



# Proposed BSkyB digital terrestrial television services

Consultation

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# Contents

Section		Page
1	Executive summary	1
2	Introduction	5
3	Competition assessment	15
4	Other policy considerations	31
5	Options	34
<b>Annex</b>		<b>Page</b>
1	Responding to this consultation	41
2	Ofcom's consultation principles	43
3	Consultation response cover sheet	44
4	Consultation questions	46
5	Glossary	47
6	Legal framework and impact assessment	50

## Section 1

# Executive summary

## The proposal

- 1.1 National Grid Wireless Ltd (NGW) and British Sky Broadcasting Ltd (Sky) have applied to remove the three free to air (FTA) channels that Sky currently provides on the digital terrestrial television (DTT) platform and replace them with five pay TV channels. Sky currently provides *Sky News*, *Sky Sports News* and *Sky Three* on a FTA basis. These would be replaced by *Sky Sports 1*, *Sky Movies SD1* in the evening and *Sky One* in the evening (including an hour of *Sky News* content). In addition, the remainder of Sky's capacity would be used by Sky to retail two further pay TV channels from third party providers in the daytime: a factual channel and a children's channel. Sky's proposed pay TV service would not be compatible with any existing set-top boxes. Consumers would therefore need a new set-top box to receive these pay TV channels.

## Ofcom's objectives

- 1.2 The proposal must be considered in the context of Ofcom's duties. Ofcom has a principal duty to further the interests of citizens and consumers, where appropriate by promoting competition. We also have other duties which could be relevant to consideration of the proposal, for example the duty to secure the efficient use of spectrum. In the light of these duties we are consulting on the issues raised by the proposal.
- 1.3 In addition, under broadcasting provisions, the licence variation requests will require us to consider the proposed changes against a test of whether the capacity of the services to appeal to a variety of tastes and interests is unacceptably diminished. Given that we are consulting on the issues raised by the proposal, and because the third party channels to be retailed by Sky have not yet been finalised, we are not intending to carry out this test at this stage.

## Ofcom's considerations

- 1.4 The specific proposal involves a move from offering FTA services to offering pay TV services on DTT, and in particular, offering premium sports and movies content. This represents some of Sky's most attractive content to pay TV subscribers on other digital television platforms (i.e. satellite and cable) and is content which is not currently available on DTT.
- 1.5 The development and take up of digital television in the UK is widely regarded as a success story. For instance, in the ten years since it was introduced, penetration of digital TV in the UK has risen to around 85% of households. As a result of the success of the Freeview proposition (which includes Sky's existing FTA channels), the DTT platform has become the single largest platform for the delivery of digital TV in the UK. An obvious concern would arise if the NGW/Sky proposal encouraged sufficient FTA channels to move to a subscription basis to damage Freeview. While future developments present a degree of uncertainty, there are few reasons to think that the proposal is likely to damage the Freeview proposition materially or negatively affect take up of digital television as digital switchover approaches.

- 1.6 In comparison to pay TV services on the satellite and cable platforms, the provision of pay TV services on the DTT platform is in its infancy. Top Up TV re-introduced pay TV services on DTT in 2004, and Setanta and BT Vision launched pay TV services using the DTT platform within the last year. The development of these services is therefore uncertain reflecting not only uncertainty in the demand for pay TV services on DTT, but also uncertainty in the rate of technical and service innovation. For example, in the near future the sector will need to address issues in relation to: digital switchover and the use of the released spectrum; a possible move to different technical transmission standards (e.g. MPEG4, DVB-T2); and the introduction of high definition services. The evolution of the DTT platform is therefore reaching a significant transition point.
- 1.7 In this context, the launch of a Sky pay TV service on DTT, offering premium sports and movies, as well as related technical platform services (including conditional access encryption services), is a significant development and would have an impact on competition for pay TV services on the DTT platform and possibly across other digital TV platforms. Given the critical stage in the development of pay TV on DTT, the competition issues need to be considered with great care.
- 1.8 For example, if as a result of Sky's position in the wholesale provision of sports and movies channels, Sky were to emerge as the main retailer of pay TV services not only on the satellite platform but also on DTT, it may well be more difficult for other providers of pay TV services to enter the market. Such reduction in potential inter-platform competition may not be in the long term interest of consumers.
- 1.9 This consultation therefore considers the competition and other regulatory issues raised by the NGW/Sky proposal.

### **Preliminary views**

- 1.10 Sky's proposal to replace channels which are currently available on a FTA basis and retail the channels envisaged in the proposal will undoubtedly have an impact on viewers and on competition.
- 1.11 The proposal would have an immediate, positive effect on choice and availability of retail pay TV services on the DTT platform. Consumers would be presented with an increase in choice of sports, movies, factual, children's and general entertainment programming. The increased choice brings with it the potential for more competition on the DTT platform in terms of quality of service, and technical innovation, as well as ensuring that there is competitive pressure on pricing, all of which is likely to be to the benefit of consumers at least in the short term.
- 1.12 In the longer term the impact on competition at both the retail and wholesale level depends on expectations for the development of pay TV services on the DTT platform and the nature of competition in the provision of pay TV services more widely. These competition issues are being considered in the broader context of our market investigation into the pay TV industry. It may be the case that the DTT platform can support sustainable competition amongst pay TV retailers. However, given the capacity constraints of the platform, it is also possible that features of the pay TV market make it likely that a single retail provider of pay TV services will emerge on DTT. As a result, more effective competition may be between vertically integrated companies on competing pay TV platforms. If the NGW/Sky proposal foreclosed the opportunity for a pay TV provider on DTT emerging to compete with providers of pay TV services on other delivery platforms (e.g. satellite and cable), leading instead to the emergence of Sky as the main provider of pay TV services on

DTT in addition to the satellite platform, this might be the source of significant concern and potential consumer detriment in the long term.

- 1.13 A further issue arises from Sky's proposal to use technical standards which are incompatible with existing DTT pay TV services and set-top boxes. This could mean that more than one set-top box would be required to view all pay TV services available on DTT (e.g. all Premier League football matches available from Sky and Setanta) which is likely to be a concern for a number of consumers. Furthermore, there is potential for consumer confusion over which pay TV services are available with different types of set-top boxes.
- 1.14 On the basis of an initial analysis of the issues raised by this proposal, taking account of Sky's position in the wholesale provision of content and its potential impact on the retailing of pay TV services and access to wholesale platforms, we consider that the proposal does raise competition concerns.
- 1.15 In light of the concerns identified and given the uncertainty about the development of the DTT platform and the impact of the proposal, we have identified options to address such concerns and are consulting on these in this document. In doing so, it is relevant to focus on fostering an environment that encourages effective competition on the DTT platform and which would also allow for the development of competition between pay TV platforms.

## **Options**

- 1.16 In the light of these concerns, we must consider how best to secure fair and effective competition in these markets. Three options have been identified.

### Option 1: consent to the proposal on an unconditional basis

- 1.17 In light of the increased choice of programming, including premium sports and movies, and associated consumer benefits identified in the consultation document, one option would be for us to consent to the proposal as it stands without requiring any additional specific conditions to be met. This option would reflect a conclusion that any competition concerns could be effectively addressed under ex post competition powers.

### Option 2: consent to the proposal subject to imposing additional conditions

- 1.18 Given the consumer benefits identified in the consultation document, but the concerns about the longer term development of pay TV, a second option would be to consent to the proposal subject to imposing conditions to address longer term competition issues.
- 1.19 Option 2 would seek (i) to gain the benefits of bringing new programming content to DTT, providing consumers with a greater choice of premium movies and sports, as well as factual, children's and general entertainment programming, but also (ii) to ensure the conditions for competition in pay TV, both on DTT and more widely, to the benefit of consumers in the longer term.
- 1.20 In balancing these objectives, and consistent with our regulatory principles, we would seek to impose additional conditions which are the least intrusive necessary to achieve the policy objectives effectively. The exact formulation of any additional conditions would depend on where in the supply chain it would be most effective to focus any regulatory intervention. Broad categories of approach include:

- accepting commitments from NGW and Sky which address concerns identified in the consultation process.
- requiring Sky to make some or all of its channels available to other retailers on a wholesale basis, subject to certain conditions in relation to wholesale pricing. These conditions would seek to address concerns relating to the wholesale provision of content.
- requiring the retail and/or wholesale provision of channels by Sky to be subject to certain conditions relating to technical platform services. These conditions would seek to address concerns relating to incompatibility of pay TV services and set-top boxes and wholesale platform access.
- limiting Sky's ability to retail certain/all channels directly on the DTT platform. These conditions would seek to address longer term competition concerns associated with Sky acting as a retailer without preventing Sky's attractive content from being made available to viewers on DTT.

1.21 Imposing additional conditions can lead to further complex issues of detail which would require careful consideration to ensure that the conditions are effective but no more intrusive than necessary.

#### Option 3: not consent to the proposal

- 1.22 Given the competition issues and the critical stage in the development of pay TV on DTT, a third option would be not to consent to the proposal at this point in time. Despite the consumer benefits associated with increased choice of programming, including premium sports and movies, this option would reflect a decision that it is not possible to identify appropriate conditions to address concerns about longer term competition problems in the development of pay TV services.
- 1.23 We are not making a recommendation at this stage but welcome comments from stakeholders on these options.

## Section 2

# Introduction

## Introduction

- 2.1 Ofcom is consulting on a proposal from British Sky Broadcasting Ltd (“**Sky**”) and National Grid Wireless Ltd (“**NGW**”) (together, the “**Parties**”) to remove the three free to air (“**FTA**”) channels that Sky currently broadcasts on the Digital Terrestrial Television (“**DTT**”) platform and replace them with five pay TV channels (the “**Proposal**”).
- 2.2 On 17 April 2007, Sky submitted an application (the “**Sky Application**”) to us to vary its Digital Television Programme Service (“**DTPS**”) licences. This was followed by NGW’s application (the “**NGW Application**”) to vary its multiplex C licence, which was submitted to us on 30 April 2007 (the Sky Application and the NGW Application together the “**Applications**”). Following requests for further information, we announced on 26 June 2007 that we intended to consult on the competition issues raised by the Applications<sup>1</sup>. The Applications are narrower in scope than previously indicated by Sky in February 2007, when it announced that it would broadcast four channels using MPEG4 encoding. In particular its proposal does not at this stage make use of MPEG4 encoding, though a migration from MPEG2 to MPEG4 does still form part of Sky’s longer term plans.
- 2.3 The Parties require consent from us before they are able to implement the Proposal. This consultation describes the Proposal and sets out our thinking on the issues which it raises, in particular in relation to its impact on competition. We then consider what measures, if any, it might be appropriate for us take in order to secure fair and effective competition.
- 2.4 We welcome views from all stakeholders on the issues raised by the Proposal. We are particularly interested in stakeholders’ responses to the consultation questions listed together in Annex 4.

## Summary of the Proposal

- 2.5 Sky currently broadcasts three Sky channels on multiplex C: *Sky News*; *Sky Sports News* and *Sky Three*. Under the Proposal these three channels will be replaced with five channels as follows:
- *Sky Sports 1*: the same channel broadcast as *Sky Sports 1* on digital satellite (“**DSat**”) including live coverage of Football Association Premier League (“**FAPL**”) football matches, broadcast 24 hours a day, 7 days a week;
  - *Sky Movies SD1*: the same content as *Sky Movies SD1* on DSat comprising a selection of recent movies covering different genres, broadcast between 6.00pm and 3.00am;
  - *Sky One*: a simulcast of the general entertainment *Sky One* channel which is already available on DSat broadcast from 7.00pm to 6.00am, together with one

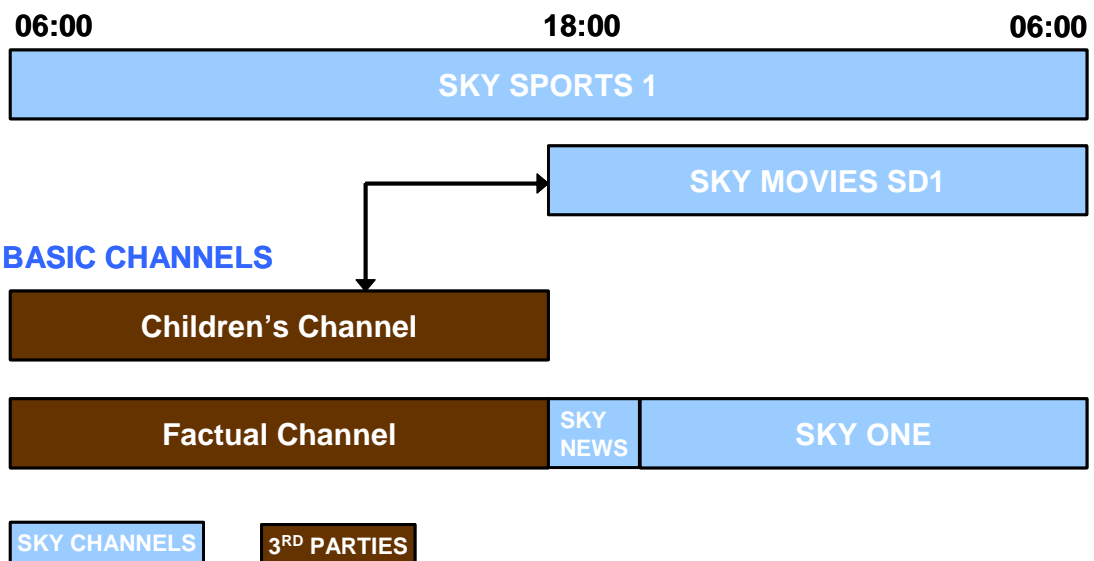
<sup>1</sup> Ofcom made an initial announcement on 16 February 2007 which, amongst other things, envisaged that competition issues raised by an application from Sky would be subject to consultation.

hour of *Sky News* content scheduled between the hours of 6.00pm to 7.00pm daily, up to 7 days a week;

- a factual channel, which will be broadcast between the hours of 6.00am and 6.00pm, 7 days a week; and
- a children's channel, which will be broadcast between the hours of 3.00am and 6.00pm, 7 days a week<sup>2</sup>.

2.6 We have illustrated the Proposal in the diagram below.

### PREMIUM CHANNELS



2.7 Sky has yet to announce the identity of the factual or children's channels. While Sky has announced that the Proposal will form part of its new "Picnic" entertainment and communications service in its press release of 1 October 2007, it has not yet announced details of the package structure or pricing of the proposed pay TV services. However, we consider that we have obtained sufficient certainty on the nature of the Proposal at this stage in order to be able to consult effectively.

2.8 Under the Proposal Sky's pay TV channels would be protected using conditional access ("CA") technology. Consumers would need a set-top box ("STB") that supported the relevant CA technology in order to gain access to the channels. Choice of CA technology is therefore an important component of the Proposal. Sky is proposing to use CA technology supplied by NDS Group plc ("NDS"), which is controlled by Sky's biggest shareholder, News Corporation. This is a different CA technology from the one currently used by existing pay TV services on DTT.

### Ofcom process and legal framework for assessment of the Proposal

2.9 NGW is licensed by Ofcom to operate multiplexes C and D on the DTT platform. It is currently a condition of the multiplex C licence that *Sky News*, *Sky Sports News* and *Sky Three* will be broadcast on multiplex C<sup>3</sup>. The NGW Application therefore

<sup>2</sup> Sky announced in its press release of 1 October 2007 that it initially expects the children's channel to commence broadcasts daily at 6.00am, but will have the flexibility to commence its DTT broadcasts as early as 3.00am, when the *Sky Movies* service usually ends its daily schedule.

<sup>3</sup> Annex A Part 3 of the multiplex C licence.



requests a change to the description in the licence of the services to be broadcast by NGW on multiplex C. Under the relevant provisions of the Broadcasting Act 1996 (“**BA96**”), as reflected in the terms of the multiplex C licence, such changes are subject to a test as to whether the capacity of the programmes broadcast by NGW to appeal to a variety of tastes and interests is unacceptably diminished<sup>4</sup>.

- 2.10 Under its DTPS licences Sky is authorised to provide a “Licensed Service”, as described in the licence. The description used currently reflects the channels broadcast on multiplex C. If the Proposal meets the test described above concerning variety of tastes and interests, the Sky Application effectively requests that a consequential change be made to the description of the Licensed Service to reflect the changes proposed for the multiplex C licence.
- 2.11 For the reasons set out below we are consulting on the competition implications of the Proposal. Given this, and the fact that the third party channels to be retailed by Sky have not yet been finalised, we are not intending at this stage to carry out the statutory test relating to the variety of tastes and interests served by the programmes broadcast. The carrying out of this test should not however delay the overall process as we do not propose to consult publicly on that test.
- 2.12 We have addressed the Proposal by reference to our general duties under the Communications Act 2003 (“**CA03**”). A number of duties are relevant. In particular Ofcom has a principal duty to further the interests of consumers in relevant markets, where appropriate by promoting competition. By virtue of this duty Ofcom must also secure (amongst other things) the efficient use of spectrum. In carrying out its duties Ofcom must also have regard to various factors, which in this context could include:
- the desirability of promoting the fulfillment of the purposes of public service television broadcasting in the United Kingdom;
  - the desirability of promoting competition in relevant markets;
  - the different needs and interests of all users, both current and potential, of the spectrum used for DTT capacity; and
  - the opinions of consumers and members of the public.
- 2.13 The Applications would result in the introduction by Sky of pay TV packages containing basic and premium content onto the DTT platform<sup>5</sup>. As a result the Proposal raises significant competition issues relating both to competition on the DTT platform and the development of competition between DTT and other digital television platforms. In the light of these issues we are consulting on the Proposal in the context of our duty to promote competition.
- 2.14 In carrying out our competition analysis we must achieve a balance between the promotion of competition and any other duties which may have a bearing on the competition assessment (e.g. the different needs and interests of people using the spectrum). It may also be the case that the Proposal raises issues which directly affect duties other than the duty to promote competition, for example the duty to

<sup>4</sup> Section 12(3) of the BA96 and Condition 17(2) of the multiplex C licence.

<sup>5</sup> From a pricing perspective, pay TV content has historically been divided into two broad categories: (i) basic content (covering a range of genres) and (ii) premium content, such as certain types of sports content or events e.g. FAPL football matches and first run Hollywood films.

secure efficient use of spectrum. We therefore consider whether issues other than competition issues may need to be addressed.

- 2.15 The competition assessment and the options emerging are discussed in Sections 3 and 5 below. Other policy issues arising are discussed in Section 4 below. Our general duties and the legal framework for consideration of the changes to the multiplex C licence are explained in more detail in Annex 6.

## Market context

### The development of the DTT platform

- 2.16 The DTT platform is comprised of six digital multiplexes<sup>6</sup>. Each multiplex is able to carry a number of digital TV, radio or interactive services. The exact number of services that can be carried on each multiplex is dependent on the configuration of the transmitter equipment and the degree to which the audio and video services are digitally compressed. It should be noted that not all channels are broadcast 24 hours a day. This allows capacity to be shared between different TV channels (as envisaged under the Proposal)<sup>7</sup>.
- 2.17 The Independent Television Commission (“**ITC**”) issued licences to operate all the DTT multiplexes (other than multiplex 1<sup>8</sup>) in 1997<sup>9</sup>. When it made its application to operate multiplexes B, C and D the British Digital Broadcasting (“**BDB**”) consortium was comprised of Carlton, Granada and Sky. However, owing to competition concerns, Sky left the consortium, but remained as a supplier of TV channels.
- 2.18 The DTT platform launched in 1998, branded as ONdigital – a joint venture between Granada television and Carlton Communications, providing a mix of FTA and pay TV services. Despite being re-branded as ITV Digital in 2001, the pay TV operation closed in 2002 after falling into receivership.
- 2.19 The ITC re-advertised the licences for multiplexes B, C and D and solicited applications from all interested parties. In 2002 the ITC issued the licence for multiplex B to the BBC and multiplexes C and D to NGW.
- 2.20 Part of the NGW “core proposal” in its 2002 licence application was to include three FTA channels from Sky. A condition of the licence award was that the number of channels operated by Sky should be restricted to three to prevent Sky from effectively controlling the multiplex<sup>10</sup>. The three Sky channels that formed the NGW proposal were *Sky News*, *Sky Sports News* and *Sky Travel*<sup>11</sup> and continued carriage of these channels on a FTA basis was made a condition of the NGW licence for multiplex C. In this context it should be noted that a number of other conditions

<sup>6</sup> The channels currently carried on the DTT platform are listed on the DTG website ([http://www.dtg.org.uk/retailer/dtt\\_channels.html](http://www.dtg.org.uk/retailer/dtt_channels.html)).

<sup>7</sup> For example, CBBC and BBC Three share capacity on multiplex 1, with CBBC broadcasting through the day and BBC Three in the evenings.

<sup>8</sup> The BBC was allocated multiplex 1 by the Government.

<sup>9</sup> The operators of the multiplexes were: BBC (multiplex 1); ITV and Channel 4 (multiplex 2); SDN (multiplex A); multiplexes B, C and D (BDB/OnDigital).

<sup>10</sup> [http://www.ofcom.org.uk/static/archive/itc/latest\\_news/press\\_releases/release.asp-release\\_id=610.html](http://www.ofcom.org.uk/static/archive/itc/latest_news/press_releases/release.asp-release_id=610.html)

<sup>11</sup> Ofcom approved a licence amendment in 2005 to replace Sky Travel with Sky Three.

regarding Sky were included in the licences for multiplexes B, C and D in order to address competition concerns associated with Sky's presence on the DTT platform<sup>12</sup>.

- 2.21 The BBC, NGW and Sky formed DTV Services Limited ("**DTSL**") to jointly promote and market the DTT platform and developed the Freeview brand to that end. The service was launched in October 2002<sup>13</sup>. ITV and Channel 4 joined DTSL in 2005. Freeview continues to be promoted by DTSL.

### Capacity constraints on DTT

- 2.22 The DTT platform is relatively capacity constrained compared to digital cable ("**cable**") and DSat. A broad indication of the relative capacity of each platform can be attained by comparing the number of videostreams currently available on each. For example, Sky's electronic programme guide ("**EPG**") currently lists over 500 TV channels on DSat, Virgin Media offers approximately 200 channels on cable, while only 50 channels are listed on the DTT EPG<sup>14</sup>.
- 2.23 IPTV platforms are constrained in a different way to other broadcast platforms. They are designed to deliver individual channels to individual households, meaning that the broadband connection used to deliver IPTV to a particular household requires sufficient capacity to carry a single TV channel<sup>15</sup>. Developments in IPTV are discussed further in paragraphs 2.54 to 2.57 below.

### Existing regulation of DTT

- 2.24 The DTT platform is regulated in terms of (i) control of the multiplexes (in particular the public service broadcaster ("**PSB**") multiplexes), (ii) the content that must be carried on the PSB multiplexes<sup>16</sup> and (iii) the technical conditions that apply.
- 2.25 In particular, Ofcom has an important role in setting technical performance standards for the DTT platform through the Ofcom Television Technical Performance Code<sup>17</sup>. This requires that all multiplex operators must (i) use the DVB-T broadcast transmission standard, (ii) broadcast their services using MPEG2 in standard definition format and (iii) carry a minimum level of service information data to support the DTT EPG.

### Significance of digital switchover

- 2.26 In the UK, the Government announced in 2005 that current analogue broadcasting should cease on a TV region by TV region basis. The digital switchover ("**DSO**") process will take place between 2008 and 2012. The exception is Whitehaven in

<sup>12</sup> For example, condition 11(8) of the multiplex C and D licences requires NGW to obtain Ofcom's consent in relation to certain types of agreement with Sky, including access to transmission capacity on multiplexes C and D.

<sup>13</sup> The current operators of the multiplexes are: BBC (multiplexes 1 and B); Digital 3 & 4 – owned by ITV and Channel 4 (multiplex 2); SDN (multiplex A); NGW (multiplexes C and D).

<sup>14</sup> Many of the channels on the DTT EPG are "day parted" i.e. they share capacity on the platform by broadcasting at different times of day. The DTT platform currently supports approximately 36 separate video channels. Day parting is less common on cable and satellite due to the relative greater availability of capacity.

<sup>15</sup> Most existing IPTV services cannot provide services to multiple STBs in a home due to lack of bandwidth on the broadband connection.

<sup>16</sup> In addition to the variety test referred to at paragraph 2.9 above the PSB multiplexes must carry certain PSB content.

<sup>17</sup> [http://www.ofcom.org.uk/tv/ifi/tech/codes\\_guidance/tv\\_tech\\_platform\\_code.pdf](http://www.ofcom.org.uk/tv/ifi/tech/codes_guidance/tv_tech_platform_code.pdf)

Cumbria, which becomes the first place to switch on 17 October 2007. The Government's decision will allow DTT to expand its coverage – to match that of analogue, at 98.5% for the main PSB channels.

- 2.27 Currently, around 85% of households already receive digital television services on their primary television set<sup>18</sup>. In the lead up to DSO, the remaining 15% of households will need to make choices about how they receive digital television. The options available to consumers are to access digital television signals via DTT, cable, DSat or telephone line (broadband). Households will also need to make the same choices in respect of all secondary sets which cannot receive digital television signals.
- 2.28 This programme of change – which is a unique period in the development of the UK broadcasting sector – will have two major consequences. The first is that there will be an expansion in the number and range of services available via DTT across the whole country. The second is that a large amount of spectrum (the 'digital dividend') should become available for new uses<sup>19</sup>. One potential use for this additional spectrum is to increase capacity on the DTT platform. These consequences will potentially have a significant impact on the development of the DTT platform.
- 2.29 In our view, these changes in technology and consumer demand spell a period of uncertainty for the development of the DTT platform.

### Growth of Freeview households and drivers for take up

- 2.30 Since its re-launch as Freeview in 2002 the DTT platform has seen strong growth and is now estimated to provide the primary digital TV service for around 9.1 million<sup>20</sup> UK households.
- 2.31 Since 2002 the channel line up on Freeview has been enhanced through the introduction of new channels. This has been made possible through advances in video compression technology which has allowed TV channels to be broadcast using a lower bit rate.
- 2.32 In addition to the improved channel line up, consumer demand has also been driven by the reduction in equipment costs. At launch, STBs were retailed for around £100, but it is now possible to purchase a basic Freeview receiver for under £20. Furthermore, a growing number of televisions now include a DTT tuner as standard and demand for flat screen LCD and Plasma TVs has helped drive adoption of DTT reception equipment.
- 2.33 In 2007 DTSL launched the Freeview Playback brand to help promote DTT based Digital Television Recorders ("**DTRs**"). This has the potential to further drive the demand for DTT receivers as consumers look to replace their existing analogue video recorders in the lead up to DSO. Demand for DTT receivers may be further boosted during the DSO process as coverage is increased from the current 73% of UK households to over 98%<sup>21</sup> and analogue services are withdrawn.

<sup>18</sup> [http://www.ofcom.org.uk/research/tv/reports/dtv/dtv\\_2007\\_q2/dtvq207.pdf](http://www.ofcom.org.uk/research/tv/reports/dtv/dtv_2007_q2/dtvq207.pdf)

<sup>19</sup> See further Ofcom's consultation on the proposed approach to the award of digital dividend spectrum: <http://www.ofcom.org.uk/consult/condocs/ddr/ddrmain.pdf>

<sup>20</sup> [http://www.ofcom.org.uk/research/tv/reports/dtv/dtv\\_2007\\_q2/dtvq207.pdf](http://www.ofcom.org.uk/research/tv/reports/dtv/dtv_2007_q2/dtvq207.pdf)

<sup>21</sup> 90.5% is currently expected for multiplexes A, C and D.

## Pay TV on DTT

- 2.34 Pay TV services were re-introduced on the DTT platform in 2004 by Top Up TV (“**TUTV**”), which offered a number of pay TV channels which were accessible through legacy ONdigital STBs. TUTV encouraged manufacturers and retailers to produce and market new STBs capable of receiving the TUTV service.
- 2.35 In 2006 TUTV began migrating its linear channel pay TV service<sup>22</sup> to a new service, called “Top Up TV Anytime”, which requires subscribers to purchase the TUTV Anytime DTR. The Anytime service uses overnight DTT capacity to broadcast TV programmes which are automatically recorded onto the hard disk of the DTR, thereby allowing the subscriber to watch the content at a time that suits them. At an additional cost, TUTV linear and Anytime subscribers can receive *Setanta Sports* (see below). Anytime subscribers, again at an additional cost, can also receive *Picturebox*, which provides one movie from Universal Studios for subscribers to watch each evening.
- 2.36 In 2007 Setanta Sport Holdings Limited (“**Setanta**”) launched a pay TV sports channel on DTT which can be received using STBs, DTRs and integrated digital televisions (“**IDTVs**”) which are compatible with the “**Mediaguard**” CA operated by TUTV<sup>23</sup>.
- 2.37 Since the beginning of 2007 BT Vision has offered on demand content over digital subscriber lines using a hybrid internet protocol television (“**IPTV**”) / DTT STB. Consumers are able to watch and record Freeview channels<sup>24</sup> using the DTT tuner and hard drive on the STB as well as streaming on-demand content from the BT Vision servers across their broadband connection. Other Internet Service Providers have indicated that they also intend to produce similar products.
- 2.38 Broadcast pay TV content on DTT is protected from piracy using CA technology. As referred to above, Mediaguard CA technology is used to protect both TUTV and Setanta content<sup>25</sup> on the DTT platform and the operation of the CA system is controlled by TUTV. TUTV’s operation of CA on DTT was the subject of a consultation published by Ofcom on 15 February 2007<sup>26</sup>.
- 2.39 To receive pay TV channels that are protected with Mediaguard CA technology consumers must have DTT reception equipment that includes compatible Mediaguard hardware and an active viewing card supplied and activated by TUTV. We believe that there are in excess of a million DTT STBs incorporating Mediaguard CA technology in the UK, including legacy ONdigital STBs, TUTV STBs, BT Vision STBs and CA modules (“**CAMs**”) that subscribers have installed in IDTVs and STBs.

## Technology developments

- 2.40 The technology that underpins the DTT platform has remained largely unchanged since the launch of ONdigital in 1998. The European DVB-T transmission standard is used on all six multiplexes, MPEG2 compression is used on all videostreams and the MPEG1 Layer 2 standard is used for audio compression.

<sup>22</sup> At present, the TUTV linear service comprises UKTV Gold, UKTV Style and British Eurosport.

<sup>23</sup> Mediaguard is licensed to TUTV by Nagra France.

<sup>24</sup> The BT Vision STB is also able to receive Setanta’s pay TV channel when enabled with an active viewing card.

<sup>25</sup> TUTV have also developed a technology which is used by channels such as Television X to offer PPV services. This technology uses the interactive TV functionality available on the DTT platform rather than an encryption based system.

<sup>26</sup> <http://www.ofcom.org.uk/consult/condocs/tutv/topup.pdf>

- 2.41 There are a number of new technologies that have recently been developed, or are in development, which might increase the number of TV channels that can be carried on a multiplex. The MPEG4 H264/AVC video compression standard (commonly referred to as MPEG4 compression) allows standard definition videostreams to be delivered at almost half the bit rate possible when using MPEG2 and new audio compression technologies are now available which provide a similar improvement compared to the existing standard.
- 2.42 In addition to improvements in compression technologies, a new transmission standard, DVB-T2, is currently in development which aims to increase the bit rate of a DTT multiplex by over 30% compared to the existing DVB-T standard. Whilst timelines for development are liable to change, those involved in defining the standard estimate that DVB-T2 will be ready for commercial deployment in 2009 or 2010.
- 2.43 Whilst these new transmission and compression technologies allow more TV channels to be broadcast via DTT, they also require consumers to purchase a new STB or IDTV. The introduction of these technologies onto the DTT platform is therefore not straightforward and may require careful planning and management.
- 2.44 The Proposal would require the consumer to purchase a new STB which includes NDS CA technology. Existing DTT STBs and CAMs which support Mediaguard CA technology would not be able to receive the Sky pay TV services unless technologies such as DVB simulcrypt were implemented by the broadcasters (see below for more details). Similarly, new STBs including NDS CA technology may not necessarily support pay services protected by Mediaguard.
- 2.45 The Proposal does not include a request to broadcast using the new MPEG4 compression technologies (which represents a change from Sky's press statement of February 2007). However, Sky has indicated that it intends support for MPEG4 to be a mandatory requirement for STBs capable of receiving its pay TV service. This would allow the Parties to introduce broadcasts using MPEG4 compression at some time in the future<sup>27</sup> without having to swap-out STBs. If the Sky channels were to be broadcast using MPEG4 compression in the future this would lead to greater efficiencies but also mean that existing STBs, whether used for obtaining FTA or pay services, would not be compatible with the Sky services because these STBs only support MPEG2 decoding<sup>28</sup>.
- 2.46 In addition to new transmission and compression standards, the Digital Video Broadcasting Project ("**DVB**"), a worldwide industry alliance, is developing new specifications that are specifically related to pay TV. DVB has recently developed a new version of the Common Scrambling Algorithm (the "**CS algorithm**") that has formed the core of CA solutions on DTT, cable and DSat since 1998. The new version of the CS algorithm has been developed in response to the growing threat of piracy.
- 2.47 The DVB are also developing a new version of the common interface which allows CAMs to be inserted in STBs and IDTVs – reducing the need to have the CA technology embedded within the consumer equipment to ensure security of the content. However, it is uncertain when the new version will be ready and whether it will adequately address security concerns for interested parties.

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<sup>27</sup> Subject to regulatory approval.

<sup>28</sup> The inability for MPEG2 STBs to decode MPEG4 broadcasts is independent of interoperability issues associated with CA systems.

## Simulcrypt

- 2.48 The CA systems used in the UK are based on a set of technologies developed by DVB. Whilst each CA vendor has its own proprietary encryption technology, a single CS algorithm is used to scramble the video and audio components of a TV channel and the information required by a STB to de-scramble the service is then encrypted by the CA system and broadcast alongside the video and audio streams. Only STBs which support the particular CA system are able to de-encrypt the information required to descramble the channel.
- 2.49 One advantage of the CS algorithm is that it makes it possible for multiple CA systems to be used in respect of the same TV channel. This “**simulcrypt**” solution allows the channel to be viewed on STBs which support different CA systems. For example, MTV broadcasts the video and audio streams for its MTV Base channel just once on the Astra 1G satellite but uses simulcrypt with five different CA systems<sup>29</sup>. This allows STBs on various networks in Europe to “share” the same transmission.
- 2.50 In the absence of simulcrypt, multiple versions of a TV channel have to be broadcast in order to make it available on STBs supporting different CA systems. Given the capacity constraints on the DTT platform (see paragraph 2.22 above), use of simulcrypt may therefore have certain advantages. However, one disadvantage is that the protection afforded to a TV channel using simulcrypt is only as good as the least secure CA system in use.

## HDTV on DTT

- 2.51 We are currently working with multiplex operators and the PSBs, to determine whether it is possible to adopt new technical standards on part of the DTT platform to increase the capacity available and improve the efficiency with which it is used. This could enable the introduction of high definition (“**HD**”) channels on the DTT platform within existing multiplex capacity. Use of the new DVB-T2 transmission standard is being considered as an option for increasing the capacity of the existing multiplexes. This standard could be adopted in combination with the use of MPEG4, to enable the introduction of HD. Our intention is to publish a consultation document later this year regarding the possible introduction of HD channels on to the DTT platform.
- 2.52 Because reception of HD services would require consumers to purchase HD capable STBs there is merit in considering the introduction of HD capability alongside the introduction of the new technologies identified above.
- 2.53 The Parties have not requested to broadcast the pay TV channels in HD format. However, introduction of HD onto DTT forms part of the context for the analysis under this consultation, as it may itself increase the number of different types of STB associated with different types of services on DTT. It should also be noted that if HD channels are launched on DTT, this may have implications for the existing capacity constraints on the platform.

## Developments in IPTV

- 2.54 Recent years have seen a growth in the provision of IPTV services. The two main providers, which are subscription funded, are BT Vision and Tiscali TV.

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<sup>29</sup> The five CA system used in this simulcrypt solution are Conax, Cryptoworks, Mediaguard, Nagravision, ThalesCrypt.

- 2.55 The BT Vision service uses a hybrid DTT/IPTV STB which provides viewers access to content broadcast via DTT as well as on-demand content delivered from the BT Vision servers across the consumer's broadband connection. The BT Vision STB is compatible with the Mediaguard CA system currently used by TUTV<sup>30</sup> and Setanta but it is understood that it is not compatible with the NDS CA system. The hybrid model adopted by BT has the potential to address some of the capacity constraints of the DTT platform as delivery over broadband provides viewers access to a wider range of content and greater control over when it is viewed.
- 2.56 The BT Vision service currently only delivers pre-recorded and pre-compressed content across the broadband connection. BT Vision does not currently stream linear TV channels across the broadband connection.
- 2.57 Unlike BT Vision, Tiscali TV does deliver live TV channels as part of its IPTV service. However, digitally compressing TV channels in real time cannot achieve the same level of bandwidth efficiency that can be obtained from non real time compression techniques. Consequently, whilst the BT Vision service can be offered to customers with broadband connections of 2Mbps or more, it is understood that higher broadband speeds are required for the Tiscali TV service.

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<sup>30</sup> However, the BT Vision STB is not compatible with TUTV's 'Anytime' service.



## Section 3

# Competition assessment

- 3.1 This Section considers the potential impact of the Proposal on the development of competition. Specifically, we consider:
- the legal framework for carrying out the competition assessment;
  - the relevant economic markets which may be affected by the Proposal;
  - the potential implications for the development of competition on the DTT platform; and
  - the potential impact on the development of competition between DTT and other digital television platforms.

## Legal framework for competition assessment

- 3.2 As discussed above, a number of Ofcom's duties are relevant to the consideration of the Proposal. In particular Ofcom has a principal duty to further the interests of consumers in relevant markets, where appropriate by promoting competition. A summary of our duties is set out in Annex 6 below.

## Competition law powers

- 3.3 Ofcom's competition law powers fall under two separate regimes:
- Sections 316 to 318 CA03 create a framework for our regulation of competition issues in the broadcasting sector ("**sectoral competition powers**"). In particular section 316 provides for conditions to be inserted into broadcasting licences to deal with competition concerns. Such conditions may be used to secure that the provider of a licensed service does not enter into arrangements, or engage in a course of conduct, which we consider, or would consider, to be prejudicial to fair and effective competition.
  - We also have concurrent power with the Office of Fair Trading ("**OFT**") to apply and enforce competition law under the Competition Act 1998 ("**CA98**") and Articles 81 and 82 of the EC Treaty ("**general competition powers**")<sup>31</sup>.
- 3.4 Under s317 of the CA03, where we are considering competition issues we must determine first whether it is more appropriate to act under sectoral competition powers or under general competition powers.
- 3.5 The competition issues raised by the Proposal are considered below. Following that analysis we must consider appropriate methods of dealing with any issues raised. This could involve the use of sectoral competition powers to impose particular remedies on an ex ante basis if it is considered that an arrangement or course of conduct would be prejudicial to fair and effective competition. This could involve, for example, the imposition of new licence conditions or the giving of directions under an existing licence condition. Alternatively we might consider that it is more appropriate

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<sup>31</sup> Section 371 CA03

not to use sectoral competition powers on an ex ante basis and instead to rely on ex post powers.

### “Fair and effective competition” licence conditions

3.6 In the context of using sectoral competition powers there are existing “fair and effective competition” licence conditions already contained in the multiplex C licence and in Sky’s DTSPS licences. We are not however restricted to using these existing conditions.

- Condition 11(1) of the multiplex C licence contains a general “fair and effective” competition clause based on s316 CA03. It requires that NGW shall:
  - “(a) *not enter into or maintain any arrangement, or engage in any practice, which is prejudicial to fair and effective competition in the provision of licensed services or of connected services; and*
  - (b) *comply with any code or guidance for the time being approved by Ofcom for the purpose of ensuring fair and effective competition in the provision of licensed services or of connected services; and*
  - (c) *comply with any direction given by Ofcom to the Licensee for that purpose.”*
- Sky’s DTSPS licences also contain a general fair and effective competition clause which mirrors the clause in Condition 11(1) of the multiplex C licence. The provision can be found at Condition 14(1) of the Sky DTSPS licences and provides that Sky shall:
  - “(a) *not enter into or maintain any arrangement, or engage in any practice, which is prejudicial to fair and effective competition in the provision of licensed services or of connected services; and*
  - (b) *comply with any code or guidance for the time being approved by Ofcom for the purpose of ensuring fair and effective competition in the provision of licensed services or of connected services; and*
  - (c) *comply with any direction given by Ofcom to the Licensee for that purpose.”*

3.7 These provisions are based on the wording of section 316 CA03, and in particular provide us with the power to issue codes, guidance and directions “for the purpose of ensuring fair and effective competition”.

### Consent under Condition 11(8) of the multiplex C licence

3.8 Condition 11(8) of the multiplex C licence requires NGW to obtain our consent in relation to certain types of agreement with Sky, including over access to transmission capacity. The Proposal requires substantive amendments to the existing agreement for carriage between NGW and Sky (dated 13 June 2002) (the “**Carriage Agreement**”). Ofcom consented to the Carriage Agreement on 16 August 2002. We consider that the proposed amendments do not raise any issues which are separate from the issues relating to the Proposal. Our consent to the changes proposed to the Carriage Agreement will therefore be conditional upon the outcome of the consultation.

## Condition 11(11) of the multiplex C licence

- 3.9 Condition 11(11) of the multiplex C licence provides that NGW shall not, without our prior consent, enter into any agreements which would result in more than three digital television programme services being provided by Sky on multiplex C. There also exists a corresponding provision in NGW's multiplex D licence preventing Sky from providing services over multiplex D. The Proposal would not alter the number of digital television programme services licensed by Sky which are broadcast on multiplex C. The Proposal does however bring into question whether Condition 11(11) should be retained or amended as a mechanism for dealing with any competition concerns.

## Removal of the FTA Requirement

- 3.10 The licences for television multiplexes B, C and D formerly contained a general requirement that any services carried on the multiplex "*shall be provided on a free to air basis save with the prior consent of Ofcom*" (the "**FTA Requirement**"). In 2005 we consulted on whether this blanket FTA Requirement should be removed<sup>32</sup>. In the April 2006 Statement we concluded that we would be prepared to remove the FTA Requirement in response to requests from the Licensees. It was considered that a general restriction on pay services was no longer required as this form of intervention could unnecessarily inhibit the development of pay services by the market. Against that background Ofcom was prepared to rely on the other powers at its disposal to respond to individual applications as they arose.
- 3.11 The April 2006 Statement therefore concerned the removal by Ofcom of a general restriction on the provision of pay services on multiplexes B, C and D. It did not deal with any specific applications, which remained to be determined on an individual basis dependent on the issues (including competition issues) raised in each case. Sky has argued in the Sky Application that we have already reached certain conclusions regarding the impact on competition of the introduction of pay channels by Sky. We do not accept the argument put forward by Sky. The April 2006 Statement could not and did not address the competition issues raised by any specific proposals from any organisation, since those would relate to specific facts, such as the nature of the content being provided, and the technical standards used to deliver that content. As indicated in Ofcom's previous public statements, Sky's proposals are such that the competition issues raised merit detailed consultation.

## Technical Platform Services

- 3.12 Technical Platform Services ("**TPS**") involve the provision of CA services, EPG services and Access Control services. The regulation of TPS is harmonised at EU level by the Access Directive and implemented in the UK under sections 73 to 75 CA03. In this context Sky is already subject to conditions relating to the provision of TPS, and these conditions are platform neutral. However, the guidelines which set out how these TPS conditions apply to Sky's satellite platform do not apply to the DTT platform<sup>33</sup>. In due course it may be appropriate to issue guidelines for the provision of TPS by Sky on the DTT platform. Any such guidance would have to take into consideration the relative immaturity of this platform.

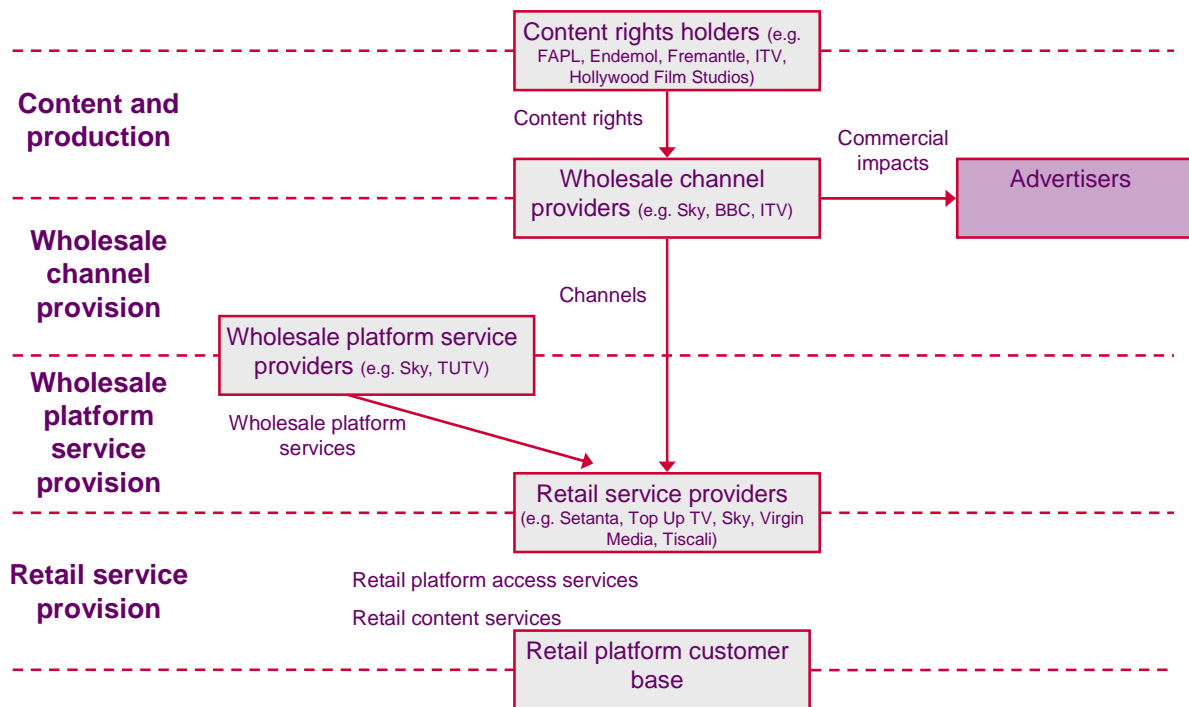
<sup>32</sup> <http://www.ofcom.org.uk/consult/condocs/paytv/>

<sup>33</sup> See "Provision of Technical Platform Services, Guidelines and Explanatory Statement 21 September 2006" <http://www.ofcom.org.uk/consult/condocs/tpsguidelines/statement/statement.pdf>

## Market background

### The supply chain for pay TV services

3.13 The supply chain for pay TV services may be considered to consist of four basic layers as illustrated by the diagram below.



3.14 In practice, a number of operators in the broadcasting industry are vertically integrated and operate at multiple layers of the supply chain. For example, Sky is a vertically integrated wholesale channel provider, wholesale platform service provider and retail service provider.

3.15 The content and production layer includes the businesses which produce programmes/films, perform other creative services, and hold intellectual property rights for programme content / films. Content is supplied by content and production providers to wholesale TV channel providers.

3.16 The wholesale channel provision layer includes the activities around the assembling of content into channels that are ultimately retailed to viewers but also encompasses activities such as the development of channel brands, the sale of advertising airtime around the television channels to media buying agencies etc.

3.17 The wholesale platform layer involves companies which operate TV broadcasting platforms and companies which provide technical capacity and transmission related services to retail service providers for TV channels and other content to be distributed to viewers/subscribers over those platforms.

3.18 The retail layer involves companies that retail platform access products (e.g. providing TV reception equipment) and content services (e.g. Pay TV and/or FTA channels and packages) to subscribers and make arrangements for customer support services such as call centres.

3.19 In the UK there are four established types of TV platform:

- traditional analogue terrestrial broadcast, which will be “switched off” as part of the DSO process;
  - DTT, which includes the Freeview branded FTA platform and pay TV services retailed by TUTV and Setanta;
  - cable, with pay TV services retailed principally by Virgin Media; and
  - DSat, with pay TV services retailed principally by Sky, but also by Setanta and other retailers.
- 3.20 As noted at paragraphs 2.54 to 2.57 above, recent years have also seen the development of IPTV services. There are certain technical constraints about the operation of these services and there are currently only a relatively small number of subscribers to these services. However, the main providers, Tiscali TV and BT Vision, both have plans for the roll-out of national networks and so it is conceivable that over time IPTV will become a more important platform for the delivery of pay TV services.

### Basic and premium pay TV content

- 3.21 Given the nature of the Proposal (i.e. the introduction of additional pay TV services on the DTT platform), pay TV content is central to this consultation. Pay TV content is usually considered in terms of the two broad categories of premium content and basic content.
- 3.22 Premium content, such as certain types of sports content or events e.g. FAPL football matches and first run Hollywood films, is typically characterised as being highly attractive to pay TV subscribers and has historically been regarded as an important determinant of take up of pay TV services<sup>34</sup>. Absent access to such content it may be very difficult for a retail content service provider to gain or retain consumers. We recognise that the TV sector is evolving but nonetheless consider that the distinction between basic and premium content is likely to remain important.
- 3.23 Furthermore, we note that in December 2002, the OFT in its *BSkyB investigation: alleged infringement of the Chapter II prohibition* (the “**BSkyB Chapter II case**”) concluded that Sky enjoyed a dominant position for the purposes of Chapter II CA98 in the wholesale and retail supply of packages containing content unique to premium pay TV sports channels (identified as live FAPL football) and of packages containing premium film channels in the UK<sup>35</sup>.
- 3.24 Sky currently wholesales its premium sports and movies channels to Virgin Media. It does not wholesale such channels to other retailers on the DTT platform, such as TUTV or Setanta nor indeed other digital TV platforms (e.g. BT Vision).

<sup>34</sup> Indeed, the European Commission has recognised in its decisions that premium content is an essential input for pay TV operators active in the delivery of audiovisual content. For instance, Commission Decision of 13<sup>th</sup> October 2000, Vivendi/Canal+/Seagram, Case No. IV/M.2050, OJ C 311 of 31<sup>st</sup> October 2000.

<sup>35</sup> Decision of the Director General of Fair Trading (DGFT), *BSkyB investigation: alleged infringement of the Chapter II prohibition*, No CA98/20/2002, Case CP 01916-00, 17 December 2002. The DGFT is referred to hereafter as the OFT for convenience.

## The DTT platform

- 3.25 The take up of DTT to date has largely been driven by the success of Freeview: the number of subscribers to TUTV and Setanta pay TV services account for only a very small proportion of the 9.1 million DTT-only Freeview households. In addition, even though viewers have access to around 40 different channels on Freeview, the majority of their viewing takes place on the existing PSB channels. Audience data suggest that in DTT-only households, viewing of PSB channels accounts for around 70% of viewing. In addition, the remainder of the viewing is heavily skewed towards the FTA channels linked to PSBs: in DTT-only households, the PSB channels and their associated FTA digital channels accounted for over 90% of overall viewing at the end of June 2007<sup>36</sup>. As explained in paragraph 4.3 below, our preliminary view is that the Proposal is unlikely to have a significant detrimental effect on the FTA channels that are available on DTT.
- 3.26 As DSO approaches, there is likely to be a further increase in take up of DTT. The 15% of households that have yet to convert to digital are among those least interested in multi-channel television and as such are likely to be content – at least in the first instance – with the no subscription/more limited range of channels available on DTT. This hypothesis is supported by analysts' reports<sup>37</sup>, which suggest that Freeview is the digital TV offering that is most likely to be taken up by the majority of analogue households.
- 3.27 These arguments suggest that in the short term at least the focus of DTT will remain on FTA channels. It is possible that in the lead up to DSO, some of the households newly converted to DTT might also be prepared to subscribe to some pay TV services. Nevertheless, our starting presumption is that pay TV subscribers will form only a small proportion of DTT households in the short term.

## Market definition

### Approach to market definition

- 3.28 In order to assess the impact on competition, it is necessary to consider the relevant markets in which Sky would be operating. The relevant product market is determined by identifying constraints on the price setting behaviour of potentially competing products and services. There are two main competitive constraints to consider: how far it is possible for customers to substitute other products and services for those in question if prices were to increase (demand side substitution); and to what extent could other firms switch production to supply the relevant products or services if prices were to increase (supply side substitution).
- 3.29 Market definition in the broadcasting sector is complex for a number of reasons, including the prevalence of a variety of different business and pricing models as well as extensive product and service bundling. In addition, not all programmes or all channels will be direct substitutes for each other: viewers typically tend to watch a range of programming across a range of channels. The demand for TV content reflects considerable heterogeneity in consumer preferences: content that may be regarded as "critical" for one group of viewers may be of little interest to others. Channels can also choose to differentiate themselves in a number of different attributes: for instance, the amount of original commissioned programming, the

<sup>36</sup> Broadcasters' Audience Research Board data.

<sup>37</sup> For example, UBS (29 May 2007) claims that DTT will become the new default platform (instead of analogue TV).

balance between domestic and imported material, the mix of (say) recent film releases versus back-catalogue material etc. As a result there is likely to be a range of content for which some consumers have very imperfect substitutes.

- 3.30 We have not been able to carry out a detailed market definition exercise at this stage. However we set out below a range of potential candidate markets and the way in which those candidate markets affect our conclusions on potential competition concerns.
- 3.31 In conducting our analysis, we have also considered relevant precedents. The European Commission has historically drawn a distinction between different modes of delivery of audiovisual content to consumers. For instance, in *TPS*<sup>38</sup> and *Newscorp/ Telepiù*<sup>39</sup> the Commission decided that the market for pay TV was separate from that of FTA TV<sup>40</sup>. In the *BSkyB Chapter II case*, the OFT found that at the retail layer and wholesale layer there are relevant markets for the wholesale supply of certain premium sports channels and of certain premium film channels. Since that finding, there have been a number of market changes, such as the introduction of the FAPL remedy and the wider take up of new forms of content delivery.
- 3.32 More recently, the OFT has considered market definition in the context of the reference of Sky's acquisition of its stake in ITV plc to the Competition Commission ("CC")<sup>41</sup>. The OFT discussed the potential need for different approaches to market definition in the merger control context. In order to analyse the competitive pressures on Sky and ITV the OFT suggested that the inquiry should be framed broadly to look not only at the impact on premium pay TV markets but also at the TV sector as a whole. In its provisional findings the CC "concluded that at current prices ITV and BSkyB operate within a UK market for all TV including both pay-TV and FTA services"<sup>42</sup>. The CC's provisional findings indicate that FTA services do pose "a constraint to BSkyB's offer" but the provisional findings do not elaborate on the nature or extent of this constraint.
- 3.33 Although we recognise that the above market definitions may depend on specific circumstances, they do provide a useful reference point for considering issues around market definition. Ofcom is also assessing market definition issues as part of its market investigation into the pay TV industry.

## Candidate markets

- 3.34 We are not proposing in this document to go as far as formally defining relevant economic product markets at this stage. It is important to understand that market definition is not an end in itself, but provides a framework for the analysis of competition issues. It may therefore not be necessary to reach final conclusions on market definition.

<sup>38</sup> Commission Decision of 30 April 2002, COMP/JV 57-TPS, at § 14.

<sup>39</sup> Case COMP/M.2876, OJ L 110 of 16 April 2004.

<sup>40</sup> Defining FTA and pay TV to be separate markets does not mean that there is no interaction at all between the two types of services. It is instead an assessment of the extent to which one imposes a competitive constraint on the other.

<sup>41</sup> Acquisition by British Sky Broadcasting Group plc of a 17.9 per cent stake in ITV plc: Report to the Secretary of State for Trade and Industry (27 April 2007).

<sup>42</sup> Reference relating to the acquisition by British Sky Broadcasting Plc of 17.9% of the shares in ITV plc. Notice of provisional findings made under Rule 10.3 of the Competition Commission Rules of Procedure (2 October 2007). <http://www.competition-commission.org.uk/inquiries/ref2007/itv/index.htm>

## Retail service provision

- 3.35 Against that background, we consider that there may be four alternative markets / sets of retail markets against which to assess the Proposal. They are as follows:
- all TV: i.e. a market for the retail provision of all FTA and pay TV channels across all TV platforms. In the context of the analysis of this Proposal, we currently consider that this market definition is likely to be too broad;
  - all pay TV: i.e. a market for the retail provision of all pay TV channels across all platforms (this would be consistent with the European Commission's findings in cases such as *Newscorp/Telepiù*);
  - premium and basic pay TV markets: i.e. separate markets for the retail provision of premium and basic pay TV channels across all TV platforms. We acknowledge that there may be even narrower markets within the premium segment for each of premium sport and premium movies; and
  - DTT specific markets: i.e. separate markets for the retail provision of premium and basic pay TV channels on the DTT platform. We acknowledge that, assuming premium content is a key driver for the take up of pay TV, this may well not be a distinct market. This is because the price of premium content on one platform is likely to constrain the price of premium content on another platform.

## Wholesale Layers

### *Wholesale channel provision*

- 3.36 At the wholesale channel level, a clear reference point is the OFT's finding in the *BSkyB Chapter II case* in relation to wholesale premium sports and movies channels. While the FAPL remedy introduced in 2006 is undoubtedly important for market power assessment, it is less clear that it would have an impact on market definition.
- 3.37 We are continuing to address market definition issues, including within the context of our market investigation into the pay TV industry. Accordingly, we do not wish to define relevant economic product markets formally in this document. However, drawing on the candidate retail market definitions described above, we consider that the candidate wholesale channel market definitions are likely to be as follows:
- a market for the wholesale provision of all FTA and pay TV channels across all platforms;
  - a market for the wholesale provision of all pay TV channels across all platforms; and
  - markets for the wholesale provision of, separately, premium and basic pay TV channels across all platforms<sup>43</sup>.
- 3.38 As far as we are aware, content rights, particularly premium content rights, tend not to be sold on a platform specific basis. For instance, in the sale of the FAPL rights the key distinction in the way in which the rights were sold was between "live" and "near live" rather than (say) between DSat and cable. This tends to suggest that – at

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<sup>43</sup> We acknowledge that there may be even narrower markets within the premium segment for each of premium sport and premium movies.



the wholesale level – the relevant market would not be platform specific although we recognise that this could change over time according to how content rights are packaged.

### *Wholesale provision of technical platform services*

- 3.39 Channel providers looking to offer channels over a particular platform need to acquire TPS from that platform provider: they cannot acquire the relevant TPS services from another platform provider. TPS are a necessary input in relation to pay TV services where service providers need to use CA systems to ensure that only those subscribers that are authorised to view particular channels can do so.
- 3.40 The limited nature of close substitutes could mean that there are relatively narrow markets for the provision of TPS services<sup>44</sup>. This could indicate relevant markets at the level of each separate TPS provider or at least at the level of TPS on a given platform. However, the competitive conditions for the provision of TPS are likely to be strongly influenced by the nature of competition in the relevant wholesale channel and retail content provision markets and these “indirect constraints” could have a bearing on market definition.

### **Development of competition**

- 3.41 As indicated in earlier sections, the next few years are likely to represent a period of significant upheaval in the development of the DTT platform and the delivery of TV services more generally. Whilst there is some uncertainty in how competition will evolve in the longer term, the focus in this section is on describing how the services provided on the DTT platform may develop. We consider later the impact of that development.
- 3.42 Providers of TV retail services on DTT essentially purchase or self-provide two wholesale inputs: wholesale channels and platform access. For pay TV services, platform access includes the provision of conditional access services to ensure that only those viewers that have paid for the content are able to watch it<sup>45</sup>. At the retail level, viewers of pay TV face two key choices: which content to purchase and over which platform? The two choices can be linked in that certain content may only be available via one specific retail content provider and in order to access that content, the viewer has to purchase specific reception equipment (i.e. a particular STB because not all STBs will necessarily be compatible with the CA system that the content provider is using). In this context, the term “platform” could thus be narrower than just the DTT platform: it could refer to the specific CA technology that is used.
- 3.43 Against this background there are a number of different scenarios which could play out in terms of the way in which competition on DTT evolves. These include:
- a single CA technology which supports multiple retailers. This is the current position in that TUTV is currently the provider of the only CA technology for pay TV services on DTT but viewers can purchase retail services from both TUTV and Setanta;

<sup>44</sup> Ofcom has been considering the relevant markets for TPS in the context of its review of wholesale digital television broadcasting platforms.

<sup>45</sup> In certain instances, FTA channels are also encrypted, for example to prevent international spill-over of satellite channels.

- competing CA technologies with competing retailers (including multiple retailers on some CA technologies). In this instance, a viewer chooses reception equipment supporting a particular CA technology but then can only view the content provided by the retailer(s) that uses that CA technology; and
  - a single CA technology with a single retailer. For example, this is the result if the market “tips” in favour of a particular content provider and with it the choice of CA system.
- 3.44 Given that the Proposal explicitly envisages the use of a different CA system (NDS) from that being used by TUTV and Setanta, there would certainly be a period in which there are competing CA technologies with competing retailers in the absence of any regulatory intervention. However, depending on the success of the different content packages, the operation of competition in the market may result in one of the other outcomes e.g. a single CA system/single retailer or single CA system/multiple retailers for pay TV content on DTT.
- 3.45 There has been a tendency within the UK for one main retailer of pay TV services to emerge on any given platform. The same tendency has also been observed in other countries. For example, Digital Plus, which is owned by Sogetel, is the sole provider of pay TV services on the DSat platform in Spain, Sky Italia is the sole provider of pay TV services on the DSat platform in Italy and Noos Numericable has a 90% share of the cable sector in France. To date, there have been relatively few counter-examples, although the entry of Setanta – facilitated by the FAPL remedy and the regulation of TPS on DSat – and BT Vision’s hybrid platform (offering video on demand services combined with content broadcast via DTT) may provide case studies.
- 3.46 There are a variety of potential reasons for the observed tendency towards a single retailer, including, for example, consumer inertia, economies of scale, concentration of control of certain premium content and the benefits to a retailer of being able to bundle content for which consumers have heterogeneous preferences, thereby extracting willingness to pay more efficiently. These factors may enable a retailer systematically to assemble the most compelling range of content offered on a given platform. If – as seems likely – consumer choice is largely based on content rather than the characteristics of a particular CA technology, then the retailer that assembles the most attractive body of content on DTT is likely to be able to attract consumers to its service offering, to the potential exclusion of other retailers.
- 3.47 The likelihood of this outcome may be greater on a platform with significant capacity constraints. At present, the DTT platform is capacity constrained which would limit the ability of a channel provider to broadcast services using different videostreams. In this case, the only technical alternative would be for a channel provider to choose to simulcrypt its service – i.e. to use different CA encryption systems with the same videostream. The shortage of DTT capacity also significantly restricts the likelihood of new entry by other competing retail content providers.
- 3.48 Against this, it is also possible that retailers on a particular platform may be able to differentiate their offerings in ways that go beyond purely the content offered. This may involve offering additional functionality – video on demand for example.
- 3.49 Given these factors, while there may be scope for effective competition between competitors on the DTT platform (“**intra-platform competition**”) in the short term, it is possible that intra-platform retail competition on DTT is unsustainable in the longer term and that competition, therefore, is not likely to take place *within* but *for* pay TV

on the DTT platform. If so, the likelihood is that one competitor will, in due course, become the *de facto* monopoly provider of pay TV services on the DTT platform. While this would not imply a failure of competition, the emergence of a single provider, if the relevant market were defined narrowly, may raise competition concerns – particularly if such a position became entrenched. This concern would apply regardless of the identity of the eventual “winner”.

- 3.50 Even if the market were defined more broadly there could be a concern about this outcome for the development of competition between different TV platforms (“**inter-platform competition**”). In this situation, even if one player were to emerge as the monopoly provider of pay TV services on the DTT platform as a result of fair competition for the market, there might still be competition concerns if that player also had a significant role/*de facto* control over other platforms for the delivery of pay TV services in the UK. Those concerns could relate to the ability to exclude potential competitors in relation to both content and TPS and there could be important implications for the development of competition upstream, for instance, in relation to the acquisition of content rights. These issues are discussed in more detail below.

### Analysis of the entry of Sky pay TV channels on to the DTT platform

- 3.51 In general, the entry of new products and market players has a positive impact on consumers. Entry enhances the choice available to consumers, may result in lower prices, and, under certain conditions, in more innovation, leading to greater benefits for consumers. The enhanced competition associated with entry may also spur efficiency gains. In this particular case there is an immediate benefit to consumers associated with the greater availability of content on DTT, in particular premium sports and movies.
- 3.52 However, we note that competition concerns have previously been raised in respect of Sky’s involvement with the DTT platform. Most notably, in 1997 regulators and competition authorities had concerns about Sky’s role as a shareholder in the BDB consortium (the precursor to ONdigital/ITV Digital) and as a supplier of programmes to BDB. Ultimately, these concerns were addressed by Sky ceasing to be a shareholder in BDB. In 2002, at the time of the re-licensing of the multiplex licences previously operated by ITV Digital, Sky was limited to participating in DTT as a broadcaster – rather than a multiplex operator – on multiplex C and a number of conditions were attached to the multiplex licence in order to protect fair and effective competition.
- 3.53 In the current situation, there is an important distinction to be drawn between the benefits from enhanced choice and availability, and the potential risk that in the longer term competition is in fact diminished as a result of Sky’s entry. This is not to argue against competition on the merits: on the contrary, our objective is to create an environment in which effective competition can thrive.

### Benefits

- 3.54 The launch of Sky’s pay channels would increase competition in the provision of pay TV services thereby increasing choice for consumers. It would bring new pay TV content to DTT and provide consumers with a choice of general entertainment, sports, movies, children’s and factual content. Specifically, the Proposal would meet any currently unmet demand for the options of:
- accessing more live FAPL matches on DTT – the *Setanta Sports* channel will be able to offer 46 live FAPL games whereas the *Sky Sports 1* channel will offer up

to 92 live FAPL games (at present it is only possible to watch the maximum number of live FAPL matches on the DSat and cable platforms);

- subscribing to a bundle of a premium sports and movies channels – some consumers might be more prepared to access pay TV services on the DTT platform only if both movies and sports are offered;
- accessing more premium movies (Sky’s channel might offer “blockbuster” films from a greater range of Hollywood studios than any other channels); and
- accessing more general entertainment, factual and children’s programming with the inclusion of third party channels, which are yet to be announced by Sky.

3.55 Furthermore for the sub-set of viewers that has access to neither cable nor DSat services (for coverage and/or planning restriction reasons), this may represent the only opportunity they have to access this type of content.

3.56 BARB<sup>46</sup> data suggests that the Proposal is likely to be attractive to pay TV consumers. Sky’s existing channels on DTT, taken together, have an audience share of between 1.5% and 2% on the platform. These channels command a similar audience share on the DSat platform. In contrast, the proposed new channels, taken together, have an audience share on DSat that is three to four times greater than this. We recognise, however, that for various reasons (such as audience profiles and pricing) a perfect comparison cannot be drawn between audience shares on different platforms.

3.57 The presence of Sky as a provider of retail pay TV services on DTT may also contribute to innovation (beyond simply the provision of content) and place competing retailers under pressure to provide sustained quality of services to consumers wishing to subscribe to pay TV services on DTT.

3.58 These effects are all positive. However, there might remain a concern about issues of compatibility in that viewers on DTT would be forced either to make a choice between competing pay TV delivery systems or to install two set-top boxes. This is because it would not be possible, under the Proposal, to view Sky content over the TUTV delivery system nor vice versa. We note that incompatibility would not in itself be a competition issue, although it may lead to confusion and inconvenience for consumers (considered at paragraphs 4.7 to 4.12 below), which could influence the development of competition.

## Competition concerns

### *Marketing of STBs*

3.59 In relation to the marketing of STBs there is a concern that Sky would have an incentive to influence the market in such a way as to distort competition, for example by incentivising retail outlets such as Dixons and Argos. Sky has however made proposals designed to protect the operation of a “horizontal market” for STBs, which are described at paragraph 4.7 below. There is an additional argument that the mere fact that Sky announced that it was going to provide pay TV services on the DTT platform has had the effect of “chilling” the market for other providers of pay TV on DTT.

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<sup>46</sup> Broadcasters' Audience Research Board

- 3.60 Marketing activity is of course not anti-competitive. Investment in marketing could well signal the presence of a healthy competitive environment or be a recognition of the importance of competition for the market. For instance, we are aware that Sky would be competing both for DTT users who do not currently subscribe to pay TV services and also potentially for consumers that subscribe to the other pay TV services on DTT. In both cases Sky will have to persuade the consumer to make an explicit decision to purchase its STBs. We recognise that Sky will have a particular advantage stemming from its existing relationships with manufacturers for DSat STBs: for instance, it might benefit from economies of scope in terms of STB design or economies of scale in terms of volume of orders. We would be interested to establish how significant these issues could be in the development of competition for pay TV services on the DTT platform.
- 3.61 We also recognise the theoretical possibility of an impact on competition from Sky's pre-entry announcement. For example, it is possible that retailers of STBs may have been less inclined to stock STBs of competing pay TV service providers as a result of the announcement. As discussed further at paragraph 4.7 below, Sky has stated its intention to encourage a contestable market for the supply of Sky STBs by any manufacturer that could meet Sky's technical requirements rather than to control the exact specifications and production of Sky STBs. Therefore, we would wish to see evidence from both pay TV retailers/STB manufacturers that the pre-entry announcement had a significant and sustained impact on their businesses. In particular, it would be necessary to demonstrate that the sales channels affected by the announcement constituted the main routes to market for the affected pay TV retailers/STB manufacturers.
- 3.62 There could be concerns about the impact on competition if there were incentive schemes structured so as to penalise a retailer for sales of other competing STBs, for example if discounts were reduced if the retailer sold competing STBs or if the structure of any discounts clearly incentivised the retailer to only sell one STB.

#### *Longer term concerns*

- 3.63 An area of greater concern is the way in which Sky's entry might influence the future evolution of the pay TV sector as a whole. As described above, we consider that capacity constraints will limit the number of viable providers of pay TV services on DTT. Sky's entry would constitute a transition from a situation where there is a single "platform" for the provision of pay TV services on DTT with several retailers (e.g. Setanta and TUTV) to a situation where there is more than one platform and more than one retailer on some or all of those platforms. In the longer term, pay TV on DTT may evolve such that a single provider of pay TV services emerges on DTT or at the very least there is a significant degree of concentration.
- 3.64 This evolution raises two sets of questions:
- first, what concerns are raised by the eventual market outcome?
  - second, what is the mechanism by which the market evolves? Does the market evolution itself raise competition concerns?
- 3.65 On the first of these questions, it appears unlikely that a situation in which there are even a relatively limited number of similarly sized competing providers of pay TV services on DTT would create any material competition concerns. There is a risk that viewers would require more than one STB or more than one retail subscription to view their preferred content, but this is not, in itself, a competition concern although it

may raise concerns for consumers (this issue is considered more fully at paragraphs 4.7 to 4.12 below). The only exception would be under an extremely narrow definition of the market, where each CA-based pay TV offering was considered to be in its own retail market. The competition concern in this context would be the emergence of a single monopoly provider or set of monopoly providers.

- 3.66 If there is just one provider of pay TV services on DTT, then there is a greater risk that competition issues will arise. In the case of a relatively narrow retail product market (for example, a market for pay TV services on DTT), then a *de facto* monopoly provider of retail and TPS services could give rise to concerns about the scope for abusive behaviour in relation e.g. to pricing, customer service, providing services to other channels etc. This concern could arise regardless of the identity of the provider of DTT pay TV services.
- 3.67 Under the definition of a broader market for retail pay TV (across all platforms), the identity of the single provider of pay TV services on DTT would be critical. Specifically, there could be a concern if Sky were to emerge as the sole retailer of pay TV services on DTT in that it would be in control of two of the major pay TV platforms in the UK at both the retail and wholesale (platform provision) level. In such a situation there would be an expectation that inter-platform competition would be weaker than in a world where there was a different provider of pay TV services on DTT. By virtue of its strengthened market position and raising entry barriers, it would be more difficult for other suppliers of retail pay TV channels and platform services to enter the market. While we recognise that dominance in itself is not an abuse, we note that in such a situation Sky might have not only the incentive to exclude new entrants but that going forward it would be better placed to implement such a strategy across multiple platforms and at multiple levels in the value chain.
- 3.68 In considering longer term issues, it is also relevant to consider our ability to address competition concerns after the fact. For instance, in the case where Sky has become the *de facto* monopoly provider of pay TV services on DTT, including at the wholesale TPS level, and where there remain capacity constraints (see paragraph 2.22 above), it could be very difficult for regulatory intervention to enable a new competitor to enter the market to establish a competing pay TV platform on DTT.
- 3.69 The outcome in which Sky emerges as the sole retailer of pay TV services on DTT is also a relevant one to consider when addressing the question of how the market evolves. That outcome could arise purely through competition on the merits. We also need to consider the incentives that might exist for anti-competitive conduct. In that context we would need to consider the role of upstream dominance, and in particular whether Sky is dominant at the wholesale level in the provision of content (either premium or premium and basic).
- 3.70 A key issue is the incentives on Sky to make its content available to third party retailers. Where a wholesale channel provider is not vertically integrated with any retailer, it will typically have a strong incentive to license its channels to a wide variety of retailers to maximise the viewing of those channels. However, where a wholesale channel provider is vertically integrated with a retailer the incentive to offer content to rivals may be weakened by the impact on its own downstream retail business: there may be an opportunity cost to wholesaling since the availability of content from the third party retailer will tend to increase the relative attractiveness of that retailer's offering (and therefore reduce the relative attractiveness of the vertically integrated firm's own retail offering). Under certain conditions, licensing channels to a rival retailer may therefore lower the profitability of the wholesale channel provider's own retail business.

- 3.71 These incentives are likely to be strengthened by dominance at the wholesale content provision level: under this argument, any (constructive) refusal to license content to third parties on the DTT platform could potentially raise concerns that it was intended to foreclose the emergence of rival players on DTT, enabling Sky to strengthen its position in the overall pay TV market. We note that Sky already licenses a number of its premium channels to Virgin Media, so in principle we would assume that a wholesale product could be made available on DTT as well, subject to various technical constraints relating to TPS. A further concern arises if Sky has an incentive to use its position as a purchaser of third party content on the DSat platform to influence the availability of that content on DTT.
- 3.72 The above discussion is intended to highlight the potential economic incentives on Sky in the DTT market in the absence of regulation. In particular, it outlines ways in which Sky might have the ability and incentive to foreclose the market. However, it is important to consider the scope of the current competition rules in that, for example, CA98 should provide a deterrent to the sort of conduct highlighted above and TPS regulation would apply in the context of CA services.

### **Legal basis for addressing any competition concerns**

- 3.73 The extent to which we would be able to rely on ex post enforcement (under either our CA98 or sectoral powers) to remedy any competition issues is a key consideration. An issue identified in the concerns set out above is the possibility that Sky's actions in relation to the retail market could have a material impact on the longer term development of competition at all levels and that it would be difficult to address that after the event. If Sky's entry leads quickly to the exclusion of other retailers it is unlikely that ex post measures would be effective in unwinding that position.
- 3.74 If there is the potential for certain types of behaviour to have a material impact on competition, it may be relevant to adopt a precautionary principle and put in place ex ante rules to prevent such potential from being exploited. However, any such rules should be a proportionate response to the issue that has been identified.

### **Preliminary views**

- 3.75 In comparison to pay TV services on cable and DSat, the provision of pay services on the DTT platform is in its infancy and the development of these services is uncertain. This reflects not only the uncertainty in the demand for pay TV services on DTT but also uncertainty in the rate of technical and service innovation across DTT and other delivery platforms.
- 3.76 The emergence of DTT as a pay TV platform raises the issue of whether it could come to represent a significant competitive constraint on more established pay TV delivery platforms i.e. DSat and cable. This question will depend on consumer switching behaviour and at present it is not possible to define the boundaries of the relevant market(s) precisely.
- 3.77 It would appear that the entry of Sky is likely to offer benefits to consumers in terms of expanding the choice of pay TV content that will be available to them and ensuring that there is competitive pressure on pricing at the retail and wholesale level.
- 3.78 Given the dynamics of competition in the retail provision of pay TV services on DTT and Sky's position in the wholesale provision of premium sports and premium movies channels, Sky may have an incentive to act in a way that could prevent, restrict or

distort competition at the retail level. The principal motivation could be a desire on the part of Sky to avoid a situation in which a rival pay TV retailer was able to establish a position in the retail market which it could use to become a more credible rival in competition for premium content rights, particularly premium sports rights.

- 3.79 We consider that there is a degree of uncertainty as to the impact of the Proposal on competition and consumers. On the one hand there is a realistic prospect that entry by Sky will benefit consumers, at least in the short run. On the other hand there could be concerns about the longer term development of DTT as a pay TV platform which rivals could use to compete more effectively with Sky in upstream markets and, in turn, to deliver benefits to consumers.
- 3.80 On the basis of an initial analysis of the issues, we consider that the Proposal does raise competition concerns. There will obviously be a need to take into account the likelihood that these concerns will be realised in our final decision. It is possible that the nature of those concerns is such that it may be difficult to address them adequately on an ex post basis.
- 3.81 Against this background and given the uncertainty about the development of the DTT platform and the impact of the Proposal, we have considered options which might address such competition concerns. We consider it relevant to focus on fostering an environment that encourages effective competition on the DTT platform and which would also allow for the development of competition between pay TV platforms. However, we also consider it essential that any such measures should be constructed with a view to promoting and securing the benefits of effective competition in the long run rather than favouring specific competitors. The possible conditions that we have considered are set out in Section 5 below.

### Consultation questions

1. *To what extent do you consider that DTT, DSat, cable and IPTV are in competition with one another for subscribers of pay TV services – either at present or in the future?*
2. *To what extent do you consider the Proposal is likely to deliver benefits to the consumer?*
3. *To what extent do you consider that there is scope for sustainable competition in pay TV on the DTT platform and, more broadly, across all pay TV platforms?*
4. *What are likely to be the key aspects of competition between providers of retail pay TV services on the DTT platform? E.g. what is the role of premium sports and movies content?*
5. *Do you consider that if Sky were to become the only provider of pay TV on the DTT platform it would be likely to have a significant detrimental effect on competition in the long term? How might this affect the development of other platforms for the delivery of pay TV services?*



## Section 4

# Other policy considerations

- 4.1 As discussed above in Section 2, Ofcom must consider how the Proposal may give rise to policy issues affecting duties other than the duty to promote competition.

### Implications for FTA television and perceptions of “Freeview”

- 4.2 As DSO approaches (see paragraphs 2.26 to 2.29 above), we would be concerned if the Proposal had a detrimental effect on the appeal of Freeview and the DTT platform, more generally, by significantly reducing the number of FTA channels available to consumers on DTT.
- 4.3 There are few reasons to think that such an outcome is likely. The PSB channels (all BBC channels, ITV1, Channel 4, S4C and Five) will remain on the DTT platform on a FTA basis and at the end of Q1 2007 accounted for about 70% of audience share on the DTT platform<sup>47</sup>. While these channels have continued to lose audience share on DTT over the past few years, it is important to understand that the audience share of the PSB channels and their spin-off channels taken together has significantly increased. At the end of June 2007 they accounted for over 90% of overall viewing on the DTT platform<sup>48</sup>.
- 4.4 The Freeview brand name, which was launched in 2002, has been used to promote FTA DTT in the UK and is particularly attractive to viewers who do not want to pay a subscription but still want to be able to watch multi-channel digital television. The DTT platform has developed rapidly under the Freeview brand since 2002, including a pay TV option provided by TUTV. There are now around 9.1 million DTT-only Freeview households in the UK out of about 21.4 million total digital households<sup>49</sup>.
- 4.5 There is a risk that if we were to consent to the Proposal, there would be a more general migration towards pay services. At present, we remain of the view expressed in the April 2006 Statement that an increase in pay TV on DTT would be unlikely materially to affect the achievement of DSO within the Government’s timetable<sup>50</sup>. In this context it should be noted that a number of channels have in recent years moved away from being provided on a subscription basis to a FTA basis. An example of this is E4 and Film4, which used only to be available on DTT via TUTV, but which are now available on Freeview.

### Marketing of Freeview

- 4.6 As noted at Section 2 above, Freeview is promoted by DTSL. We would be concerned if the Proposal resulted in any conflict of interest between Sky’s role as a shareholder of DTSL and its role as a provider of pay DTT services. We note that Sky does not anticipate that its move to become a pay TV broadcaster on DTT would automatically result in a conflict of interest with DTSL. This is because it considers DTSL’s attitude towards pay TV services on DTT is increasingly one whereby the provision of pay services is seen to be an opportunity to increase the awareness of

<sup>47</sup> [http://www.ofcom.org.uk/research/cm/cm07/cm07\\_print/cm07\\_1.pdf](http://www.ofcom.org.uk/research/cm/cm07/cm07_print/cm07_1.pdf)

<sup>48</sup> Broadcasters’ Audience Research Board data.

<sup>49</sup> [http://www.ofcom.org.uk/research/tv/reports/dtv/dtv\\_2007\\_q2/dtvq207.pdf](http://www.ofcom.org.uk/research/tv/reports/dtv/dtv_2007_q2/dtvq207.pdf)

<sup>50</sup> See paragraph 3.12 of the statement.

the DTT platform in general and to ensure that the platform is “fit for purpose” in the future.

### Concerns regarding DTT reception equipment

- 4.7 Sky has said that it will require consumers to buy reception equipment which includes NDS CA technology in order to receive its proposed service. As announced in its press release of 1 October 2007, Sky also intends to foster conditions for the supply of such equipment to DTT subscribers that will essentially replicate the “horizontal market” already in place for DTT Freeview STBs. According to Sky, this would mean that there would be a contestable market for the supply of Sky STBs by any manufacturer that could meet Sky’s technical requirements. Sky has said that it will work with manufacturers to ensure the supply of reception equipment that is compatible with both (existing and future) Freeview services as well as Sky’s pay TV services. In this context, we note that in July 2007, Sky announced that it had acquired Amstrad – a long term supplier to Sky of DSat STBs.
- 4.8 Notwithstanding this, given the complexities of incorporating more than one CA system in a STB, manufacturers may decide to only include the NDS CA system in Sky STBs and the Mediaguard CA system in TUTV STBs. The result would be that STBs with NDS CA would only be able to access DTT pay TV services retailed by Sky and STBs with TUTV’s CA would only be able to access DTT pay TV services retailed by TUTV and Setanta. As a result, there may be some confusion over which services are available from which STBs. We do note, however, that retailers of pay TV services and STBs are likely to have strong incentives to help ensure that their marketing materials are clear which may help to alleviate these concerns.
- 4.9 Another consequence is that consumers would be required to have a Sky STB and a TUTV STB if they wished to obtain Sky’s content and existing pay TV content on DTT, unless manufacturers incorporated NDS CA and Mediaguard CA in the same STB. Consumers may find this an inconvenient and more expensive outcome. For example, consumers that wish to view all 138 live broadcast FAPL matches on DTT would be required to have both STBs given that the rights to 92 matches are held by Sky and the rights to 46 matches are held by Setanta. This can be contrasted with the position on cable and DSat, where a common CA system allows consumers with a single STB to access all live broadcast FAPL matches from Sky and Setanta.
- 4.10 Sky has said that it may broadcast the proposed new channels using MPEG4 compression in the future. Whilst such innovation is likely to have beneficial effects, it may also contribute further towards these issues, as Sky’s pay TV channels on DTT would not be capable of being viewed using any of the DTT reception equipment which had already been deployed. Any confusion might be compounded if the MPEG4 profile otherwise adopted in the UK differs from the MPEG4 profile being adopted by Sky<sup>51</sup>.
- 4.11 As noted at paragraph 2.53, the Parties have not requested to broadcast the pay TV channels in HD format. However, the introduction of HD onto DTT is relevant to this issue as it may increase the number of different types of STB associated with different types of service on the DTT platform in the future.
- 4.12 We recognise that to some degree these issues already exist, as consumers currently have a choice of digital television platforms. In relation to the DTT platform,

<sup>51</sup> The specific MPEG4 profile for DTT in the UK has not yet been agreed by industry or approved by Ofcom.

the TUTV Anytime service can only be received through a dedicated STB and BT Vision services cannot be received through TUTV STBs. Furthermore, future technology developments (including MPEG4 and also the potential transition from DVB-T to DVB-T2) may add to potential confusion and inconvenience regardless of the issues raised by the Proposal.

### Preliminary views

- 4.13 Given the strong presence of the PSBs on the DTT platform, there are few reasons to think that the Proposal would be likely to have a significant detrimental effect on the FTA channels that are available on DTT. However, we would welcome views on this.
- 4.14 There remains some uncertainty as to whether the Proposals are likely to result in other FTA channels being provided on a subscription basis in the future, and whether this would be likely to damage the Freeview brand or impede take up of digital TV services in the lead up to DSO. However, at present we remain of the view expressed in the April 2006 Statement, which is that we do not consider the Proposal would be likely materially to affect the take up of digital television as DSO approaches. Again, we would welcome views on this.
- 4.15 We are uncertain as to whether Sky's launch of a STB, which is MPEG4 compatible and contains NDS CA technology, would be likely to lead to consumer confusion. We are also uncertain how critical it is for consumers to be able to obtain Sky and TUTV content without having to purchase separate STBs. However, we would be concerned if either of these potential consequences had a detrimental effect on the take up of digital television in the lead up to DSO. To the extent that customer confusion is likely and / or that significant weight should be placed on consumers being able to obtain Sky and TUTV services through the same STB, these issues might be addressed through the inclusion of appropriate conditions. We address possible conditions at Section 5 below.

### Consultation questions

6. *To what extent, if at all, do you consider that the Proposal would be likely to lead to any of the public policy concerns outlined at Section 4?*
7. *Specifically, to what extent do you consider that the Proposal would be likely to lead to consumer confusion?*
8. *To what extent do you consider that it is beneficial for consumers to be able to obtain Sky and existing DTT pay TV content without having to purchase separate STBs?*
9. *Do you consider that the Proposal might lead to any additional public policy concerns?*

## Section 5

# Options

### Areas of Concern

- 5.1 Sky's proposed pay TV service offers consumers an increase in choice of general entertainment, sports, movies, children's and factual programming. That choice also brings with it the potential for more effective competition in terms of quality of service and technical innovation, as well as ensuring that there is competitive pressure on pricing, all of which are likely to benefit consumers, at least in the short term.
- 5.2 As noted in paragraph 3.49 above, while there may be scope for intra-platform competition on DTT, it is possible this may be unsustainable in the longer term. As noted at paragraph 3.76 above, in the longer term, there may be the possibility for the emergence of DTT as a pay TV platform which represents a significant competitive constraint on other pay TV delivery platforms e.g. DSat and cable. This would represent an increase in inter-platform competition which would be expected to benefit viewers.
- 5.3 However, given the dynamics of competition in the provision of pay TV services and Sky's position in the wholesale provision of premium content, the Proposal raises competition concerns. Specifically, if Sky were to emerge as the sole or predominant provider of pay TV services on DTT, then the ability of pay TV on DTT to provide a competitive constraint to DSat and vice versa would inevitably be weakened. Furthermore, there is a concern that Sky may have the incentive and ability to secure such an outcome through anti-competitive means.
- 5.4 We must consider these concerns in the context of our principal duty to further the interests of consumers in relevant markets, where appropriate by promoting competition. We are concerned to ensure that there is fair and effective competition in the provision of licensed services affected by the Proposal.

### Options

- 5.5 Based on the above discussion, we have identified three broad options (the "Options").

#### **Option 1: consent to the Proposal on an unconditional basis**

- 5.6 In light of the consumer benefits identified in this consultation document, one option would be for us to consent to the Proposal as it stands without requiring any additional specific conditions to be met. This option would reflect a conclusion that the competition concerns raised in Section 3 could be effectively addressed under ex post competition powers.
- 5.7 Option 1 recognises that there are likely to be consumer benefits of approving the Proposal in terms of greater choice in the provision of pay TV services on DTT as discussed at paragraphs 3.54 to 3.58 above.
- 5.8 It is important to note that this option is not predicated on an assumption that there would not be any competition issues. Rather it would reflect a view that the competition issues discussed in Section 3 that may emerge in the longer term could be dealt with effectively using ex post powers.

## **Option 2: consent to the Proposal subject to imposing additional conditions**

- 5.9 Given the immediate benefits of approving the Proposal, but the concerns about the longer term development of pay TV, a second option would be to consent to the Proposal subject to imposing conditions to address longer term competition issues.
- 5.10 Option 2 would seek (i) to gain the benefits of bringing new programming content to DTT, providing consumers with a greater choice of premium movies and sports, as well as factual, children's and general entertainment programming, but also (ii) to ensure the conditions for competition in pay TV, both on DTT and more widely, to the benefit of consumers in the longer term. This option would reflect a conclusion that the competition concerns cannot be effectively addressed through the use of ex post competition powers.
- 5.11 In balancing these objectives, and consistent with our regulatory principles, we would seek to impose conditions which are the least intrusive necessary to achieve the policy objectives effectively. This would include ensuring that additional conditions minimise the likelihood of disputes and the need for further regulatory intervention. The exact formulation of any additional conditions would depend on where in the supply chain (illustrated at paragraph 3.13 above) it would be most effective to focus any regulatory intervention in order to address the concerns highlighted.
- 5.12 Within this area we consider there are four categories of conditions that merit discussion:
- accept commitments from the Parties. These commitments would follow the intentions set out by the Parties in their Applications, potentially including additional commitments offered by the Parties to address our concerns.
  - require Sky to make its channels available to other retailers on a wholesale basis, subject to certain conditions in relation to wholesale pricing.
  - require the retail and/or wholesale provision of channels by Sky to be subject to certain conditions relating to TPS.
  - limit Sky's ability to retail channels directly on the DTT platform.

## **Option 3: not consent to the Proposal**

- 5.13 Given the competition issues discussed in Section 3 and the critical stage in the development of pay TV on DTT, a third option would be to not consent to the Proposal at this point in time. Despite the consumer benefits associated with increased choice of programming, including premium sports and movies, this option would reflect a decision that it is not possible to identify appropriate conditions to address longer term competition problems in the development of pay TV services – problems that would outweigh any immediate benefits.
- 5.14 In considering this option, we would take full account of the immediate benefits identified at paragraphs 3.54 to 3.58 above. However, we would also recognise that the longer term development of pay TV on DTT is a critical issue for the evolution of pay TV services in the UK as a whole and should be considered with great care. As highlighted at paragraph 3.52 above, fundamental competition concerns have previously resulted in significant limitations on Sky's involvement in DTT.

- 5.15 In particular, the imminent DSO process represents a critical window of opportunity for the development of the DTT platform. There may be a prospect of the emergence of a pay TV provider on DTT to compete with providers of pay TV services on other delivery platforms such as DSat and cable. As noted at paragraph 3.67 above, it may be a less desirable outcome should the Proposal lead to Sky emerging as the sole provider of pay TV services on DTT in the longer term and hence controlling a second major pay TV platform than an outcome where there is a different provider of pay TV services on DTT. We are separately looking at competition in the UK pay TV industry more widely and it may be appropriate for us to adopt a cautious approach to the Proposal at this point in time, when there is still significant uncertainty about the development of the DTT platform. It is important to stress that this would not preclude the Parties from re-submitting a request at some point in the future.

## Issues relevant to the consideration of Option 2

- 5.16 In considering Option 2, we recognise that imposing additional conditions can lead to further complex issues of detail which would require careful consideration to ensure that the conditions are effective whilst no more intrusive than necessary. An indication of the relevant issues which might be raised is provided below. It should be noted that any package of additional conditions might comprise a combination of any of the possibilities considered below. It is also important to note that any package of additional conditions would need to be technically and commercially viable, taking account in particular of the limited capacity on DTT.

## Commitments

- 5.17 This recognises that some of the concerns and risks identified in Sections 3 and 4 may be managed by accepting commitments from the Parties. The starting point for such commitments would be the intentions stated by Sky in its submission to us accompanying the Sky Application. As noted at paragraph 4.7 above, Sky intends to foster the development of a horizontal marketplace for DTT reception equipment. Commitments of this nature may therefore help to alleviate concerns regarding the provision of reception equipment in the retail layer of the supply chain. Further, additional commitments offered by the Parties could be adopted to address broader concerns raised in this consultation document. Such commitments may be close in nature to the conditions considered below.
- 5.18 Examples of commitments which might alleviate concerns regarding the provision of reception equipment, and which build on the intentions communicated by Sky, include:
- **enabling development of STBs compatible with multiple pay TV services.** For STBs compatible with Sky's proposed service, Sky has indicated that it would not seek to prevent manufacturers incorporating a second CA system in addition to NDS should manufacturers wish to develop STBs which are also compatible with existing pay TV services.
  - **limiting potential for confusion resulting from inclusion of MPEG4.** As noted at paragraphs 4.7 to 4.12 above, Sky's intention to make support for MPEG4 a mandatory requirement for STBs capable of receiving Sky's proposed service could lead to consumer confusion and inconvenience should Sky's specifications be incompatible with the MPEG4 profile ultimately adopted in the UK. It may be

appropriate to seek commitments limiting the marketing of such STBs as being “MPEG4-ready”<sup>52</sup>.

- **ensuring access to wholesale NDS-based encryption services.** As noted at paragraph 3.44 above, a possible outcome for pay TV on DTT is for a single CA technology to prevail. In the case that the Proposal leads to this being NDS, it would be desirable to provide the possibility for this CA system to support multiple retailers.

- 5.19 Commitments might also be accepted from the parties to address the broader concerns.
- 5.20 We would welcome comments from stakeholders on what further commitments might be appropriate.

### Wholesale provision of channels

- 5.21 It may be that the competition concerns arise primarily from Sky’s position in the upstream wholesale provision of content (see paragraph 3.69 above) and such concerns are unlikely to be effectively addressed by ex post intervention or commitments alone. If this is the case, it may be appropriate to impose conditions which address the relevant part of the supply chain directly. For example, in addition to consenting to Sky retailing its content directly to subscribers, conditions could be imposed to require Sky to make its content available to other retail providers on a wholesale basis. The imposition of a wholesaling requirement on Sky would clearly raise implications for the position of other providers of pay TV services. It would therefore be necessary to consider the role of such wholesaling requirements across pay TV markets<sup>53</sup>.
- 5.22 On more detailed consideration of such a condition, specific further issues are raised in order to ensure the effectiveness of the condition. For example, it might be necessary to ensure that content is made available in a form which supports the full range of any value-added services (e.g. interactive services), and on equivalent terms and conditions to those which might be expected in a competitive market. Specific questions include:
- **what content should be made available on a wholesale basis?** It may be appropriate to require all channels to be offered on a wholesale basis. Alternatively, if the concern arises as a result of consideration of relative positions in the provision of wholesale premium content, it may be more appropriate to require only the wholesale provision of Sky’s premium sports and movies channels<sup>54</sup>.

<sup>52</sup> It should be noted that Ofcom intends to consult separately on the possible introduction of MPEG4.

<sup>53</sup> In this context we note that in the United States, the 1992 Cable Television Consumer Protection Act gave the Federal Communications Commission the power to require vertically integrated cable programme suppliers to make their programming available to third party distributors on a non-discriminatory basis. We also note that wholesale remedies have been imposed in a number of merger cases - see for example *Newscorp/ Telepiù* (referred to above) and *Conseil de la Concurrence 13/08/2006 Acquisition of TPS and Canalsatélite by Vivendi Universal and Canal Plus Group*, Case 06-A-13.

<sup>54</sup> Other possibilities, such as the wholesale provision of only a single channel, could also be contemplated although it is likely to be impracticable to require parts of channels to be provided on a wholesale basis.

- **what wholesale pricing conditions might be specified?** It is likely to be necessary to establish a framework for deriving appropriate wholesale prices in order for such requirements to be effective. One approach would be to require the adoption of a “retail-minus” approach or “ex ante margin squeeze” rule to help ensure that retail competitors can compete at the retail price level while still recovering efficiently incurred costs, including retail distribution costs.

5.23 We recognise that a wholesaling requirement on its own may not be workable in practice if multiple versions of a TV channel need to be broadcast in order to make it available on STBs supporting different CA systems. This is because capacity on the DTT platform is at present significantly constrained (see paragraph 2.22 above). Conditions relating to TPS may therefore be required in order to implement an effective wholesaling requirement on Sky.

### Conditions relating to TPS

- 5.24 Conditions relating to TPS may be required if the Proposal raises competition problems at the wholesale TPS level of the supply chain. For example, in the scenario where it is appropriate to require the wholesale provision of content, but no technical conditions are imposed, Sky may fulfil these requirements by providing the relevant NDS-encrypted videostream to retail competitors. This may result in an outcome where NDS is ultimately the prevailing single CA technology on the DTT platform, with Sky controlling access to the wholesale provision of encryption services on DTT, not necessarily as a result of the efficacy of the NDS CA system but due to the ownership of key content. In this outcome, Sky would control access to the wholesale provision of encryption services on two major pay TV platforms, making it more difficult for suppliers of retail channels and encryption services to enter the market.
- 5.25 Concerns of this nature might be addressed through TPS regulation. Alternatively, there may be a desire to foster an environment for fair and effective competition at the wholesale platform service layer of the supply chain, on the merits of competing TPS. In this case, it may also be appropriate to stipulate technical conditions which address concerns of incompatibility in pay TV services offered by different retailers.
- 5.26 We have considered a broad range of mechanisms for addressing these issues. In this context we would need to take into account in particular our duty to promote the optimal use of spectrum. Capacity constraints on the DTT platform suggest that multiple broadcasts of the same TV channel would not be efficient.
- **use of simulcrypt.** As discussed at paragraphs 2.48 to 2.50 above, simulcrypt enables a channel to be viewed on STBs which support different CA systems. Sky could be required to simulcrypt its videostreams in order that any channels that are to be provided on a wholesale basis are compatible with STBs of other pay TV providers on DTT. However, concerns about the use of simulcrypt have been raised by some parties: there is debate about the practicalities of using simulcrypt in this context, other than on a short term basis (e.g. during transition from the use of one CA system to another) or whether it can be used in respect of more than two CA systems, even given the example referred to at paragraph 2.49 above. Sky has also raised security concerns about the use of Mediaguard CA, which would apply equally to the simulcrypt approach. It would also be necessary to consider whether such a condition should apply to only one provider of wholesale content or more broadly.



- **specification of STB compatibility with existing pay TV services.** In theory we could require Sky to stipulate that all STBs which are capable of receiving Sky's proposed service are also compatible with existing Mediaguard-encrypted pay TV services. However, such an approach is likely to have significant implications for the complexity, development timescales and resulting retail price of such STBs and is unlikely to be scalable should other CA providers emerge on DTT in the future.
- **use of Mediaguard CA system.** A third approach would be to require Sky to use the same variant of Mediaguard CA which TUTV and Setanta use at present on the DTT platform. This would ensure that all pay TV services on DTT could be received by existing DTT pay TV STBs as well as those designed to receive the proposed Sky service. However, this approach is more intrusive and could be regarded as effectively mandating a CA standard, raising a number of issues, not least given our duties regarding technological neutrality, particularly when alternative CA providers may emerge in the future. Sky's security concerns would also still be relevant.
- **restriction from operating a CA system.** A further approach may be to restrict Sky (or any subsidiary company) from operating a CA system on DTT. This approach would address concerns regarding Sky controlling wholesale access to the DTT platform, although it would not necessarily ensure that the Sky channels could be viewed by subscribers to other pay TV services on the DTT platform. In addition, Sky's position on the use of Mediaguard would apply.

5.27 It is clear that each mechanism raises significant difficulties in terms of practicability and implementation. We would therefore welcome comments as to how a workable technical solution might be reached, on the premise that incompatibility of STBs does raise concerns to be addressed. We would particularly welcome comments from providers of pay TV services and NGW.

### Limiting Sky's ability to retail channels directly

5.28 As discussed in Section 3, we would have concerns regarding the effect on inter-platform competition if Sky were to emerge as the monopoly provider of pay TV services on the DTT platform. At the same time, not giving consent to the Proposal (Option 3) prevents Sky's attractive content from being made available to viewers on DTT.

5.29 There may therefore be grounds for allowing the Proposal only on the more limited basis of restricting Sky's ability to retail channels directly on DTT. This might be achieved by limiting the number of channels which may be included in Sky's retail package, for example to the five channels which are currently proposed. This would permit Sky to make available a limited amount of content on DTT, including premium content, whilst ensuring that sufficient capacity remained available to other pay DTT retailers. In that context we would need to consider whether to amend Condition 11(11) of the multiplex C licence or whether further provisions are required.

5.30 Alternatively, if the risk and degree of harm to inter-platform competition is considered to be sufficiently high, it may be appropriate to make consent to the Proposal conditional on Sky not retailing any services directly on DTT.

## Preliminary views

- 5.31 We have identified three broad options regarding competition and policy considerations:
- **Option 1:** consent to the Proposal on an unconditional basis
  - **Option 2:** consent to the Proposal subject to imposing additional conditions
  - **Option 3:** not consent to the Proposal
- 5.32 While Option 1 would realise the likely consumer benefits resulting from enhanced choice and availability, it may run the risk that competition concerns about the longer term development of DTT and pay TV in general cannot be addressed effectively at a later stage. Conversely, Option 3 reflects a cautious approach to considerations of the longer term impact, at a critical stage in the development of pay TV on DTT, but at the expense of likely consumer benefits, at least in the short term.
- 5.33 Option 2 reflects a desire to balance the realistic prospect that Sky's proposed service will benefit consumers, at least in the short term, with effective management of the risks to the longer term development of pay TV on DTT. However, the above discussion highlights a number of challenges associated with identifying appropriate regulatory conditions which would be practicable and effective. This might ultimately result in us being required to adopt Option 3.
- 5.34 We are not making a recommendation at this stage but welcome comments from stakeholders on these options.

## Consultation questions

*10. If Sky becoming the only provider of pay TV services on the DTT platform were likely to have a significant detrimental effect on competition, do you consider that it is possible to address this through a set of additional conditions and/or directions? If so, what form should those conditions/directions take?*

## Annex 1

# Responding to this consultation

## How to respond

A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 14 December 2007**.

A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://www.ofcom.org.uk/consult/condocs/dtv/howtorespond/form>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.

A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email [steven.ball@ofcom.org.uk](mailto:steven.ball@ofcom.org.uk) attaching your response in Microsoft Word format, together with a consultation response coversheet.

A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Steven Ball  
Competition Policy Manager  
Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA

Fax: 020 7981 3333

A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.

A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

## Further information

A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Steven Ball on 020 7981 3379.

## Confidentiality

A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether

all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

### Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement next year.
- A1.12 Please note that you can register to receive free mail updates alerting you to the publications of relevant Ofcom documents. For more details please see: [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm)

### Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk) . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash  
Ofcom  
Sutherland House  
149 St. Vincent Street  
Glasgow G2 5NW

Tel: 0141 229 7401  
Fax: 0141 229 7433

Email [vicki.nash@ofcom.org.uk](mailto:vicki.nash@ofcom.org.uk)

## Annex 2

# Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

### Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

### During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will normally allow ten weeks for responses to consultations on issues of general interest.

A2.6 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organizations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

### After the consultation

A2.8 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

## Annex 3

# Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk).
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at [www.ofcom.org.uk/consult/](http://www.ofcom.org.uk/consult/).
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we do not have to edit your response.

**Cover sheet for response to an Ofcom consultation**

**BASIC DETAILS**

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

**CONFIDENTIALITY**

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

**DECLARATION**

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

## Annex 4

# Consultation questions

### Section 3: Competition assessment

1. *To what extent do you consider that DTT, DSat, cable and IPTV are in competition with one another for subscribers of pay TV services – either at present or in the future?*
2. *To what extent do you consider the Proposal is likely to deliver benefits to the consumer?*
3. *To what extent do you consider that there is scope for sustainable competition in pay TV on the DTT platform and, more broadly, across all pay TV platforms?*
4. *What are likely to be the key aspects of competition between providers of retail pay TV services on the DTT platform? E.g. what is the role of premium sports and movies content?*
5. *Do you consider that if Sky were to become the only provider of pay TV on the DTT platform it would be likely to have a significant detrimental effect on competition in the long term? How might this affect the development of other platforms for the delivery of pay TV services?*

### Section 4: Other policy considerations

6. *To what extent, if at all, do you consider that the Proposal would be likely to lead to any of the public policy concerns outlined at Section 4?*
7. *Specifically, to what extent do you consider that the Proposal would be likely to lead to consumer confusion?*
8. *To what extent do you consider that it is beneficial for consumers to be able to obtain Sky and existing DTT pay TV content without having to purchase separate STBs?*
9. *Do you consider that the Proposal might lead to any additional public policy concerns?*

### Section 5: Options

10. *If Sky becoming the only provider of pay TV services on the DTT platform were likely to have a significant detrimental effect on competition, do you consider that it is possible to address this through a set of additional conditions and/or directions? If so, what form should those conditions/directions take?*



## Annex 5

## Glossary

<b>British Digital Broadcasting (BDB)</b>	The consortium of Granada and Carlton which operated the Ondigital (later renamed ITV Digital) pay TV service on the digital terrestrial television platform.
<b>British Sky Broadcasting Group plc (Sky)</b>	Operator of the primary digital satellite platform in the UK and retailer of the 'Sky' pay television service.
<b>BT Vision</b>	A video-on-demand service offered by BT to BT broadband customers. Services are delivered using both the digital terrestrial TV platform and BT telephone lines.
<b>Conditional Access (CA)</b>	Scrambling and encryption technologies that allow a broadcaster to restrict reception of its digital channels to consumers who have been authorised to view them. Typically used by pay TV operators to protect subscription and pay per view revenues.
<b>Digital Cable (cable)</b>	A television distribution network based on optical fibre and coaxial cable technology. The main provider in the UK is Virgin Media.
<b>Conditional Access Module (CAM)</b>	A device inserted into a set-top box or integrated digital TV which allows digital services protected with different Conditional Access technologies to be displayed.
<b>Communications Act 2003</b>	The parliamentary act that set out, amongst other things, Ofcom's duties and powers.
<b>DVB Common Scrambling Algorithm (DVB CSA)</b>	The standards based scrambling algorithm that forms the basis of conditional access systems used in Europe.
<b>Digital Satellite (DSat)</b>	The digital television distribution network based on satellite transmission.
<b>Digital Switchover (DSO)</b>	The process in the UK by which analogue terrestrial television services will cease on a region by region basis between 2008 and 2012.
<b>Digital Television Programme Service (DTPS) Licence</b>	A licence issued by Ofcom to all broadcasters of digital television channels on the UK digital terrestrial TV platform.
<b>Digital Television Recorder (DTR)</b>	A device for recording digital television broadcasts, typically using a computer hard disk with a set-top box. Also known as a personal video recorder (PVR) and digital video recorder (DVR).
<b>Digital Television Services Limited (DTSL)</b>	The consortium that owns and markets the Freeview brand on the digital terrestrial TV platform. Jointly owned by NGW,

	Sky, BBC, ITV and Channel 4.
<b>Digital Terrestrial Television (DTT)</b>	The digital television distribution network based on terrestrial transmitter towers
<b>Digital Video Broadcasting (DVB)</b>	The standards development body that has produced many of the specifications used on digital satellite, cable and terrestrial platforms, including transmission and conditional access technologies.
<b>DVB-T</b>	The DVB transmission technology standard that forms the basis of the digital terrestrial television platform . The DVB-T standard has been in use in the UK since 1997, work is underway to develop and improved standard (DVB-T2).
<b>Electronic Programme Guide (EPG)</b>	An on-screen guide to scheduled broadcast television programmes, allowing a viewer to navigate and select content by time, title, channel and genre.
<b>Football Association Premier League (FAPL)</b>	The body which is responsible for licensing the television rights for the English Premier Football league.
<b>Free To Air (FTA)</b>	The transmission of digital television (and radio) services without conditional access.
<b>Freeview</b>	The brand used to promote the free to air services available on the digital terrestrial television platform.
<b>High Definition (HD) / High Definition Television (HDTV)</b>	A television picture format that has higher picture resolution than 'standard definition' services.
<b>Integrated Digital Television (IDTV)</b>	A television set which has a built in digital tuner and receiver (typically for reception of digital terrestrial TV). IDTVs remove the need for an external set-top box.
<b>Internet Protocol Television (IPTV)</b>	Delivery of television content using the internet protocol used for transferring data over the internet and private IT networks. IPTV is often used to refer to services delivered across the public internet as well as "walled garden" services provided over broadband connections, such as BT Vision.
<b>Independent Television Commission (ITC)</b>	The public body that was responsible for licensing television services in the UK prior to the creation of Ofcom.
<b>Mediaguard</b>	The conditional access technology provided by Nagra France and currently used in the UK by Top Up TV and Setanta on the digital terrestrial television platform.
<b>MPEG2</b>	The digital technology used to compress the video component of the majority of digital television services in the UK. MPEG2 has been in use for over 10 years.

<b>MPEG4 H264/AVC</b>	A relatively new digital compression technology which is more efficient than MPEG2. Commonly referred to as MPEG4.
<b>Multiplex</b>	The combination of a number of digital television and radio services into a single datastream in order that they can be transmitted on a network. The DTT platform currently consists of 6 multiplexes.
<b>NDS Group plc (NDS)</b>	A technology company that provides the conditional access technology used by BSkyB on its digital satellite service. NDS is controlled by Sky's biggest shareholder, News Corp.
<b>National Grid Wireless Ltd (NGW)</b>	A transmission company that operates approximately 50% of the terrestrial TV transmitters in the UK and is licensed to operate two of the digital terrestrial multiplexes.
<b>ONdigital</b>	The brand name of the pay TV service operated by British Digital Broadcasting on the DTT platform.
<b>Public Service Broadcaster (PSB)</b>	The four PSBs in the UK include: BBC, ITV, Channel 4 and Five.
<b>Setanta Sport Holdings Limited (Setanta)</b>	A provider of pay TV sports channels on all the major digital TV platforms in the UK.
<b>Simulcrypt</b>	A technology that allows a single broadcast channel to be used with two or more conditional access systems.
<b>Set-Top Box (STB)</b>	A digital television receiver that is connected to a television display. A STB may also include DTR capabilities.
<b>Tiscali TV</b>	An IPTV provider which provides linear and on-demand TV services via BT telephone lines.
<b>Technical Platform Services (TPS)</b>	The provision by digital television platform operators of various technical services (including CA and EPG listing services) on a wholesale basis to broadcasters. Provision of some TPS may be regulated.
<b>Top Up TV (TUTV)</b>	A provider of pay TV services on the digital terrestrial TV platform.

## Annex 6

# Legal framework and impact assessment

## Introduction

A6.1 This Annex summarises Ofcom's duties under CA03 and the background to the assessment of the NGW Application under the relevant licence conditions.

## Ofcom's duties

A6.2 Under s.3(1) of CA03 it is Ofcom's principal duty in carrying out its functions to:

- further the interests of citizens in relation to communications matters; and
- further the interests of consumers in relevant markets, where appropriate by promoting competition.

A6.3 Under s.3(2) Ofcom is further required to secure:

- the optimal use of the electro-magnetic spectrum;
- the availability throughout the UK of a wide range of TV and radio services of high quality which appeal to a variety of tastes and interests; and
- the maintenance of a sufficient plurality of providers of different TV and radio services.

A6.4 Section 3(4) sets out certain other factors which Ofcom should have regard to in performing its principal duty of furthering the interests of citizens and consumers. The factors which are most likely to be relevant in this context are:

- the desirability of promoting the fulfilment of the purposes of public service television broadcasting in the United Kingdom;
- the desirability of promoting competition in relevant markets;
- the different needs and interests of all users, both current and potential, of the spectrum used for DTT capacity; and
- the opinions of consumers and members of the public.

A6.5 Under s.3(5) Ofcom must also, when performing the duty of furthering the interests of consumers, have regard to the particular interests of those consumers in respect of choice, price, quality of service and value for money. The Applications raise issues affecting all of these duties. In particular:

- Issues relating to competition. The regulatory framework for this area is described at Section 3;
- Issues relating to other policy objectives of Ofcom addressed at Section 4.

## NGW Application and the multiplex C Licence

- A6.6 The statutory provisions and licence conditions relevant to the Applications derive from the original award to NGW of the multiplex C Licence in 2002.
- A6.7 Section 7(4) BA96 concerns applications for multiplex licences and provides that an application for a multiplex licence must be in writing and accompanied by (*inter alia*):
- “the applicant’s proposals as to the number of digital programme services to be broadcast, as to the characteristics of each of those services and as to the areas in which they would be provided<sup>55</sup>”.*
- A6.8 Consequently NGW’s application for the multiplex C Licence included proposals regarding the number and characteristics of the services that would be broadcast on multiplex C. Those proposals were assessed under s.8 BA96 which provides that among the matters to be taken into account when deciding whether to award a licence is:
- “the capacity of the digital programme services proposed to be included in the service to appeal to a variety of tastes and interests<sup>56</sup>”.*
- A6.9 The award by Ofcom to NGW of the multiplex C Licence therefore included an assessment as to the capacity of the services presented in the application to appeal to a variety of tastes and interests.
- A6.10 The key proposals made by NGW and accepted by the ITC were then incorporated into the multiplex C Licence as a result of Section 12(1)(b) BA96 which provides that multiplex licences should include such conditions as appear to be appropriate for securing (*inter alia*):
- “the implementation of any proposals submitted by the licence holder under s.7(4)(c), (d), (e) or (f)”.*
- A6.11 The relevant proposals presented by NGW in its licence application were therefore made the subject of licence conditions included in the multiplex C Licence.
- A6.12 In relation to amendments to conditions relating to the services broadcast, Section 12(3) BA96 further provides that:
- “Where the licence holder applies to the Commission for the variation of any condition imposed in pursuance of subsection (1)(b) and relating to the characteristics of any of the digital programme services to be broadcast under the licence, the Commission shall vary the condition accordingly unless it appears to them that, if the application were granted, the capacity of the digital programme services broadcast under the licence to appeal to a variety of tastes and interests would be unacceptably diminished.”*

### Licence commitments in the multiplex C Licence relating to services broadcast

- A6.13 NGW’s commitments relating to the television services to be broadcast under multiplex C are set out under Part 2 of Annex A to the multiplex C Licence -

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<sup>55</sup> S.7(4)(c)

<sup>56</sup> S.8(2)(e)

“Conditions relating to Digital Television Programme Services”. This condition provides that the Licensee:

*“shall implement the Core Proposals in response to Question A.3 in the Attachment to Part III of the Invitation to Apply as amended from time to time by agreement in writing between the Licensee and Ofcom in accordance with Condition 17.”*  
(emphasis added)

“Core Proposals” are defined in Part 1 of Annex A as follows:

*“Core Proposals” means the proposals as to the number and characteristics of the digital television programme services and digital television additional services to be provided on multiplex C submitted by the Licensee in his Application for the Licence in response to Questions A.3 and A.4 in the Attachment to Part III of the Invitation to Apply (save that any reference in that proposal to free to air shall be deemed to be omitted) and Licensee letter dated 27 May 2004 - titled ‘Application for Variation of Crown Castle’s licence to provide a multiplex service’, such services to include for the avoidance of doubt, Sky News, Sky Sports News, Sky Three, UK History and Talksport.”* (emphasis added)

A6.14 The inclusion of *Sky News, Sky Sports News* and *Sky Three* in the services broadcast on multiplex C is therefore a licence condition subject to amendment in accordance with Condition 17.

#### **Amendments under Condition 17 of the multiplex C Licence – the variety test**

A6.15 Condition 17(2) of the multiplex C Licence provides that:

*“If the Licensee applies to Ofcom for the variation of Conditions in the Annexes which relate to the characteristics of the digital television programme services to be broadcast in the Licensed Service, Ofcom shall permit the variation requested unless it appears to Ofcom that, if the application were granted, the capacity of so much of what is broadcast under the Licence as consists of digital television programme services or of such services together with digital sound programme services, to appeal to a variety of tastes and interests would be unacceptably diminished provided that in deciding whether or not to permit such variation, Ofcom may have regard to the digital television programme services broadcast in all the television multiplex services for the time being provided by the Licensee or any person connected with the Licensee and provided further that any variation to the Conditions of the Annexes which would have the result that a digital television programme service may be provided otherwise than on a free to air basis shall not be deemed to be a variation relating to the characteristics of such service.”*

A6.16 This wording reflects the wording of s.12(3) BA96 (see above). The main elements of Condition 17(2) are that:

- It applies where the Licensee brings forward a variation request relating to characteristics of the programme services being provided. The Applications satisfy this requirement.
- Ofcom must permit the variation unless it appears that the “capacity” of the programme services to appeal to a “variety of tastes and interests” would be “unacceptably diminished”.

- In assessing the capacity of the services to appeal to a variety of tastes and interests Ofcom may have regard to the other services broadcast on television multiplexes by Licensee – i.e. services broadcast by NGW on multiplex D.
- The last part of Condition 17(2) provides that a variation resulting in a programme service being provided on a pay basis rather than FTA is not to be regarded as a variation to the characteristics of that service – and therefore the Condition 17(2) test would not apply to the free/pay distinction.

## Impact assessment

- A6.17 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of CA03, which means that generally Ofcom has to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out and publishing impact assessments in relation to the great majority of its policy decisions.
- A6.18 The analysis presented at Sections 3 to 5, when read in conjunction with the rest of this document, represents an impact assessment of the Proposal, as defined in section 7 of CA03. Given the range of options identified and the nature of the questions raised there is some limit on the detail with which Ofcom can carry out its impact assessment in this instance.
- A6.19 It is clear that the Proposal could deliver significant benefits for consumers, as described at paragraphs 3.54 to 3.58 of the main document. Ofcom has a duty to further the interests of consumers in relevant markets, where appropriate by promoting competition. The analysis presented above explains the issues arising in this context. Ofcom must consider the benefits to competition of the options identified, taking into account the corresponding impact on consumers.
- A6.20 The possible options for Ofcom to pursue in relation to the Proposal are set out at Section 5. Ofcom would however consider other options for dealing with the issues raised if those are identified during the consultation process. The impact on stakeholders and on competition of a Sky pay TV on DTT is discussed at Section 3.
- A6.21 For further information about Ofcom's approach to impact assessments, see the guidelines, Better policy-making: Ofcom's approach to impact assessment, which are on the Ofcom website:  
[http://www.ofcom.org.uk/consult/policy\\_making/guidelines.pdf](http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf).