of each type of television channel provider in relation to particular rights depends subtly on the underlying nature of demand to view the relevant programming on the part of consumers … it is not possible to determine, *a priori*, whether a particular sports right is of more value to an advertising funded broadcaster or a pay television channel provider without robust knowledge of the underlying nature of demand.'[48]

83. The Director agrees with this assessment. The fact that only premium channels carry a certain type of content means that they become sufficiently differentiated from channels not carrying such content for them to become recognisably different products to potential consumers. They can therefore properly become the subject of competition analysis as potentially forming a separate market.

7. Conclusion on the relevant product: unique to premium sports channel content, currently identified as live FAPL football

84. It is not possible to state definitively for every given right whether it will always appear exclusively on premium channels, as the popularity of particular sports and the staging of particular events change. However, the Director has considered the available survey evidence to identify the major sports content that will appear only on premium sports channels. The table in Annex 4 shows the range and importance of BSkyB's current sports rights.[49]

85. Of these, the Director considers that live FAPL football falls within this category.[50] By observing the value of such rights, the Director considers that they will only appear on pay TV. The FAPL rights have been auctioned on three occasions and on each occasion have been acquired by BSkyB. At the last auction BSkyB paid the FAPL over £370 million per season for 66 live matches. The importance of these live FAPL rights can be gauged from the fact that their cost is almost as great as the total programming expenditure on sports rights of BBC1, BBC2, ITV, Channel 4 and Channel 5 combined (see further paragraph 98). The Director

47 Response Part 3 Annex 1.

48 Response, Part 3 paragraph 266.

49 This table is illustrative of rights likely to appear on premium sports channels because it relates to rights that BSkyB has won in competition with other pay TV providers, rather than those rights that a hypothetical monopolist could obtain. Therefore this table represents an underestimate of the range and depth of sports that would appear on premium sports channels.

50 The Director notes that although he has identified only live FAPL matches as sports content that will appear only on pay TV this does not preclude other sports events also appearing exclusively on pay TV either now or in the future.

considers it most unlikely that any free-to-air channel could afford to purchase the live FAPL rights at this price and that consequently the rights will only appear on pay TV.

86. Further, the Director has considered whether a commercial free-to-air broadcaster could achieve viewing figures sufficiently high to have enabled it to bid competitively against BSkyB for live FAPL football in the most recent auction (see Annex 5). The Director concludes that FAPL football will only be broadcast live on a premium sports channel, as the premium sports channel provider can outbid rivals as its funding characteristics allow it to realise a greater return from this content.[51] Accordingly, this content has migrated to pay TV platforms, as pay TV channel providers have tended to outbid free-to-air channel providers for that content. BSkyB appeared to accept this in its Response and oral representations.[52]

87. The Director therefore considers that the product that BSkyB supplies relevant to assessing whether it may be dominant is the provision of unique-to-pay TV sports content, currently identified as live televised FAPL football. Since BSkyB provides such content only in its premium channel Sky Sports 1 (i.e., bundled with other content) which itself is only available bundled with other channels, the relevant product for which a relevant market need be assessed is packages of channels including Sky Sports 1.

III. LIMITATIONS OF HYPOTHETICAL MONOPOLIST TEST

88. Before assessing the constraints on BSkyB's supply of packages of channels including Sky Sports 1, the Director notes certain conceptual difficulties in defining those constraints.

89. As noted in the OFT Guidance on Market Definition,[53] the process of market definition typically starts by considering a relatively narrow

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51 In the 2000 auction for the 2001/2 – 2003/4 live FAPL rights, all the bidders were pay TV operators: ITV Digital, BSkyB, and Premium TV (NTL). Source FAPL submission dated 19 February 2001, question 13(ii). Annex 5 highlights that only a pay TV provider can realistically win the rights.

52 At the OFT oral hearing with BSkyB on 27 May 2002, Gary Roebuck for the OFT asked Mike Darcey of BSkyB "In your [BSkyB's] annex 1 of Part 4 [of the Response] you use a series of hypothetical examples to demonstrate that even the most popular content will not necessarily be exploited on pay TV. It depends on a number of assumptions. But more specifically I was wondering whether you have any comments on our annex 3 of the Rule 14 Notice [Annex 5 to this decision] which attempts to highlight that the Premier League content rights will always be won by a pay TV provider, given the inherent nature of the commercial value of that set of rights?". In his reply Mr Darcey did not attempt to argue that the OFT's Rule 14 analysis was incorrect, that any of the assumptions in it Rule 14 model were incorrect or that the overall conclusion was incorrect. Transcript of Oral Hearing, pages 67 - 69.

53 OFT 403 'Market Definition', paragraph 3.1.

potential definition, normally the products that are the subject of the complaint. The Director then considers how customers would react if a hypothetical monopoly producer of those products implemented a small but significant non-transitory increase in price ('SSNIP') above competitive levels. If sufficient customers would switch to substitutes when confronted by such an increase to render such increase unprofitable to the monopolist, the possible market definition should be expanded to include such substitutes.

1. BSkyB's criticism of the Director's use of the HMT

90. BSkyB criticised the Director's use of the HMT, claiming that he misunderstood the role of the hypothetical monopolist test and that he failed to consider the collective effect of all possible substitutes.[54] BSkyB further criticised the Director for failing to provide evidence that BSkyB's prices were above the competitive price level,[55] and argued that it was contradictory for the Director to claim to observe a lack of substitution. BSkyB argued that irrespective of whether BSkyB had market power its prices will be set at a level at which substitution in response to a SSNIP will be observed.[56] The Director addresses these criticisms below.

2. The Director's application of the HMT

91. The logic underlying the HMT test remains relevant in the current investigation but its application should reflect the market situation. In a merger investigation (the context in which the HMT was devised) the Director generally hypothesises increases in prices from observed levels in the market, to facilitate assessment of whether the merger could lead to increased prices.

92. However, when assessing an undertaking's position under the Chapter II prohibition, the Director may need to consider whether observed prices are already above competitive levels. If a dominant undertaking has raised prices to such levels, any further increase in price would cause consumers to start to switch to alternative products even though they are poor substitutes. This might lead to an overly broad market definition if the HMT were applied mechanically, as poor substitutes are included erroneously in the relevant market (the 'cellophane fallacy').[57]

93. Accordingly, any evidence of switching would be inconclusive, as it could imply equally that prices are competitive, or that BSkyB is dominant and has increased its prices to the monopoly level. If the prices of BSkyB's packages containing live FAPL football were constrained to the competitive level by other products then the Director would expect to observe switching between them following a SSNIP. However, even if other products do not constrain the prices of premium channels the

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54 Response, Part 3 paragraphs 76-80.

55 Response, Part 3, paragraphs 81-88.

56 Response, Part 3, paragraphs 89-96.

57 OFT Guidance 403, paragraph 5.13.

Director would also expect to see switching if BSkyB had previously increased the prices of such packages to the monopoly level.

94. Effectively, the cellophane fallacy means that the Director cannot rely on evidence of switching to determine the relevant market, particularly in circumstances where the 'competitive price' cannot be determined with certainty. BSkyB stated, and the Director agrees, that it is difficult to establish the competitive prices of BSkyB's channels based on the standard approach of comparing prices with costs.[58] He also notes the judgment of the Restrictive Practices Court to which BSkyB referred, which stated that

> 'The considerations set out in the previous paragraph [which dealt with product differentiation] seem to us to cause great difficulty... in identifying a competitive level of price (because competitive price levels can only be identified in homogenous markets).'[59]

95. Accordingly, the Director must seek to avoid the risk of either defining the market too broadly (as a result of the cellophane fallacy) or too narrowly, since BSkyB's premium channels are differentiated products that each may have some market power.

96. The OFT guideline on market definition acknowledges this difficulty, and proposes either examining whether the relevant undertaking is earning excess profits, or examining price movements. For the reasons given in paragraphs 290 to 292 below, the Director does not consider that evidence concerning excess profits assists in determining market definition in this case.

97. The evidence that the Director has considered therefore relates specifically to consideration of live FAPL football's characteristics and consumers' underlying preferences to permit assessment of whether other identified products can satisfy demand for such characteristics. Where possible, he has also considered relative price movements between products possibly in the same market as packages containing live FAPL football.

IV. THE CHARACTERISTICS OF LIVE FAPL FOOTBALL

98. The FAPL is hugely important to BSkyB and its success in the pay TV market. At the last auction, BSkyB paid the FAPL over £370 million per season for 66 live matches, accounting for 32.6% of BSkyB total programming expenditure in 2001. This exceeds £5 million per match, £3.7 million per broadcasting hour, and equates to approximately one third of ITV's total annual programme budget and one fifth of the BBC's total annual programme budget.[60] In comparison, total programming

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58 Response Part 3 paragraphs 83-88.

59 Response Part 3, paragraph 85, citing the Restrictive Practices Court judgment in the *Premier League* case of 28 July 1999, paragraph 278. See footnote 4.

60 FAPL/BSkyB Form AB regarding the Licensing Arrangements for the FAPL.

expenditure on sports rights[61] for BBC1, BBC2 ITV, Channel 4 and Channel 5 together was £380 million for 2001.[62]

99. The FAPL is an annual league football competition running from August through to May. It comprises England's elite professional football clubs and represents the top division of the English football league structure. In total there are 20 clubs and 380 matches played. The matches are regular fixtures which are arranged at the beginning of each season providing fans who wish to follow their team on television with a regular 'appointment to view'. The league season runs for about 9 months of the year and, unlike a knock-out competition, involves all teams for the entire season. This has the best potential to keep interest in the league high for much of the year. Although highlights coverage is of interest to fans, the interest in any particular match is highest whilst it is being played 'live'.

100. On completion of each season the three clubs accruing the fewest points are relegated to the lower division (Football League Division One) with three clubs from that division being promoted. The six clubs with the greatest points total win the opportunity to take part in the coveted international competitions the 'UEFA Champions League' and the 'UEFA Cup'.

101. Many of the clubs in the FAPL (created in the 1992/93 season) have been in the football league since its creation in 1888/89[63] and have a long heritage that can date back over a century, which contributes to fan loyalty to the club they support. The most popular clubs, such as Manchester United and Liverpool, have not only local supporters but fans all over the UK and beyond.

102. Each of the 20 FAPL clubs employs a squad of professional players. These players are typically the most able in the UK. The FAPL clubs have also attracted a substantial number of top foreign players, many of whom play, or have played, at the highest (international) level.

103. In the 2000/01 season, the 20 FAPL clubs' spending on player transfer fees far exceeded that of the 72 Football League clubs, and outstripped the amount spent by clubs in any domestic league in the world.[64] The huge investment in players by FAPL clubs means the standard and entertainment value of the league is now widely considered to be amongst the best worldwide.

104. A significant disparity in quality and income is perceived to exist between FAPL and Football League clubs, such that '*clubs who make it [to the*

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61 And other non-qualifying expenditure.

62 Source: ITC report 'A review of the UK programme supply market' Appendix 1 page 6

63 Source http://endlesssoccer.tripod.com/englishfootball/premierleague/

64 In the 2000/01 season, the 20 FAPL clubs spent £364 million on player transfer fees. The 72 Nationwide clubs together invested around £60 million. See The Deloitte & Touche Annual Review of Football Finance, June 2002, page 38.

FAPL from the Football League] tend to slide back down again quite quickly and then often struggle financially to meet their long-term financial commitments'.[65]

105. The level of football and entertainment displayed within the FAPL means that stadia are almost full. Average stadium utilisation for FAPL clubs stood at 94.2% in the 2000/01 season.[66] At the same time, average capacity utilisation at Football League stadia ranged from 38% in Division 1, to 43% in Division 2 and 63% in Division 3.[67] Further, average attendance in the 2001/02 season was 34,471 in the FAPL, more that double the average Football League Division One average of 14,960.[68]

106. Although other football leagues may have a similar structure, the Director notes that only the FAPL includes the most popular English clubs and that the most successful English players (those chosen to represent their country) generally play their football for FAPL clubs. The Director considers that this indicates that the objective characteristics of the FAPL are different to those of other leagues.

107. The Director sets out below, paragraphs 120 to 137, his consideration of customer preferences regarding those differences in objective characteristics.

V. POTENTIAL SUBSTITUTES FOR UNIQUE-TO-PREMIUM SPORTS CHANNEL CONTENT

108. The following sections assess whether various other products could be considered sufficiently close substitutes for live televised FAPL football matches to be within the same relevant product market. Since distributors' demand for premium channels derives from consumers' subscription decisions, the Director has focussed on subscribers' preferences, and in effect, what their switching conduct would be at the competitive level in defining the relevant market.

109. However, the Director notes that potential switching conduct of subscribers influences the pricing of channels at wholesale level only indirectly. In particular, the retail price to which consumers might react includes not only the wholesale price, but also the costs and possible profits of distribution that are included in the retail price. Therefore a certain percentage increase in the wholesale price of a channel is likely to give rise to a lesser percentage increase in the retail price faced by

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65 See article by David Moffett, Chief Executive of Sport England, entitled 'Scrap promotion and relegation', http://www.observer.co.uk/sport/story/0,6903,788163,00.html

66 The Deloitte and Touche Annual Review of Football Finance, June 2002, page 59.

67 The Deloitte and Touche Annual Review of Football Finance, June 2002, page 61.

68 http://soccernet.*espn*.go.com/soccernet/attendance?leagueCup=ENG.1&year=2001

consumers, and correspondingly less switching than if the retail price of the channel had itself risen by that percentage.

110. The Director identifies three main potential substitutes for BSkyB packages containing live FAPL football at the retail level.[69] The Director considers that the wholesale demand for packages containing live FAPL football is a derived demand. If subscribers' preferences can be satisfied at the retail level equally well by packages not including live FAPL content as they are by packages that do include such content, this suggests that other channels may equally be a good substitute at the wholesale level.

111. The main potential substitutes for packages containing live FAPL football at the retail level are:

(i) Free-to-air sports programming

(ii) Basic pay TV channels

(iii) Other programming content on pay TV or free-to-air channels

112. The Director has also considered various BSkyB submissions concerning competition more generally in pay TV. Further, the Director has considered whether there is a separate class of input substitutes, which are not good substitutes for packages containing live FAPL football at the retail level but are at the wholesale level. The Director has therefore also considered at wholesale level:

(i) Supply side substitutes

(ii) Input substitutes

VI. FREE-TO-AIR SPORTS PROGRAMMING

1. Content on premium TV channels does not constrain decisions on access to free-to-air TV, but free-to-air TV may constrain the price of premium channels to some extent

113. Consumers must first obtain a TV (and licence) before deciding whether also to subscribe to pay TV, whether to packages containing basic or both basic and premium channels. Therefore subscribing to pay TV, including to packages containing live FAPL football, is a complement to free-to-air TV since it cannot be directly substituted for free-to-air TV channels: pay TV cannot be accessed without access to free-to-air TV.[70]

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[69] Following consideration of BSkyB's Response (Part 3, paragraph 13, footnote 2, and paragraph 201), and in light of the limited availability of sports content by such transmission methods, the Director has not considered Internet or PPV broadcasts as a potential substitute for live FAPL football during the period investigated.

[70] Pay TV may constrain the level of viewing of free-to-air TV and, as a consequence, its advertising revenue.

114. While for reasons given in this section, the Director considers that pay TV does not constrain the price of free-to-air services, the converse may not be true, since free-to-air channels might constrain the pricing of packages containing live FAPL football: a subscriber to packages containing live FAPL football can cease subscribing and switch to viewing free-to-air channels. However, for free-to-air channels to be in the same relevant market as packages containing live FAPL football, they must be able to constrain the prices of packages containing live FAPL football to competitive levels.[71]

2. BSkyB's submission on sports content available free-to-air

115. BSkyB provided a description of free-to-air channels in general and their sports content in particular.[72] According to BSkyB, the continued pre-eminence of the free-to-air terrestrial broadcasters must not be overlooked, particularly when examining the importance to pay TV of sports and film programming. In respect of the importance of FAPL football, for example, the Restrictive Practices Court stated:

> 'Although much was made in the evidence and submissions of the power of the Premier League rights and the ascendancy which Sky had gained from them, we find it necessary constantly to remind ourselves that the audience for sports channels remains a relatively small part of television audiences, [and] that there are many powerful distributors in the market place showing other programmes of wide appeal…'[73]

116. BSkyB stated that the extent of the constraint the five main free-to-air channels place on the retailers of pay television packages depends on the range and quality of programming available on these channels taken collectively, as all five channels are received by substantially all television viewers. These channels provide viewers with an enormous quantity and variety of high quality programming, including programming in the genres to which Sky's premium sports and film channels are dedicated.

117. In sports programming, the terrestrial free to air channels obtain rights to show the so-called 'Crown Jewels' of the sporting calendar as a result of listed events legislation. These include events, and series of events, such as the Olympic Games, Wimbledon tennis finals, the finals of the World Cup football tournament and the European Championships, the Grand National and so on. They also show live a large range of events of the highest quality from sports such as motor racing (Formula One Grand Prix), football (FA Cup matches in addition to the final, Champions' League, UEFA Cup, England international matches), cricket (England

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71 See Annex 6.

72 Response Part 4 paragraphs 58-70.

73 Paragraph 289 of the judgment of the Restrictive Practices Court of 28 July 1999 in the *Premier League* case (footnote 4 above). It should be noted that the Restrictive Practices Court uses the term 'distributors' here in relation to the role of channel providers.

domestic Test matches), rugby union (Six Nations matches, Rugby World Cup), horseracing (Royal Ascot), in addition to a large number of events and competitions of narrower appeal (such as US sports, motor racing, and so on).[74]

118. BSkyB stated that across all analogue terrestrial free-to-air channels, viewers are therefore able to watch a large variety of sports events, many of which are of the highest quality.

Table 1:
The most popular sports events on TV (% of adults watching)

Event	**Sport**	**Share (%)**
Olympics	Athletics	63
Football: International Tournaments	Football	60
Wimbledon	Tennis	54
The Grand National	Steeplechase horse racing	47
Grand Prix	Motor racing	46
Snooker Championships	Snooker	45
London Marathon	Marathon running	43
FA Cup Final/ Scottish Cup final	Football	41
Five Nations	Rugby union	38
Title fights	Boxing	34
Challenge Cup final	Rugby League	32
"Opens"	Golf	28
Test cricket	Cricket	27
Skiing championships	Skiing	23

Source: Key Note Ltd

The great majority of these events are shown only on analogue free-to-air channels.

119. Similarly, in a consumer survey prepared for ITV, the sports events which achieved the highest ratings when interviewees were asked which events they would definitely watch on television, were predominantly events shown on analogue terrestrial free-to-air television.[75]

3. Evidence on customer preferences for sports programming

120. The Director accepts that there is a broad range of attractive sports content available free-to-air. The question he must seek to determine is whether it has constrained the prices of BSkyB's packages containing live FAPL to competitive levels.

121. In the absence of meaningful switching data (see paragraphs 88 to 97), analysis of subscribers' preferences can inform market definition. Evidence on the intensity of subscribers' preferences regarding different

74 Response Part 3 Table 1.

75 Response Part 3 paragraphs 249-268.

sports and sporting events can provide a strong indication of product differentiation and hence whether packages are in separate markets.

122. The Director is aware that surveys do not necessarily identify the exact preferences of marginal consumers (i.e., those most likely to switch). Nevertheless, survey analysis of preferences can help characterise the likely behaviour of subscribers as a whole to assist determination of whether live FAPL football satisfies a distinct demand.[76]

123. The Director's methodology, therefore, commences with consideration of customer preferences for different sports to identify whether FAPL matches are considered to be qualitatively different to other kinds of sports in the eyes of subscribers. If live FAPL football matches are thought to be qualitatively different, this is a clear indication that FAPL rights could be content that could differentiate a channel, and so form a distinct market.

4. Survey evidence regarding customer preferences

124. The available survey evidence indicates the underlying nature of demand for live FAPL matches. The survey indicators compiled by NOP in the MMC's report on *BSkyB/Manchester United* present evidence on the consumer preferences between football (in particular FAPL), and other sports.[77] Table 4.10[78] reported that 82% of BSkyB Sports subscribers regularly watched football and 47% quoted football as their 'most favourite' sport.[79] Regarding football rights, Table 4.12 gave the importance of various football matches or tournaments to Sky Sports viewers.[80]

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[76] For example an observation that 90% of subscribers appreciate the sport shown exclusively on premium sport channels to the extent that they would not switch even if the face of a 15% price increase does not inform the Director about the 'marginal' subscriber. However, that would not prevent the Director observing that premium channels could profitably increase prices by 15% above the competitive level because, at the very most, only 10% of subscribers would switch.

[77] *British Sky Broadcasting Group Plc and Manchester United Plc: a report on the proposed merger;* Cm 4305, April 1999.

[78] BSkyB/Manchester United report, Page 104.

[79] Based on the question 'Which sport do you and/or your household regularly watch on the BSkyB Sports channel;' and 'Which is your most favourite sport shown on BSkyB sports?' Source: NOP

[80] *British Sky Broadcasting Group Plc and Manchester United Plc: a report on the proposed merger*, Cm 4305, April 1999, Table 4.18 (page 110) highlights that BSkyB had higher average viewing figures for live FAPL football than for other types of football. In 1997/98 BSkyB's average audience for live FAPL football was nearly 17% higher than its average audience for live FA Cup matches, 41.8% higher than for its coverage of Worthington Cup matches and 240% higher than for its Nationwide League matches. BSkyB's submission dated 10 May 2000, Annex 3.2.8 (III) showed that the average FAPL audience for 1999/2000 was 1.23 million.

Event	Share considering event to be 'very important' or 'fairly important' (%)
FA Cup	92
Premier League	91
European matches involving British clubs	88
Coca-Cola Cup	86
England Internationals	79
Other matches and competitions	57
League and Cup matches from Scotland	56
Endsleigh (now Nationwide) League	53
European matches involving European clubs	53
Internationals not involving England	30
League matches from other European countries	28
League and Cup matches from S. America	20

125. Market research supplied by Telewest also indicated the differing consumer preferences between different sports events.[81]

126. ITV asked 164 current Sky Sports subscribers whether they would switch from a Sky Sports channel to subscribe to a new competitively priced sports channel.[82] The channel would show essentially the same sporting mix as the Sky Sports channels (major football events, boxing, tennis, snooker etc.) The key differentiating content was that live UEFA Champions League would be available on the new channel while the FAPL was not (which would only be available on Sky Sports 1). Of the total responses, [*over 50*]% who were interested in the new channel said that this would not be at the expense of Sky Sports 1 but that they would instead maintain all their BSkyB subscriptions.[83] ITV's other market research findings also reinforced the *BSkyB/Manchester United* NOP survey findings that the attractiveness of different football competitions

[81] Telewest submission dated 10 October 2000, Question 11, pages 5-9. Source: Keynote.

[82] Market Research prepared for ITV by ACCESS, the Omnibus Division at BMRB International, May 2000, supplied in ITV submission dated 11 December 2000, page 190.

[83] This does not imply that [*under 50*]% of customers would switch from premium sports channels altogether upon a hypothetical monopoly test for premium sports, since the choice in the survey is between the sports content of two premium sports channels. Rather it is stressing the importance of FAPL football within a premium sports portfolio.

varies widely.[84] These results further indicate that consumers' preferences do vary between different sports events.

127. NTL extended this conclusion further. NTL stated that the MMC report into the BSkyB bid for Manchester United plc concluded that the relevant market in which Manchester United operated was no wider then FAPL. NTL argued that this market definition could be extended into the rights market to imply that the relevant market for TV rights could be defined along the same lines.[85] NTL qualified this by suggesting that particular tournaments or events might only define the relevant market with respect to football and that the relevant market for other sports is defined by the category of sport (e.g., cricket, golf, tennis).

128. Further, survey research from NTL, for example, showed that 17% of 'all pay TV' subscribers subscribe solely for access to these live FAPL rights, and would cease subscribing to pay TV altogether if these rights were not carried on a pay TV platform. As much as 64% of 'Sky Sports' subscribers would remain with pay TV but cease subscribing to Sky Sports.[86]

129. The Director does not consider that survey evidence, by itself, is sufficient to establish NTL's conclusion. Nevertheless, the Director considers that additional evidence indicating a lack of substitutability between sports events would support the proposition that the relevant market definition is limited to specific categories of sports.

5. BSkyB submissions on customer preferences

5.1 Criticism of Director's evidence

130. BSkyB criticised the Director's data on viewers' preferences and behaviour.[87] Its principal criticism was that the survey data the Director referred to does not specifically identify the preferences of the marginal consumer, but rather that of the average subscriber.[88] With regard to specific data, BSkyB stated that the NOP survey from 1996 was too old to be reliable since the marginal customer changes over time and only the marginal customer is relevant to a switching analysis.[89] BSkyB also

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84 ITV asked the question: 'If you had access to view all of these events, can you please rate the interest you would have in watching each of them, using a scale of 1-10'. 2027 adults aged 15+ gave the following percentages for those 'very interested'. FA cup (32%), FAPL (28%), UEFA Champions League (26%), UEFA cup (22%), Nationwide League (15%), Worthington cup (13%). ITV submission dated 11 December 2000, page 172.

85 NTL submission 8 May 2000, page 10.

86 NTL submission dated 26 January 2001, enclosure 11, conducted by BMRB Consumer Research. The question asked 'If no Premier League football on Sky Sports, I would stop subscribing to [the relevant platform]'.

87 Response, Part 3, paragraphs 100-128.

88 Response, Part 3, paragraphs 109-114.

89 Response, Part 3, paragraphs 102-106.

argued that because the market is not in a steady state survey evidence that looks only at existing subscribers gives only a partial picture of the preferences of marginal consumers, as marginal consumers will also be potential subscribers that the pay TV provider wishes to attract.[90]

5.2 BSkyB's evidence

131. BSkyB addressed the issue of customer preferences by presenting two pieces of evidence. First, it remarked that many of the most popular sports appear only on free-to-air terrestrial television channels.[91] The Director considers that this observation is not inconsistent with a conclusion that sports content unique to premium channels and other content is in a separate market.

132. Second, BSkyB referred to a survey undertaken by OFTEL.[92] This survey reported the 'Reasons for not having digital TV'. BSkyB observed that the five most often cited reasons all related to the issue of value for money. As the Director sets out below, this does not prove that content unique to premium sports channels and content on other TV channels are in the same market. Rather, it relates to the issue of possible consumer switching conduct, which may indicate equally well that prices are at competitive or monopoly levels.

133. The Response also presented evidence concerning the proportion of viewers in multi-channel households who watch particular events on Sky Sports 1. BSkyB observed that the FAPL matches shown on a Sunday afternoon and a Monday night attract about 19% and 8% of the total TV audience respectively.[93]

134. Further, BSkyB presented a second OFTEL survey,[94] and concluded that because the responses to that survey related to new customers, they are most likely to reflect the decisions of marginal subscribers. The Director does not accept this conclusion as he considers that marginal customers are not identified by when they purchase a product, but by whether they are one of the first to switch in response to a price increase. The Director considers that, at best, the OFTEL survey reflects the response to a change in quality without adjusting for any simultaneous change in prices and is therefore unreliable in identifying marginal subscribers.

6. The Director's assessment of customer preferences

135. BSkyB's evidence (paragraph 131 to 134) above supports the Director's view that subscribers have strong preferences. The fact that nearly 80% of viewers did not watch any given FAPL match only indicates that they must have subscribed to a package including Sky Sports 1 for other

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[90] Response, Part 3, paragraphs 107-108.

[91] Response, Part 4, paragraph 65, see paragraph 171 above.

[92] Response, Part 4, paragraph 87.

[93] Response, Part 3, paragraph 156

[94] Response, Part 3, paragraph 295.

programming, or that they subscribed for FAPL, but do not wish or are not able to watch every match. This latter scenario is not unlikely. For example, fans traditionally support specific teams, and if a subscriber were to watch all 66 exclusive FAPL matches s/he would have seen approximately 50% more matches than if s/he had attended all the live matches of their favourite club.

136. The Director agrees with BSkyB that the survey evidence available does not allow him to identify accurately the marginal consumer. However, survey results do allow reasonable inferences to be drawn concerning consumer behaviour as a whole, including marginal consumers. Accordingly, notwithstanding BSkyB's submission, the Director observes that a large proportion of subscribers to premium sports channels do not consider other sports events, other sports channels or other channels to be a good substitute for the exclusive sports shown on premium sports channels. There is no reason to believe that this has changed in the period since the NOP data was gathered.

137. The Director has not concluded that this evidence alone proves that BSkyB's packages containing live FAPL football can sustain their prices above the competitive level, but he notes that this is much more likely in markets where a high proportion of subscribers have clear and intense preferences for individual sports events (as opposed to sport more generally) which appear on an exclusive basis. The survey evidence indicates, and the Director considers, that consumers do have such clear 'favourites'.

7. Price comparison between live FAPL football and free to air content

138. With regard to a price comparison between premium packages containing live FAPL football and free-to-air content, it is apparent that the prices of packages containing live FAPL football have not been constrained by other content appearing on free-to-air channels, which is available to viewers at a zero marginal subscription price.

VII. BASIC PAY TV CHANNELS

1. BSkyB's submission on basic channels

139. BSkyB provided a description of the provision of basic channels in the UK.[95] There were a significant number of channels available in the UK suitable for inclusion in basic channel packages. Many such channels are devoted to specific genres, such as music (MTV, VH-1) documentaries (Discovery, Animal Planet, National Geographic, History Channel, Biography Channel), children's television (Fox Kids, Cartoon Network, Trouble), comedy (Paramount) and so on. In addition, there is an increasing number of general entertainment channels that are, in many respects, very similar to the most popular free-to-air channels, such as

[95] Response Part 4, paragraphs 144-146, 183.

Sky One, Play UK,[96] E4 and ITV2. In total, there were 74 different basic television channels available in the UK.

140. BSkyB stated that each pay television retailer provides consumers with a range of packages of basic television channels from which to choose. Digital satellite subscribers, for example, can choose from six different packages of basic channels, at prices which range from £10 per month to £16 per month. The smallest of these packages contains 6 television channels, while the largest contains a total of 65 television channels. Cable companies offer subscribers combined packages of basic television channels and telephony line rental. For example, Telewest currently offers subscribers three tiers of basic television channel packages, with telephony line rental, priced at £11.49, £18.50 and £21.50.[97] Telewest's largest basic package contained 40 different channels.[98] Nearly half of all U.K. households (44%) took at least a basic package of pay television channels.[99]

141. A large amount of sports programming was also shown on channels such as Extreme Sports, a digital free-to-air channel dedicated to special interest sports such as surfing, skateboarding, skiing, snowboarding and so on, Go Barking Mad, a digital free to air channel dedicated to greyhound racing, and British Eurosport, a basic pay television channel dedicated to sports broadcasting.

2. Relationship between basic channels and packages containing live FAPL content

142. With the exception of niche channels such as The Racing Channel and MUTV, consumers cannot purchase premium sports channels without first subscribing to a basic package.[100] The relationship between basic pay TV channels and premium sports channels is therefore similar to the relationship between free-to-air content and premium sports channels. Accordingly, the 'buy-through' relationship does not exclude, in principle, the ability of basic pay TV channels to constrain premium sport channel pricing to some extent.

143. However, two factors (additional to the differing consumer preferences between content described in paragraphs 120 to 137, which apply equally with regard to content carried by basic channels) indicate that basic channels do not constrain the prices of premium sports channels to the competitive level: relative price evolution and large absolute price differences.

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96 This is no longer running.

97 As at 1 April 2002.

98 This includes channels such as BBC1 and ITV1 which are free-to-air on DTT and digital satellite.

99 Source: ITC Annual Report 2001

100 This is due to a contractual requirement imposed by BSkyB, with regard to all its premium channels, including sports.

2.1 Price evolution of premium and basic channels

144. Since 1992, when BSkyB first secured FAPL rights, the cost per season has increased from £38.3 million to £370 million. See table below. These figures indicate the existence of significant and increasing rents which have not been constrained by competition from other sports content available on free-to-air channels.

COST OF RIGHTS FOR THE TV COVERAGE OF LIVE MATCHES FROM THE FAPL							
Start Date of the Contract	**1983**	**1985**	**1986**	**1988**	**1992** [101]	**1997**	**2001***
Length of Contract (years)	2	0.5	2	4	5	4	3
Distributor	BBC/ ITV	BBC	BBC/ ITV	ITV	BSkyB	BSkyB	BSkyB
Rights Fee (£m)	5.2	1.3	6.2	44	191.5	670	1,110
Annual Rights Fee	2.6	2.6	3.1	11	38.3	167.5	370

Source: BSkyB and Manchester United MMC report of April 1999 Cm 4305, Table 4.23, page 115, except final column
Source: * FAPL letter dated 19 February 2001, page 2

145. The dramatic inflation in the price of live FAPL rights has been reflected in BSkyB's premium channel prices. Between September 1996 and December 2000, BSkyB's incremental prices for its premium sports channel increased by 67%. In contrast, over the same period, retail prices for basic channels, taking account of the increasing number of channels within packages, have fallen by 45%.[102] BSkyB argued that these trends are not meaningful as it is incorrect to characterise the incremental package price as the price of premium sports.[103] While the Director accepts that such prices are indicative only, when using an alternative version of the price for premium sports, the results give similar indications.[104]

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[101] The FAPL was formed in 1992.

[102] Sources: BSkyB submission dated 26 January 2001, Table 3.1b; NTL submission dated 26 January 2001, Annex F. September 1996: retail price for BSkyB's largest basic package was £11.99 divided by 31 channels = 38.6p per channel. By December 2000, the price per channel had fallen to £13/61 channels = 21.3p. The incremental price of Sky Sports 1 or Sky Sports 2 in September 1996 was £17.99 - 11.99 = £6 which increased to £23 – 13 = £10 by December 2000.

[103] Response Part 3 paragraphs 208-216.

[104] If the premium plus basic channel package price is considered to comprise an access charge plus an incremental charge for the right to view a premium channel, then comparing the 1996 premium plus basic package price with that of 2000 gives a 28% increase. Again this price movement is in the opposite direction to that of the per channel basic package price change (i.e. a 45% fall) further suggesting that

146. Any relative price evolution should be controlled for changes in relative quality. This is very difficult to do with precision. BSkyB has been lauded for the quality of its sports coverage.[105] However, while the quality of FAPL football may have increased, the Director does not consider that such increases would be even remotely sufficient to account for the inflation in FAPL rights prices observed (see further paragraph 154 below). The underlying product (namely a league of top flight UK football teams) has remained the same. The significant rights price inflation shown above has principally led to player wage inflation, with comparatively limited implications for the quality of the resulting product.[106] This disparity in price increase offers strong evidence that the pricing of premium sports channels is only weakly constrained by basic-only package prices.

2.2 Absolute prices of premium and basic channels and packages

147. By definition, a premium sports channel is one which has sufficiently coveted and exclusive material that it can be, and is, priced as an individual channel. In contrast, a basic channel is insufficiently attractive to stand alone. Its subscription revenue is collected as a share of the total basic subscription paid by consumers who subscribe to a basic package containing that channel, and whose valuations of it vary (exploiting the 'season ticket' effect).

148. One indicator of the relative value of premium sports packages containing live FAPL football compared to basic channels is that very large proportions of subscribers cite 'premium' sports as the principal reason for subscribing to pay TV in the first place. Further, 75% of DTH subscribers take at least one BSkyB premium sports channel, whilst the share across all pay TV platforms is 55%.[107]

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basic channels do not constrain the price of premium channels. (This compares a per channel price with an overall package price.) Source: OFT calculations based on BSkyB price lists.

105 Response Part 5, paragraph 228.

106 Between 1994/95 and 1998/99 total annual wages for Manchester United, Newcastle, Liverpool, Arsenal, Leeds, Chelsea and Tottenham Hotspur increased by 218%; and wages as a percentage of turnover increased from 34% to 51%, on average. Source: Mintel, 'The Football Business', Leisure Intelligence, November 2000. In 2000/2001 Premiership clubs' total wages and salaries grew by 17.6% and now represent 60% of clubs' income. Source: Deloitte & Touche Annual Review of Football Finance, Season 2000/01. The average season ticket price has increased between 1997 and 2000. The average price for a season ticket in 1997 was £298, compared to £317 in 1999 and £380 in 2000. Source: Mintel, 'The Football Business', Leisure Intelligence, November 2000 and Sir Norman Chester Centre for football research 'A Profile of FA Premier League Club Supporters in 2000'.

107 There is considerable survey evidence showing that sport is a principal reason for subscribing to pay TV. Accordingly, for a large proportion of subscribers to premium sports channels, non-sports content is not an acceptable substitute. For example, 49% of BSkyB subscribers cited sports as the reason for subscribing.

149. In terms of viewer valuation between basic content and premium channels, the average retail price per channel in BSkyB's basic packages was approximately 21p per month,[108] with Sky One at the top of the range at approximately £1.[109] In contrast, subscribers must pay an additional £8 to £13 per month on top of the basic package to receive one premium channel,[110] and BSkyB's incremental retail charge for Sky Sports 1 ranged from £8 to £12.[111] Such large absolute price differentials provide further evidence that premium and basic channels are in separate markets.

150. Comparing package rather than average channel prices, BSkyB's own largest basic package was the 'Family Pack'. This offered 65 basic channels for £16 per month. BSkyB's largest premium package was the 'Family Pack' combined with 'Sky World' which offered 72 channels including all four BSkyB premium channels for £34 per month. Consequently the premium package was over 100% more expensive than the basic package.

151. The difference in price could reflect that the premium package offers more channels than the basic package. Calculating an average price per channel for both packages shows that the basic package costs 25p per channel and the premium plus basic package costs 51p per channel. Even when differences in the number of channels are taken into account, the premium package is still over 100% more expensive than the basic package.[112]

Source 'Television: the Public's view' (ITC 1999) cited in Telewest submission dated 25 August 2000, page 6, footnote 6. See also ITC submission dated 21 August 2000, Table 1, page 11.

108 Based on a retail price of £13 and 61 basic channels at December 2000. Source: BSkyB submission dated 26 January 2001, question 3.1, Table 3.1b.

109 Based on estimate by Merrill Lynch (European Pay TV and Cable, December 2000, Table 8). There is no precise retail price for Sky One because it is currently always bundled with other basic channels (though the price difference between NTL's 'First Choice' and 'First Choice Plus' packages offered during 2000 offers an implicit retail price for Sky One of £1.50. Source: NTL submission dated 29 August 2000, Question 3(a)). The wholesale price (September 2000) is [...] (Source: NTL submission dated 26 January 2001, question 20). The average retail price of basic channels offered within the largest package (August 2000) is 63p (inclusive of telephony) for CWC and 70p for NTL (also inclusive of telephony.) Sources: ITC submission dated 21 August 2000, footnote 23 and OFT calculations.

110 Includes premium films. See http://www1.sky.com/skydigital/PremiumPackage.html

111 According to price list effective 1 January 2001. Source: See http://www1.sky.com/ skydigital/ Pricing_CompleteList.htlm dated 18 September 2001

112 In the Response (Part 3, paragraphs 225-242) BSkyB criticised the Director for making such a comparison over time without controlling for differences in other variables. In addressing this the Director has compared the average prices at a single point in time during which all the other variables would be unchanged.

3. BSkyB's submission on premium/basic price comparisons

152. As indicated above, BSkyB states that neither basic nor premium channels have a retail price as both types of channel are only provided in bundles. The Director's averages are therefore meaningless.[113] Further, his consideration of trends over time failed to take into account changes in quality in addition to changes in quantity of channels provided.[114]

4. The Director's finding on price differences

153. The Director accepts that individual channels have no individual retail price. The Director is also aware that price differences alone cannot be used to define a market as these might be due to differences in quality between the premium packages and basic packages.[115] BSkyB criticised the Director for failing to do this in his analysis of prices.[116]

154. Quality, however, is subjective, and BSkyB was not clear on the differences in quality, or how to measure it.[117] The Director considers that potentially there may be some increase in quality, but that this does not account for the approximate three fold increase in relative prices over the last four years and approximately ten fold increase in the cost of FAPL rights over the last ten years.[118] The extent to which these prices relate to increases in the costs of sports rights is therefore consistent with BSkyB having market power, even though the rents are likely to be largely captured by players and others in the FAPL. In relation to the product itself, relative quality is unlikely to have improved markedly, if at all, in the UK. This is consistent with the finding that the between 1991 and 2001 only 5 English clubs successfully won the European Cup, Champions winners Cup or UEFA Cup. This is in comparison with 8 wins between 1980 and 1989 and 11 between 1970 -1979.[119]

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113 BSkyB criticised the Director in the Response (Part 3, Section F(I)) for trying to use average prices per channel to compare the price of premium channels and basic channels. The Director notes that in this analysis he has not done that. Rather he has used an 'average price' to control for the different numbers of channels in the packages he is considering.

114 Response Part 3, paragraphs 217-224.

115 In the Response, Part 3, paragraphs 129-146 BSkyB criticised the Director for failing to consider price and quality combinations and for assuming that differences in prices, of themselves, indicate different markets. The Director's explicit treatment of price and quality combinations addresses these concerns.

116 Response, Part 3, paragraphs 144-146.

117 BSkyB was questioned about quality differences between premium channels and basic channels. Its chief economist stated that, 'I do not think there is a quality point...' BSkyB also made this point in the Response arguing that, *'if there were significant quality differences between the content shown on a premium sports channel and that shown on, for example, a free-to-air channel (which there is not)...'*

118 See paragraphs 144 and 145

119 Source: http://european-football-statistics.co.uk/atec.htm

155. The Director considers that these changes in relative prices are evidence of market power and that the analysis conducted is consistent with the failure of basic channels to constrain the prices of packages containing live FAPL football, in the absence of strong evidence of a large increase in the quality of FAPL football relative to content available on basic channels.

VIII. NON SPORT FREE-TO-AIR AND PAY TV CONTENT

1. BSkyB's submissions on competition in Pay TV

156. BSkyB stated that the Director had failed to consider whether non-sport content competed with such content available on its premium sports channels. BSkyB provided the Director with its view of the relevant market:[120]

> 'At a very general level, all television programming, whether on a free to air or pay television service, meets the common intended use of providing consumers with visual entertainment, education, and information.'[121]

157. All BSkyB's criticisms concerning the Director's market definition stem from this view: BSkyB could not be dominant and so could not have abused any dominant position given a market that encompasses all visual entertainment, education and information services consumed via a television set.

158. In support of this, BSkyB argued: (i) that the relative attractiveness of free-to-air channels affects viewers' decisions to subscriber to pay TV;[122] (ii) UK evidence showed that [*over 10% of*] consumers declined to subscribe to pay TV since they did not consider it sufficient value for money;[123] (iii) UK evidence showed that those cancelling BSkyB subscriptions switched to viewing only free-to-air channels;[124] (iv) this was supported by evidence from non-UK countries, in particular the US and Germany;[125] and (v) the viewing habits of subscribers demonstrate the continued attraction of free-to-air channels, namely that households watch a stable amount of TV regardless of the number of services to which they have access.[126]

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120 Response Part 4.

121 Response Part 4 paragraph 71.

122 Response Part 4 paragraphs 75-82.

123 Response Part 4 paragraphs 83-88. BSkyB's monthly consumer survey that covers households who do not currently subscribe to a pay TV package.

124 Response Part 4 paragraphs 89.

125 Response Part 4 paragraphs 90-95.

126 Response Part 4 paragraphs 96-101.

159. BSkyB made certain additional points: that there are negligible switching costs between pay TV and free-to-air TV;[127] pay TV providers must incur significant costs in acquiring customers that they must retain over an extended period to recover this investment;[128] and that audience share is critical to any channel's success.[129] Finally, public statements of free-to-air channel providers indicate that they see pay TV providers as competitors,[130] a point supported by the involvement of the ITV companies and the BBC in the provision of pay TV channels.[131]

160. BSkyB therefore considered that there are numerous, significant inter-relationships between the supply of free-to-air and pay TV, so that free-to-air television channels place collectively a significant constraint on retailers of pay TV services, which in turn places a significant constraint on the prices that BSkyB can charge third party distributors of its premium film and sports channels.

2. The Director's view

161. Broadly speaking, the Director does not contest (and has never contested) the view that free-to-air channels constrain the prices of pay TV channel packages to some extent.[132] The key question is whether this constraint is sufficient to prevent the prices of packages containing unique-to-premium pay TV channels (in particular live FAPL football) being raised above the competitive level. For the reasons detailed above (paragraphs 88 to 97) evidence of switching by subscribers is necessarily inconclusive. Accordingly, beyond the price analyses, the Director has, amongst other things, assessed consumers' underlying preferences to form his view of the relevant market.

162. Given that the Director is satisfied that the sports content available free-to-air (for the reasons given in paragraphs 113 to 138 above) and basic channels as a whole (for the reasons given in paragraphs 139 to 155 above) do not constrain the prices of packages containing live FAPL to competitive levels, he considers that other forms of TV content (which are more distant potential substitutes) are unlikely to constrain the prices of such packages to competitive levels.

IX. THE WHOLESALE MARKET

163. The evidence considered above relates to conditions at retail level. Given that the Director considers that demand at wholesale level is a demand

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127 Response Part 4 paragraphs 104-109.

128 Response Part 4 paragraphs 110-114.

129 Response Part 4 paragraphs 115-119.

130 Response Part 4 paragraphs 130-133.

131 Response Part 4 paragraphs 134-140.

132 The Director General's Review of BSkyB's Position in the Wholesale Pay TV Market, December 1996, paragraph 2.4.

derived from consumer demand, he is satisfied that the market at wholesale level will be no wider than it is at retail level. If other products are not good substitutes at the retail level, then by implication they will not be good substitutes at the wholesale level (the final consumer is the same in both cases). For this reason, the Director considers that the products identified as being weak substitutes for premium sports channels at the retail level, specifically free-to-air sports programming, basic pay-TV sports channels and other programme content on pay TV and free-to-air channels, are weak substitutes at the wholesale level.

164. The Director has, however, considered whether there are products that might be weak substitutes for packages containing live FAPL football at the retail level but are good substitutes at the wholesale level. He has considered first, supply side substitutes and second, input substitutes.

1. Supply side substitutes

165. The issue on the supply side is whether a supplier in a business closely related to the provision of live FAPL matches (e.g., free-to-air broadcaster, PPV supplier or basic channel provider) could purchase FAPL rights to create new coverage promptly (say, within 12 months.) The Director considers that the funding of pay TV in general, and premium channels in particular (detailed above, paragraphs 70 to 83), mean that free-to-air suppliers using such methods of distribution cannot compete effectively for live FAPL rights with the intention of exploiting them free-to-air.

166. However, free-to-air broadcasters already have sports branding and the expertise of buying sports rights, so they might be regarded as potential entrants to the pay TV market. The Director does not consider, however, that they extend the relevant market itself. This applies equally to basic pay TV channel providers: given the time delay (the current licensing agreement does not expire until the end of the 2003/4 session) and cost,[133] associated with acquiring FAPL rights, such free-to-air providers should be regarded as potential entrants rather than supply side substitutes.[134] BSkyB did not provide any substantive comments on this issue.[135]

133 The current FAPL rights cost BSkyB £370 million a season. This compares with £38.3 million per season when BSkyB first purchased the rights in 1992. Whether the new start up BSkyB could have afforded £370 million per season in 1992 is an open question. Source: BSkyB and Manchester United report of April 1999, CM4305, Table 4.23, page 115.

134 Some basic sports channel providers held rights to high quality content for which they have not charged subscribers a premium (for example, the Champions' League coverage on ITV Digital's sports channels only formed part of a premium sport channel from August 2001, until its insolvency. It was subsequently broadcast free-to-air once again). For the purposes of market definition, the Director's concern is whether basic sports channels providers (without such 'premium' content) can be supply side substitutes to the extent that the relevant market should be extended. As with free-to-air channels, the presence of certain attractive sports rights on basic channels does not indicate that they constrain the prices of premium sports

2. Input substitution

167. In the Response, BSkyB argued that the demand for premium channels in the wholesale market is different to demand in the retail market because third party distributors can substitute other inputs.[136] Cable operators may offer telephony or internet services as well as pay TV. While such services might not be substitutes for consumers, they might be a substitute for a cable operator seeking to generate a return from its business of connecting homes to cable networks.[137] BSkyB argued that it could not profitably pass on wholesale price increases above the competitive level because third party distributors could substitute BSkyB's premium channels with other products such as telephony services.

168. The Director does not accept this argument. BSkyB misapplies the concept of substitutes in suggesting that third party distributors would consider telephony services to be substitutes for channel distribution. Cable distributors (but not DTT) have the capacity to offer telephony services, channel distribution and internet access to their customers. They are not mutually exclusive. A customer who purchases a premium package from a cable distributor can also purchase telephony services as well (unlike, say, a retailer with limited shelf space who must substitute one product offering for another). To recover their high fixed costs, cable distributors can spread these costs over several products. As such, a cable distributor would wish to sell each customer both a television subscription and telephony services. Such an aim is incompatible with BSkyB's notion of input substitution that a cable distributor would be content to offer its customers only channel distribution or telephony services.

X. CONCLUSION ON PRODUCT MARKET FOR PREMIUM SPORTS CHANNELS

169. The Director finds that, taken as a whole, the available evidence demonstrates that the relevant markets are no wider than the wholesale and retail supply of channels containing sports content that is unique to pay TV.[138] The content that he has identified as falling within this category during this investigation is live FAPL football.

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channels to the competitive level. The Champions' League example illustrates the difficulties of launching a premium sports channel.

[135] Response, Part 3, paragraph 13, footnote 2 suggests that BSkyB considered this analysis flawed, but did not elaborate.

[136] Response, Part 5, paragraphs 169-184

[137] Response Part 5 paragraph 174. DTT also could substitute other inputs, though to a lesser degree than cable: Response Part 5 footnote 193.

[138] In doing so, he addresses BSkyB's criticism that he had failed to consider in the Rule 14 Notice whether there are separate markets for premium sports and film channels. See Response, Part 3, paragraphs 57-72.

170. The analysis of subscriber preferences (see paragraphs 120 to 137) indicates that other sports and non-sports content is not likely to be a good substitute for live FAPL football, even if they are more popular overall. The Director notes that all of his analyses are consistent in suggesting that this is the relevant market.

171. The analysis of potential substitutes (see Part Six, Sections V to VII) suggested that there are few good substitutes for live FAPL football matches. This combined with exclusivity is responsible for the high price of FAPL rights relative to other sports rights, and other content rights.

172. The nature of competition in the market also convinced the Director that the FAPL rights are important content that helps BSkyB differentiate its premium sports channels from sports events screened elsewhere.

173. The Director also observed that the structure of supply and demand (see Part Six, Section IX) is such that if BSkyB's premium channels are not constrained to the competitive level in the retail market then they are unlikely to be constrained to the competitive level in the wholesale market.

174. Against this background the Director also conducted a price analysis (see paragraphs 144 to 155). The Director found that the relative prices of BSkyB's premium channels and basic channels are much more variable over time than would be expected if they were competing on the same market.

175. The Director therefore considers that the relevant retail market is the provision of packages containing live FAPL football. Accordingly, he considers that the relevant wholesale market (and the market relevant to this investigation) is the wholesale supply of packages containing sports content that will only be shown on premium pay TV channels, in particular live FAPL football.

PART SEVEN RELEVANT MARKET FOR PREMIUM FILM CHANNELS

176. In this Part, the Director considers the market relevant to the provision of BSkyB's premium film channels, one of the products to which submissions responsive to the March 2000 Review related. The Director's assessment covers both the relevant wholesale market and retail markets.

177. After describing BSkyB's premium film channels in more detail, he considers their defining characteristics (i.e., that they carry 'Hollywood' films from the premium pay TV film channel time 'window'), and considers the extent to which potential substitutes might constrain the pricing of channels carrying such films. He concludes that such products are not sufficiently close substitutes to be included in the same relevant market.

178. BSkyB argued that it, '*faces significant and increasing competition constraints from the suppliers of free to air television channels, basic pay television channels, pay per view services, other premium sports and film channels and rental of films on video and DVD. Accordingly the relevant retail and wholesale markets in this case should be regarded as including these services.'* [139]

179. The Director has considered each of these proposed substitutes below.

I. DEFINING THE RELEVANT PRODUCTS WITH REGARD TO BSKYB'S PREMIUM FILM CHANNELS

1. BSkyB's description of its premium film channels

180. According to BSkyB, Sky Premier and Sky Moviemax broadcast a mix of films and film-related programming.[140] On the digital satellite platform they each comprise five channels (one main channel and four multiplexes). All of BSkyB's film channels broadcast for 24 hours a day with the exception of the Sky Premier Widescreen multiplex which broadcasts for six hours a day during weekdays and 12 hours a day during the weekend. In 2001, 1,335 different titles were broadcast on these channels, of which 760 were on Sky Moviemax and 575 were on Sky Premier.

181. The type of films broadcast on these channels varies from library titles (i.e., films that have previously been shown on television), through to 'blockbuster' titles. Categories A-C are defined as follows:

- Category A: US box office receipts exceeding $[...] and/or UK box office receipts exceeding £[...] and/or UK video rentals exceeding [...]m transactions.

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[139] Response, Part 4, paragraph 201.

[140] Response, Part 4, paragraph 48.

- Category B: US box office $[…] - $[…] and/or UK box office £[…]-£[…] and/or UK video rentals […]-[…] transactions. Also includes movies acquired as […] and […].

- Category C: US box office under $[…] and/or UK box office under £[…] and/or UK video rentals under […] transactions.

[*Explanatory note: Category A films are the most successful at the box office and in the rental window while Category C films are the least successful.*]

Films in categories A-C are shown on Sky Premier and Sky Moviemax in the 'pay television' window. This begins 18 months after cinematic release, and runs for 15 months. The films in these categories are available to rent on video and DVD and many will have been shown previously in the PPV window.

2. Windowing

182. The Director accepts BSkyB's description of premium film channels. However, he considers that they have certain additional characteristics. While the funding characteristics of premium sports channels set out above, paragraphs 70 to 83, apply equally to premium film channels, films are released in the UK through a series of time 'windows' set by the film distributors and studios.

183. Under this system, new films are typically first shown at UK cinemas for up to 12 months before becoming available on video/DVD for rental/purchase for a further period of 12 months (i.e., the video 'window'). During the second half of the video window, some films may be released for PPV and/or video-on-demand ('VOD') broadcasting. Next, there is the subscription-based pay TV window which lasts 15 months. Following the pay TV window, films become available for broadcasting on free-to-air services for a period of five years. Subsequently, films are regarded as library stock.

184. In the retail market premium film channels are a bundled product, so that when a subscriber purchases a package containing either of BSkyB's premium film channels they obtain a film channel that screens a variety of films. A subscriber to a premium film channel cannot choose to receive just the films in the 'pay television' window. S/he also receives films in the free-to-air window (including any films shown on channels bundled with BSkyB's premium film channels). BSkyB calculated that in 2001 […]% of the films screened on Sky Premier and […]% of the films screened on Sky MovieMax are not in the 'pay television' window.[141]

3. BSkyB's criticisms of the Director's treatment of windows

185. BSkyB argued that the Director had erred in concluding that films in different windows do not compete with each other because, in BSkyB's

[141] Response, Part 4, Charts 2 and 3.

view, they compete in three ways.[142] First, certain time windows overlap with video rental and sale. Second, BSkyB argued that the length of time from cinematic release is only one aspect of the appeal of a film and so a 'blockbuster' on free-to-air TV might be a good substitute for a less successful film on a premium film channel. Third, BSkyB argued that there is some competition between different windows because they are 'economic substitutes'.

4. Effect of windows

186. While the Director considers that time windowing alone does not imply separate relevant markets, he considers that windowing differentiates TV products sufficiently to allow them to be assessed as forming potentially separate markets.

187. Windowing is a form of price discrimination that allows the film producer to extract more revenue from consumers than if the film were to be shown in all windows simultaneously. Among any group of viewers of a specific film there will be varying degrees of willingness to pay to watch that film. The film studios use this windowing strategy to price discriminate and segment viewers according to their willingness to pay: the later the release window, the lower consumers' willingness to pay for the ageing film. The stronger a consumer's desire to view a particular film the shorter the time since release s/he will wish to wait before viewing it and the more s/he will be prepared to pay to see it. Accordingly, the earlier the window the more expensive it is to watch any given film.[143]

188. The Director considers this an important characteristic of the way films are retailed. Premium film channels are aimed at a particular group of film consumers: those with a lower willingness to pay than consumers who would rent films on video or go to the cinema, but with a higher willingness to pay than those who would only pay to watch films on basic channels or who have insufficient willingness to pay to purchase any pay television channels, and watch films free-to-air.

189. The Director considers that the presence of a 'pay television' window, first run Category A and Category B films (i.e., not yet available on free-to-air channels) differentiates premium film channels from other TV

[142] Response, Part 3, paragraphs 195 - 198.

[143] This is much the same principle that is employed by publishers with regard to hardback and softback books: hardback books are substantially more expensive because they are published first and are purchased by consumers with the highest willingness to pay. Softback books are published later and are purchased by consumers with a lower willingness to pay. Hardback books do cost more to produce than soft back books but the difference in price is much greater than the cost of production. This differential is the effect of price discrimination through time windows.

services sufficiently, so that they might be assessed to determine if they form a separate relevant market.[144]

190. Like live FAPL football, 'premium' films are central to BSkyB's success in attracting high numbers of subscribers. Between 1999-2001, premium film programming costs amounted to £852m and accounted for some 30% of BSkyB's total programming expenditure. This represents over double Channel Five's total programming spend, and 29% of ITV's total programming spend.[145]

II. POTENTIAL SUBSTITUTES FOR PREMIUM FILM CHANNELS

191. The prime attraction of packages containing premium film channels is that they offer consumers the opportunity to watch a range of films recently released in the UK. The Director identified the potential substitutes as:

(i) Video/DVD rental and sales

(ii) PPV films

(iii) Basic pay TV packages

(iv) Free-to-air channels

(v) Supply side substitutes.

192. The Director notes three points at the outset. First, the difficulties associated with the hypothetical monopolist test identified above (paragraphs 88 to 97). Second, marginal consumers of premium film channels are not readily identifiable, given that premium films are sold as part of a package, with no well defined retail price. Moreover, BSkyB acknowledges that its mixed bundling pricing strategy (paragraphs 562 to 565) induces subscribers not to select channels within packages sequentially, but on the basis of total consumer surplus.[146]

193. Third, even if the Director accepted BSkyB's definition of a wide retail market, this would not necessarily apply to the wholesale market. A certain percentage increase in the wholesale price of a channel is likely to give rise to a lesser percentage increase in the retail price faced by final consumers, and correspondingly less switching, than if the retail price of the channel had itself risen by the percentage increase in the wholesale

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[144] Just as the presence of certain content unique to premium sports channels allows packages containing such content to be assessed as potentially forming a separate market.

[145] Sources: BSkyB submission Form 20F Year 2000 page 43 and 44. FAPL/BSkyB Form A/B regarding the licensing arrangements for the FAPL dated 21 June 2002 section D, paragraph 9.28, page 92.

[146] Response, Part Seven, paragraphs 31-47.

price.[147] Given that premium film channels are bundled with basic channels, and offered in mixed bundles with other premium channels, an increase in the wholesale price may not give rise to any identifiable increase in premium film channel prices for final consumers.

1. Video/DVD rental

1.1 BSkyB's description of Video/DVD rental

194. BSkyB stated that consumers have been able to rent films on pre-recorded video cassettes for many years.[148] More recently, films have also become available to rent (and purchase) on DVDs. Films on DVD have significantly enhanced picture and sound quality relative to those on video cassette. BSkyB stated that it is estimated that around 90% of households have a video recorder or DVD player in the UK and, thereby, the ability to watch films in this manner.

195. BSkyB also stated that the video and DVD rental window continues indefinitely, so that it overlaps with all other windows other than the initial cinematic distribution window. It provided details of rental transaction trends from 1986 to 2001. The volume of video rentals declined significantly between 1989 and 1994, with annual rental volumes falling from 289 million transactions to 167 million transactions. Since then, it has been relatively stable. The volume of transactions increased in 1998. After a decline in 1999 the volume of rentals regained the 1998 level in 2000 as a result of a significant increase in rental of films on DVD. DVD rentals accounted for 5% of rentals in 2000. In 2001 the number of DVD rentals increased three-fold, to off-set a 9% decline in rental of films on video cassette. As a result, the total number of rental transactions remained unchanged relative to the level in 2000.

1.2 BSkyB's evidence

196. BSkyB stated that Video/DVD rental imposes both a direct and an indirect constraint on the prices that may be charged for packages including premium film channels.[149] With regard to the direct constraint, BSkyB identified the marginal subscribers to its premium film channels as those who have a preference for viewing films closer to their cinematic release date and those who watch relatively few films.[150] Telewest supported this view.[151] BSkyB also argued that video/DVD rental imposes an indirect constraint on the price of packages that include premium film channels because they constrain the price of PPV services. In turn BSkyB argued that PPV services constrain the price of premium film channels.

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[147] The converse is also true. Observing switching for a 10% increase in a retail product might imply a 15-20% increase in the wholesale price, but no relevant inferences concerning market definition should be based on such a large increase.

[148] Response, Part 4, paragraphs 168 - 170

[149] Response, Part 4, paragraph 171.

[150] Response, Part 4, paragraph 172.

[151] Telewest submission dated 28 April 2000, Annex One, page 13.

197. Additionally, BSkyB referred to some econometric studies of the US market concerning the substitutability of video hire and premium film channel subscription, see Annex 7.

1.3 The Director's analysis

198. As noted in paragraph 183, video rental has access to the earliest UK TV film release window. It offers individual films from the early time window at a comparable cost to PPV, and is likely to involve an individual viewing decision rather than a household decision to subscribe. There is a further clear difference from premium film channel subscription and PPV in that video hire necessarily entails search time and costs in obtaining and returning a video for hire.

199. Although BSkyB stressed the increasing volume of DVD penetration, there has not been any significant change in trend when VHS and DVD rentals are aggregated together. This is illustrated in terms of revenue and volume below.

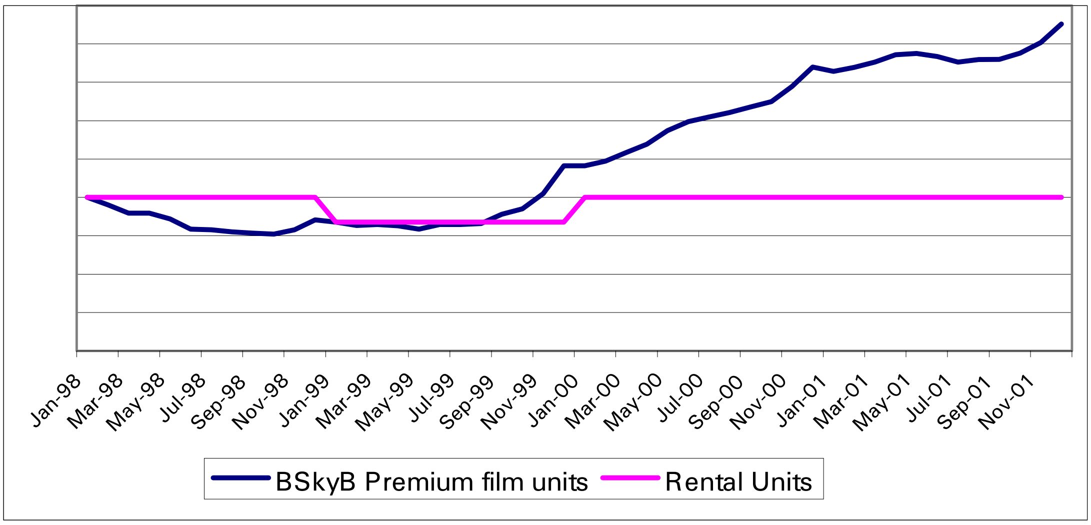
The video and DVD hire market by value and by volume (£m and million units)

	1998	**1999**	**2000**	**2001**
VHS Value (£m)	437	408	422	399
VHS Units (m)	186	174	178	162
Average price per unit (£)	2.35	2.34	2.37	2.47
DVD Value (£m)	-	-	22	65
DVD Units (m)	-	-	8	25
Average price per unit (£)	-	-	2.75	2.60
Total Value (£m)	437	408	444	465
Total Units (m)	186	174	186	186
Average price per unit (£)	2.35	2.34	2.39	2.50

Source: Keynote 'Video and DVD retail & hire' Market Report 2002

Video hire in terms of total units has remained relatively stable between 1998 and 2001. This has corresponded with only a rise of only 6.4% in the average hire price.

Chart 1: Index of premium film and rental units 1998 - 2001[152]



200. In contrast, BSkyB premium film units[153] sales increased by [*over 30*]% from [*over 4*] million in January 1998 to [*over 6*] million in December 2001. This has also corresponded with price rises for both single and dual movie packages. Between January 1997 and September 2001 the incremental price of a single movie package, Sky Premier or Sky MovieMax increased by 38.9%. Additionally, the dual movie package incremental price rose by 36.4%.[154] This analysis uses BSkyB DTH data only. The trend is also illustrated using total film units (cable, DTH, DTT), where a [*more than 20*]% increase occurred between 1997 and 2000.[155] These diverging trends support the Director's conclusion that video hire is not in the same market as film subscription.

201. As noted above (paragraph 193) evidence at the retail level may result in overly broad market definition at the wholesale level. Further, the Director noted the difficulties in identifying marginal customers.

202. BSkyB argued that video/DVD rental imposes an indirect constraint on the price of packages that include premium film channels via the chain of substitution including PPV services. Although the Director accepts that video/ DVD rental may be a substitute to some degree for PPV services (though he has no concluded view, and notes the increased search time

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152 The index graph is for illustrative purposes to contrast the trends between premium film and rental units. Rental units source: Keynote June 2002, corresponds to three data points. Premium film units source: BSkyB submission dated 7 October 2002 tables 2.1, 2.2, 9.1a and 9.1b.

153 Data comparisons in this paragraph have been made between 1997 and 2001, except that the Director does not have data on premium film units sold before January 1998.

154 Data relates to analogue packages. There are similar price increases for digital packages between October 1998 and December 2001. Sky Premier increased by 8.7%, MovieMax by 31.6% and Dual movies by 20%.

155 Response, Part 3, paragraph 238.

entailed in video hire relative to PPV, due to the need to go to a video hire outlet twice to hire and return a video) he does not consider that PPV services impose a sufficient constraint on premium film channels to be within the same relevant market. His reasoning is set out at paragraphs 204 to 223 below.

203. Finally, the Director is not persuaded by the US studies BSkyB referred to. First, they do not offer consistent results. Second, there is no evidence to suggest that consumer preferences are close enough over time and across countries to permit direct inferences about the UK market. Third, it is unclear whether there is like-for-like content across the US and UK. Fourth, the studies establish substitution between US pay services rather than the direct question of whether customers of video hire would constrain a monopolist of premium services to the competitive level. Accordingly, the Director considers that the characteristics of video/DVD rental are such that it is unlikely to constrain premium films to the competitive price.

2. PPV

2.1 BSkyB's description of PPV films

204. BSkyB provided a description of PPV services.[156] PPV television services enable viewers to watch a particular television programme, in a particular period, usually for a one-off payment. Viewers order the programme either via their set top box, or via a telephone call to a call centre. They are then enabled electronically to view the particular programme by the retailer of the PPV service.

205. BSkyB's PPV film service, Sky Box Office, typically begins showing a film 12 months after its cinematic release, and may continue screening for six months. The PPV window overlaps with the video/DVD rental window, so that consumers may rent the same titles as are available on PPV services. Sky Box Office typically shows around 35 film titles each month, with around 17,800 film runs.

156 Response, Part 4, paragraphs 154-161.

206. During the period investigated, the PPV film services available were:

PPV FILM SERVICES AS AT JANUARY 2001		
Platform	**Service**	**Operator**
Cable	Front Row	Joint venture between Telewest and NTL
DTT	ITV Select (formerly ONrequest)[157]	Joint venture between ITV Digital and SDN
Digital satellite	Sky Box Office	BSkyB
Digital satellite	u>direct	dbc[158]

207. Front Row, ITV Select and Sky Box Office were only available to subscribers to a pay television package retailed by NTL or Telewest, ITV Digital and BSkyB respectively. No subscription to any pay television package was required before digital satellite viewers could purchase films and events from u>direct. The supply of the great majority of films to Front Row, ITV Select and Sky Box Office was non-exclusive, so that the same titles may be shown simultaneously on all three services.

208. The pricing of PPV films was relatively consistent across the platforms, with films typically costing around £3 to view.

2.2 The Director's additional description of PPV films

209. As outlined in paragraph 183 above, PPV providers have access to earlier windows than are available to premium film channels, so that identical films are not available simultaneously on PPV and premium film channels.

210. A subscriber (i.e., the household) to a premium film channel is obtaining access to a range of films provided by a broadcaster,[159] and must initially commit to paying for the film channel for an initial period of one year. Broadcast times are selected by the channel provider. In contrast, a PPV purchaser is not necessarily the household but may be an individual within the household with specific tastes, making a one-off purchasing decision. Multiplexing (i.e. showing films on different channels with differing start times) allows greater consumer choice with regard to start time.

211. Premium film channels are a bundled product with more recent releases being screened on the same channel as older films. In contrast, PPV films

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157 ITV Digital's PPV service now discontinued.

158 dbc ceased operating in August 2001.

159 If one specific film was very important to a customer, it is unlikely that they would go to the trouble and expense of subscribing, given the availability of video rental, for example (assuming a video cassette recorder is owned).

are not bundled and consumers not only have access to films not available on a premium film channel but also can select individual films (in much the same way as renting a video).

2.3 BSkyB's submissions

212. BSkyB argued that when trend comparisons are made between sales figures of two products changes in quality must be considered.[160] In particular, during the period under consideration, BSkyB launched its digital services, which offered multiplexed versions of its channels. Second, such sales are seasonal, peaking over Christmas. Third, evidence from Telewest and BBC in particular suggests that PPV films are a good substitute for packages containing premium film channels.

213. BSkyB's assessment of the relevant market stated that there are two groups of marginal consumers who might consider ceasing to subscribe to a premium film channel or not to subscribe in the first place unless the prices of packages including such channels are competitive with PPV services. These are consumers who have a preference for viewing films close to their cinematic release, and consumers who watch relatively few films.[161]

2.4 The Director's analysis of PPV films

214. BSkyB in effect argued that the price of PPV films constrains a bundle of older films, that does not include those PPV films, to the competitive level. The Director has stated (paragraph 187) that he considers windowing allows film distributors to increase the price of films above the level that would prevail in the absence of windowing by discriminating between customers with differing willingness to pay. The Director has considered whether the available evidence indicates that PPV films constrain the prices of premium film channel subscriptions to competitive levels.

215. Data from BSkyB, Chart 1, shows that the launch of Sky Box Office as an analogue service in December 1997 and its expansion to digital subscribers on a Near Video-On-Demand ('NVOD') basis in October 1998[162] had no discernible effect on sales of BSkyB's film channels. Between the period January 1998 and December 2001, PPV film buys increased substantially, by [*over 200*]%. This corresponded with PPV prices remaining relatively constant at £2.99/£3 per buy.[163] BSkyB premium unit sales also increased by [*over 30*]% while prices rose between January 1998 and September 2001. The single film package,

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160 Response, Part 3, paragraph 232.

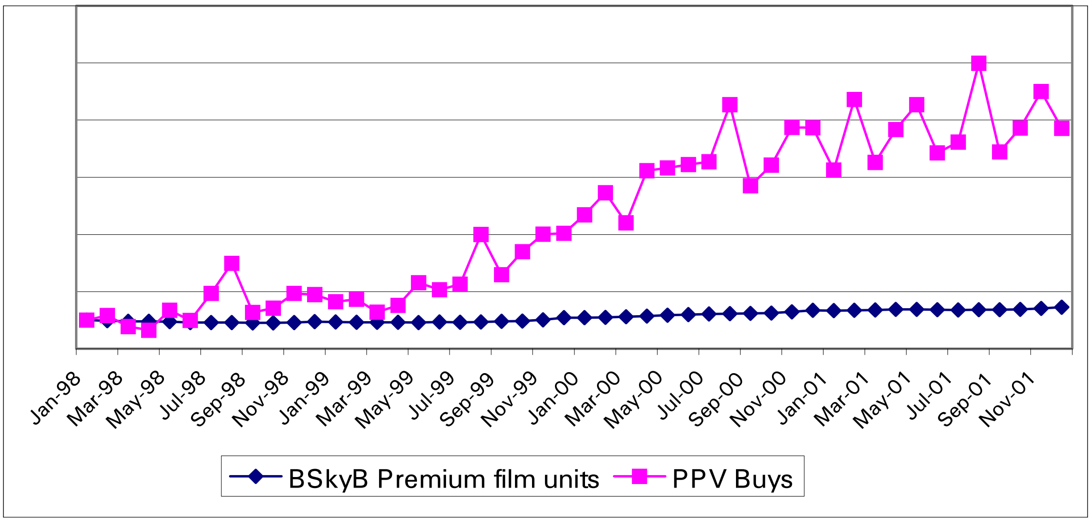
161 Response, Part 4, paragraph 163.

162 BSkyB response Part 3, footnote 133 provides introduction dates.

163 From July 2001 to December 2001 digital grades 1-4 price increased to £3.25. BSkyB submission dated 7 October 2002 question 2.

Sky Premier or Sky MovieMax increased by 19.1%. Additionally, the dual movie package price rose by 20%.[164]

Chart 2: BSkyB's PPV buys and premium film unit sales[165]



The Director notes that if PPV and premium film channels were in the same market he would expect, other things being equal, to observe an adverse effect on film channel subscriptions or a fall in their prices following the launch of new PPV services. However as illustrated in Chart 2 this is not observed.[166]

216. BSkyB generally criticised analyses such as the one above on the grounds that the 'test' does not recognise that demand for a product or service may be affected simultaneously by a range of factors.[167] BSkyB was particularly concerned that the Director may make incorrect inferences from situations where coincident shifts in the demand for a product (e.g., through quality changes) may mask the true underlying effect on the sales of a product following a change in price of a potential substitute. BSkyB argued that the way to overcome this is through econometric testing of a system of demand equations.

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164 Data relates to analogue packages. There are similar price increases for digital packages between October 1998 and December 2001. Sky premier increased by 8.7%, MovieMax by 31.6% and Dual movies by 20%.

165 The index graph is for illustrative purposes to contrast the trends between premium film and PPV buys. Premium film units and PPV data source: BSkyB submission dated 7 October 2002.

166 BSkyB argued that it is better to use the buy rate (the number of buys per month per subscriber) as the measure of demand for PPV and use the number of subscribers as the measure of demand for subscription film services. BSkyB submission dated 7 October 2002 paragraphs 4.6 and 4.7. The Director has carried out this analysis and the trends illustrated in Chart 2 are still observed.

167 See BSkyB response to a section 26 notice, dated 7 October 2002; 'Substitutability of pay per view film services and subscription film services.'

217. The Director agrees that there is a risk that unduly strong inferences may be potentially made from price changes in isolation. However, this risk is reduced if the trend over a long time period containing a number of price increases for one product is analysed.

218. With regards to changes in quality, as noted, these are subjective and hard to assess. BSkyB stated that the quality of its premium film channels increased substantially as both premium channels were expanded from one screen to five screens (i.e., multiplexing) and one screen was replicated in 'widescreen', giving a total of 11 premium channels where previously there had been only two, at no extra cost to subscribers.[168]

219. The Director notes that these quality improvements were the result of the introduction of NVOD digital services. These services became available in October 1998 and could explain the first retail price increase the Director has considered. However, the increase of 10 September 1999, is much less likely to be explained by a quality improvement that occurred 12 months previously. Accordingly, the Director considers that the lack of an effect on the take up of BSkyB's premium film channels between September 1999 and December 2000 indicated in Chart 2, despite an increase in the retail price of those channels in September 1999, indicates that this price increase (while quality was constant) did not cause BSkyB subscribers to switch from packages containing BSkyB's premium channels to a combination of packages without such channels and Sky Box Office.

220. The Director does not consider that the PPV services Sky Box Office and Front Row had an effect on the take-up of BSkyB's film channels that would be sufficient to constrain appreciably the pricing of premium film channels.[169]

221. BSkyB provided a hypothetical example of substitution between windows in the Response.[170] The Director does not consider that this example shows that the price of an earlier window constrains the price of a later window to the competitive level, although he accepts that there is some constraint: see Annex 8.

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168 Response, Part 3, Page 68, paragraph 236.

169 The Director notes the submissions of the BBC and Telewest referred to by BSkyB, (Response Part 3 paragraph 201 and 202) with regard to the effect of PPV services on the prices of channels including premium packages. The BBC evidence notes that the price of the following time window constrains the price of the preceding window. Source BBC submission of 26 January 2001, Page 9. PPV, however, precedes premium films. Telewest stated that 18% of Front Row users surveyed said they spent less time watching BSkyB's film channels. Source, Telewest submission 28 April 2000, pages 12-13 Annex 1 and 10 October 2000. The relevant behaviour, however, is how many stopped subscribing to BSkyB's film channels as a result of using Front Row. The survey does not address this point and as such the Director does not consider the results relevant to his analysis of the relevant market.

170 Response, Part 3, paragraphs 198-200.

222. BSkyB criticised the Director's analysis of PPV prices stating that he failed to focus on the marginal consumer or take into account all the other substitutes that also constrain the prices for such packages.[171] BSkyB noted the average number of films watched by a subscriber to BSkyB's premium film channels was 6.2 films per month in 2001. The Director considers that the correct definition of the marginal consumer is not someone who watches fewer films but rather someone who values them less than the average subscriber and is therefore more likely to switch in response to a price increase. As noted, given the packaged nature of BSkyB's offerings, the marginal subscriber cannot readily be identified.[172]

223. It is incorrect that products that are substitutes to some degree necessarily belong to the same relevant market. If that were so, products not in the same relevant market should not be substitutes at all. Indeed, the Director considers that PPV films could be regarded as a substitute if the price advantage compared with premium channels became large enough. The Director considers, however, that PPV film supply does not constrain to a sufficient degree to fall within the same relevant market as premium film channels.

3. Basic pay TV channels

3.1 BSkyB's description of basic Pay-TV channels

224. BSkyB provided a description of basic pay TV channels (paragraphs 139 to 141 above). BSkyB highlighted that many films are shown on basic channels: in particular, Carlton Cinema and The Studio are dedicated to films. Many other basic channels, such as Sci-Fi, UK Gold and Sky One, regularly carry films. In 2001, there were 1,098 different films shown on basic channels, and a total of 13,171 films shown.[173]

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171 Response, Part 3, paragraph 245.

172 Following this analysis the Director notes that the difference in retail price between the Family Pack and the Family Pack plus Sky Premier is £11 a month (Response, Part 3, Annex 1). With PPV films retailing at approximately £3 each this would suggest that only a subscriber to Sky Premier who watches less than four films a month (for which he would have been prepared to pay £3 on PPV) would consider it cost effective to stop subscribing to Sky Premier and just take the Family Pack. The analysis is complicated if the subscriber also takes a premium sports channel. The difference in retail price between a package containing the Family Pack, Sky Sports 1 and 2 and Sky Premier and a package containing just Sky Sports 1 and 2 and the Family Pack is £3 per month. Again, with PPV films priced at £3 on average only the consumer who watches less than one film a month would find it cost effective to cease subscribing to Sky Premier and rely on PPV services. As the average number of films watched per month was 6.2 in 2001, (Response, Part 3, paragraph 245) the Director considers that the number of subscribers watching only one film a month is likely to be so small as to not constrain the pricing of packages containing premium film channels to the competitive level.

173 These figures include TCM, The Studio and Carlton Cinema.

3.2 BSkyB's evidence

225. BSkyB argued that the existence of basic channel packages constrains the pricing of packages including premium channels:[174] *'The more that households are able to fulfil their desired viewing via a combination of free to air television and a subscription to a basic package, the less willing such households will be to subscribe to a more expensive pay television package that includes premium channels'*.[175]

226. BSkyB noted that [*over 1000*] subscribers per week 'spin down' from premium packages to basic packages while [*over 1000*] trade up from basic-only packages to packages including premium channels.[176] BSkyB stated that this was switching.

3.3 The Director's analysis

227. The Director considers that BSkyB's points about fulfilling viewing desires overlook the different characteristics of basic and premium film channels and the competitive conditions relevant to their retail.

228. Basic channels have the capacity to offer a volume and range of films similar to that provided by premium film channels. However, regardless of funding ability, as outlined in paragraph 183 most film studios have an explicit release window for basic pay TV that is some time after the premium pay TV window (and sometimes even after free-to-air).[177] Consequently, basic channels do not have access to films of a comparable release date to premium channels and are therefore limited in their ability to provide directly competing products. By definition, basic channels must collect subscription revenue as a share of the total basic subscription paid by consumers who subscribe to the whole basic package (the season ticket principle, see footnote 40).[178]

229. As noted in paragraph 187, the fact that studios price discriminate by means of time windows is itself an indication that willingness to pay differs substantially, even for the same film, as between 'premium' and 'basic' windows. If the basic window was a strong susbtitute it would not be possible to sustain the price differentials within the windowing system.

230. The Director also disagrees with BSkyB's conclusions derived from its 'spin down' data. Switching is the response of subscribers to a change in

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174 Response, Part 4, paragraph 148.

175 Response, Part 4, paragraph 148.

176 Response, Part 4, paragraphs 151-152.

177 BBC submission dated 26 January 2001, question 2.

178 For example, if the only way a pay TV basic channel provider can successfully bid for a premium film package is to add a premium to the price of a basic channel package, and subscribers' valuations of the channel is consistently high enough to do this, then the film package becomes part of the premium film market itself, by definition.

price. Given that BSkyB's prices do not alter on a weekly basis the Director does not find that this can be considered to be evidence of switching. As discussed above, premium and basic film channels are both retailed in bundles of packages. As such, switching from premium film channels to basic film channels at the retail level involves switching from a package that includes premium film and basic channels to a package that only includes basic film channels. A subscriber will only switch between packages if, as a result of an increase in the price of premium film channels, s/he now obtains less 'consumer surplus'[179] from a package including premium film channels than s/he does from a package including only basic channels.

231. As outlined in paragraphs 92 to 95, the 'cellophane fallacy' means that a high propensity to switch would not be inconsistent with BSkyB dominating a relevant market, and so, even if there were good evidence of switching, the Director can place little weight on such information. If premium films were hypothetically priced at the competitive level, the differences in the characteristics of premium film channels as characterised in paragraphs 180 to 190, and basic channels, as outlined above, leads the Director to consider that there would be a low propensity to switch between premium film channels and basic channels in response to an increase in the price of premium channels. In particular, a SSNIP from that level would be profitable.

232. This is also supported by the indicative differences in viewer valuation between basic content and premium channels. As is the case with premium sports channels (paragraphs 149 to 151), there have been large disparities in price movements: between September 1996 and December 2000 the incremental price of Sky Premier, for example, increased in nominal terms by some 100%, compared to an average retail price reduction of 45% for basic channels.[180] Using an alternative version of the price of premium films offers a similar result.[181] Between December 1998 and December 2000, BSkyB's basic subscriber volume increased from 3.3 million to 4.9 million (46%), whilst sales of its premium film channels increased from [*over 4*] million units to [*over 6*] million units

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179 The difference between what a consumer was willing to pay and what s/he actually paid.

180 See footnote 102 for sources and the price changes of basic channels. In September 1996 the incremental price of Sky Premier was £17.99 – 11.99 = £6, and this increased to £25 - 13 = £12 in December 2000. MovieMax has increased by 33% over the same period: in September 1996, the incremental price of MovieMax was £17.99 – 11.99 = £6, and this increased to £21-13 = £8 in December 2000.

181 If the premium plus basic channel price is considered to comprise an access charge plus an incremental charge for the right to view a premium channel, then comparing the 1996 premium plus basic package price with that in 2000 gives a 39% increase for Sky Premier and a 17% increase for Sky MovieMax. Again both price movements are in the opposite direction to the per channel basic package price change (i.e. a 45% fall), further suggesting that basic channels do not constrain the price of premium channels. (This compares a per channel price with overall package prices.) See footnote 104.

([*over 30*]%). The figures above offer evidence that the pricing of premium film channels is only weakly constrained by basic-only package prices.

233. As wholesale demand for premium film channels is a derived demand, a lack of switching at the retail level in response to an increase in the wholesale price, will result in correspondingly little switching at the wholesale level.

234. The Director concludes that neither his analysis nor BSkyB's evidence suggest that basic channels are a good substitute for packages including premium film channels.

4. Free-to-air channels

4.1 BSkyB's description of free-to-air channels

235. According to BSkyB,[182] TV households have access to five major free-to-air channels (ITV, BBC 1, BBC2, Channel 4 and Channel 5) at no marginal price, other than the annual licence fee which has to be paid in order to use any television. There are increasing numbers of new free-to-air channels on the DTT and digital satellite platforms,[183] these are available to any household with appropriate reception equipment and no subscription to a pay television service is required. In 2001 the five main free-to-air terrestrial channels showed 2,954 different films[184] compared with 760 different titles on Sky Moviemax and 575 different titles on Sky Premier, a total of 1,335 different titles.[185]

236. BSkyB argued that free-to-air channels have significant strength within the market and this is demonstrated by large viewing figures and higher audiences in absolute terms. Pay TV has captured around 20% of total viewing hours within the past eleven years. In addition, BSkyB argued that free-to-air channels constrain premium film channels due to the large number and variety of high quality films shown.

4.2 BSkyB's view of the relevant market

237. The Director notes that BSkyB's submission on the competitive effect of free-to-air channels does not take account of his analysis[186] which shows that although there is some competition between free-to-air channels and packages containing premium film channels, this is not enough to constrain the prices of the latter to the competitive level (see Annex 6). BSkyB stated that there is interaction between free-to-air channels and premium channel packages. The Director does not dispute this but

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182 Response, Part 4, paragraphs 58-70.

183 It is not possible to broadcast free-to-air on cable networks as access to those networks is controlled by cable operators.

184 Response, Part 4, paragraph 69.

185 Response, Part 4, paragraph 48.

186 See, for example, Response, Part 4, paragraph 72.

considers that BSkyB's evidence does not contradict his analysis that this competition is not sufficient to constrain prices to the competitive level.

238. As noted (paragraph 132) BSkyB referred to an OFTEL survey[187] that it stated shows that the five most important reasons for not taking a pay television subscription, '*are all related to the issue of existing free to air services being of sufficient value that the extra value offered by pay television services does not warrant the extra cost*.'[188] The Director noted that the survey related to the reasons for not subscribing to digital TV, not pay TV. The fifth most important reason is identified as '*analogue pay TV provides all I want*'. The Director does not consider that this survey can identify the effect that free-to-air services have on the decision to subscribe to pay television services.

239. BSkyB provided evidence regarding the viewing share for the top five rating films on its premium film channels compared with the audience share for programming shown concurrently on free-to-air channels.[189] This evidence shows that the free-to-air channels and in particular, BBC1 and ITV1, attract a greater share of the audience than BSkyB's premium film channels.[190]

4.3 The Director's analysis of free-to-air channels

240. The Director considers that the films on free-to-air channels and premium film channels are appreciably differentiated as they show different films with differing regularity and that premium film channels will always have access to films not yet available to free-to-air broadcasters. The Director's analysis of the effect of product differentiation with regard to premium sports channels at paragraph 113 to 138 is equally relevant to his discussion of premium film channels.

241. Free-to-air channels also show a wide variety of popular non-film programming. The Director considers that it is necessary to consider whether both the films available on free-to-air channels and the non-film programming available constrain the price of premium film channels.[191]

242. The Director notes that the nature of substitution between packages including premium film channels and free-to-air programming is different to substitution in most product markets. Specifically, free-to-air channels

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187 Response, Part 4, paragraph 87.

188 Response, Part 4, paragraph 87.

189 Response, Part 3, paragraph 289.

190 BSkyB notes that of the five highest rating films on its premium film channels three were not recently released, as they were released in 1977, 1980 and 1983. The Director notes that these three films, despite their age, had not yet been shown on free-to-air terrestrial channels and as such were still effectively in the subscription window.

191 This addresses BSkyB's criticism that the Director had not considered non-film programming in his assessment of the relevant market.

impose only an indirect constraint on the prices of packages including premium film channels. The Director discusses this at Annex 6.

243. The Director's analysis demonstrates that the films and the non-film content shown on free-to-air channels do not constrain the prices of packages including premium film channels to the competitive level.[192]

244. The Director does not consider that BSkyB's evidence regarding the audience share of its premium film channels indicates that free-to-air channels constrain the prices of packages including premium film channels to the competitive level. In particular, the Director notes that most, if not all, television viewers are interested in seeing a variety of programmes. Even the most ardent film fan is unlikely to watch only films. Accordingly, the Director finds that the observation that free-to-air channels can attract a larger audience share than premium film channels is consistent with the analysis at Annex 6 that shows that free-to-air channels do not constrain the pricing of packages including premium film channels.

245. The Director concludes on the basis of the evidence supplied by BSkyB, third parties, and his own analysis that free-to-air television channels do not constrain the prices of packages including premium film channels to the competitive level.

5. The wholesale market

246. As in his consideration of channel packages containing live FAPL football, the evidence above relates to conditions at retail level. Again, given that the Director considers that demand at wholesale is a demand derived from consumer demand, and given the lack of supply side and input substitutes (see paragraphs 247 to 251 below), he is satisfied that the market at wholesale level will be no wider than it is at retail level (see paragraph 163 above).

5.1 Supply side substitutes

247. As with the provision of premium sports channels, the issue is whether a supplier in a business closely related to premium films could use existing rights or readily purchase new rights to form a competitive new premium film channel promptly, within, say, 12 months.

248. The key constraint on supply side substitution is the windowing system instituted and maintained by the film rights holders (see paragraphs 182 to 184 above). This prevents any new entrant from launching a premium film channel carrying recently released popular films without the appropriate licence from the rights holder. Although free-to-air broadcasters may have access to popular films whose attractiveness has not significantly declined over time, in terms of packaging a large number

192 The Director notes that he included this analysis in the Rule 14 Notice but BSkyB chose not to consider it when criticising the Director for not taking account of non-film programming.

of films for a dedicated channel, they only have access to the film distributors' later release window. They would not be able to construct a premium channel showing films in the pay television subscription window by migrating such material.[193]

249. It is possible for a free-to-air broadcaster to purchase films directly from the subscription-based pay TV window and become an alternative premium channel provider. However, given the range of films required, the funding level, and the difficulty in negotiating rights with the film distributors, this would require significant investment and would take considerably longer than one year to complete. Further, and of particular significance, BSkyB has concluded lengthy, exclusive agreements with practically all the Hollywood studios (see Annex 9).[194]

250. Another potential source of supply side substitutability might be PPV film providers. PPV providers are potential entrants to the premium film channel market; but the Director does not consider that such providers extend the relevant market. First, the purchasing cost of using PPV films to mimic a premium channel would prove prohibitive (i.e., by offering subscribers bulk PPV films at a fixed price.) Second, if a new entrant wished to purchase premium films through the usual later release window (i.e., rather than using PPV material), it would take considerable investment and more time than one year to enter the market. Free-to-air broadcasters would be in a similar position with regards to entry.

5.2 Input substitutes

251. The factors considered above (paragraphs 167 to 168) apply equally to BSkyB's provision of premium film channels.

III. CONCLUSION ON THE RELEVANT MARKET FOR PREMIUM FILM CHANNELS

252. The Director finds that, taken as a whole, the available evidence demonstrates that the relevant markets are no wider than the wholesale and retail supply of premium film channels, characterised by first run Category A and Category B films shown on the pay TV window ('premium films').

253. Premium film channels' closest substitutes, video/DVD hire, PPV and films on basic packages and free-to-air TV have some characteristics in

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[193] BBC submission dated 26 January 2001, questions 2 and 6.

[194] The presence of *Film Four* does not contradict this. The channel is a 'niche' product offering 'art house' and library material and films directly commissioned by Channel Four. The reliance on own-commission films implies that entry on this basis would take longer than one year, so that free-to-air broadcasters are potential entrants to the premium film market rather than a (supply side) extension of the relevant market itself. Channel Four submission dated 30 January 2001 (page 3) stresses that obtaining access to sufficient films is a major entry barrier to the wholesale premium film market.

common: in particular, they all allow consumers to watch films of varying quality on a TV screen. BSkyB argued that this necessarily means that they compete with premium film channels and that even certain films overlap between these alternative media at any one time.

254. The key to understanding the product differentiation of premium films and its potential substitutes, however, lies with the release windows set in the UK by the film studios and distributors. Whilst the Director considers that time windowing and the resulting ability to discriminate between consumers does not by itself imply separate relevant markets, in this case it clearly differentiates the characteristics of premium film channels and their alternatives on which consumer preferences can be tested.

255. The Director's analysis of the differences in these products' characteristics and consumer preferences has consistently indicated that the closest substitutes would not constrain the price of premium film channels were they priced at the competitive level. The high value placed by many consumers on the 'newness' of a film and the ability to watch a selection of films in a period without prohibitive costs has been central to the Director's analysis.

256. Any precise empirical SSNIP test on the premium film market would be likely to suffer from the cellophane fallacy outlined in the section concerning the market relevant to the supply of packages containing unique to pay TV sports content (currently identified as live FAPL football), but when the Director has been able to examine indicative trends in relative prices and volume growth of premium films and potential substitutes, the results have supported his conclusions. Moreover, whilst the Director has necessarily examined the potential substitutes in an incremental fashion, there is no evidence to further BSkyB's claim that taking these alternatives together would offer a different conclusion.

257. The Director therefore considers that the relevant retail market is the provision of packages containing premium film channels as defined by first run Category A and Category B films shown in the pay TV window.[195] Accordingly, he considers that the relevant wholesale market (and the market relevant to this investigation) is the wholesale supply of packages containing such premium film channels.

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195 This includes channels, or packages of channels, that occasionally show first run pay TV window films that would be given the Hollywood/BSkyB Category A or Category B label if it were supplied by BSkyB. For example, 'East is East' produced by FilmFour and shown on the FilmFour channel, grossed over £[...] in the UK. Source: Guardian Unlimited, 'FilmFour's blurred vision', http://media.guardian.co.uk/ channel4/ story/ 0,12225,752628,00.html

PART EIGHT GEOGRAPHIC MARKET RELEVANT TO SUPPLY OF PACKAGES CONTAINING UNIQUE TO PREMIUM SPORTS CHANNEL CONTENT AND PREMIUM FILM CHANNELS

I. INTRODUCTION

258. The relevant geographic market is the area over which substitution takes place. Geographic markets are defined using the same process and concepts as that used to define the product market.[196]

259. Both EC and UK precedent have consistently defined TV markets, as well as the distinct pay TV market, as national. The EC Commission has found in several decisions that the national character of TV broadcasting derives from different regulatory regimes, existing language barriers, cultural factors and other different conditions of competition prevailing in the various national markets (such as the structure of the market for cable networks).[197] In particular, for pay TV, the EC Commission has found that programmes broadcast in one country are to a large extent not interchangeable with programmes broadcast in other countries[198] and that the conditions of competition for pay TV suppliers differ considerably in the individual Member States.[199]

260. Similarly, the Director in the 1996 Review and the Competition Commission in several merger reports have defined the relevant market or pay TV provision as the UK.[200] In particular, the Competition Commission, in its report on *BSkyB/Vivendi,*[201] stated:

> 'The territorial nature of rights means that there are no substitutes for UK rights and hence, in an economic sense, the market is national.'

261. The Director has considered whether the geographic scope of the market for premium films and sports channels is narrower than the UK and extends only to a region of it, or whether it could encompass a wider region.

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196 OFT 403 'Market Definition', Section 4.

197 E.g. Case IV/M.779, *Bertelsmann/CLT*, European Commission decision of 7 October 1996, paragraph 20; Case IV/M.553, *RTL/Veronica/Endemol*, [1996] OJ L-134/32, paragraph 25; Case IV/M.584, *Kirch/Richemont/Multichoice/Telepiu*, European Commission decision of 5 May 1995, paragraph 17; Case IV/M.1219, *Seagram/Polygram*, [1998] OJ C-309/8, paragraph 53.

198 E.g. TV viewers who want to watch sports are significantly more interested in seeing teams and players of their own nationality than those from other countries.

199 See Case IV/M.469*, MSG Media Service*, [1994] OJ L-346/1, paragraph 46.

200 E.g. *British Sky Broadcasting Group Plc and Manchester United Plc: a report on the proposed merger;* Cm 4305, April 1999; *Vivendi SA and BSkyB: A report on the merger situation*; Cm 4691, April 2000; *NTL Incorporated and Cable & Wireless Communications Plc: A report on the proposed acquisition*, Cm 4666, March 2000.

201 *Vivendi SA and BSkyB: A report on the merger situation*, Competition Commission, Cm 4691, April 2000.

II. REGIONAL GEOGRAPHIC MARKETS

262. The narrowest potential market definition is a region of the UK. Although the coverage of UK distributors varies,[202] any gaps are not large or predictable enough to yield localised pricing opportunities for individual platform operators. The national pricing strategies of cable companies indicate that they regard the relevant market as being broader than individual franchise areas,[203] while both BSkyB and ITV Digital (prior to insolvency) also pursued national pricing policies.

III. MARKETS WIDER THAN THE UK

263. Following the European Commission's approach,[204] the Director has considered whether the geographic market could extend beyond the UK and encompass a wider English-speaking region. The Director considers that such linguistic area could potentially extend to beyond the UK to Eire, as BSkyB acquires TV rights and distributes its premium films and sports channels in both countries.[205]

264. The Director considers that Eire should not be included in the relevant geographic market as no significant demand and supply side substitution exists between the two countries. UK subscribers would not relocate to Eire when faced with raised premium sports and films channel prices in the UK (and vice versa). Equally, the Director believes that a monopolist supplier of packages containing live FAPL football and films in the UK would be able to raise prices significantly above the competitive level without attracting supply side substitution from operators in Eire.[206] The same high barriers to entry to the product market described below (Part Nine) would prevent entry to the UK.

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202 BSkyB's DTH platform has a large reach to actual and potential customers (98.2% of households in the UK according to ITC report 'Satellite Coverage Prediction' published at www.itc.org.uk/documents/satcover.doc), DTT coverage is approximately 68% of the population (expected to rise to approximately 75%) while cable passes around 53% of UK households. ITC submission dated 16 February 2001, page 4.

203 Franchise areas are no longer exclusive to specific cable companies.

204 Approach taken by the EC Commission in *Bertelsmann/Kirch/Premiere* (Case IV/M.993, [1999] OJ L-53/1, paragraph 22) where it states that '*to the extent that German providers of digital Pay TV also acquired subscribers in other German-speaking regions, MSG's service market would probably also spread to such areas. In the present case, the market for technical services for Pay TV may … be deemed to encompass the entire German-speaking area*.' See also *Deutsche Telekom/BetaResearch*, Case IV/M.1027, [1998] OJ L-53/31, paragraph 23.

205 BSkyB's contract for the sale of live Premier League rights (FAPL submission dated 21 February 2001) and all BSkyB's licence contracts with the principal film studios (see BSkyB submission dated 25 May 2001) cover both the UK and Eire (as well as the Channel Islands and the Isle of Man).

206 See considerations made above paragraphs 165 to 166 and paragraphs 247 to 250 on the lack of supply-side substitutability.

265. Finally, the Director notes that the structure of distribution in the two countries (UK and Eire) are different, implying different conditions of competition. Although BSkyB is the only DTH distributor and its rights to content typically extend to Eire, the dominant form of distribution of pay TV in Eire is cable.[207] Cable penetration is high at 53%, compared with 13% in the UK. DTH has not achieved significant penetration levels. As of the third quarter of 2000 BSkyB, the only DTH pay TV operator in Eire, had an estimated 79,000 subscribers.[208]

IV. BSKYB'S VIEW

266. BSkyB states that in the Response that it considers the relevant geographic market to be national or at most the UK and Ireland.[209]

V. THE DIRECTOR'S CONCLUSION

267. The Director, in line with the precedent quoted above, considers that the relevant geographic markets do not extend beyond the UK. Many programmes and channels are created for a national audience, and are therefore influenced by the country's language and its culture. Viewers in the UK cannot switch easily to receiving signals broadcast to other countries, whilst distributors of channels in other countries cannot easily switch to distributing those channels to UK viewers. The Director therefore considers that the relevant geographic markets are the UK.

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207 Two companies dominate the Irish cable market: NTL Ireland (formerly known as Cablelink) the largest operator with over 365,000 residential subscribers as of the third quarter of 2000, and Chorus (formerly known as Irish Multichannel) the second largest cable operator with a network of 258,000 subscribers, out of over 675,000 homes passes. Source: *European Pay TV and Cable 2000*, report by Merrill Lynch of December 2000.

208 From *European Pay TV and Cable 2000*, report by Merrill Lynch of December 2000.

209 Response, Part 4, Section I, paragraph 202.

PART NINE BSKYB'S POSITION IN THE RELEVANT MARKETS

268. Following the analysis in Parts Six and Seven above, the Director considers that the relevant economic markets comprise the wholesale and retail supply of channels containing unique to pay TV sports content (currently identified as live FAPL football) and premium film channels in the UK.

I. BSKYB'S MARKET SHARES

269. In its Response, BSkyB proposed two possible methods of measuring market shares: by reference to total viewer figures, and by reference to expenditure on all TV programming.[210] By both methods, BSkyB considered it had a share well below that typically associated with dominance, on what it considered to be the properly defined economic market (i.e., under 6% by viewers and approximately 19% by expenditure).

1. Share of unique to premium pay TV sports content, currently identified as live FAPL football

270. As detailed in Part Six above, the Director does not accept BSkyB's proposed market definition. With regards to the relevant sports channel market (defined as channels offering unique to premium pay TV content, currently identified as live FAPL football), during the period of the investigation, BSkyB was the exclusive licensee of such rights, able to broadcast 66 live matches each season. Accordingly, by whatever measure that may be considered appropriate, BSkyB had 100% of this market.[211]

271. Under EC precedent, market shares significantly exceeding 70% are themselves a clear indication of dominance.[212] Following *AKZO*, shares exceeding 50% raise a presumption of dominance.[213] The Director recognises that some products outside the relevant market are substitutable to some degree with BSkyB's product (though not enough

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[210] Response, Part 5, paragraphs 23-26.

[211] From the start of the 2001 season, 40 additional matches were available on a non-exclusive PPV basis, which BSkyB, ITV Digital (prior to insolvency), NTL and Telewest each offered. These matches were selected once BSkyB had selected its 66 matches, and so featured less popular matches. This service was not available during the period under investigation.

[212] T-30/89 *Hilti v. Commission* [1992] ECR II-1439, paragraph 92; Case T-83/91 *Tetra Pak International v Commission* [1994] ECR II-755. See also Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461, where the European court held (paragraph 40): 'although the importance of the market shares may vary from one market to another, the view may legitimately be taken that very large market shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position.'

[213] Case C-62/86 *AKZO Chemie BV v Commission* [1991] ECR I-3359.

to warrant inclusion in the relevant market). The Director therefore does not consider that BSkyB is in the position of a 'pure monopolist' i.e., a firm with 100% of the supply of products for which no other products are substitutable at all. Nevertheless, BSkyB's share is sufficiently high for the Director to presume dominance.

2. Share of premium film channel market

272. Watching television is not itself an economic activity. Given the Director's definition of the relevant market, the relevant economic activity is the wholesale provision of premium film channels.

273. Since demand for premium channels from distributors derives from demand at the retail level (i.e., from subscribers, see paragraphs 110 and 233 above), the appropriate measure of market share for channel provision is that deriving from retail level demand for premium film channels. However, BSkyB (and other pay TV distributors) offer channels in packages with bundled prices,[214] so that it is not possible to calculate precise shares by value. Accordingly, the Director has calculated, and relied upon, shares by subscription volume. These are summarised below. Further data are supplied in Annexes 10 and 11.

MARKET SHARES IN THE SUPPLY OF PREMIUM FILMS (BY SUBSCRIPTION VOLUME) %[215]			
Premium channel provider	**June 1999**	**June 2000**	**June 2001**
BSkyB	98.1	96.5	95.6
FilmFour	1.9	3.5	4.4

274. FilmFour launched an eponymous premium film channel in November 1998. It does not carry first run Hollywood films, but focuses on library films and 'Art House' content. If FilmFour is included in the relevant product market, its market share is insignificant and does not affect the competition analysis. The table in paragraph 273 shows that FilmFour's

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214 BSkyB requires that distributors package its premium channels with basic channels (Ratecard, paragraph 3 of Transmission and Distribution section of its Annex). This requirement is imposed unilaterally in the case of BSkyB's premium sports channels, but reflects the requirements of the film rights holders in respect of its premium film channels.

215 Sources: BSkyB submission dated 7 October 2002; Telewest submissions dated 26 January 2001 (Appendix 1), 25 April 2001, 5 September 2001 and 2 November 2001; ITV Digital submission dated 31 October 2001; NTL submissions dated 26 January 2001 (Annex A), 14 May 2001 and 2 November 2001.; MUTV submission dated 31 October 2001; Film Four submission dated 23 October 2001; SIS (The Racing Channel) submissions dated 1 February 2001 and 31 October 2001.

UK market share in the supply of total premium units was approximately 4.4% in June 2001.[216]

275. While PPV is not part of the relevant market, the Director has considered if its inclusion would lead to a materially different BSkyB market share. BSkyB's own PPV services in 2000 accounted for [*over 50*]% of the PPV total revenues of £[*between 50 million and 150 million*] earned in that year by Sky Box Office, Front Row, and ITV Select (see Annex 12). The table below sets out BSkyB share of PPV revenues between January 2000 and June 2001.

PPV REVENUES						
	JANUARY 2000-JUNE 2000		**JULY 2000-DECEMBER 2000**		**JANUARY 2001-JUNE 2001**	
	All services	**Film**	**All services**	**Film**	**All services**	**Film**
Total (£m)	[...]	[...]	[...]	[...]	[...]	[...]
BSkyB (£m)	[...]	[...]	[...]	[...]	[...]	[...]
BSkyB share (%)	[*over 50*]	[*over 50*]	[*over 50*]	[*over 50*]	[*over 50*]	[*over 50*]

Source: see Annex 12

276. Accordingly, inclusion of PPV film revenues within a relevant market including PPV services and premium film channels would not displace a presumption of BSkyB's dominance.

II. BARRIERS TO ENTRY

277. The Director considers that a barrier to entry is a cost that must be borne by an undertaking entering a market that need not be borne by an incumbent undertaking already operating in the market, and that it may be useful to distinguish between three sources of such barriers: absolute advantages, strategic advantages, and exclusionary behaviour.[217]

1. Sports content unique to premium pay TV channels

1.1 Supplying substitutes for live FAPL football

278. BSkyB has licensed exclusively the rights to live FAPL football from the FAPL. There appear to be insurmountable barriers to duplicating such content successfully. To supply additional FAPL-standard football content in competition with the FAPL a new entrant would have to establish an entire competition. The FAPL comprises 20 clubs and each employs a squad of professional players. To compete with the FAPL, the new entrant would have to enter the market with a similar product at a similar scale.

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216 OFT calculations based on data provided by Section 26 Responses from BSkyB, NTL, Telewest, ITV Digital and Atlantic, Film Four and MUTV.

217 OFT Guidance 415, paragraph 5.2-5.3.

279. The FAPL currently sells 66 premium football matches to BSkyB. With a league structure, the minimum number of clubs necessary to produce 66 matches is nine. To set up such a number of clubs, over 100 FAPL-standard professional footballers are required. There is a limited supply of players of sufficient quality. While players might be attracted from the FAPL clubs or foreign clubs to a new league by higher salaries, it is uncertain if subscribers would be interested in a new league competition.

280. The current FAPL clubs have a long history and viewers of matches typically have an emotional attachment to the clubs competing. Fan loyalty is principally focussed on the club, rather than the transient management or players, and is not directly related to the sporting success of that club. Manchester City FC, a well supported club with a long tradition and loyal fans, attracted an average 26,753 fans to a home match even when playing in the First Division of the Football League.[218] Wimbledon FC attracted an average of 15,156 fans despite playing in the Premier League.[219]

281. Although no direct evidence is available to indicate how subscribers might view a new league competition, the limited interest in foreign league competitions compared with the FAPL suggests that a new league might be considered of secondary interest to the Premier League. Channel 4 showed Italian football matches live but was unable to attract an audience similar to that for FAPL clubs playing in matches on free-to-air channels[220].

282. An alternative might involve a certain number of top English clubs setting up a 'breakaway' league together with other top European clubs. This was mooted in 1998, for example, when certain clubs were reported as considering setting up what was called the 'Superleague'.[221] However, the establishment of such a league would probably require the consent of existing national and international footballing bodies or those clubs involved would risk expulsion from existing national or international leagues or tournaments.[222] There is also a question as to whether this sort of international league would attract the loyal following of a large number of UK fans, given the established fan preferences for the FAPL competition.

283. There would therefore appear to be little or no scope for entry to supply football matches as attractive to subscribers as those provided by the FAPL.

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218 The First Division of the Football League is the second tier of professional English football.

219 Attendance figures from Rothmans Football Year Book, 1997-1998

220 http/www.channel4.com/sport/football_italia/

221 *Media Partners challenges UEFA to embrace the EFL concept*, press release 6 October 1998.

222 *UEFA warning to clubs: don't be pushed into Super League*, press release 7 August 1998.

1.2 BSkyB's exclusive rights to live FAPL football

284. BSkyB has exclusive rights, and has held such exclusive rights since 1992. No other distributor or broadcaster can exploit such rights without infringing BSkyB's rights. The Director therefore considers that BSkyB's exclusive licence acts as an absolute barrier to entry to the relevant market.

1.3 Effect of competitive auctions

1.3.1 BSkyB's view of 'competition for the market'

285. BSkyB stated that, even accepting the Director's proposed market definition, it could not be dominant. In typical markets, BSkyB stated, shares are 'sticky' and tend not to shift rapidly over time. Accordingly, an undertaking with a large share is not likely rapidly to lose share and so enjoys a degree of immunity from competition. In markets characterised by large but infrequent bids, however, competition may be said to be 'for the market'. Large market share may do no more than indicate who won the most recent auction, and shares may shift very rapidly.[223] BSkyB referred to several European Commission and UK precedents where large shares were not considered indicative of dominance.[224]

286. BSkyB considered that if there is intense competition for rights at the time of auction, then it follows that the successful bidder cannot be dominant, as it will have paid a full market price, and must recoup its costs by maximising revenues from its customers.[225]

1.3.2 The Director's view of 'bid markets'

287. The Director agrees that the market for the exploitation of live FAPL football is currently characterised by infrequent auctions. However, BSkyB's position may be distinguished from bid markets that were the focus of the precedents to which BSkyB referred. They each related to a situation where an undertaking is bidding to supply a specific order from a specific customer, be it defence procurement or commercial aircraft. Accordingly, the bidding was to supply the auctioneer. In those circumstances, should the auctioneer be dissatisfied with the winning bidder's subsequent performance, it may select another supplier in any subsequent auction, as the winning bidder well knows. Its conduct is constrained accordingly, notwithstanding its large market share.

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223 Response, Part 5, paragraphs 55-63.

224 Response Part 5, paragraph 60, and Part 5, Annex 2: European Commission decisions Case No COMP/M.2111 *Alcoa/British Aluminium* decision dated 27 October 2000; Case No IV/M.1198 *BAe/SAAB* decision dated 3 July 1998; Case No IV/M.945 *Matra BAe Dynamics/DASA/LFK* decision dated 27 January 1998; Case No COMP/M.1940 *Framatome/Siemens/Cogema* decision dated 6 December 2000; Case No IV/M.368 *SNECMA/TI* decision dated 17 January 1994. Also Competition Commission cases *Alcatel Cable SA and STC Limited* (February 1994); *British Aerospace Plc and VSEL plc* (May 1995).

225 Response, Part 5, paragraph 63.

288. BSkyB is not bidding to supply the FAPL. While the FAPL has an interest in the successful promotion of its product, its principal interest is in maximising its own revenues. The Director agrees that, under certain conditions, a firm with 100% market share may be constrained to competitive behaviour if the market is contestable. In this case, BSkyB's conduct in exploiting the rights between auctions is not threatened by entry since intellectual property rights protect exclusivity: there can therefore be anticompetitive exploitation of rights as this has no impact on the outcome of the subsequent auctions.

289. The test the Director must apply to determine whether BSkyB is dominant is whether it has the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers.[226] Regardless of the price it had to pay for the FAPL licence, and the intensity of competition for such rights at the time of auction, between auctions, the exclusive FAPL rights it enjoys give BSkyB the autonomy of action in the relevant market that characterises dominance, even if such autonomy in the future is contingent on BSkyB's continued success at FAPL's periodic auctions.[227] That BSkyB's argument is not logically compelling can be illustrated by a simple example. If the owner of rights conferring monopoly power were to sell those rights at a competitive auction, the successful bidder would acquire monopoly power notwithstanding the competitive nature of the auction for the rights conferring that power. Indeed the price paid for the rights might give some indication of the degree of monopoly power.

1.4 Excess profits

290. Key to BSkyB's criticism of the Director's view that BSkyB is dominant was its contention that it does not earn excess profits. It considers that the absence of such profits provides good evidence that a firm does not have a position of significant market power.[228]

291. While the Director considers that excess profits may indicate dominance, their absence does not indicate that an undertaking is not dominant. First, excess profit is not part of the definition of dominance that binds the Director under section 60 of the Act.

292. Second, circumstances may exist where an undertaking may be dominant but fail to earn excess profits.[229] In the current investigation, with regards to the relevant market the Director has identified, it appears that FAPL is the dominant content provider. Accordingly, to win those rights

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226 Case 27/76 *United Brands v Commission* [1978] ECR 207.

227 Accordingly intense competition at such periodic auctions does not indicate an absence of dominance post auction.

228 Response Part 5, paragraph 194.

229 A predating dominant undertaking, for instance, would not be expected to earn excess profits during the period of predatory conduct. The key point is that conferred dominance would still enable anticompetitive activity that is not related to excessive prices and profits.

at auction, BSkyB had to bid very large sums to win the exclusive license on offer (£1.1 billion for three seasons of 66 live matches). The excess profits that BSkyB's dominance might otherwise earn are likely to be appropriated in good part upstream by the participants in the FAPL.[230] BSkyB's contention that the periodic auctions involve intense competition increases the likelihood that this is the case. Therefore the Director would not necessarily expect to find that BSkyB had made excess profits, and has not sought to conduct such an exercise nor to review the data that BSkyB provided in this regard.[231]

2. Supply of premium film channels

2.1 BSkyB's portfolio of studio contracts

293. Access to content is key to the launch of a premium film channel. BSkyB had exclusive pay TV film contracts with all seven of the major Hollywood film studios: Sony/Columbia, Disney, Paramount, MGM, Universal, Warner Brothers and Twentieth Century Fox, which is owned by News Corporation.[232] These major US studios supply more than 70% of the films sold in the European Economic Area.[233] BSkyB stated that its licence agreements grant it exclusive rights to broadcast certain television movies and library films from each of the seven major Hollywood film studios and from other film distributors in the UK and Eire.[234]

294. BSkyB's exclusive contracts with the seven major Hollywood studios exclude any new entrant from this content and prevent it acquiring sufficient rights to compile a premium film channel. Between the 1996 Review and the end of the period under consideration, none of these contracts had expired. A potential entrant had therefore to wait, at the earliest, until 2002 to obtain rights to one of the seven major Hollywood studios (when BSkyB's contract with Warner Brothers expired.

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230 For an explanation of how, in the presence of exclusive contracts, monopoly power can be conferred downstream in the pay TV market but the rents appropriated by the rights holder, see 'Contracts and Competition in the Pay-TV Market', David Harbord and Marco Ottaviani, July 2001. For a non-technical summary, see Harbord, D & Ottaviani, M (2002), 'Anti-Competitive Contracts in the UK Pay TV Market, ECLR, Volume 23, Issue 3 – March 2002.

231 Response Part 5, paragraphs 194-224.

232 BSkyB submission dated May 2000 (Annex 3.1.1.1 (III)). [...]

233 Case No. Comp/M.2050 *Vivendi/Canal +/Seagram* OJ [2000] C-311/3 footnote 17.

234 BSkyB Form 20-F 1999 page 8. In addition to the Hollywood movies, BSkyB acquires, on an *ad hoc* basis, rights to individual or collections of movies for exploitation on its premium channels. BSkyB also has agreements with several smaller distributors, including Dreamworks, New Line, Polygram and Pathé. The remainder of the programming scheduled on BSkyB's premium film channels is from agreements which grant them exclusive rights to broadcast in the UK and Eire certain other non-Output Film (current movie output) and current movies that have been produced for theatrical distribution but acquired by BSkyB exclusively for exhibition in the UK and Eire. Source: BSkyB Form 20-F 1999 page 9.

That contract has since been extended for a further [...] years).[235] BSkyB's contract with Disney does not expire until [...]. See Annex 9.

295. This contractual barrier to acquiring content has been highlighted by several third parties. ITV Digital stated that other film rights are available but these would only support a basic service (e.g., a library service such as Carlton Cinema) or a niche premium service such as FilmFour.[236] Telewest commented that old films are not premium quality as subscribers are unwilling to pay any premium for dated content.[237] Therefore, library films could not be used to produce a film channel to imitate Sky Moviemax and Sky Premier.

2.2 Asymmetric cost of acquiring rights

296. A channel must contain sufficiently attractive content before it can command a premium. Until a channel has sufficient attractive content to command a premium, the full cost of the constituent rights cannot be recovered. Since renewal dates of licence agreements inevitably vary, there is therefore a significant barrier to entry formed by the cost of the carried, but not fully exploited, premium content, that hinders compilation of an entrant premium channel. This is a cost borne by a would-be entrant that BSkyB, supplementing its existing premium channels, does not bear that can therefore deter potential entrants, and to an extent is a consequence of BSkyB's first mover advantage in acquiring content for its premium channels.[238]

297. With regard to the Hollywood studios, the rights licensed relate specifically to the carriage of films on the pay TV window, thus precluding exploitation in other ways. There is no potential, therefore, for a separate owner of PPV film content, to enter the relevant market and thereby constrain an otherwise dominant provider of subscription-based films.

298. The staggered renewal dates of BSkyB licence agreements with the Hollywood studios hinder the acquisition of sufficient attractive content to permit the launch of a premium channel to rival BSkyB's own premium film channels, since a minimum number of 'output' deals is necessary for a film channel to offer sufficiently consistent quality to sustain a premium channel.

299. Each studio typically produces between one and five blockbusters per year (a blockbuster is defined here as a film that earns more than US$100 million at the US box office.)[239] The output agreed in BSkyB's contracts with each studio varies from [*over 5*] films to [*under 80*] films per year.

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235 BSkyB fax to OFT dated 17 April 2002.

236 ITV Digital submission dated 26 January 2001 page 23.

237 Telewest submission dated 26 January 2001 page 3.

238 Accordingly, the marginal valuation of the right arising for renewal is typically greater for the incumbent than the would-be entrant.

239 ITV Digital submission to OFT review dated 26 January 2001 page 37.

Telewest estimated that a channel screening [...] films per month is likely to be the smallest possible entry for a premium film channel.[240]

300. ITV Digital stated that soon after its launch in 1998, it was approached by [...] with a view to setting up a DTT-exclusive premium film channel based on these [...] studios.[241] However ITV Digital declined this opportunity since the channel would not have sufficient content to allow marketing as a premium channel, and further film rights would not become available for negotiation until 2003, due to the exclusive contracts signed with BSkyB.[242] Accordingly, output deals with two studios appear insufficient to launch an entrant premium film channel, and BSkyB, supplementing the content of its current channels is best placed in competing for such content rights as its current agreements expire.

2.3 Matching rights

301. With regards to acquiring rights to Hollywood studio content, a new entrant may not be able to acquire those film rights even when they do eventually become available, as BSkyB has renewal options with some of the Hollywood studios.[243] BSkyB's contracts with [...] and [...] give BSkyB a matching right.[244] Also [...], agreed to negotiate with BSkyB on expiry of its agreement, for the pay TV rights for its films released in the years [...].[245] Warner had the right to extend its agreement with BSkyB for a further [...] years, but if it did so, BSkyB could extend the term of this extension to [...] years. Warner and BSkyB have both exercised their

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[240] Telewest assumes that a film channel has a minimum of 12-14 hours airtime during which six films are shown. It also assumes that half the films are shown once, one third are shown twice and one sixth are shown three times. Source: Telewest Section 26 submission dated 26 January 2001, page 3.

[241] ITV Digital submission responsive to BSkyB Review dated May 2000 page 38.

[242] BSkyB stated that, compared to the 1996 Review, its pay TV contracts are no longer for 'first run films,' since film rights to the PPV window are now the first run films on pay-TV. BSkyB argues that PPV film rights are non-exclusive and so a new entrant can easily acquire film rights. While PPV rights are easier to obtain than pay TV rights, the Director has concluded in paragraphs 204 to 223 above, that PPV films are in a separate economic market. Therefore examples of entry of PPV movie channels are not examples of entry in the relevant market, and the 'windowing' enforced by film rights licensors prevents supply substitution into the relevant market. BSkyB submission dated May 2000 page 35.

[243] *BSkyB/Vivendi* Competition Commission Report April 2000, paragraph 4.100. BSkyB stated that contracts for future rights were negotiated in advance of the time at which they become available.

[244] Therefore in the event that [...] and [...] do not exercise their option to extend the agreement (on expiry of the initial term for a further [...] years), then they undertake not to grant such rights to any third parties, without having offered the contract to BSkyB at no more than what a third party would be prepared to pay. Source: BSkyB submission dated 26 January 2001, Question 2.10 page 2.

[245] BSkyB submission dated 26 January 2001, page 2, question 2.10.

respective options, so that their agreement is now due to extend until [...].

302. BSkyB made no direct submissions on this issue with regard to film rights. It did, however, state that rights of first renegotiation could not act as barriers to entry with regards to sports rights, principally on the basis that sports rights holders would seek the best price for their rights, notwithstanding any contractual right of renegotiation.[246]

303. The Director considers that contracts with 'matching rights' may foreclose the market, as such rights affect the bidding process for the acquisition of such content. BSkyB does not have to bid as aggressively, so there is a reduction in competition to BSkyB from other bidders in the acquisition of these rights. In view of BSkyB's renewal options, potential bidders may be deterred from seeking to acquire this content knowing that they can only win if they pay a price in excess of BSkyB's valuation.

3. Access to potential subscribers

304. Assuming that a new entrant acquires a portfolio of core content rights, it must create a channel and package and market it to distributors for retail to subscribers. Distribution is key to a new entrant to premium channel provision, as it must reach subscribers to recover its costs. Pay TV distribution was principally via the BSkyB DTH platform, with lesser shares achieved by cable and DTT during the period investigated.[247] ITV Digital has since become insolvent.

305. In June 2001, BSkyB's DTH platform had 54% of all UK pay TV subscribers. See table below.

PAY TV SUBSCRIBERS IN JUNE 2001		
Company	**Number of subscribers**	**% of Pay TV**
BSkyB DTH	5.45 million[248]	54%
Cable	3.67 million[249]	36.4%
DTT	0.97 million[250]	9.6%
Total	10.09 million	100%

246 Response Part 5 paragraph 119.

247 Potential technologies, such as ADSL, are not currently of a scale to form a viable alternative to the three technologies listed.

248 BSkyB submission dated 7 November 2001, see also Annex 13.

249 Telewest submission dated 5 September 2001 and NTL submission dated 2 November 2001

250 ITV Digital submission dated 22 October 2001

In addition, DTH subscription revenues are BSkyB's largest source of revenue.[251]

BSKYB'S SOURCES OF TOTAL SUBSCRIPTION REVENUE			
Revenue	**1999**	**2000**	**2001**
DTH	79.4%	79.7%	79.8%
Cable	20.5%	17.8%	15.6%
DTT	0.1%	2.5%	4.6%

Source: Merrill Lynch, referred to in ITC submission dated 14 February 2001.

306. In the Rule 14 Notice, the Director considered that this vertical integration and large subscriber base acted as a barrier to entry: any premium channel provider would need access to BSkyB's subscriber base more than BSkyB (given its current portfolio) would need such channel.

307. BSkyB contested this. It stated that as a platform operator it had strong incentives to carry attractive content: while a new channel might cause some BSkyB-channel subscribers to switch, others would take the new channel in addition, and some consumers might subscribe to the new channel alone. BSkyB pointed to the many agreements it had concluded, both for carriage within its packages, and for the provision of conditional access services to channels retailed independently (on terms ultimately regulated by OFTEL).[252] With regard to the CA charges it offered, BSkyB stated that the relevant question is whether the charges are such that an entrant would not find it economic to seek access and so would not bid for content.[253]

308. Each of NTL,[254] Film Four,[255] Telewest,[256] and ITV Digital,[257] stated that the cost of licensing the necessary conditional access

251 BSkyB's DTH subscription revenue increased to £979.3 million in the fiscal year in 1999 from £967 million in fiscal year 1998 and £861 million in 1998. Source: BSkyB Form 20-F 1999 page 46.

252 Response Part 5, paragraphs 130-158.

253 Response Part 5, paragraph 153.

254 NTL found the CA charges to be uneconomic when drafting a business plan for a new sports channel: all scenarios for regulated access showed very poor financial returns. Source: NTL submission dated 26 January 2001 page 25.

255 FilmFour submission dated 30 January 2001 page 5.

256 Telewest's subsidiary, Flextech, approached BSkyB/SSSL (the BSkyB company that provides CA services) for terms to broadcast a channel on a free-to-air basis. SSSL quoted a price of [...] per subscriber receiving the channel per month. Given a subscriber base of 3.5m, this amounts to [...] per year for broadcasting the channel. Ultimately, Flextech decided not to proceed with the option of independent CA

technology/software and subscriber management was sufficiently high to deter them from this mode of distribution. The BBC noted that few third parties are in a position to decline to have their services made available on the BSkyB platform even if the terms on offer for the supply of technical services are unpalatable, and that BSkyB is able to gain competitive advantage from its control of conditional access technology.[258]

309. The Director accepts that BSkyB has concluded agreements with many channels. However, given BSkyB's position and subscriber base, he considers that carriage on BSkyB's platform would be key to the success of any new premium channel, and that BSkyB acts as effective gatekeeper to this subscriber base. He notes that BSkyB is obliged to offer conditional access services on fair, reasonable and non-discriminatory terms to any third party channel provider. However, he also notes that BSkyB's indicative ratecard for CA charges is a 'starting point for negotiations' (according to BSkyB),[259] from which BSkyB [...] discounts.

310. It is unclear to the Director where the bargaining power would lie in a negotiation between a holder of the live FAPL rights and BSkyB as distributor. He also notes that FilmFour successfully negotiated distribution on BSkyB's platform.

311. Given his view of the barriers to entry provided by BSkyB's portfolio of intellectual property rights, the Director has no concluded view of whether BSkyB's CA charges foreclosed entry. He notes, however, that OFTEL has conducted a review of these charges and has revised its guidelines,[260] and that it is OFTEL's responsibility to ensure that BSkyB's CA charges are indeed 'fair, reasonable and non-discriminatory'.

III. BUYER POWER

312. OFT guideline 'Assessment of Market Power' states that buyer power allows an undertaking to exert a substantial influence on the price, quality or the terms of supply of a good purchased.[261] It requires that a buyer should be large in relation to the relevant market, well informed about

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broadcast on commercial grounds. Source: Telewest submission dated 26 January 2001 page 6.

257 ITV Digital said that the CA ratecard costs seem to bear little relation to the direct costs of providing CA services which do not change in relation to the genre of video content to broadcast. ITV Digital claims that the allocation of common costs, box subsidy and marketing costs appear to be aimed directly at preventing the launch of an alternative premium sports channel. Source: ITV Digital submission dated 26 January 2001 page 43-44.

258 BBC submission dated 12 May 2000, paragraphs 97-8, 143.

259 Response Part 5, paragraph 154.

260 http://www.oftel.gov.uk/publications/broadcasting/2002/cagu1002.htm

261 'Assessment of Market Power' OFT 415 paragraph 6.1.

alternative sources of supply and should face low switching costs from changing suppliers.

313. BSkyB had three principal customers for its premium channels that distribute its channels via alternative platforms during the period investigated: NTL and Telewest (using cable to distribute); and ITV Digital using DTT. BSkyB's three principal customers together only accounted for [*between 15% and 30%*] of BSkyB's retail sales of its premium channels between March 2000 and June 2001. From March 2000-June 2001, [*over 50*]% of the total BSkyB premium units sold were on its DTH platform, compared to [*less than 10*]% sold on DTT (see Annex 10).[262]

314. Evidence of ITV Digital's, NTL's and Telewest's lack of buyer power is provided by BSkyB's ability to impose wholesale price rises. BSkyB has increased the wholesale price of its premium channels on several occasions: 1 September 1997, 1 October 1998, 10 September 1999, and 1 January 2001.[263] A further price rise was announced on 31 October 2001, effective 1 January 2002.[264] As explained above (paragraphs 146, 154, and 218 to 219), the Director does not accept BSkyB's argument that these price increases can be explained by improvements in quality.

315. ITV Digital said that no price change had ever been negotiated by it with BSkyB.[265] Telewest stated that it had never successfully opposed a BSkyB price increase,[266] [...]. In particular, since BSkyB was Telewest/Flextech's largest customer for its basic channels, the greatest threat to Telewest in negotiating prices for its basic channels was that BSkyB would leverage its strong position in the premium channel market into the basic channel market. Further, Telewest had a customer base of approximately only 1 million subscribers, which would provide BSkyB with a comparatively low level of income for basic channels, so giving Telewest only weak bargaining power against BSkyB.[267]

1. BSkyB's submissions on buyer power

316. BSkyB considered that the Director's assessment of buyer power was materially flawed.[268] BSkyB referred to the OFT Guidelines on the

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262 ITV Digital estimated that (at the end of September 2000) its share of BSkyB's premium channel subscribers was only 5%, which was worth £[...]. Therefore, the loss of ITV Digital premium channel subscriptions would not have a significant effect on BSkyB, reducing ITV Digital's ability to impose a credible threat. Source: ITV Digital submission dated 26 January 2001, questions 1, 3.

263 NTL Section 26 response dated 26 January 2001, question 20, page 23.

264 BSkyB letter dated 31 October 2001.

265 ITV Digital submission dated 26 January 2001, question 19, page 42.

266 Telewest submission dated 26 January 2001, question 16, page 6.

267 Telewest submission dated 26 January 2001, question 15, page 5.

268 Response, Part 5, paragraphs 167-191.

assessment of market power that indicate that it is important to consider evidence of any '*constraints that might prevent an undertaking from persistently raising prices either directly or implicitly above competitive levels*.'[269] One such constraint explicitly mentioned in the Guidelines is buyer power.[270] It also referred to a recent research paper prepared for, and published by, the OFT which states:

> 'One must also take into account a number of other factors in assessing dominance. For example, despite a high market share of the market under any plausible market definition, a firm may not be dominant where one or more of the following hold... The nature of the buyers in a market and the volumes that they purchase are such that they can exert significant countervailing power against a firm with a high market share. They may be able to do this by threatening to promote competitors' products (particularly in a retail context), switch strategic volumes of business to deny the suppliers economies of scale (particularly where suppliers need to maintain high levels of capacity utilisation) or engender new entry by underwriting entry costs with long term contracts.'[271]

317. BSkyB did not contest that third party distributors account for only limited shares of its retail sales of premium channels. It did, however, emphasise the ability of distributors to substitute other inputs for BSkyB's premium channels. Cable operators may offer telephony or internet services as well as pay TV. While such services might not be substitutes from a consumer's point of view, they might be a substitute for a cable operator seeking to generate a return from its business of connecting homes to cable networks.[272] BSkyB stated that such substitution had occurred,[273] and had damaged BSkyB.[274]

318. With regard to the Director's allegation that BSkyB had imposed 'unilateral' price increases, BSkyB stated that price rises under BSkyB's 1997 ratecard were subject to two negotiations, with the OFT, and with the cable industry as a whole. Other price rises were under long term agreements with Telewest, CWC and ITV Digital, and so price rises could be said to be pre-negotiated.[275] BSkyB also contested that the proposed

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269 'Assessment of Market Power,' OFT 415, paragraph 3.2.

270 'Assessment of Market Power', OFT 415, paragraph 3.3.

271 See paragraph 4.7, "*The role of market definition in monopoly and dominance inquiries*," A report prepared for the Office of Fair Trading by National Economic Research Associates, July 2001.

272 Response Part 5 paragraph 174. DTT also could substitute other inputs, though to a lesser degree than cable: Response Part 5 footnote 193.

273 Response Part 5, paragraphs 176-178.

274 Response Part 5, paragraphs 179-184.

275 Response Part 5 paragraph 186-187.

finding of a margin squeeze in the Rule 14 Notice or the ability to pass on cost increases indicated dominance.[276]

2. The Director's findings on buyer power

319. The Director considers that the key element of buyer power is the ability, for whatever reason, to exert significant countervailing power to limit price rises by a supplier. This is absent in the case of BSkyB's distributors. Evidence of negotiations is not evidence to show that dominance is absent. According to the 1996 Undertakings, the Director did not agree absolute price levels. BSkyB has consistently and repeatedly imposed significant price rises that its distributors have not been able to oppose, even though they considered that the wholesale prices offered allowed them little or no profit margin on distributing such channels. As stated in paragraphs 290 to 292, it is immaterial to the Director's case whether any associated excess profits are earned by BSkyB or appropriated upstream.

320. BSkyB submissions on the ability of distributors to substitute inputs for its channels is not evidence of buyer power in this case. As noted above paragraphs 167 to 168, there is no true substitution, since carriage of BSkyB premium channels does not preclude the simultaneous offering of telephony and internet access by cable companies, as capacity constraints do not bind. Rather it is just that certain of its distributors have multiproduct offerings, and might survive even if forced to exit the relevant distribution market. The evidence that the penetration of BSkyB's premium channels on Telewest's network has declined is cited by Telewest as evidence that BSkyB has exercised an anticompetitive margin squeeze on it.[277]

IV. CONCLUSION ON DOMINANCE

321. In Parts Six and Seven, the Director defined the product markets relevant to the supply of BSkyB's premium channels, namely the wholesale and retail supply of packages containing content unique to premium pay TV sports channels (currently identified as live FAPL football) and of packages containing premium film channels, defined as those including first run category A and B films. BSkyB supplies almost all such packages. It has exclusive rights, protected by intellectual property, to that content necessary to compete in those markets. These exclusive rights act as an absolute barrier to the market for the duration of the exclusivity. Buyer power is weak: BSkyB controls the distribution system that supplies most UK pay TV subscribers. Accordingly, the Director finds BSkyB dominant on the relevant markets.

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276 Response Part 5 paragraphs 188-191.

277 Telewest submission dated 20 March 2002 page 4.