

MOVIES ON PAY TV MARKET INVESTIGATION

Statement of issues

Introduction

1. On 4 August 2010 the Office of Communications (Ofcom) referred the supply and acquisition of **subscription Pay TV movie rights** and the wholesale supply and acquisition of **packages including core premium movies channels** to the Competition Commission (CC) for investigation. The reference was made under [sections 131](#) and [133](#) of the Enterprise Act 2002 (the Act).
2. The terms of reference define ‘subscription Pay TV movie rights’ as the intellectual property rights licensed by the six largest Hollywood studios, which:
 - (i) permit the exhibition of movies on broadcast channels and/or subscription video on demand (SVOD) services in the UK; and
 - (ii) relate to the first period during which movies are licensed for exhibition on subscription broadcast channels or SVOD services.
3. The terms of reference define ‘core premium movies channels’ as Sky’s movies channels.
4. We are required to determine whether any feature or combination of features of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.¹ If we find that there is such a prevention, restriction or distortion of competition, there will be an ‘adverse effect on competition’ (AEC).²
5. Our statutory remit is to assess competition in the market for movies on Pay TV services, and we will not address any broader public policy issues. However, we will consider such issues in so far as they interact with the process of competition.

The background to Ofcom’s reference

6. The process which led to the reference to us from Ofcom began over three years ago. In January 2007, BT, Setanta, Top Up TV (TUTV), and Virgin Media made a preliminary submission to Ofcom, alleging that competition in the Pay TV industry was not working properly, and asking Ofcom to refer the industry to the CC for investigation. In March 2007, Ofcom announced that it was opening an investigation into the Pay TV industry.
7. In December 2007, Ofcom published its First Pay TV Consultation, setting out its preliminary views on the operation of the industry.
8. In September 2008, Ofcom published its Second Pay TV Consultation. In this document, Ofcom said that Sky, as a vertically integrated firm with market power in a key upstream market, was likely to distribute its premium content (including recent movies from the six largest Hollywood studios) in a manner that favoured its own

¹See [section 134\(1\)](#) of the Act.

²As defined in [section 134\(2\)](#) of the Act.

retail business and platform. Ofcom also expressed concern about Sky having limited incentives to exploit its rights to offer recent movies by SVOD, due to the effects on its linear broadcast service. Ofcom proposed to tackle its concerns about the access to premium movies content by putting in place a 'wholesale must-offer' (WMO) obligation, using its sectoral competition powers under Section 316 of the Communications Act 2003. However, Ofcom invited views on this remedy, and other possible forms of remedy.

9. Many of the responses Ofcom received to its second consultation focused on Sky's unique ability, as a result of its arrangements with the six largest Hollywood studios, to offer an SVOD service for most of the popular recent movies.
10. In June 2009, Ofcom published its Third Pay TV Consultation. In this document, Ofcom argued that Sky had an incentive to restrict the exploitation of its rights to offer recent movies to consumers by SVOD in order to protect its linear movie channels. Consequently, Ofcom was concerned that innovation in the development of SVOD services could be stifled. This concern led Ofcom to believe that there may be a case for targeted intervention in the sale and purchase of SVOD rights, and it suggested that making the SVOD rights available separately from the linear rights could allow other companies to acquire SVOD rights and establish new services to consumers.
11. Ofcom said that its preference was for a commercial solution to address the competition issues it had identified. Therefore, Ofcom engaged in discussions with the six largest Hollywood studios in order to ascertain whether market developments were likely which would obviate the need for regulatory intervention. However, Ofcom concluded that it was unlikely that there would be a substantial change in the way these rights were awarded in the short to medium term.
12. As well as receiving responses to its Third Consultation, Ofcom:
 - collected a wide range of information from stakeholders, including:
 - updated revenue and subscriber data, to inform its analysis of market definition and market power;
 - details of the commercial negotiations between the UK Pay TV operators (including Sky) and the six largest Hollywood studios, in relation to the acquisition of UK Pay TV movie rights;
 - further details of the commercial negotiations between Sky and other UK Pay TV operators in relation to the possible wholesale supply of movie channels; and
 - detailed cost data to inform its assessments of pricing and profitability;
 - commissioned some further research on consumer preferences;
 - carried out an internal assessment of its pricing and impact assessment models, and subjected both models to an independent external review; and
 - commissioned a further detailed review of Sky's profitability.

13. In March 2010, Ofcom published its Pay TV Statement and, at the same time, published a consultation document, which set out its proposals to make a market reference to the CC with regard to movies on Pay TV.³

The Ofcom reference

14. On 4 August 2010, Ofcom published its decision to make a market investigation reference to the CC.⁴ It said that, within the markets it had referred, there were a number of features that had an adverse effect on competition, resulting in a number of harmful effects on consumers. Table 1 sets out the features identified by Ofcom.

TABLE 1 **Features which prevent, restrict or distort competition, as identified by Ofcom**

- A limited pool of premium movies content.
- The way in which the rights to broadcast movies are made available over time (ie the release windows structure).
- The licensing of linear rights and SVOD rights together for recent movies from the six largest studios.
- The exclusivity of linear rights and SVOD rights for recent movies from the six largest studios.
- Other restrictions in the contracts for the rights in the first Pay TV subscription window.
- The aggregation of substitutable premium movies content into a single wholesale offering (ie Sky's premium movies channels).
- The staggered availability of content rights and the duration of existing contracts for premium movie rights from each of the six largest Hollywood studios.
- Sky's market power in the wholesale and retail supply of its movies channels, giving Sky a high degree of negotiating power with the six largest Hollywood studios.
- the vertical integration of firms (in particular, Sky's vertical integration in conjunction with its market power, giving Sky an incentive to limit the exploitation of its SVOD rights and to restrict the distribution of its wholesale channels).

Source: Ofcom's reference decision, paragraph 1.3.

The CC's inquiry

15. Although we are conducting our own comprehensive investigation, we are mindful that it follows a three-year investigation by Ofcom, in which Ofcom has assembled and analysed a great deal of information, including evidence and submissions from many industry participants. Some of this material is unlikely to be relevant to our investigation. However, much of the information gathered by Ofcom is likely to be relevant and Ofcom is in the process of identifying and providing us with this information.
16. We have reviewed the initial information which Ofcom has supplied to us, and will continue that process as we receive the remaining information.

The purpose of the issues statement

17. This issues statement sets out our view of the analytical framework for our investigation, given our terms of reference.
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³In a separate but related process Ofcom concluded on Sky and Arqiva's proposal to launch 'Picnic,' a proposed Pay TV service on digital terrestrial television (DTT). Ofcom published its Picnic Statement at the same time as the Consultation on the proposed reference to the CC. It decided that Sky could launch Picnic conditional on a WMO on Sky Sports 1 and 2 being in place, and on any movies channels included in Picnic being offered to other DTT retailers.

⁴*Premium Pay TV movies: market investigation reference to the Competition Commission, 4 August 2010* (Ofcom's reference decision), which can be found at:

http://stakeholders.ofcom.org.uk/binaries/consultations/movies_reference/statement/pay-tv-movies-decision.pdf.

18. We are publishing this statement in order to assist parties submitting evidence to focus on the issues we envisage being relevant to our investigation and to invite parties to notify us if there are additional relevant issues which they believe we should consider. This statement also calls for evidence from the parties on certain specific matters.

The issues

19. Ofcom has referred to us for investigation the supply and acquisition of certain reference products, namely subscription Pay TV movie rights and the wholesale supply and acquisition of packages including core premium movies channels (see paragraph 1).⁵ Ofcom has not referred to us the supply and acquisition of other Pay TV content, or the supply and acquisition of Pay TV services more generally. We will focus our analysis on the relevant markets in which the reference products are supplied and acquired, though, in order to perform this task, we may need to consider how trade in these markets is affected by trade in upstream, downstream or adjacent markets.
20. We will consider the features identified by Ofcom (see Table 1) and we will consider whether there are other features of the supply and acquisition of the reference products which prevent, restrict or distort competition.
21. We believe that the relevant issues can be separated into three broad areas of inquiry, which are:
 - (a) market definition and market power in the relevant markets;
 - (b) the process of wholesale and retail competition; and
 - (c) the supply of movie content by the six largest Hollywood studios and the effects of the supply arrangements.
22. We do not envisage the analysis under these areas to be conducted in sequence and there are clearly issues in which these areas overlap.
23. We set out below some questions that are of interest in each of these areas.

Market definition and market power in the relevant markets

24. We will examine the substitutability between different types of content (eg recent movies, old movies and television programmes) and between different means by which to deliver the same content (eg pay linear channels, free to air (FTA) linear channels, pay per view (PPV) VOD, SVOD or DVD). We will also consider whether Sky, or any other party, has market power in any relevant market(s). We see the following two questions as of particular interest.

Is there a retail market, a wholesale market and a rights market for recent movies from the six largest Hollywood studios on linear Pay TV and SVOD in the UK?

25. To a certain extent, our identification of the relevant market(s) overlaps with our assessment of competition in the market(s) and we will consider both issues in parallel.

⁵Annex 1 to Ofcom's reference decision.

26. Ofcom has conducted some detailed analysis in this area, which it has developed through its three consultations, and it has presented its conclusions in both its Pay TV Statement and its reference decision. The evidence which Ofcom has gathered, and its analysis of this evidence, appears to us to be relevant to our investigation.
27. Ofcom found that there are distinct economic markets for:
 - the upstream supply of movie rights from the six largest Hollywood studios in the first Pay TV subscription window in the UK;
 - the wholesale supply of packages containing channels showing recent movies from these studios; and
 - the retail supply of packages containing these channels.
28. We will test Ofcom's analysis and we invite parties to set out their views on Ofcom's analysis and conclusions. We ask parties to provide us with any further evidence which is relevant to our identification of the relevant product and geographic market(s).
29. A specific issue that we will look at is the value of movie content under different conditions of sale (eg the change in the cumulative value to a studio if the right to broadcast a movie on a linear channel is sold to a different buyer than the right to offer the same movie at the same time through an SVOD service; or if the movie content from different studios is made available to different buyers). The different value of movie content under different licensing arrangements might be informative about the degree to which wholesale and retail movie packages could be expected to be close substitutes. We invite parties to comment and provide evidence on this issue.

Does Sky have market power in any relevant market(s) and, if so, where does that market power derive from and what results from it?

30. We will examine:
 - (a) Sky's pricing and non-pricing behaviour (as both wholesaler and retailer) over time, with regard to movies;
 - (b) Sky's profitability, with regard to movies, and why Sky is able to achieve this level of profitability;
 - (c) the effects of Sky's vertical integration as a wholesaler and retailer of movies products;
 - (d) Sky's interactions with the six largest Hollywood studios, including consideration of the extent to which the studios (or any other relevant party) has market power;
 - (e) whether Sky's aggregation of content from all six of the largest Hollywood studios has enabled Sky to extend any market power it has to the wholesaling of its linear movie channels and to the retail market; and
 - (f) barriers to entry and expansion (including consideration of how Sky's provision of movie content is affected by other parts of its offering).
31. If we find that Sky does have market power in any relevant market(s), we will seek to identify where Sky derives this power from and what results from it, including the

effect on technological and service developments, and on whether Sky can leverage its market power in one market to increase its market power in another market.

32. On many of these issues, Ofcom has already conducted much analysis. In particular, with regard to profitability, we note that Ofcom has commissioned two reports from Oxera. We invite parties to set out their views on Ofcom's analysis and conclusions, and to provide us with any further evidence which is relevant to our assessment of whether Sky has market power in any relevant market(s) and, if so, where it is derived from and what results from it.

The process of wholesale and retail competition

33. In this area we consider the importance of recent movies from the six largest Hollywood studios to Pay TV retailers, and the developments taking place to the offerings of these retailers. We see the following three questions as of particular interest.

Are recent movies from the six largest Hollywood studios important to Pay TV providers (ie do consumers choose their Pay TV provider because of access to these movies)?

34. We are inviting evidence which may inform us on the extent to which the ability to offer recent movies from the six largest Hollywood studios on linear channels or by SVOD is a driver of competition and consumers' choice of Pay TV provider. We are interested in the extent to which offering these movies makes a difference to consumer choices, in the context of the other content available from each Pay TV provider.
35. We also invite evidence on the quantity of movie content which is necessary in order to be able to attract consumers, and on the extent to which the aggregation of content from all six of the largest studios by one Pay TV provider may be beneficial to consumers.
36. We are also interested in whether the ability to offer other movie content can attract consumers in the same way as the ability to offer recent movies from the six largest Hollywood studios.
37. On this issue, Ofcom has already conducted much analysis and we invite parties also to set out their views on Ofcom's analysis and conclusions.

How would the ability to offer an SVOD service for recent movies from all of the six largest Hollywood studios affect retail competition among Pay TV providers?

38. We will examine:
- (a) characteristics of the Pay TV offerings of different providers, particularly with regard to the delivery methods for VOD and linear Pay TV, and expectations for future developments;
 - (b) consumer demand for VOD, and expectations for future demand;
 - (c) the importance of the payment mechanism (ie subscription or PPV), and likely future developments; and

(d) the extent of any unmet demand for SVOD services for recent movies from the six largest Hollywood studios, and the capability of existing or new service providers to meet it.

39. We will consider if the VOD offerings of providers in other geographic markets provide any useful information on these issues.

Does Sky's position as a retailer of Pay TV affect its activity as a wholesaler of premium movie content for Pay TV?

40. We will be interested to review the extent to which Sky's position as a retailer of Pay TV affects its strategy as a wholesaler of movie channels.
41. We are calling for evidence which may inform us on the various interactions between the relevant parties, eg between Sky as a wholesaler of movie channels and other Pay TV retailers, and between all Pay TV retailers and the six largest Hollywood studios, in order to understand the dynamics of the market(s) as structured currently.

The supply of movie content by the six largest Hollywood studios and the effects of the supply arrangements

42. In this area we will consider issues relating to the effects on competition from the way in which movie content is licensed to Pay TV providers. We will seek to understand the trading arrangements between the six largest Hollywood studios and Pay TV retailers, and the outcomes of these arrangements. The following two questions set out the issues of interest.

What are the effects of the trading arrangements between Sky and the six largest Hollywood studios with respect to the licensing of linear and SVOD Pay TV movie rights?

43. Ofcom found that there were a number of features of the trading arrangements between Sky and the six largest Hollywood studios which affect competition (see paragraph 14). We will examine:
- (a) why the various restrictions exist, what other trading arrangements have been considered by the relevant parties, and why these other arrangements have not been adopted;
 - (b) whether and to what extent such trading arrangements exist in order to achieve efficiencies or other economic benefits to consumers that would not be achieved without them;
 - (c) whether such restrictions are typical (ie in comparison with arrangements in other geographic markets or in other product markets with sufficiently similar characteristics);
 - (d) how these trading arrangements impact on other parties and consumers;
 - (e) the effects of the trading arrangements between Sky and the six largest Hollywood studios; and
 - (f) overall, the economic costs and benefits of these trading arrangements.

Are there any other features which affect competition in the relevant market(s)?

44. We will consider any other features which might affect competition in the relevant market(s). One example, as raised by Ofcom (see paragraph 14), might be the staggered availability of content from the six largest Hollywood studios.

Summary

45. At this stage of our investigation we would like to receive submissions and evidence relevant to the above issues to assist our analysis. Some evidence is likely to be relevant to more than one area.
46. The issues identified in the questions above are not exhaustive and are likely to develop as we proceed with our investigation.