

Briefing for Analysts: Broadcasting and Media

22 September 2009

Ed Richards
Chief Executive

Agenda

- Introduction Ed Richards
- Media Ownership Rules Review Jonathan Thompson
- TV Advertising Kate Stross and Chris Banatvala
- Pay TV Steve Unger
- Q&A Ed Richards

Media Ownership Rules Review

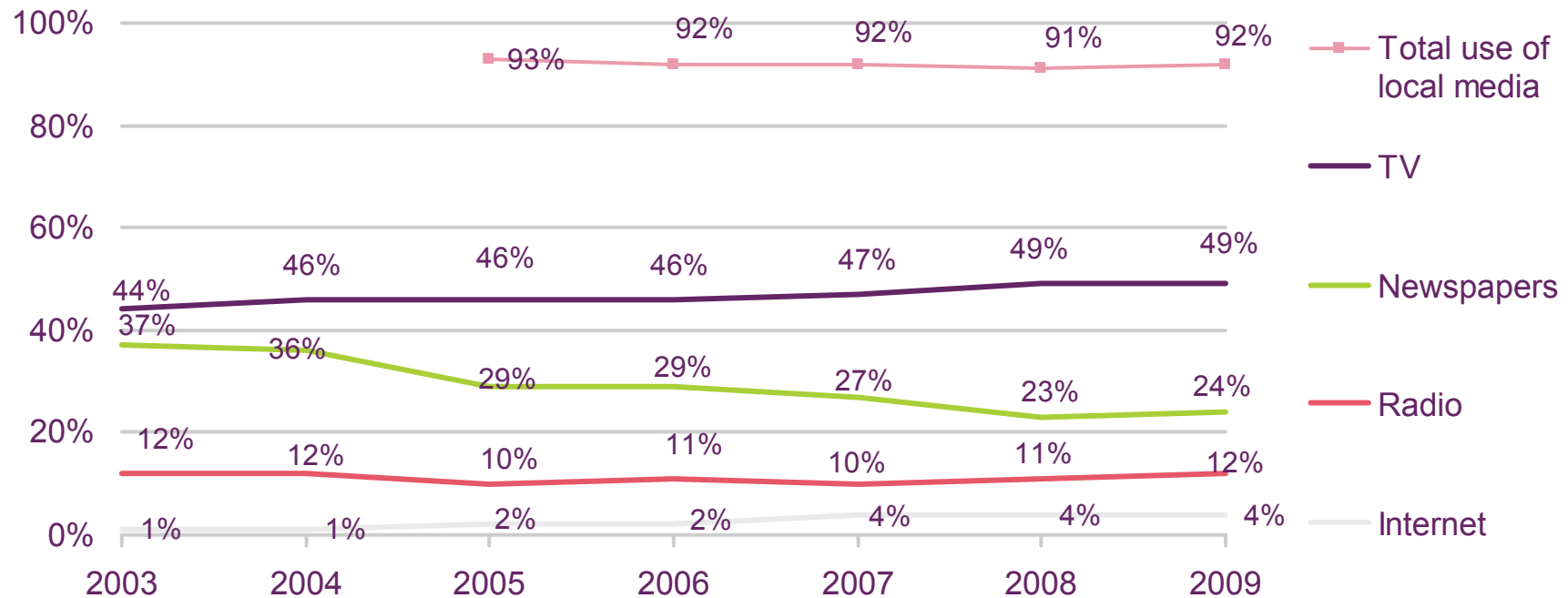
Jonathan Thompson
Director, Strategy

The media ownership rules help protect plurality in TV, newspapers and radio

Rule	Principle
Local radio ownership	sets the level of radio licences one entity can own in specified geographical areas
Local cross-media ownership	prevents one entity owning different types of local media over specified market share levels
National cross-media ownership	prevents one entity owning both a Channel 3 Licence and greater than a 20% market share in one or more national newspapers
National radio ownership	prevents one entity owning more than one national radio multiplex
Broadcasting licences	prevents or limits control of television and radio by certain owners whose influence might cause concern
Appointed news provider	ensures Channel 3 sources its news from an independent news source
Public interest test	enables the Secretary of State to intervene in media mergers on “public interest grounds”

In local media, consumers still rely on television, newspapers and radio as sources of news

What is your main source of news about what is going on in your local area?



Source: Ofcom media tracker, April 2009

Note: 2004-2008 based on rolled yearly data, not directly comparable with 2009 data. Figures for 2009 may change as further data is gathered this year.

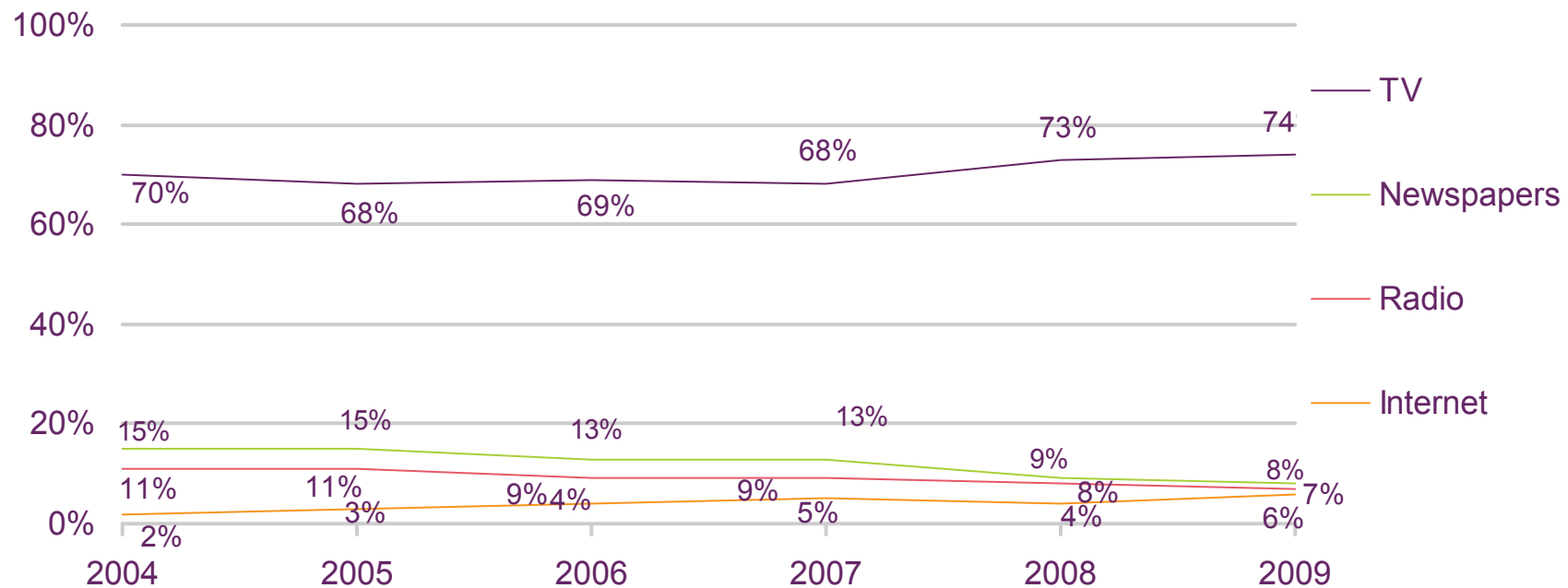
We propose changing the radio and local cross-media rules

- Consumers still rely on television, newspapers and radio for news
- However, these industries are facing significant economic challenges
- Removing local radio rules might enable local radio stations to group to make operational efficiencies
 - Majority of consumers not concerned about single ownership
- Liberalising local cross media rules could enable local media industry to respond to economic pressures
 - Complete removal could reduce protections for plurality

Our recommendations subject to consultation are removal of the local radio rules and liberalisation of the local cross media rules

At a national level, television remains consumers' main source of news

What is your main source of news about what is going on in the UK today?



Source: Ofcom media tracker, April 2009

Note: Data not available for 2003. 2004-2008 based on rolled yearly data, not directly comparable with 2009 data. Figures for 2009 may change as further data is gathered this year.

We don't recommend changing the media ownership rules at a national level

- Channel 3 and national newspapers remain significant sources of news
- Television and radio remain media with potential to influence society
- The media public interest test provides a backstop for the Secretary of State to prevent media mergers on public interest grounds



We do not propose to recommend changes to the remaining rules:

- National cross media ownership
- Broadcasting licence restrictions
- Appointed news provider
- Media public interest test

Next Steps

- The Media Ownership Consultation closed on 17 September 2009 and is at: <http://www.ofcom.org.uk/consult/condocs/morr/morrcondoc.pdf>
- We are now reviewing responses received
- All non-confidential responses are published at: <http://www.ofcom.org.uk/consult/condocs/morr/responses/>
- We will report to the Secretary of State at the Department of Culture, Media and Sport by 13 November 2009
- The Secretary of State decides how to take forward

Commercial Public Service Broadcasters

Kate Stross
Director of Content

Current issues

- Regional news on Channel 3
- Licence revaluation
- Advertising regulation

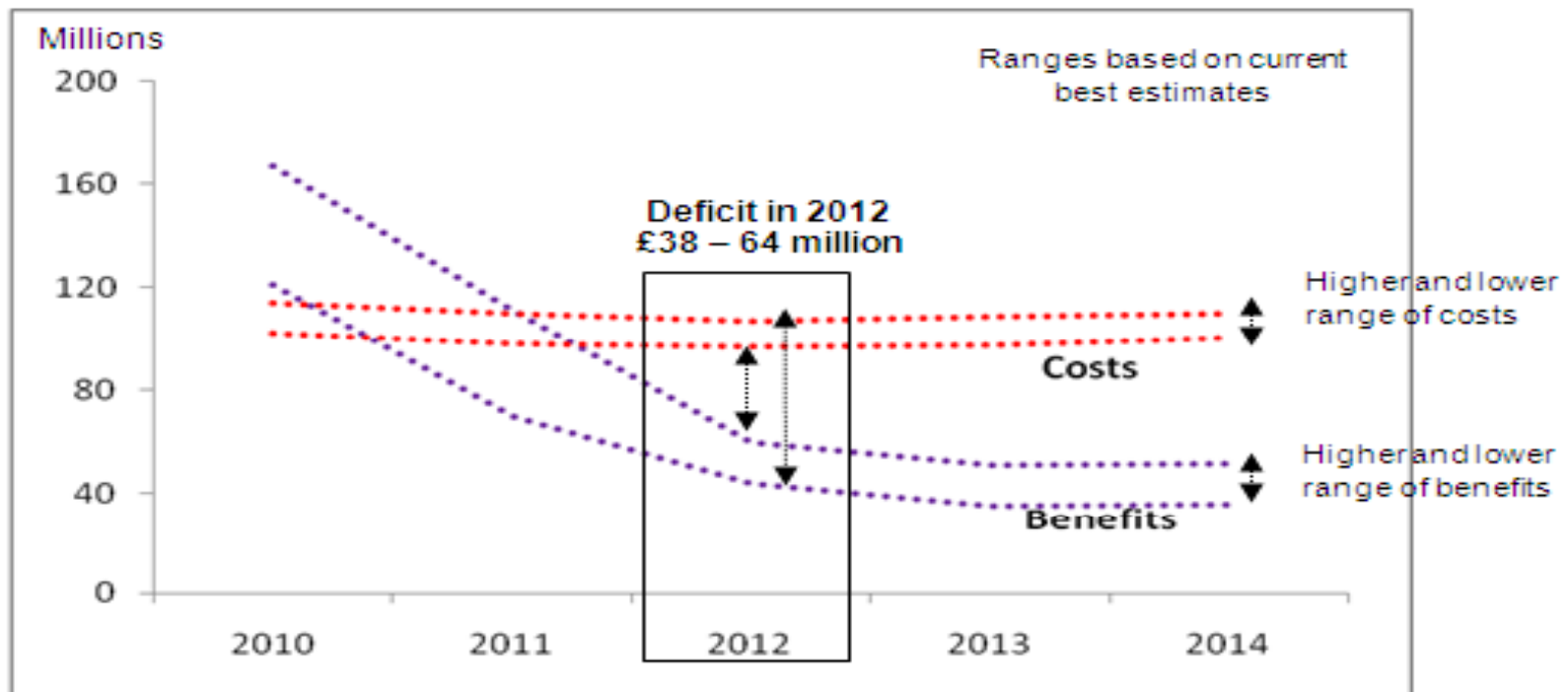
Current issues – Regional news on Channel 3

We have published two documents this morning:

- Response to the DCMS consultation ‘Sustainable, independent and impartial news; in the Nations, locally and in the regions’
 - DCMS seeking views on a ‘Contained Contestable Element’ within the licence fee to fund regional news on Channel 3
 - This can be found at:
<http://www.ofcom.org.uk/consult/ofcomresponses/dcms.pdf>
- Local and Regional Media in the UK
 - Evidence and analysis on the local media sector
 - Evidence to support our DCMS consultation response
 - This can be found at: <http://www.ofcom.org.uk/research/tv/reports/lrmuk>

Our analysis shows that the regional Channel 3 licences could face a deficit of £38 - 64 million in 2012

Cost Benefit of PSB status for the Channel 3 regional network



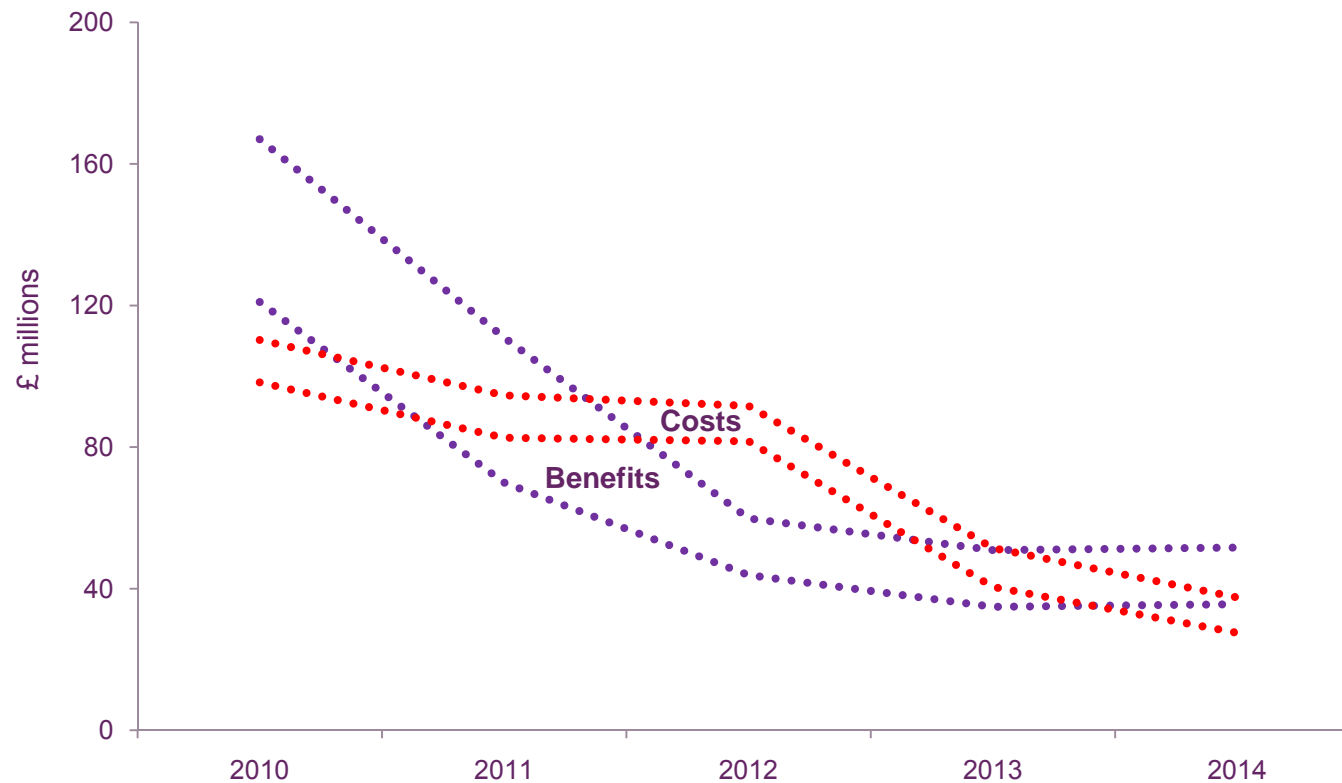
Source: Ofcom

The Government has proposed new model for delivering regional news on Channel 3

- Independently funded news consortia would bid to provide regional news service on Channel 3
- Consortia could include incumbent TV news providers, newspaper groups, TV production companies and newsgathering agencies
- Consortia awarded contracts based on public criteria, including:
 - reach & impact
 - high production & editorial standards
 - financial stamina

Phased funding for news consortia could balance costs and benefits over 5 years

Cost benefit of PSB status for the Channel 3 regional network including IFNC funding



Source: Ofcom

Licence revaluation for Channels 3 and 5

Digital Britain final report said:

- “The government is prepared to bring into force sections 272 and 273 of the Communications Act 2003. This has two effects: firstly it ensures that ITV’s (and Five’s) programming remains available on all specified platforms for the remaining duration of their public service licences; secondly that Ofcom can bring forward by a year the re-valuation of their remaining analogue licences.”
- The necessary Commencement Order was passed on 27 July 2009
- All ITV licensees, GMTV and Five are now able to apply for a revaluation of their licences with effect from 2010

Licence revaluation – next steps

- Licensees have until end 2009 if they wish to apply for a licence revaluation with effect from 2010
- We expect to publish a consultation on the valuation methodology later this autumn
 - We last undertook such a valuation in 2005
 - Details of the valuation process used are at http://www.ofcom.org.uk/consult/condocs/channel3_consultation/ch3ch5fin/
- Not all licensees will necessarily apply - some payment levels are already insignificant
- We expect to undertake any revaluations requested in early 2010

CRR – Competition Commission’s provisional findings

- The CC published its provisional decision following its review of the contract rights renewal (CRR) remedy on 15 September
- Its assessment of competition proposed that there has been a decline in ITV1’s market share but that ITV1 retains an advantage in delivering large audiences
- The adverse effects associated with the 2003 merger continue to be a concern
- And there may be unintended consequences of the CRR remedy
- The CC decided it was not appropriate to release ITV from the CRR Undertakings but there is a case to vary them
- The CC is currently consulting on its provisional findings and possible variations to the Undertakings

Advertising restrictions

- Ofcom has announced we will be looking at the TV advertising rules in Spring 2010
- Advertising minutage
 - We consider there is a strong case for applying the same rules to PSBs and other channels
 - Consultation will consider whether rules should be harmonised
 - Options include levelling up, levelling down or meeting in the middle
- Airtime sales rules
 - Require PSBs (but not other channels) to sell all their airtime
 - May need modification or scrapping in light of minutage changes
- Earliest date for change will be 2011

Product Placement

Chris Banatvala
Director of Standards

Product Placement – The Process

- DCMS to consult on relaxing PP rules
- Government to enact regulations
- Ofcom must consult on PP rules
- Changes to Code in place
- On screen – Summer 2010?

Product Placement – European Law

- Permitted in films, series, sports and light entertainment
- Not in kids
- Must not affect editorial independence
- Must be:
 - signalled
- No:
 - undue prominence
 - promotion
 - tobacco products & prescribed medicines
 - alcohol aimed at children
 - encouragement of harmful activities
 - themes - only products can be placed

Product Placement – The Government

- AVMS is minimum requirements
- Countries permitted tighter rules
- Extra safeguards:
 - other prohibitions
 - other restrictions
 - scheduling
 - programme genre – news, current affairs and documentaries?

Product Placement – Ofcom and further implications

- Code Consultation:
 - signalling
 - genre
 - treatments (e.g. no themes)
 - what's promotion?
- Future:
 - paid references in programmes
 - no more separation
- Consequences:
 - Approach to commercial references
 - Sponsorship rules
 - Undue prominence

Pay TV Market Investigation

Steve Unger
Competition Director, CTO

Context

Pay TV Market Investigation

- Initiated in 2007, following a submission from BT, Setanta, Top Up TV and Virgin Media
- First Consultation, December 2007: set out some initial concerns
- Second Consultation, September 2008: explored concerns surrounding supply of premium content, and set out for consultation our broad approach to addressing them
- Third Consultation, June 2009: sets out a case for intervention on premium channels and details of a proposed 'wholesale must-offer' obligation
- The consultation has just closed, and we are starting our analysis of responses. What we will present today is our position as set out in June

Content markets and market power

Importance of premium content

- Consumers' choice of pay TV service is primarily influenced by the content that is available
- For specific content to be an effective driver of subscriptions it must be:
 - Attractive to consumers
 - Not widely available free-to-air
- The most important examples are:
 - Live top-flight sports
 - First-run Hollywood movies
- Sky's success has been based on acquiring and aggregating most such content:
 - Aggregation can be good for consumers
 - Potential concern when it results in market power



Market definition and market power

Specific narrow economic markets exist for: the wholesale supply of

- Core Premium Sports channels: Sky Sports 1 and 2 and Setanta Sports 1 (now ESPN ?)
- Core Premium Movies channels: most Sky Movies channels

Sky has market power in these markets, based on:

- Current market shares and future barriers to entry
- The degree of countervailing buyer power held by retailers

Three effects on competition and consumers

- We considered that Sky distributes its premium channels in a manner that favours its own platform and its own retail business, thereby distorting competition
 - Reduces consumer choice
 - Reduces innovation, holding back the development of non-Sky platforms
- We thought that Sky might exploit content rights in a manner that favours its own platform.
 - Subscription 'Video on Demand' movie rights are sold with linear channel rights
 - Sky acquires them but has a limited ability to exploit them
 - Could prevent innovative IPTV-based services from being offered to consumers
- We considered that Sky could set high wholesale prices, reflected in high retail prices to consumers:
 - Complex evidence, but under a range of different scenarios, Sky's returns are above 20%, well above our estimate of its current cost of capital
 - Care needed interpreting past returns, given historic risks incurred by Sky
 - Such considerations less relevant on a forward-looking basis

A wholesale must-offer remedy

- We proposed to place a wholesale must-offer obligation on Sky. We considered this was preferable to far-reaching changes in the way content rights are sold, because we believed it would deliver significant consumer benefits with a low risk of unintended consequences.
- It should allow other operators to develop pay TV offers which include premium content, increasing access to this content, and facilitating choice and innovation
- It would not be disruptive for Sky's existing business or existing consumers
 - Sky already wholesales to Virgin Media
 - Sky offered on a voluntary basis to extend this to other platforms
 - We disagreed on price, not on the principle of this type of supply arrangement
- It would not be disruptive for rights owners, and the continued generation of content
 - Our proposal would not materially reduce the level of wholesale revenue available to pay for rights
 - Nor did we believe that there would be a major change in the incentives faced by bidders

Proposed terms of supply

Scope and structure:

- Obligation to apply to those channels which make a material contribution to market power, in both HD and SD variants
- Implemented via a new license condition on relevant channels
- Excluded retail on Sky platforms, or to commercial customers
- Sky should set 'Minimum Security Requirements', to guard against content piracy

Pricing principles:

- Prices set on a retail-minus basis, to avoid artificially depressing rights values
- Retail cost stack based on Sky's own costs, with additional corrections for:
 - DTT as well as DTH transmission costs
 - Fixed costs associated with efficient market entry

Pricing example:

- The wholesale price of Sky Sports 1 and 2 is £18.39 per month per sub
- Our central case implied a reduction to £15.69, or about 15%
- As compared to our cost plus cross-check of £11.34

Estimated impact of our proposals

Static effects on consumers

- New consumers on DTT / IPTV
- Some churn down to DTT / IPTV from Sky / Virgin customers
- Consumer surplus gain estimated at £370m over 5 years

Static effects on Sky

- Reduced growth rate in Sky's retail subscriber base, but still positive
- Substantial growth in wholesale subscriber base
- These effects net off to an estimated £240m additional benefit for Sky
- Some additional administrative costs. Difficult to quantify but likely to be low

Static effects on other pay TV retailers

- Our pricing model is designed to allow other retailers to break even after 10 years

Dynamic benefits for consumers

- Longer-term benefits from platform innovation in particular, using new distribution technologies such as IPTV
- Greater and freer choice of platforms, retailers and packages

Next steps

- The consultation closed on 18 September. We must now revisit our analysis. Once we have reviewed the responses we expect to issue a statement, probably early in the new year
- In parallel with this we expect to conclude our assessment of the Picnic proposal. The majority of respondents to our previous consultation agreed that our consent to Picnic would need to be subject to an effective wholesale must-offer obligation being in place on Sky's premium channels
- We have stated that we do not believe there is a case for intervening to require far reaching changes in the way content rights are bought and sold. There may however be a case for more targeted interventions in relation to:
 - Subscription Video on Demand rights
 - Live Premier League rights

- Pay TV Market Investigation first consultation (December 2007):

http://www.ofcom.org.uk/consult/condocs/market_invest_paytv/

- Pay TV Market Investigation second consultation (September 2008):

http://www.ofcom.org.uk/consult/condocs/second_paytv/

- Pay TV Market Investigation third consultation (June 2009):

http://www.ofcom.org.uk/consult/condocs/third_paytv/

- Proposed BSkyB Digital Terrestrial Television Services (October 2007):

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

- Proposed BSkyB Digital Terrestrial Television Services (September 2008):

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

Any questions?