A REVIEW OF THE EVIDENCE RELIED ON BY OFCOM AS THE BASIS FOR ITS CONCLUSIONS ABOUT THE SCOPE OF RELEVANT RETAIL MARKETS IN ITS THIRD PAY TV CONSULTATION DOCUMENT

A. Introduction

1. In its Response to Ofcom’s Third Consultation Document (‘the Consultation Document’), Sky indicated that it intended to make an additional submission on the evidence and analysis cited by Ofcom in relation to market definition at the retail level.¹

2. In the Consultation Document, Ofcom concludes that there are relevant markets for:

   (a) “retail supply of Sky Sports 1, Sky Sports 2 or Setanta Sports 1, as well as HD versions of these channels or TV packages that contain these channels”; and

   (b) “retail supply of television bundles containing Core Premium Movie channels”³.

3. In this submission Sky demonstrates that the evidence or analysis on which Ofcom relies in support of these conclusions does not in fact properly support them.

4. Sky notes that this submission is confined to this particular issue. Sky does not discuss in this submission the numerous significant methodological flaws in Ofcom’s general approach to market definition, nor, in general, does it consider relevant evidence and analysis that Ofcom has not addressed (or has not

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¹ See paragraph 5.39 of Sky’s Response.

² Paragraph 4.252 of the Consultation Document.

³ Paragraph 4.410 of the Consultation Document. Sky notes that Ofcom does not adopt a consistent definition of what constitutes “Core Premium Movie channels” in the Consultation Document. Different definitions are used, for example, at footnote 2, paragraph 4.8 and the glossary of the Consultation Document.
adequately addressed) as part of its assessment of relevant markets at the retail level.\(^4\)

5. Ofcom's focal products in this assessment are pay TV services supplied to consumers (*i.e.*, supplied at the retail level) that include premium sports and/or movie channels.\(^5\) Such services normally also include a range of other services – notably basic pay TV channels, but they also may be bundled with broadband, telephony (both fixed line and mobile), multiroom\(^6\), VoD\(^7\), high definition and PVR services. In this submission, for convenience, Sky refers to services that include premium sports channels as ‘premium sports channel packages’, and those which include premium movie channels as ‘premium movie channel packages’. This shorthand cannot be taken to mean that other services provided to consumers in conjunction with premium pay TV channels can or should be disregarded in an analysis of market definition at the retail level in this sector.

6. Part One of this submission discusses a number of general issues related to Ofcom’s evidence and analysis, while Part Two discusses the particular evidence and analysis relied on by Ofcom in support of its conclusions about the scope of relevant retail markets in this case.

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\(^4\) These matters are considered in submissions Sky has made to Ofcom previously, which Ofcom has not properly addressed in the Consultation Document. These submissions include Sky’s Response to the Complaint, Sky’s Responses to the First and Second Consultation Documents, ‘Additional comments on Ofcom’s analysis of market definition and market power in the pay TV review’ (1 June 2009), ‘Changes in the quantity and quality of services delivered to subscribers to Sky’s packages that include Sky’s sports channels, 2001/02 – 2006/07’ (July 2008), and ‘Analysis of the quality of films broadcast on Sky’s movie channels: 2001/02 – 2006/07’ (August 2008), as well as Sky’s responses to various Ofcom information requests.

\(^5\) See paragraph 4.19 of the Consultation Document.

\(^6\) Multiroom services are services which enable subscribers to access pay TV services in multiple rooms in their homes.

\(^7\) VoD services include services that provide programming either on a paid-for basis (*e.g.*, pay per view services, subscription VoD ('SVoD') services) or at no additional charge. They can be ‘true VoD’, near VoD (‘NVoD’) and ‘push-VoD’ services.
Part One

B. Burden of proof and standard of evidence

7. In considering the strength of evidential support required in relation to Ofcom’s conclusions about the scope of relevant markets, it is important to recognise that they underpin Ofcom’s proposition that it is necessary to impose on Sky new, highly intrusive regulation. Accordingly, the burden lies with Ofcom to establish the scope of relevant markets based on evidence that is of a high standard.  

C. Ofcom’s retail market definition analysis is inchoate

8. The combination of two factors renders Ofcom’s analysis of relevant retail markets in the Consultation Document inchoate:

(a) Ofcom’s process in its pay TV market investigation in relation to market definition at the retail level and the way in which its arguments in the Consultation Document are presented; and

(b) Ofcom’s approach in the Consultation Document of adding its retail market analysis onto its wholesale market analysis.

9. Each of these is discussed below.

(a) **Ofcom’s process in its pay TV market investigation in relation to market definition at the retail level and method of presentation of its arguments in the Consultation Document**

10. The process by which Ofcom has arrived at its current conclusion with regard to the scope of relevant retail markets has been somewhat tortuous:

(i) Ofcom’s First Consultation Document, of December 2007, set out a number of “preliminary conclusions” about the scope of relevant retail markets. Sky made a significant number of important criticisms of the evidence and analysis on which Ofcom purported to base those “preliminary conclusions”;

(ii) Ofcom’s Second Consultation Document, of September 2008, however, argued that Ofcom did not need to consider relevant markets at the retail level. As a result, Ofcom essentially set to one side its preliminary conclusions on this matter from the First Consultation Document, and consultees’ responses to that analysis. The fact that it remained necessary for Ofcom to consider relevant markets at the retail level was pointed out by a number of respondents to its Second Consultation Document.

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8 See paragraph 3.4 of Sky’s submission of 1 June 2009.

9 One of Sky’s key criticisms was that Ofcom’s “preliminary conclusions” appeared to be based on preconceptions, rather than emerging from a thorough and objective consideration of relevant evidence. See paragraphs 1.4 to 1.6 of Annex 2 to Sky’s Response to Ofcom’s First Consultation Document.
Document. Significant parts of Ofcom’s analysis of relevant markets at the wholesale level included in the Second Consultation Document, however, relate to the issue of market definition at the retail level. For example, that analysis includes a lengthy discussion of changes over time in retail prices and quality of pay TV services supplied to consumers. Again, consultees (including Sky) provided comments on that analysis, and Sky made a substantial additional submission to Ofcom on its market definition and market power analysis in June 2009; and

(iii) having recognised that the proposition that it did not need to consider relevant markets at the retail level was erroneous, Ofcom returned to that issue in its Third Consultation Document, of June 2009.

11. In its consideration of relevant markets at the retail level in the Consultation Document, Ofcom adopts the following process in relation to each issue that it considers (e.g., the constraint imposed on retailers of premium movie channel packages by the availability of movies on DVDs).

(i) First, Ofcom summarises the evidence and analysis presented, and Ofcom’s conclusion on each issue, in the First Consultation Document.

(ii) Second, Ofcom seeks to summarise consultees’ responses to its evidence and analysis. It is wholly unclear – both from the summaries, and from the title of these sections (which are entitled “Responses to our consultation”) – whether Ofcom is seeking to summarise responses to Ofcom’s First Consultation Document, or the points made by consultees throughout the consultation process.

(iii) Third, Ofcom sets out its “current view” on each of the issues. Normally, this does not involve any further evidence or analysis – it is usually simply a statement of Ofcom’s view on each matter. For example, Ofcom’s statement of its “current view” on the constraint imposed on retailers of premium movie channel packages from the large number of movies available to consumers on free to air and basic pay TV channels comprises the following, in its entirety:

“Our current view

The growth in movie channels on FTA and basic tier packages has increased the availability of older films to consumers. However, these films are likely to be less valuable to consumers and therefore represent a weak competitive constraint on retailers of premium movie channels.”]

10 Paragraph 4.403 of the Consultation Document.

12. The consequence of the combination of (a) the tortuous process which Ofcom’s analysis of this issue has followed to date, and (b) the approach taken by Ofcom
to setting out its evidence and analysis in the Consultation Document, is that Ofcom’s consideration of these matters is unsystematic.

13. In particular, neither (a) Ofcom’s presentation of its own evidence and analysis in previous consultation documents, nor (b) Ofcom’s summaries of consultees’ responses to such evidence and analysis, is full and accurate. Ofcom’s summary of the criticisms that Sky, in particular, has raised in relation to each part of Ofcom’s evidence and analysis is wholly inadequate.

14. For example, Ofcom’s summary of consultees’ responses to its “evidence of consumer preferences and product characteristics” in relation to pay TV packages that include premium movie channels is as follows (in its entirety):

“Sky argued that our analysis focused on the preferences of average subscribers, rather than those most likely to switch in response to a price rise.”

15. That fails entirely to summarise adequately Sky’s response to Ofcom’s First Consultation Document on the issue of “evidence of consumer preferences and product characteristics”, and certainly does not provide a full and accurate summary of the totality of the evidence and analysis that Sky has presented to Ofcom on this issue since the publication of the First Consultation Document.

16. Similarly, Ofcom would appear to believe that the entirety of Sky’s views on the issue of the constraint faced by pay TV retailers from the availability of a wide range of programming (including movies) on DVD (for both sale and rental) comprises the following:

“Sky believed that DVD retail and rentals were a strong constraint on the retailing of Sky Movies channels. In response to our second consultation it stated that the reduction in time between the cinema release and DVD rental release meant that the pay TV window was becoming less valuable.”

17. While the first sentence of this cursory summary of Sky’s views is partially accurate, the two sentences together fail properly to reflect the arguments and evidence that Sky has submitted to Ofcom on this matter during the course of its market investigation.

18. In relation to Ofcom’s own analysis, Ofcom fails to recognise that, even though it put the issue of retail market definition to one side in the Second Consultation Document, that Consultation Document considered numerous issues which have a bearing on retail market definition. For example, Ofcom’s approach in the Consultation Document fails to recognise that Ofcom’s position on issues such as changes in the quality of services delivered to consumers at the retail level

\[\text{Paragraph 4.395 of the Consultation Document. Ofcom provides no source for this assertion.}\]

\[\text{Paragraph 4.399 of the Consultation Document.}\]

\[\text{It fails properly to take into account Sky’s view that such services are an important part of the aggregate constraint faced by retailers of Sky’s movie channels.}\]
changed significantly between its First and Second Consultation Documents. In response to Sky’s submission that Ofcom’s First Consultation Document had not adequately considered changes in the quality of pay TV services provided to consumers over time, in relation to premium sports channel packages Ofcom stated in the Second Consultation Document:

“We have reassessed the change in quality of packages containing Sky Sports over time. It is difficult to quantify quality changes, but we accept that the greater number of FAPL games and additional content introduced to the channels has probably more than offset any reduction in quality resulting from the loss of content.”

14 See Appendix 5 of Annex 2 of Sky’s Response to Ofcom’s First Consultation Document.

15 Paragraph 4.93 of Ofcom’s Second Consultation Document.

16 Where Ofcom does provide such cross-references, they are often too imprecise for consultees to consider the evidence and analysis on which Ofcom is relying. For example, in relation to premium sports channel packages Ofcom states: “When assessing evidence of retail demand side substitution the evidence we presented on the indirect wholesale constraint such as consumers (sic) preferences, product characteristics and the constraint of FTA remains relevant.” (Paragraph 4.243 of the Consultation Document.) Ofcom provides no indication of what “evidence [Ofcom] presented” which it considers “remains relevant”.

17 See section E(b), below.

19. By beginning, in relation to each issue considered, with Ofcom’s “position in the First Pay TV Consultation” such further developments in Ofcom's evidence and analysis are not properly considered in the Consultation Document.

(b) Ofcom’s approach of adding its retail market analysis to its wholesale market analysis

20. Having recognised the error of its previous assertion that it was not necessary for Ofcom to consider relevant markets at the retail level, Ofcom has attempted to redress that error by adding a brief section on relevant retail markets to its analysis of relevant markets at the wholesale level. This approach gives rise to several problems.

21. In particular, it appears to be the case that Ofcom seeks to rely in relation to market definition at the retail level on the evidence and analysis presented in relation to wholesale market definition, where relevant. This is not clear, however, because Ofcom does not generally refer to that evidence and analysis in its retail-level market definition analysis. For example, Ofcom’s retail market definition analysis makes no reference to the analysis of changes over time in the quality of packages that include Sky’s premium sports channels that is included in Ofcom’s discussion of wholesale market definition. (The lack of reference to material providing descriptions of the focal products and potential substitutes is discussed further below.)

22. Ofcom’s approach of attempting to add a brief analysis of retail markets to its analysis of wholesale markets also gives rise to analytical difficulties because the focal products are different in each case. For example, in relation to premium sports services, the focal product at the wholesale level is Sky Sports
18, while at the retail level it is pay TV packages that include Sky Sports 1, Sky Sports 2 or Setanta Sports 1 (among other channels).

Conclusion

23. Rather than undertake a standalone, fully considered analysis of relevant retail markets, Ofcom has sought to add a short retail section to its analysis of relevant markets at the wholesale level. Both this approach, and the confused process that Ofcom’s analysis of issues relating to relevant retail markets has followed in its pay TV market investigation, mean that Ofcom does not, in the Consultation Document, set out clearly the evidence and analysis on which its conclusions about the scope of relevant retail markets rely. The inchoate nature of Ofcom’s presentation of its evidence and analysis in relation to retail market definition means that it is extremely difficult for consultees to give intelligent consideration and provide intelligent responses to Ofcom’s analysis, and the comments set out below are without prejudice to this fundamental point.

D. Ofcom’s retail market definition analysis is too cursory to form the basis of soundly-based conclusions about the scope of relevant markets

24. A further consequence of the issues set out above is that Ofcom’s analysis of relevant markets at the retail level is too cursory to form the basis for soundly-based conclusions. This is the case even if regard is had to those parts of Ofcom’s wholesale-level analysis to which Ofcom cross-refers.

25. For example, the entirety of Ofcom’s expression of its “current view” of the important issue of the extent of competition faced by pay TV retailers from the availability of movies and other programming on DVD consists of the following:

“Our evidence on pricing of DVDs and the growth of DVD rentals indicates that these are likely to be relatively weak substitutes for premium movies. Similarly, although downloading films may become a more important factor, relatively few consumers currently use it.”19

26. The only evidence and analysis cited in support of this view are the following statements:

“We assessed changes in prices and demand for Sky Movies and DVDs. We found that between 2001 and 2006 the retail price of DVDs has fallen in real terms by 43% while expenditure on retail DVDs has tripled over the period.

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18 For example, in its analysis of market definition at the wholesale level, Ofcom states: “we have considered the characteristics of Sky Sports 1 and potential substitutes.” (Paragraph 4.94 of the Consultation Document.) Ofcom then follows this statement with a lengthy (but irrelevant) pairwise comparison of sports events broadcast on Sky Sports 1, with events that Ofcom considers may be potential substitutes available on other television channels.

19 Paragraph 4.400 of the Consultation Document. The latter sentence would appear to be irrelevant to the issue being discussed in this section.
As stated above,\textsuperscript{20} it is difficult to draw firm conclusions from such data. However, we noted that the price of Sky Movies had grown at approximately the same rate as that of Sky Sports, despite what appeared to be a greater array of potential substitutes. In particular, the growth in popularity of renting and purchasing DVDs did not appear to have had a constraining impact on the price of Sky Movies. \textsuperscript{21}

27. The cursory nature of Ofcom's summaries of both its previous views and those of consultees in relation to the issues discussed by Ofcom is a significant contributor to their incompleteness, discussed in section C, above.

E. Relevant background

28. One of the key reasons for the unreliability of Ofcom's analysis and evidence in relation to retail market definition in this case is that Ofcom fails properly to consider:

(a) the nature of the activity of retailing pay TV services, and the constraints faced by pay TV retailers; and

(b) the range of audiovisual services available to UK consumers, and their characteristics.

29. In reviewing the adequacy or otherwise of the evidence and analysis on which Ofcom relies in support of its conclusions about relevant markets at the retail level, it is, therefore, necessary for Sky briefly to set out such matters.

30. Sky emphasises that the purpose of this brief explanation is solely as a basis for evaluation of the adequacy of the analysis that Ofcom has undertaken. Sky has discussed these types of issues more fully in its previous submissions.\textsuperscript{22}

\textbf{(a) The nature of the activity of retailing pay TV services, and the constraints faced by pay TV retailers}

31. Pay TV retailers offer consumers subscriptions to television services. Outside any initial subscription period (typically twelve months), subscribers are able to choose each month whether to retain their subscription or revert to relying on a range of other services to fulfil their viewing demands — for example, relying on a combination of free to air television, DVDs, and VoD services. Subscribers to

\begin{footnotes}
\item[20] Ofcom provides no cross reference for this statement.
\item[21] Paragraphs 4.397 and 4.398 of the Consultation Document. This section of Ofcom’s analysis is discussed further below.
\item[22] See footnote 4, above.
\end{footnotes}
pay TV services that include premium sports and/or movie channels may also choose to ‘spin down’ to less inclusive, or basic-only, pay TV packages.

32. Persuading consumers to subscribe to pay TV services for the first time (or to re-subscribe if they have formerly subscribed but subsequently cancelled their subscription) is a difficult task – in part because pay TV is an experience good, but also because many non-subscribers to pay TV services are reluctant to pay for television services when there is so much programming available to them for free. And switching between free to air television services and pay TV services is straightforward.

33. Accordingly, it must be borne in mind that the key challenge facing pay TV retailers is to attract and retain subscribers in the face of the range of different means that consumers have available to them for meeting their demand for audiovisual entertainment.

34. The key question that Ofcom should ask in such circumstances is whether the range of alternative sources of audiovisual programming available to consumers sufficiently competes with that available from pay TV retailers to be sensibly regarded as being in the same market.

(b) The characteristics of the range of audiovisual services available to consumers

35. As noted in the CCAT’s judgment in Aberdeen Journals v. DGFT:

“...a description of the objective characteristics of the products in question is almost always necessary in cases of disputed market definition, because it is on that foundation that the discussion of the relevant product market must rest.”

36. While there are numerous partial descriptions of the objective characteristics of the products in question scattered throughout the 1,850 pages of material that Ofcom has now produced in its Pay TV market investigation, there is no complete or comprehensive description of the relevant products in the sections of the Consultation Document that deal with market definition at the retail level.

23 The term ‘spin-down’ refers to pay TV subscribers switching to less inclusive pay TV subscriptions. There is a substantial amount of movement by subscribers among pay TV packages over time, including spin-down, which is partly a reflection of the ease of such switching. Further information on switching among different types of pay TV packages is presented at Annex 3 of this submission.

24 In its judgment in Aberdeen Journals v. DGFT, the CCAT stated:

“Each case will depend on its own facts, and it is necessary to examine the particular circumstances in order to answer what, at the end of the day, are relatively straightforward questions: do the products concerned sufficiently compete with each other to be sensibly regarded as being in the same market?” (Paragraph 97 of Aberdeen Journals Limited v. The Director of Fair Trading [2002] CCAT 4, 19 March 2002.)


26 For example, Section 3 of Annex 8 to Ofcom’s First Consultation Document includes material of this nature.
37. The result is that Ofcom’s market definition analysis does not rest on the firm foundation of a description of the products for which the relevant market is being assessed, and their potential substitutes. In turn, this results in piecemeal reference to various products and their characteristics, rather than the careful and comprehensive assessment that should be expected. For example, the retail market definition section of the Consultation Document fails:

- to consider the supply of non-movies programming as a constraint on the supply of premium movie channel packages;
- to consider VoD services as constraints on the supply of premium movie channel packages; and
- adequately to consider the constraint imposed on the retail supply of premium sports channel packages by the aggregate of the live sports programming available on free to air and basic pay television channels.

38. Ofcom’s focal products at the retail level are services that include either premium sports channels (defined as Sky Sports 1, Sky Sports 2 and Setanta Sports 1), premium movie channels (defined as a range of Sky’s movie channels and Disney Cinemagic) or both.

39. Premium pay TV channels are normally provided to consumers in ‘packages’ that combine such channels with other services. At the time that Ofcom undertook its analysis, such channels were provided as part of broader packages that included basic pay TV channels.28 Other services that are bundled with premium pay TV packages (i.e., packages that usually include basic pay TV channels and premium pay TV channels) include:

- telephone calls packages;
- telephone line rental;
- mobile telephony services;
- broadband services;
- multiroom services;
- PVRs;
- high definition television services; and
- access to VoD services.

40. This means that Ofcom’s focal ‘product’ in relation to both movies and sports services in fact in each case comprises a vast range of different products. For example, even leaving to one side the products described above (e.g., telephony and broadband services), at the time that Ofcom undertook its analysis there were around 1,800 different products available via DTH satellite and cable alone.

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27 Somewhat bizarrely, Ofcom appears to regard the identification of products’ characteristics as comprising part of the exercise of assessing the scope of relevant markets, rather than as a precursor to that exercise – see paragraph 4.396 of the Consultation Document.

28 Virgin Media’s packages also normally include telephone line rental.
that fell within Ofcom’s focal product in relation to premium sports services, *i.e.*, “retail packages that include Core Premium Sports channels”.

41. A range of such packages is listed in Table 1 below.

**Table 1**

Types of different services covered by Ofcom’s definition of its focal product available in March 2008

<table>
<thead>
<tr>
<th>Retailer(s) (platform)</th>
<th>Package</th>
<th>Total standard monthly subscription charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sky (DTH satellite)</td>
<td>1 Mix (basic package) + 1 Sky Sports package</td>
<td>£28.00</td>
</tr>
<tr>
<td>Sky (DTH satellite), Setanta (DTH satellite)</td>
<td>1 Mix (basic package) + 1 Sky Sports package + Setanta Sports package</td>
<td>£40.99</td>
</tr>
<tr>
<td>Sky (DTH satellite)</td>
<td>6 Mix (basic package) + 2 Sky Movies packages + 1 Sky Sports package</td>
<td>£44.00</td>
</tr>
<tr>
<td>Virgin Media (cable)</td>
<td>M Pack (‘basic’ channel package) + 1 Sky Sports package*</td>
<td>£39.50</td>
</tr>
<tr>
<td>Virgin Media (cable)</td>
<td>L Pack + two Sky Sports packages*</td>
<td>£47.50</td>
</tr>
<tr>
<td>Virgin Media (cable)</td>
<td>XL Pack (included Setanta Sports 1)*</td>
<td>£33.50</td>
</tr>
<tr>
<td>Top Up TV (DTT)</td>
<td>Anytime (basic non-linear service) + Setanta Sports 1</td>
<td>£14.99</td>
</tr>
</tbody>
</table>

* includes telephone line rental at £11.50 per month

**Substitutes available to consumers**

42. The most significant constraint on the ability of pay TV retailers to attract and retain subscribers is the competition posed by free to air television services, and other free sources of audiovisual programming. Free to air television services provide consumers with an enormous amount of programming, much of which is of very high quality. As Sky has submitted previously, free to air broadcasters collectively spend over £3.2 billion per annum on producing and acquiring programming, which enables them to offer television viewers, in aggregate, a diverse and high quality portfolio of programming. This is particularly strong in the general entertainment genre which dominates day-to-day viewing, but also offers viewers a wide range of high quality programming in genres such as sports, news, movies and documentaries.

43. By comparison, spending on programming by UK pay TV broadcasters is less than £1.8 billion per annum. Not only is this substantially less than the amount

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29 One consequence of the diversity of products covered by Ofcom’s focal product definition is that it is extremely difficult to conceive how the hypothetical monopolist test, or the SSNIP test, should be applied in such circumstances.

30 Sky emphasises that the purpose of this table is to illustrate the diversity of different types of services described by Ofcom’s focal product. It is not intended to provide, in any sense, a comprehensive overview of the range of services available.

31 See paragraph 3.18 of Annex 2 of Sky’s Response to Ofcom’s First Consultation Document.

32 See figure 2.20 in Ofcom’s publication entitled ‘The Communications Market 2008’.
spent on programming by the free to air television sector, roughly two thirds of this expenditure is attributable to purchasing rights to a limited range of content – pay TV rights to Hollywood movies, and live Premier League football.

44. Included within the portfolio of programming broadcast free to air is a wide range of live coverage of high quality sports events. A list of the major sports events that are broadcast live on free to air television in the UK throughout the year based on current rights cycles is set out in Table 2.

Table 2
Selected live coverage of sport on free to air television channels

<table>
<thead>
<tr>
<th>Month</th>
<th>Event</th>
<th>Current broadcaster</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>African Cup of Nations football*</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>Coca Cola Championship football</td>
<td>BBC</td>
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<tr>
<td></td>
<td>FA Cup football</td>
<td>ITV</td>
</tr>
<tr>
<td></td>
<td>Australian Open tennis</td>
<td>BBC</td>
</tr>
<tr>
<td>February</td>
<td>Winter Olympic Games*</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>UEFA Champions League football</td>
<td>ITV</td>
</tr>
<tr>
<td></td>
<td>Coca Cola Championship football</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>FA Cup football</td>
<td>ITV</td>
</tr>
<tr>
<td></td>
<td>Six Nations rugby union</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>UEFA Europa League football</td>
<td>IT/five</td>
</tr>
<tr>
<td></td>
<td>NFL Superbowl</td>
<td>BBC</td>
</tr>
<tr>
<td>March</td>
<td>FIA Formula 1 Grand Prix</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>UEFA Champions League football</td>
<td>ITV</td>
</tr>
<tr>
<td></td>
<td>Coca Cola Championship football</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>FA Cup football</td>
<td>ITV</td>
</tr>
<tr>
<td></td>
<td>Six Nations rugby union</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>UEFA Europa League football</td>
<td>IT/five</td>
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<tr>
<td></td>
<td>FIFA World Cup/UEFA European Football...</td>
<td>ITV</td>
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<td></td>
<td>FIFA World Cup/UEFA European Football...</td>
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<td></td>
<td>FIFA World Cup/UEFA European Football...</td>
<td>ITV</td>
</tr>
<tr>
<td></td>
<td>Cheltenham Festival</td>
<td>Channel 4</td>
</tr>
<tr>
<td>April</td>
<td>The Boat Race</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>US Masters golf</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>World Snooker Championships</td>
<td>BBC</td>
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<tr>
<td></td>
<td>The Grand National</td>
<td>BBC</td>
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<tr>
<td></td>
<td>The London Marathon</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>FIA Formula 1 Grand Prix</td>
<td>BBC</td>
</tr>
<tr>
<td></td>
<td>UEFA Champions League football</td>
<td>ITV</td>
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<td></td>
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<tr>
<td>May</td>
<td>FA Cup football</td>
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<td>UEFA Champions League football</td>
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<td>FIA Formula 1 Grand Prix</td>
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<td>Wimbledon</td>
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<td>FIFA World Cup/UEFA European Football Championship Finals*</td>
<td>BBC/ITV</td>
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<td>FIFA World Cup/UEFA European Football Championship qualifying matches*</td>
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<td>French Open tennis</td>
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<td>Royal Ascot</td>
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<td>The Derby</td>
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<td>FIFA World Cup/UEFA European Football Championship Finals*</td>
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<td>Olympic Games*</td>
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<td>The Open Championships (golf)</td>
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<td>August</td>
<td>FIA Formula 1 Grand Prix</td>
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<td>IAAF World Athletics Championships*</td>
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<td>Olympic Games*</td>
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<td>Coca Cola Championship football</td>
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<td>UEFA Champions League football</td>
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<td>Challenge Cup final (rugby league)</td>
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<td>September</td>
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<td>FIFA World Cup/UEFA European Football Championship qualifying matches*</td>
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<td>Rugby World Cup*</td>
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<td>UEFA Champions League football</td>
<td>ITV/five</td>
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<td>Coca Cola Championship football</td>
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<td>Commonwealth Games*</td>
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<td>Prix de l’Arc de Triomphe</td>
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<td>October</td>
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<td>FIFA World Cup/UEFA European Football Championship qualifying matches*</td>
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<td>Commonwealth Games*</td>
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<td>Prix de l’Arc de Triomphe</td>
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<td>November</td>
<td>UEFA Champions League football</td>
<td>ITV/five</td>
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<td>UEFA Europa League football</td>
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<td>Coca Cola Championship football</td>
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<td></td>
<td>FIFA World Cup/UEFA European Football Championship qualifying matches*</td>
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<td>Barclays ATP Tour World Tennis Finals</td>
<td>BBC</td>
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<td></td>
<td>FA Cup football</td>
<td>ITV</td>
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<td>December</td>
<td>UEFA Champions League football</td>
<td>ITV/five</td>
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<td>UEFA Europa League football</td>
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<td>Coca Cola Championship football</td>
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<td></td>
<td>FA Cup football</td>
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<td></td>
<td>UK Snooker Championships</td>
<td>BBC</td>
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* event is not held annually
45. Ofcom’s principal arguments against the attractiveness of this portfolio of programming as a source of competition for retailers of premium sports channel packages are that (a) particular sports events within it do not occur “regularly”, and (b) this portfolio of programming would be insufficient to meet the demand of consumers interested in watching particular sports or events broadcast only on premium pay TV channels – such as domestic Test Match cricket.

46. Both these arguments, however, depend on an erroneous proposition that products’ characteristics need to be identical for them to be in the same relevant market.

47. Moreover, as Table 2 indicates, there is in fact a regular availability of high quality sports events broadcast on free to air television channels throughout the year.

48. Ofcom also fails to consider ways in which consumers are able to access programming broadcast on pay TV channels that is particularly important to them, other than via a pay TV subscription. As noted in Sky’s Response to the Consultation Document\(^{33}\), they are, for example, able to watch such programmes in pubs or at friends’ homes, listen to the events on the radio, or watch highlights programmes on free to air television channels.

49. Finally, Ofcom’s second argument fails to recognise that ‘dedicated fans’ of particular events or sports are unlikely to be marginal subscribers – the consumers on whom a market definition analysis should focus. Marginal subscribers are most likely to be those who have a moderate interest in a range of sports, or sports in general, but who would not consider a subscription to pay TV packages that include sports channels worthwhile were the price of such packages to increase by a small yet significant amount.

50. Potential substitutes for subscribing to pay TV packages that include premium movie channels include consumers’ ability (a) to watch more non-movies’ programming (on both free to air and basic pay TV channels, on DVD and via VoD services) and (b) to watch movies in other windows (including those that run concurrently with the pay TV window) and via other media (e.g., at the cinema, on DVD, via VoD services and on free to air and basic pay TV channels).

F. Supply-side substitution

51. The purpose of examination of supply-side substitution is to determine whether a relevant market that has been defined by reference to demand-side factors should be widened when supply-side factors are taken into account.

52. In this case, given that Ofcom’s conclusions on the scope of relevant markets reached on the basis of its demand-side analysis are unreliable there is little merit in examining Ofcom’s analysis of the potential for supply-side substitution, and therefore this issue is not considered in this submission.

\(^{33}\) See paragraph 5.32 of Sky’s Response to the Consultation Document.
Part Two

53. This Part Two of Sky's submission discusses the reasons why the specific evidence and analysis relied on by Ofcom in support of its conclusions about the scope of relevant retail markets for premium sports channel packages, and premium movie channel packages, does not in fact support Ofcom's conclusions.

54. The evidence and analysis considered in this Part Two is that set out in the sections of the Consultation Document addressed to market definition at the retail level. The evidence and analysis set out in the sections of the Consultation Document addressed to market definition at the wholesale level, on which Ofcom may also be relying in relation to market definition at the retail level, is addressed at Annex 2 of this submission (although as noted above Ofcom does not make it entirely clear what evidence it is relying upon).

G. Retail supply of packages that include premium sports channels

55. The focal product for Ofcom's analysis of the relevant market for pay TV packages that include premium sports channels is:

   "retail packages that include Core Premium Sports channels"\textsuperscript{35}.

56. Core Premium Sports channels are defined as “Sky Sports 1, Sky Sports 2 or Setanta Sports 1, as well as High Definition (HD) versions of these channels”\textsuperscript{36}.

57. On the basis of its subsequent analysis, Ofcom concludes that the relevant retail market for premium sports channel packages is:

   "retail supply of Sky Sports 1, Sky Sports 2 or Setanta Sports 1, as well as HD versions of these channels or TV packages that include these channels.”\textsuperscript{37}

58. The most notable characteristic of the evidence and analysis cited directly by Ofcom in support of its conclusion about the scope of the retail market for premium sports channel packages is its cursory nature. In total, Ofcom's discussion of this issue comprises just over six pages, and is based on the examination of only two types of evidence – an analysis of “consumer responses to price rises”\textsuperscript{38} that comprises a ‘Critical Loss Analysis’ which Ofcom has itself described previously as being "somewhat theoretical"\textsuperscript{39}, and an extremely brief analysis of “consumer preferences, product characteristics, and the constraint from

\textsuperscript{34} See paragraph 21.
\textsuperscript{35} Paragraph 4.19 of the Consultation Document.
\textsuperscript{36} Paragraph 4.8 of the Consultation Document.
\textsuperscript{37} Paragraph 4.252 of the Consultation Document.
\textsuperscript{38} Paragraph 4.229 of the Consultation Document.
\textsuperscript{39} Paragraph 4.87 of Ofcom’s Second Consultation Document.
Such a brief analysis of an issue that is of considerable importance in the context of Ofcom’s allegations about Sky’s behaviour is manifestly insufficient.

These analyses are discussed further in the sections below.

(a) **Analysis of “consumer responses to price rises”**

The analysis included under this heading is an attempt by Ofcom to apply the ‘hypothetical monopolist test’ (‘HMT’), which seeks to examine what would happen if a hypothetical monopolist of the focal product (i.e., in this case, pay TV packages that include premium sports channels) attempted to raise prices for that product by a ‘SSNIP’\(^\text{41}\), conventionally taken to be 5-10%. In this framework, if such a price rise is found to be unprofitable, then the relevant market is wider than the focal product in question.

Ofcom seeks to apply this test using Critical Loss Analysis. Critical Loss Analysis is a way of addressing the question at the centre of the HMT. It asks what level of sales would need to be lost by a hypothetical monopolist of a particular product as a result of a SSNIP in order to make such a price rise unprofitable. This is the “critical loss”. This critical loss can then be compared against observed reactions to price rises in the past, or other information on how consumers would respond to price rises – known as the “actual loss”. If the actual loss is greater than the critical loss, then the relevant market is wider than the focal product in question.

Both the critical loss and the actual loss can be determined in terms of absolute values (e.g., the amount of revenue that would be lost in response to a SSNIP), or ‘elasticities’ (e.g., the percentage change in revenues in response to a particular percentage change in prices). Ofcom’s analysis is specified in terms of elasticities.

Ofcom previously described this approach as “somewhat theoretical”\(^\text{42}\), which suggests that, even if Ofcom’s Critical Loss Analysis were reliable (which it is not), it would be appropriate to exercise caution in relying on its results. However, Ofcom now appears to regard Critical Loss Analysis as central to its case for narrow markets at the retail level.

One of the major problems with Ofcom’s analysis is that Ofcom’s estimates of actual demand elasticities are unreliable.\(^\text{43,44}\) Ofcom has attempted to use for

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\(^{40}\) The entirety of Ofcom’s analysis of this issue – including a summary of its position on this issue in the First Consultation Document, summary of consultees’ responses to Ofcom’s consultation and setting out of Ofcom’s “current view” – consists of nine paragraphs (paragraphs 4.238 to 4.246 of the Consultation Document).

\(^{41}\) A ‘SSNIP’ is a small, significant, non-transitory increase in prices.

\(^{42}\) Paragraph 4.87 of Ofcom’s Second Consultation Document.

\(^{43}\) Ofcom’s estimates of critical elasticities depend in part on data provided by Virgin Media, and therefore are not visible to Sky. Accordingly, Sky is unable to comment on the reliability of the critical values used by Ofcom.
this purpose data taken from an internal Sky presentation of the results of a consumer survey undertaken for Sky in early 2007. Sky has explained previously why the data included in that presentation are not suitable for use in a Critical Loss Analysis. Ofcom, however, simply dismisses those explanations. Accordingly, Annex 1 of this submission repeats and expands upon the points previously raised by Sky. In summary:

- it is not possible to estimate relevant demand elasticities from this consumer research;
- the presentation from which Ofcom draws the data for its analysis does not reflect the responses given by consumers; and
- [CONFIDENTIAL].

65. As a result, Ofcom’s Critical Loss Analysis is wholly unreliable. No weight can be placed on it in support of the conclusion reached by Ofcom about the scope of the relevant market in relation to premium sports channel packages.

(b) Analysis and evidence relating to “consumer preferences, product characteristics, and the constraint from FTA”

66. Ofcom’s presentation of its “current view” of these matters consists of three paragraphs:

(i) the first paragraph (paragraph 4.244) discusses the constraint that free to air television imposes on suppliers of pay TV services that include premium sports channels;

(ii) the second paragraph (paragraph 4.245) discusses whether packages containing Setanta Sports 1, and packages that include Sky Sports 2, should be considered to be in the same retail market as pay TV services that include Sky Sports 1; and

(iii) the third paragraph (paragraph 4.246) considers issues concerning the growth in the number of Freeview households over time.

67. Each of these is discussed below.

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64 Sky has now supplied to Ofcom reliable consumer survey based data that would enable it to carry out an assessment properly. (See Annex 5 of Sky’s Response to the Consultation Document.)

(i) The constraint from free to air television services

68. This paragraph comprises two parts. First, Ofcom simply states:

“FTA cannot match the regularity and quantity of sport found on premium sports channels. We therefore think it unlikely that FTA would be a sufficient constraint on a retailer of these premium sports channels.”

69. Even leaving to one side the myriad flaws in this statement, it is entirely evident that Ofcom’s view that it ‘thinks it unlikely’ that free to air television services comprise a “sufficient constraint on a retailer” of premium sports channel packages is assertion by Ofcom rather than compelling evidence in support of its conclusion about the scope of the relevant retail market for such packages.

70. Second, Ofcom states:

“we acknowledge that the availability of some specific highly valued sports on FTA TV might act as a strong out of market constraint on a monopolist retailer of premium sports channels.”

71. This statement is based on Ofcom’s proposition that retailing premium sports channels comprises a relevant market. Accordingly, it does not comprise evidence in support of Ofcom’s conclusion about the scope of the relevant retail market for premium sports channel packages (and does not appear to be intended as such).

(ii) Whether packages containing Setanta Sports 1, and packages that include Sky Sports 2, should be considered to be in the same retail market as pay TV services that include Sky Sports 1

72. The second matter considered by Ofcom is whether, at the retail level, services that include Setanta Sports 1, and/or Sky Sports 2, should be considered to be in the same market as services that include Sky Sports 1.

73. This fails to recognise that Ofcom had already defined the focal product for its analysis as including such channels. At paragraph 4.19 of the Consultation Document, Ofcom states:

“Therefore our focal products for investigation of retail markets are... [r]etail packages containing Core Premium Sports channels.”

74. “Core Premium Sports channels” are defined by Ofcom as “Sky Sports 1, Sky Sports 2 and Setanta Sports 1.” Accordingly, if anything, Ofcom’s brief analysis of this issue simply comprises a consideration of whether the focal product for

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46 Paragraph 4.244 of the Consultation Document.
47 Most notably, Ofcom fails to consider whether a service that provided a smaller amount of sport, with potentially less regularity, for free might be an adequate substitute from the point of view of marginal consumers for pay TV services that include premium sports channels.
48 Paragraph 4.244 of the Consultation Document.
its analysis is appropriate. It does not comprise evidence in support of the conclusion reached by Ofcom about the scope of markets relevant to the retail supply of premium sports channel packages.

(iii) The impact of Freeview on demand for premium sports channel packages

75. The purpose of Ofcom returning to the subject of free to air television services appears to be to (a) assert again that the observation of increasing numbers of subscribers to premium pay TV services, at the same time as the number of Freeview households has increased significantly, indicates that they are not in the same relevant market, and (b) rebut the evidence on this matter of Professor Seabright et. al.

76. Ofcom has asserted in each of its consultation documents that the observation of increasing numbers of subscribers to premium pay TV services, at the same time as the number of Freeview households has increased significantly, indicates that they are not in the same relevant market. On each occasion, Sky has pointed out the obvious flaws in such a proposition, namely that:

(i) in a situation in which a number of variables are changing simultaneously (for example, the prices and quality of services available, or the amount of marketing expenditure), comparing the trend in two variables over time is likely to lead to false conclusions about the relationship between them;

(ii) such a proposition depends on the specification of an appropriate counterfactual – how the number of pay TV subscribers would have changed in the absence of the observed growth in the number of Freeview households.

77. Ofcom does not properly address these submissions in its analysis. Accordingly, Ofcom’s assessment of the impact of the growth in the number of Freeview households over time on demand for pay TV services that include premium sports channels cannot be given any weight in support of Ofcom’s preferred market definition.

78. Ofcom’s attempted rebuttal of the study by Professor Seabright et. al. is not considered further here as it is addressed in Sky’s Response to the Consultation Document. Sky notes, however, that, even if it were well founded (which it is

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49 Ofcom’s consideration of this issue separately from the consideration of “the constraint from free to air television services” is somewhat peculiar in view of the fact that Freeview is a collection of free to air television channels. It would make sense to consider these two issues together.


51 See (a) Appendix 5 to Annex 2 of Sky’s Response to the First Consultation Document, (b) Section 3 of Annex 6 of Sky’s Response to the Second Consultation Document, and (c) paragraphs 2.16-2.19 of Annex 1, and footnote 99, of Sky’s submission of 1 June 2009.

52 See Annex 3 of Sky’s Response to the Consultation. Sky also does not consider in this submission Ofcom’s false proposition that “Oxera’s analysis also shows that the growth of FTA has not prevented Sky making high profits from its pay TV channels”. See Section 4 and Section 7 of Sky’s Response to the Consultation Document for Sky’s discussion of this proposition.
not) such rebuttal does not comprise evidence in support of Ofcom’s preferred market definition.

Summary and conclusion

79. Ofcom’s evidence and analysis is wholly insufficient to form the basis for a well-founded conclusion that there is a relevant market for “retail supply of Sky Sports 1, Sky Sports 2 or Setanta Sports 1, as well as HD versions of these channels or TV packages that include these channels.” Ofcom’s analysis and evidence is cursory and incomplete. Ofcom asserts only two purported evidential bases in relation to retail market definition for premium sports channel packages, neither of which provides compelling support for Ofcom’s conclusion about the relevant market for such services.

H. Retail supply of packages that include premium movie channels

80. The focal product for Ofcom’s analysis of the relevant market for packages that include premium movie channels is:

“retail packages that include Core Premium Movie channels”

81. Core Premium Movie channels are defined as “channels including movies in the first TV subscription window produced or licensed by the six major Hollywood studios.”

82. On the basis of its subsequent analysis, Ofcom concludes that the relevant retail market for premium movie channel packages is:

“retail supply of television bundles containing Core Premium Movie channels.”

83. As in the case of premium sports channel packages, the most notable characteristic of the evidence and analysis cited directly by Ofcom in support of its conclusion about the scope of the retail market for premium movie channel packages is its cursory nature. In total, Ofcom’s discussion of this issue comprises six pages. Such a brief analysis of an issue that is of considerable importance in the context of Ofcom’s allegations about Sky’s behaviour is manifestly insufficient.

84. Ofcom states that its analysis of this issue comprises consideration of the following issues:

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54 Paragraph 4.19 of the Consultation Document.
55 As discussed above, Ofcom uses a variety of different definitions of “Core Premium Movie channels” in the Consultation Document.
57 Paragraphs 4.379 to 4.411 of the Consultation Document.
85. Ofcom’s evidence and analysis in relation to each of these issues is discussed below.

(a) **Consumer responses to price rises**

86. Ofcom’s analysis under this heading again comprises a Critical Loss Analysis. This analysis relies on the same source for estimates of the actual loss that would be observed in response to a price rise that is used for premium sports channel packages – an internal Sky presentation of the results of consumer research undertaken for Sky by KAE – and is therefore wholly unreliable for the reasons set out above and at Annex 1. No weight can be placed on this analysis by Ofcom in support of its conclusion about the scope of the relevant retail market for premium movie channel packages.

(b) **“Evidence of consumer preferences and product characteristics”**

87. Ofcom’s current view on this matter is expressed in a single short paragraph. Ofcom states:

   “we analysed preferences of ‘price sensitive’ subscribers and gathered further evidence from firms within the market and analysis of audience data on Sky movie channels. As with our assessment of the wholesale supply of Core Movie channels, we consider subscription access to new movies from the pay TV window to be the key characteristic of premium movie channels.”

88. The failings of such a statement as a sound basis for a conclusion about the scope of the relevant market in this case are clear. Simply identifying the “key characteristic” of a product is, on its own, wholly uninformative about the scope of the relevant market for that product. Moreover, Ofcom’s identification of the “key characteristic” of premium movie channels appears to comprise little more than a description of a premium movies TV channel. It is no more informative...
than, in a market definition analysis in which the focal product is BMW cars, a statement that the key characteristic of such cars is that they are made by BMW.

(c) “Evidence of the constraint from DVDs”

89. The entirety of Ofcom’s consideration of the issue of the competition faced by retailers of pay TV services from the ability of consumers to buy and rent movies (and other programming) on DVDs comprises the following:

“Our position in the First Pay TV Consultation

We assessed changes in prices and demand for Sky Movies and DVDs. We found that between 2001 and 2006 the retail price of DVDs has fallen in real terms by 43% while expenditure on retail DVDs has tripled over the period.

As stated above, it is difficult to draw firm conclusions from such data. However, we noted that the price of Sky Movies had grown at approximately the same rate as that of Sky Sports, despite what appeared to be a greater array of potential substitutes. In particular, the growth in popularity of renting and purchasing DVDs did not appear to have had a constraining impact on the price of Sky Movies.

Responses to our consultation

As we set out above Sky believed that DVD retail and rentals were a strong constraint on the retailing of Sky Movies channels. In response to our second consultation it stated that the reduction in time between the cinema release and DVD rental release meant that the pay TV window was becoming less valuable.

Our current view

Our evidence on pricing of DVDs and the growth of DVD rentals indicates that these are likely to represent relatively weak substitutes for premium movies.”

90. In the first instance, this is an example of reliance on analysis from Ofcom’s First Consultation Document without taking account of subsequent analysis and evidence. In particular, Ofcom’s statement that “we noted that the price of Sky Movies had grown at approximately the same rate as that of Sky Sports despite what appeared to be a greater array of potential substitutes” fails to have regard to the fact that, in its Second Consultation Document, Ofcom stated:

Paragraphs 4.397 to 4.400 of the Consultation Document. Sky does not address the last sentence in paragraph 4.400 (“although downloading films may become a more important factor, relatively few consumers currently use it”) for the following reasons: (a) it is not related to “the constraint from DVDs”, (b) given that Ofcom’s analysis is intended to be forward looking, services that “may become a more important factor” in future should be considered carefully by Ofcom, rather than being dismissed in a sentence, and (c) it does not comprise sound evidence in support of Ofcom’s conclusion about the scope of the relevant retail market for premium movie channel packages.
Average annual growth of real top tier prices was about 1.1% per year since 2002.

Real Sports Mix prices have grown by about 1.8% per year since 2002.

Real Movies Mix prices are unchanged from the 2002 level.\textsuperscript{64}

Accordingly, it appears that, in its Second Consultation Document, Ofcom considered that its preliminary analysis (in its First Consultation Document) was erroneous. Yet, in the Consultation Document, Ofcom makes no mention of this, and cites instead that erroneous analysis.

Overall, it is evident that this brief consideration cannot be regarded as comprising soundly based support for Ofcom’s conclusion about the scope of the relevant retail market for premium movie channel packages.

\textit{“The constraint from films on FTA or basic tier TV”}

The final issue considered by Ofcom is the constraint on suppliers of pay TV services that include premium movie channels from “films on FTA or basic tier TV”. Ofcom’s consideration of this matter comprises two brief sentences:

“The growth in movie channels on FTA and basic tier packages has increased the availability of older films to consumers. However, these films are likely to be less valuable to consumers and therefore represent a weak competitive constraint on retailers of premium movie channels.”\textsuperscript{65,66}

Ofcom’s assertion on this issue fails to recognise that a ‘lower quality’ product at a cheaper price can comprise an effective substitute for a ‘higher quality’ product at a higher price. Products’ characteristics do not need to be identical for them to be considered to be supplied in the same relevant market.

The proposition that older movies are less valuable to consumers than newer movies is also overly simplistic. Many older movies are likely to be valued more highly by consumers than many new movies. With movies, it is not the case

\textsuperscript{64} Paragraph 3.16 of Annex 6 of Ofcom’s Second Consultation Document.

\textsuperscript{65} Paragraph 4.403 of the Consultation Document. Ofcom’s proposition fails to recognise the growth in provision of movies on free to air channels that are not movie channels – channels such as ITV2, ITV3 and ITV4. This has been a substantial source of expansion in the number of movies available to consumers. Ofcom’s assertion that the wide range of older movies available on free to air television channels and basic pay TV channels “therefore represent a weak competitive constraint on retailers of premium movie channels” fails to consider the fact that they are supplied at lower prices than packages that include premium movie channels, or for free.

\textsuperscript{66} In its wholesale-level analysis Ofcom seeks to support this proposition by reference to the fact that about 60% of viewing on Sky’s movie channels is to movies in the pay TV window, rather than the wide range of library titles broadcast on those channels (see paragraph 4.292 of the Consultation Document). If anything, the fact that 40% of viewing is to library titles broadcast on premium movie channels demonstrates that consumers place considerable value on such movies.
that 'quality' is determined solely by temporal proximity to cinematic release.\textsuperscript{67} For example, if 'quality' is determined by subjective criteria - such as the views of movie critics - then it is evident that many older movies (e.g., \textit{Casablanca}, \textit{Citizen Kane}, \textit{The Godfather}) are considered to be 'better' movies than more recent releases. If 'quality' is measured in terms of popularity, a broadcast of \textit{Raiders of the Lost Ark} is likely, all else being equal\textsuperscript{68}, to attract more viewers than a broadcast of more recent movies such as \textit{Bangkok Dangerous} or \textit{The Number 23}\textsuperscript{69}. Indeed, it is often the case that older movies broadcast on free to air television channels on a Saturday night achieve larger audiences \textit{in Sky Movies homes} than the newer movies broadcast on Sky's movie channels. Table 3, below, shows the comparative viewing of a repeat broadcast of \textit{The Lord of the Rings: The Two Towers}, on Channel 4 in the evening of Saturday 26 September, and the main movie broadcast (for the first time) on the Sky Movies Premiere channel, \textit{Tropic Thunder}.

\begin{table}[h]
\centering
\caption{Average audience in Sky Movies homes for movies broadcast on Channel 4 and Sky Movies Premiere on the evening of Saturday 26 September 2009}
\begin{tabular}{|l|l|l|}
\hline
Movie & Channel & Average audience \\
\hline
\textit{The Lord of the Rings: The Two Towers} (2002) & Channel 4 (19:00) & 162,000 \\
& Channel 4 HD (19:00) & \\
& Channel 4 +1 (20:00) & \\
\textit{Tropic Thunder} (2008) & Sky Movies Premiere (20:00) & 100,000 \\
& Sky Movies Premiere HD (20:00) & \\
& Sky Movies Premiere+1 (21:00) & \\
\hline
\end{tabular}
\end{table}

96. Ofcom's brief consideration of the constraint on suppliers of premium movie channel packages from movies on free to air channels and basic pay TV channels does not, therefore, comprise sound evidence in support of the conclusion Ofcom reaches about the scope of the relevant market for such services.

\textsuperscript{67} Ofcom states that "\textit{Sky agreed with Ofcom that it was "axiomatic" that consumers value a given film more the closer it is to release}" (paragraph 4.286 of the Consultation Document). If Ofcom is arguing that consumers value a given film more the closer it is to its release, then this statement is normally correct. (It is not uncommon for appreciation of the value of particular movies to increase over time.) Ofcom, however, advances a different argument - that: "films in later windows \textit{[than the pay TV window]} are viewed as a poor substitute" by consumers (paragraph 4.290 of the Consultation Document). As set out above (at paragraph 95), Sky does not agree with that proposition, particularly when proper regard is had to the fact that movies in later windows are available to consumers at lower cost than via a subscription to a pay TV service that includes premium movie channels.

\textsuperscript{68} In particular, once the reach of particular types of channels is taken into account.

\textsuperscript{69} Both these movies were produced by major Hollywood studios, with star casts. \textit{Bangkok Dangerous} starred Nicolas Cage, while \textit{The Number 23} was directed by Joel Schumacher and starred Jim Carrey. Both movies performed poorly both at the box office and when broadcast on Sky’s movie channels. They are likely to have low public awareness.
Summary and conclusion

97. Ofcom’s evidence and analysis of the constraints faced by the suppliers of pay TV services that include premium movie channels comprises:

(a) a Critical Loss Analysis that is unreliable because, among other problems, the data used by Ofcom to estimate the ‘actual loss’ cannot be used for that purpose;

(b) a proposition that broadcasting movies in the pay TV window comprises the “key characteristic” of premium movie channels, which is simply a description of one aspect of those channels; and

(c) assertions that (i) DVD sales and rentals, and (ii) the large number of movies broadcast on free to air television channels, and on basic pay TV channels, represent weak competitive constraints on retailers of pay TV services that include premium movie channels.

98. It is plain that this set of points cannot be considered to comprise compelling evidence in support of Ofcom’s conclusion about the scope of the relevant retail market for pay TV services that include premium movie channels. Ofcom’s analysis of this issue is manifestly inadequate.
ANNEX 1: OFCOM’S ESTIMATE OF DEMAND ELASTICITIES BASED ON A SURVEY FOR SKY BY KAE

A1.1 Ofcom’s market definition analysis relies on a number of separate Critical Loss Analyses. In order to undertake such analyses, Ofcom requires estimates of the actual elasticity of demand for premium pay TV packages.

A1.2 In order to estimate such elasticities Ofcom seeks to use the results of a consumer research project undertaken for Sky by KAE (a consumer research consultancy) in early 2007.

A1.3 This research, however, is wholly unsuitable for the purpose to which Ofcom seeks to apply it because:

- it is not possible to estimate relevant demand elasticities from this study; and
- the presentation from which Ofcom draws the data for its analysis does not properly reflect the responses given by consumers.

A1.4 It is also important to note that [CONFIDENTIAL].

A1.5 These issues are discussed in the sections below.

1. Context

A1.6 The data used by Ofcom are from a Sky internal presentation of the results of a survey undertaken for Sky by KAE in early 2007. Its main focus was on the effects of changing the packages available to consumers. As a minor part of a broader research project, KAE tested consumers’ choice of Sky’s pay TV packages at a range of price points using a conjoint technique. This is clear from the 'Background and objectives' page of the presentation (page 4), which does not refer to a price increase. Respondents were shown a mixture of actual and hypothetical packages. In the research as originally conceived, Sky wished to examine different price points as a sensitivity check to conclusions on possible package changes.

A1.7 Only 4 of the 66 pages of the final presentation discuss the effects of price increases, and it does not mention spin-down to smaller packages as a result of price increases. As discussed below, spin-down is an important consideration when making pricing and packaging decisions and one which the presentation does address in the context of packaging changes.

2. It is not possible to estimate relevant elasticities from the KAE research

A1.8 The correct way of conducting a SSNIP test is to identify all products in the candidate market and increase the prices of those products by a small percentage (5-10%) while keeping the prices of all other products constant. At the retail level, Ofcom considers two focal products: all pay TV packages containing premium movie channels, and all pay TV packages containing...
premium sports channels. The correct way to test whether either of these is a relevant market is to increase the prices of the focal products only.

A1.9 The KAE research, which was designed for an entirely different purpose, unsurprisingly does not follow such an approach. It diverges from it in two respects: (i) it looks only at reactions to changes in charges for Sky’s packages, and (ii) it examines consumers’ decisions when charges for all packages change simultaneously.

A1.10 One of the responses to an increase in the price of a particular premium package is that some subscribers to that package will ‘spin down’ to a smaller package. For example, if Sky increased the price of all its packages containing premium sports channels, Sky would expect a significant number of subscribers to those packages to switch to basic-only packages or basic-and-movies channel packages (in addition to subscribers who churn completely). If the prices of basic-only packages and basic-and-movies channel packages also increased, there would be much less spin-down.

A1.11 This problem is compounded by the fact that, in the consumer research, the prices of all packages were increased by the same amount, which means that there is a higher percentage price increase on basic packages than on packages containing premium channels, which will further discourage spin-down and could actually lead some subscribers to switch from basic-only packages to packages containing premium sports and/or movie channels in such a scenario.

A1.12 The importance of spin-down as a constraint on price rises is well illustrated by Ofcom’s own SSNIP research, presented in the First Consultation Document, which showed that in response to a 10% increase in the “movie element of” the prices of packages containing premium movie channels:

- 18% of subscribers would switch to a package containing basic channels and premium sports channels;
- 7% would switch to a basic-only package; and
- 3% would cancel their pay TV subscription.

A1.13 Similarly in response to a 10% increase in the “sports element of” the prices of packages containing premium sports channels:

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70 As noted above (see paragraph 40), these ‘focal products’ in fact comprise an enormous number of products that are actually supplied to consumers.

71 The KAE presentation provided the results for two scenarios: a £[CONFIDENTIAL] per month increase in charges for all packages, and a scenario in which the charge for packages containing [CONFIDENTIAL] increased by £[CONFIDENTIAL] per month and all other prices increased by £[CONFIDENTIAL] per month.

72 Paragraph 4.62 of Annex 13 of the First Consultation Document. In addition, some subscribers would also respond by dropping other elements of their package (e.g., switching to a less-inclusive basic package).
• 7% of subscribers would switch to a package containing basic channels and premium movie channels;
• 4% would switch to a basic-only package; and
• 4% would cancel their pay TV subscription.73

This research suggests that spin-down to other pay TV packages is an important component of consumers’ switching away from premium pay TV services as a result of increases in their prices.74 If the price of less inclusive packages also rises, spin-down is likely to be significantly lessened.

Accordingly, the KAE research is likely to understate switching away from the candidate market significantly (and hence could falsely indicate a narrow market) because in that research the prices of all Sky’s packages were increased.

A survey of this type could be useful to test a candidate retail market consisting of all Sky’s pay TV packages (which is much closer to the sense in which the Competition Commission found it informative, since the Competition Commission was interested in the question of whether the relevant market was wider than pay TV). It is not suitable to investigate the question of whether ‘pay TV packages containing premium sports channels’ or ‘pay TV packages containing premium movie channels’ are relevant markets.

Ofcom suggests that there may be an opposite effect – that because the price increase does not apply to other retailers, the switching in the KAE survey will be overstated. In other words, some of the consumers who would churn from Sky if Sky’s prices increased would switch to other products within the candidate market from other retailers, and so they should not be counted as switching away from the candidate market. Ofcom states:

“\textit{A monopolist supplier of premium sports channels would be likely to face less price-sensitive customers than Sky does at present (because some Sky customers who have a strong demand for premium sports channels could see Setanta as a substitute).}”75

This is incorrect. The survey was carried out in early 2007, more than six months prior to Setanta beginning to broadcast live Premier League football at a time when there was little awareness of Setanta. Hence, Sky was the only broadcaster of premium sports channels (under Ofcom’s definition) at the time that the KAE survey was undertaken. If the survey were carried out today, Sky would expect to see greater churn than in this survey, because consumers now

73 Paragraph 4.22 of Annex 13 of the First Consultation Document. In addition, some subscribers would also respond by dropping other elements of their package (e.g., switching to a less-inclusive basic package).

74 Ofcom believes that this research may suffer from survey biases and issues raised by the Cellophane fallacy. Even if both faults applied, there is no reason to believe that either of these issues affect the relative importance of spin-down and churn.

75 Paragraph 4.416 of the Consultation Document.
have the option of dropping Sky Sports and subscribing to ESPN. This highlights the dangers of relying on out-of-date research in a rapidly-changing sector.\(^{76}\)

A1.19 There is a further problem in practice: an increase in the price of packages containing, for example, premium sports channels may lead to lost revenue even from subscribers who continue taking premium sports channels. For example, some customers may respond to such a price increase by dropping movie channels or basic packages from their subscription, or ceasing to take other Sky products such as multiroom or HD services. Ofcom’s methodology does not reflect this loss.

3. **The presentation from which Ofcom draws the data for its analysis does not properly reflect consumers’ survey responses**

A1.20 The subsection above explained that the KAE research is wholly unsuitable for the analysis in which Ofcom has used it. Even if that were not the case, the data used by Ofcom in its analysis are from an internal Sky presentation which does not properly reflect consumers’ survey responses: churn has been ‘dampened’, and spin-down was not included. Hence, taking outputs from the presentation leads to further distortion of the underlying consumer preferences that Ofcom needs to assess for its purposes.

(a) **Calibration of churn results**

A1.21 Sky’s internal presentation, which is the source of data used by Ofcom for its analysis, did not present the level of churn that the research actually predicted would arise from a price increase in the KAE survey.

A1.22 In the KAE survey, consumers were asked to choose from a range of packages and price points, including the option of not taking any pay TV package from Sky. Sky’s presentation provided estimates of the effect of price increases by comparing respondents’ choices at then current prices with their choices at higher prices. So, for example, the increase in ‘churn’ from a \[\text{CONFIDENTIAL}\] price rise as reported in the presentation was the proportion of current subscribers who would not take a pay TV package from Sky at prices \[\text{CONFIDENTIAL}\] higher than current prices, minus the proportion of current subscribers who said they would not take a pay TV package from Sky at then current prices.

A1.23 The results of the survey were, however, calibrated for presentational purposes, \[\text{CONFIDENTIAL}\].

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\(^{76}\) It is in theory possible that some of the respondents who said they would churn would switch to packages in the candidate market supplied by Virgin Media. This effect is unlikely to be large: the survey did not frame the possibility of switching to Virgin Media or tell respondents that Virgin Media’s prices were unchanged. Hence it is not clear that any respondents would have switched in the expectation that Virgin Media’s prices would be more attractive. In a survey that addressed the possibility of switching and (a) made Virgin Media’s pricing clear, and (b) held those prices constant, Sky would again expect to see higher levels of churn than those found in this survey.
This approach was appropriate in the context of presenting the results within Sky as the focus in this part of the presentation was on indicating the extent to which price changes might cause additional churn (over and above a 'normal' level of churn). It also highlighted which products were more or less susceptible to churn from a price increase of a given amount.\(^{77}\) It was, however, an adjustment for the purposes of presentation rather than one that could be expected to produce more accurate or reliable results. Such adjustment is not appropriate in the context in which Ofcom has used this evidence.

\(\textbf{(b)}\) \textit{Spin-down is not reported}

The presentation used by Ofcom as the basis for its analysis did not report the levels of spin-down found in the KAE research.\(^{78}\) This is important because, as mentioned above, the normal expectation is that an increase in the charge for packages containing movie channels would lead some subscribers to those packages to switch to packages containing only basic channels, for example.

By failing to examine spin-down, Ofcom underestimates the reaction to a price increase.

\(\text{4. [CONFIDENTIAL]}\)

Sky did not consider that the results of the parts of the research on which Ofcom's analysis relies were particularly robust; as discussed above, they were a minor part of the KAE research, which was commissioned to address other matters. [CONFIDENTIAL].\(^{79}\) The results of the research implied that [CONFIDENTIAL].

In September 2007, seven months after the research, Sky increased some retail prices while reducing others.\(^{80}\) For directly comparable prices, the changes were as shown in Table 1 below. Price changes for packages including premium channels ranged from a 6.7% reduction to a 3.7% increase. This resulted in reductions in real prices year-on-year for all premium channel packages as there was an increase of 3.9% in the RPI over the period September 2006 to September 2007.\(^{81}\)

\(^{77}\) [CONFIDENTIAL].

\(^{78}\) As noted above, the effect of a price increase was not the main focus of the research and the presentation did not aim to provide a comprehensive report on the consequences of such a price increase.

\(^{79}\) As noted above, the main purpose of the research was to examine responses to different packaging options.

\(^{80}\) Sky also changed its pricing structure to allow subscribers to take packages including 1, 3, or 5 basic Mixes. Previously subscribers had been restricted to choosing 2, 4 or 6 Mixes.

\(^{81}\) Ofcom's preferred deflator, GDP, increased by 4.1% between Q3 2006 and Q3 2007. Using this deflator, would result in even larger estimates of the reduction in retail prices in real terms.
Table 1
Changes in Sky's nominal retail prices in September 2007

<table>
<thead>
<tr>
<th></th>
<th>2 Mix</th>
<th>4 Mix</th>
<th>6 Mix</th>
<th>2 Mix</th>
<th>4 Mix</th>
<th>6 Mix</th>
</tr>
</thead>
<tbody>
<tr>
<td>No premium channels</td>
<td>£2.00</td>
<td>£1.00</td>
<td>£0.00</td>
<td>13.3%</td>
<td>5.6%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1 premium channel</td>
<td>-£1.00</td>
<td>-£2.00</td>
<td>-£2.00</td>
<td>-3.6%</td>
<td>-6.7%</td>
<td>-6.3%</td>
</tr>
<tr>
<td>2 premium channels</td>
<td>£1.00</td>
<td>£0.00</td>
<td>£1.00</td>
<td>2.9%</td>
<td>0.0%</td>
<td>2.7%</td>
</tr>
<tr>
<td>3 premium channels</td>
<td>£0.50</td>
<td>£0.50</td>
<td>£1.50</td>
<td>1.3%</td>
<td>1.3%</td>
<td>3.7%</td>
</tr>
<tr>
<td>4 premium channels</td>
<td>£0.50</td>
<td>£0.50</td>
<td>£1.50</td>
<td>1.2%</td>
<td>1.2%</td>
<td>3.4%</td>
</tr>
</tbody>
</table>
ANNEX 2: WHOLESALE-LEVEL EVIDENCE AND ANALYSIS IN RELATION TO MARKET DEFINITION

A2.1 This Annex 2 discusses evidence and analysis included in Ofcom’s analysis of market definition at the wholesale level which either (a) Ofcom refers to explicitly, or (b) Ofcom may be seeking to rely on, but has not referred to, in relation to market definition at the retail level.

A. Pay TV packages that include premium sports channels

A2.2 Sky presumes that the evidence cited in relation to indirect constraints at the wholesale level ‘remaining relevant’ is that set out by Ofcom at paragraphs 4.94 - 4.184 of the Consultation Document. This section of Ofcom’s Consultation Document addresses three issues:

(a) “consideration of product characteristics and consumer preferences”\(^{82}\);
(b) “consumers’ response to a SSNIP”\(^{83}\); and
(c) “assessment of the constraint from FTA TV”\(^{84}\).

A2.3 Each of these is discussed below.

(a) “Consideration of product characteristics and consumer preferences”

A2.4 Ofcom’s analysis of these topics in relation to wholesale market definition is set out at paragraphs 4.94 - 4.134 of the Consultation Document.

A2.5 Ofcom describes the purpose of this assessment as follows:

“We have considered whether our market definition for premium sports channels should be drawn more widely than we expressed in the Second Pay TV Consultation to include either other specific sports or any other sports on TV.”\(^{85}\)

A2.6 This is, in part, an erroneous approach. There is no good reason to consider that the relevant market (either at the wholesale or retail level) should be widened by adding “other specific sports”. At the retail level, the focal product comprises a wide variety of different types of packages that include premium sports channels. As Sky has submitted previously, the aggregate portfolio of sports programming available to consumers on free to air and basic pay TV channels is a key constraint imposed on retailers of such services. Seeking to examine the constraint imposed on such suppliers by the availability of “specific sports” on free to air and basic pay TV service is a misplaced focus.

\(^{82}\) Heading preceding paragraphs 4.78 to 4.134 of the Consultation Document.
\(^{83}\) Heading preceding paragraphs 4.135 to 4.162 of the Consultation Document.
\(^{84}\) Heading preceding paragraphs 4.163 to 4.184 of the Consultation Document.
\(^{85}\) Paragraph 4.94 of the Consultation Document.
A2.7 Yet Ofcom devotes a substantial amount of attention to seeking to establish which sports events or competitions broadcast on Sky Sports 1 (which is a far narrower focal product than the focal product considered by Ofcom at the retail level) subscribers consider to be ‘important’, and, for each type of sports event or competition, which events or competitions consumers might consider to be ‘close substitutes’. This analysis is almost entirely uninformative in relation to market definition.

A2.8 In general, focusing to too great an extent on product characteristics the average consumer considers to be ‘important’ in relation to any given product is hazardous in a market definition analysis. For example, survey evidence on consumers’ preferences in relation to apples might identify that 70% of consumers regard ‘crunchiness’ as an ‘important’ attribute of apples. Yet it may still be the case that a sufficient number of purchasers of apples would be prepared, for example, to purchase more oranges and fewer apples if a hypothetical monopolist of apples were to raise their price by a small significant amount for a non-transitory period.

A2.9 While this is generally the case, as Sky has submitted previously focusing to too great an extent on differences in the ‘important’ characteristics among products is particularly inappropriate in sectors (such as television broadcasting) where offering consumers programming that is not available elsewhere is a central element of competition among firms.

A2.10 For these reasons, Sky has not addressed Ofcom’s sport-by-sport assessment of the extent to which consumers consider it ‘important’, and Ofcom’s impressionistic assessment of which events consumers might regard as being ‘close substitutes’ for each type of event.

A2.11 Sky notes, however, three points about this analysis:

(i) it is riddled with factual and interpretive errors. For example: (a) Ofcom describes tennis as being one of the “six main sports shown on Sky Sports 1” yet, two paragraphs earlier, Ofcom states: “there is only a small amount of tennis on Sky Sports 1”; and (b) Figure 7 erroneously attributes to Sky: US PGA Tour Golf, Challenge Cup Rugby League and WTA tennis;

(ii) attempting to undertake market definition analysis by reference to Ofcom’s impression of what sports coverage on other television channels consumers might consider to be an effective substitute for each particular type of sports coverage on Sky’s sports channels is unlikely to be meaningful. As Sky has submitted repeatedly to Ofcom (submissions to which Ofcom has not had due regard), the relevant

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86 Ofcom considers the following sports: football, cricket, golf, rugby union, rugby league and tennis.

87 See, for example, paragraph 2.13 of Sky’s submission of 1 June 2009.

88 Paragraph 4.114 of the Consultation Document. Ofcom provides no explanation for how it determines the “main” sports covered on Sky Sports 1 – for example, whether this is measured in terms of the number of hours of coverage, or rights expenditure, and so on.
question is the extent to which marginal consumers (and not average consumers) consider the totality of what is available to them elsewhere to be sufficiently substitutable for the totality of programming that is delivered to them by subscribing to a pay TV package that includes premium sports channels;

(iii) Ofcom’s analysis, again, fails to focus on the preferences of marginal consumers. It is replete with statements such as “we therefore consider [Eurosport] would be a poor substitute for the 84% of Sky Sports subscribers who value these sports highly”\(^{89}\) – a statement that is focused on the preferences of infra-marginal, rather than marginal subscribers.

A2.12 Accordingly, Ofcom’s “consideration of product characteristics and consumer preferences” at the wholesale level provides no robust evidence in support of its conclusion about the scope of the relevant market for the supply of premium sports channel packages at the retail level.

(b) “Consumers’ response to a SSNIP”

A2.13 Ofcom’s analysis under this heading consists of two exercises: (i) a wholesale-level Critical Loss Analysis and (ii) an analysis of “observed responses to price increases”. Each of these is discussed below:

(i) Critical Loss Analysis. As discussed above, Ofcom undertook a separate Critical Loss Analysis at the retail level. Accordingly, Ofcom’s wholesale-level Critical Loss Analysis is not considered here as it is not relevant to retail market definition; and

(ii) Observed responses to price increases. The second of Ofcom’s approaches appears to be an attempt to determine the relationship between the number of subscribers to packages that include Sky’s premium sports channels over time and charges for those packages in real, value-adjusted terms. Regardless of the merits of Ofcom’s analysis (which is highly inadequate), it is evident that the conclusion that Ofcom draws from it does not provide a sound basis for its conclusion on the scope of the relevant retail market for premium sports channel packages. Ofcom concludes only that:

“Taken together, we consider the evidence on Sky’s premium sports subscriber numbers and prices continues to point towards a degree of constraint on premium sports channels, although we accept that

\(^{89}\) Paragraph 4.130 of the Consultation Document.
Accordingly, it is clear that this analysis does not comprise robust evidence in support of Ofcom’s conclusion about the scope of the relevant market for premium sports channel packages at the retail level.

(c) “Assessment of the constraint from FTA TV”

The discussion under this heading comprises a number of different arguments. As opposed to the more general issue suggested by the heading, its focus is on the impact of “the growth in availability of FTA digital channels and the greater quantity of available sport...than ten years ago when most consumers only had access to five FTA channels.”

The most notable feature of Ofcom’s discussion under this heading is that it is not evidence-based. Ofcom appears to have made no attempt to examine whether there is a “greater quantity of available sport...than ten years ago” on free to air television channels.

Most of the section is devoted to a spurious rebuttal of the econometric study undertaken by Professor Seabright and his colleagues. (As that is dealt with in Sky’s Response to the Consultation Document, it is not considered further here.) Aside from that, Ofcom’s analysis under this heading comprises the following proposition:

“Given the growth in the number of FTA channels and the increasing popularity of Freeview, we might expect that if FTA TV and premium sports channels were strong substitutes, we would observe a competitive response from Sky in the form of lower prices or margins for its Sky Sports channels, or for Sky Sports to have lost subscribers.”

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90 Paragraph 4.162 of the Consultation Document. Sky notes that, if anything, this conclusion appears to point to a view that the relevant market is wider than that which Ofcom has defined. This is a further example of Ofcom’s skewed approach to the use of evidence. Ofcom demonstrates little hesitation in making ‘definitive judgements’ in favour of narrow markets, even when the evidence relied on is weak or ambiguous. For example, Ofcom draws strong conclusions from weak or ambiguous evidence at paragraphs 4.184, 4.199, and 4.335 of the Consultation Document.

91 Paragraph 4.172 of the Consultation Document. As noted above, it is extremely strange that Ofcom does not link this analysis with its consideration of the coverage of sport on free to air television channels – for example such as in the discussion at paragraphs 4.99 – 4.130 of the Consultation Document.

92 This was pointed out in Sky’s submission of 1 June 2009. (See footnote 99 of that submission.) Ofcom has not adequately addressed this point.

93 See Annex 3 of Sky’s Response to the Consultation Document. Sky also does not consider in this submission Ofcom’s false proposition that “Oxera’s analysis also shows that the growth of FTA has not prevented Sky making high profits from its pay TV channels”. See Section 4 and Section 7 of Sky’s Response to the Consultation Document for Sky’s discussion of this proposition.

94 Paragraph 4.182 of the Consultation Document.
At the retail level, the analogue of this proposition is that Ofcom should expect to see a competitive response from Sky in the form of lower prices (in real value-adjusted terms) for premium sports channel packages, or for there to be fewer subscribers to such packages over time.

In fact, the former is readily observable. As Sky has shown, charges for both Sky’s Dual Sports package, and Top Tier package, have been broadly flat over the past four years,\(^{95}\) even though the value offered to subscribers by those packages has increased substantially.\(^ {96}\)

Furthermore, as Sky has submitted previously,\(^ {97}\) the extent to which Sky has “lost subscribers” as a result of the expansion in the range of free to air services available to consumers depends on an appropriate description of the counterfactual – i.e., what subscriber numbers might have been anticipated in the absence of that expansion. Ofcom has failed to address this issue.

B. Pay TV packages that include premium movie channels

Ofcom’s presentation of its evidence and analysis in relation to the relevant market for premium movie channels is divided into four parts:\(^{98}\)

(a) characteristics of premium movies channels and potential substitutes;\(^ {99}\)

(b) assessing consumers’ response to a SSNIP;\(^ {100}\)

(c) consumers’ observed responses to price changes; and\(^ {101}\)

(d) the potential constraint from content downloaded over the internet.\(^ {102}\)

The third of these issues – consumers’ observed responses to price changes – includes sub-sections dealing with “potential substitution away from Sky Movies to”:

- movies shown on basic and FTA channels;
- movies shown on SVoD/PPV;
- purchase of DVDs; and

\(^ {95}\) See paragraphs 3.64 to 3.65 of Annex 2 of Sky’s Response to Ofcom’s First Consultation Document.

\(^ {96}\) See Sky’s submission of July 2008 entitled: ‘Changes in the quantity and quality of services delivered to subscribers to Sky’s packages that include Sky’s sports channels, 2001/02 – 2006/07’.

\(^ {97}\) See, for example, Appendix 5 of Annex 2 to Sky’s Response to Ofcom’s First Consultation Document. This appendix sets out numerous additional flaws in the proposition set out by Ofcom at paragraph 4.182 of the Consultation Document which Ofcom has not adequately addressed.

\(^ {98}\) Excluding Ofcom’s brief consideration of the issue of supply-side substitution.


\(^ {100}\) Paragraphs 4.298 to 4.302 of the Consultation Document.

\(^ {101}\) Paragraphs 4.303 to 4.345 of the Consultation Document.

\(^ {102}\) Paragraphs 4.346 to 4.355 of the Consultation Document.
• rented DVDs.

A2.23 At the outset the inchoate structure of this analysis is evident. For example, it is wholly unclear why:

• the potential constraint from content downloaded over the internet is treated separately from issues such as the four topics considered under the general topic of “consumers’ observed responses to price changes”; and

• the assessment of consumers’ response to a SSNIP is regarded by Ofcom as a wholly separate issue from assessment of consumers’ observed responses to price changes, given that assessment of consumers’ response to a SSNIP relies on the consideration of how consumers react to price changes.

A2.24 This annex does not discuss Ofcom’s wholesale-level Critical Loss Analysis (set out in the section entitled “assessing consumers’ response to a SSNIP”). This is principally because Ofcom conducted a separate retail-level Critical Loss Analysis in relation to pay TV packages that include premium movie channels, which is discussed in the main body of this submission103 and Annex 1, above.

A2.25 Accordingly, the sections below consider Ofcom’s analysis of: (a) “characteristics of premium movies channels and potential substitutes”, and (b) “consumers’ observed responses to price changes”.104

(a) “Characteristics of premium movies channels and potential substitutes”

A2.26 Ofcom’s analysis in this section comprises the type of preliminary consideration of the objective characteristics of the products in question that the CCAT described as “the foundation [on which] the discussion of the relevant product market must rest”105.

A2.27 While much of Ofcom’s discussion in this section is relevant to the assessment of markets for pay TV services that include premium movie channels at the retail level (e.g., the discussion of alternative ways of watching movies, the movies windowing system, and the characteristics of Sky’s movie channels) it does not include a description of the objective characteristics of the services that include premium movie channels supplied to consumers at the retail level.

A2.28 Ofcom’s approach suffers from the problem that is common to much of its market definition analysis in that it is neither rigorous nor systematic. For example:

• in the brief paragraph that addresses “DVD retail”, Ofcom states: “just over a quarter of DVDs bought (27%) are bought as gifts rather than for personal or

103 See paragraphs 60 to 65, and paragraph 86.

104 Sky has not addressed the final issue examined by Ofcom – the potential constraint from content downloaded over the internet. Sky considers that this type of service is currently used by relatively few consumers, but is growing rapidly in importance.

105 Paragraph 148, Aberdeen Journals Ltd v. DGFT, op. cit.
family use\textsuperscript{106}. The relevance of such an observation to Ofcom’s market definition analysis is wholly unclear; and

- the single paragraph devoted to the description of pay per view movie services available to consumers is both unsystematic and wholly inadequate. It does not comprise a thorough description of either the range, or objective characteristics of pay per view movie services available to UK consumers.

A2.29 It also fails properly to reflect all the relevant evidence and analysis that has been accumulated on these issues during Ofcom’s pay TV market investigation. For example, there is no reference at all to the substantial report commissioned by Ofcom entitled ‘Movie Markets in the UK’, published as Annex 11 to Ofcom’s First Consultation Document.

A2.30 Finally, it mixes what should be a purely objective description of the range of services available to consumers, and their characteristics, with subjective assessments – for example, Ofcom’s argument that consumers value newer movies more highly than older movies\textsuperscript{107}.

A2.31 Moreover, overall, this section of Ofcom’s analysis does little more than provide a somewhat fragmented description of Sky’s movie channels and some of the potential substitutes for those services, revealing that:

\begin{quote}
there is a wide and growing variety of potential substitutes for Sky Movies channels.\textsuperscript{108}
\end{quote}

A2.32 Ofcom’s analysis does not provide support for its conclusions about the scope of relevant markets, either at the wholesale or retail level.

(b) “Consumers’ observed responses to price changes”

A2.33 Ofcom’s analysis in this section comprises two parts. At paragraphs 4.303 to 4.313 Ofcom seeks to determine the relationship between changes in charges for services that include premium movie channels, and the number of subscribers to those services, over time. Ofcom first summarises its “position in the Second Pay TV Consultation”\textsuperscript{109}, then briefly summarises “Respondents’ views”, before setting out Ofcom’s “current view”.

\begin{footnotes}
\footnotetext{106}{Paragraph 4.265 of the Consultation Document.}
\footnotetext{107}{See paragraphs 4.270, 4.286, 4.290 of the Consultation Document. See also the discussion of this issue at paragraph 95 above.}
\footnotetext{108}{Paragraph 4.281 of the Consultation Document.}
\footnotetext{109}{Paragraph 4.303 of the Consultation Document. Ofcom repeats in this section analyses that Sky has shown subsequently to be erroneous, without proper acknowledgement that this is the case. In particular, at paragraph 4.305, Ofcom states that “we noted that Sky’s reduction in the use of discounts in 2006/07 meant that while headline prices had been broadly constant, average prices after discounts were likely to have increased.” Ofcom does not acknowledge clearly that this proposition was neither (a) evidence-based, nor (b) correct. See Annex 6 to Sky’s Response to Ofcom’s Second Consultation Document.}
\end{footnotes}
The conclusion that Ofcom appears to draw from the sections that deal with Ofcom’s “position in the Second Pay TV Consultation” and “Respondents’ views” on this issue is ambiguous. Ofcom states:

“we recognise that the decline in demand for Sky Movies could reflect an increasing competitive constraint – although it is not clear from Figure 27 that there is any significant amount of switching to alternative ways of watching movies.”

Ofcom then attempts to assess whether there is evidence of substitution away from Sky Movies to:

- Movies shown on basic and FTA channels.
- Movies shown on SVoD/PPV.
- Purchases of DVDs.
- Rented DVDs.

Ofcom does not set out clearly the purpose of this subsequent analysis. It appears to be to attempt to establish whether any of these “alternative ways of watching movies” should be considered to be in the same relevant market as Sky’s premium movie channels.

If this is Ofcom’s purpose, it does not adequately consider Sky’s previous submissions that such a process is unlikely to be a meaningful one. As Sky has submitted previously, the competitive constraint faced by suppliers of services that include premium movie channels arises from the aggregate of the variety of alternatives available to consumers. Furthermore, such a proposition is of particular relevance in sectors in which competition via product differentiation plays an important role, as in this case. Accordingly, in such circumstances, the process adopted by Ofcom of seeking to determine whether significant switching to a number of different products and services takes place, on a product-by-product basis, may not provide any meaningful information about the scope of relevant markets in this case. Indeed, as shown below, this appears to be the result of Ofcom’s analysis.

The following sections address Ofcom’s analysis of each type of service.

Perhaps the most surprising aspect of Ofcom’s analysis of each of these services, however, is that, in general, it simply repeats analysis that was presented in the Second Consultation Document, the flaws in which Sky

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110 Paragraph 4.314 of the Consultation Document. Figure 27 simply presents the value of revenues from distribution of movies via different types of services. It is wholly unclear how Ofcom considers robust evidence on substitution among services could be derived from such a chart - particularly given that it does not separately identify revenues in relation to premium pay TV channels.

111 Paragraph 4.315 of the Consultation Document.

112 See, for example, paragraphs 4.44 to 4.46 of Sky’s submission of 1 June 2009.

113 See paragraphs 2.7 to 2.12 of Sky’s submission of 1 June 2009.
demonstrated in its submission of 1 June 2009. Ofcom has not properly addressed these arguments.

A2.40 Sky also notes the ad hoc nature of the analysis of each type of service – a point that was also raised in Sky’s submission of 1 June 2009. Ofcom seeks to evaluate the substitutability of each individual type of service with pay TV services that include premium movie channels using an entirely different analytical approach in each case.

(i) *Movies shown on basic and FTA channels*

A2.41 Ofcom’s consideration of this issue is based on an analysis of total viewing of movies on (a) subscription movie channels and (b) free to air and basic tier television channels. Ofcom concludes from its analysis that consumers’ demand for watching movies on all three types of channels has been declining, and that this is the reason for reduced demand for Sky’s movie channels, rather than substitution towards viewing of movies on free to air and basic pay TV channels.

A2.42 Showing that demand for watching movies on all types of television channel has declined, however, does not comprise evidence in favour of a proposition that movies on free to air and basic channels are not an effective constraint on the behaviour of suppliers of pay TV services that include premium movie channels. Accordingly, it does not comprise evidence that supports Ofcom’s conclusion as to the relevant retail market for such services.

A2.43 Ofcom’s analysis in this section also contains (a) a brief discussion of the substitutability of non-movies programming and movies programming, which is discussed further below, and (b) a reference to Ofcom’s attempted rebuttal of the Seabright Report. Again, Ofcom is referred to Sky’s Response to the Consultation Document for a discussion of that rebuttal.

(ii) *Movies shown on SVoD/ PPV*  

A2.44 Ofcom’s analysis of the substitutability of pay per view services and premium film channels comprises a simplistic ‘event analysis’ in which Ofcom seeks to

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114 See Annex 1 of that submission, which was summarised in Table 2 (in relation to premium movie services).

115 In relation to premium movie channels, see paragraph 3.13 of that submission.

116 Ofcom states: “the evidence...points to an overall decline in movie viewing on linear channels” (paragraph 4.318 of the Consultation Document). Sky notes that the 2009 edition of the UK Film Council’s Statistical Yearbook (which was published after Ofcom’s Consultation Document – although it appears to have been available to Ofcom when Ofcom prepared its Consultation Document – see Figure 27), shows that this trend reversed in 2008 – i.e., total viewing of movies on television rose in 2008.

117 See Annex 3 of Sky’s Response to the Consultation Document.

118 Ofcom’s points in relation to SVoD services are simply that (a) SVoD services that provide movies during the pay TV window do not currently exist in the UK, and (b) Ofcom has no evidence on the extent to which they would be substitutable with premium movie channels if they did exist. Accordingly, such analysis does not support Ofcom’s conclusion about the scope of relevant retail markets for premium movie channel packages.
determine the impact of the launch on cable networks of ‘Film Flex’, which is a ‘true VoD’ movies service. As Ofcom indicates, Film Flex simply replaced cable’s existing NVoD movie service (Front Row). Accordingly, to the extent that any impact on subscriptions to premium movie channel packages is observed, it is as a result of a move from a NVoD movie service to a true VoD movie service – not the introduction of a PPV movie service per se.

A2.45 On the basis of this analysis, however, Ofcom appears to conclude that there is evidence that pay per view services are substitutes for premium movie channels. Ofcom states:

“In summary, there is some evidence that premium movies on PPV may be substitutable for linear channels carrying premium movies”

A2.46 Yet, rather than expand its narrow market definition, Ofcom chooses to label such services as “an out-of-market constraint”.

(iii) Purchases of DVDs

A2.47 Ofcom bases its analysis of the substitutability of movies on purchased DVDs with premium movie channels on the following proposition:

“Similar patterns of price changes between both products would be consistent with their (sic) being substitutes; conversely, price divergence without substitution is consistent with the two products being in separate markets.”

A2.48 Ofcom then undertakes an extremely cursory analysis of trends in prices for movies sold on DVD, the pattern of sales of DVDs and numbers of subscribers to premium movie channels over time. Ofcom finds a “widening price differential”, yet also finds over the past four years (a) growing sales of movies on DVD, and (b) declining numbers of subscribers to premium movie channels. Despite this, Ofcom concludes that:

“the widening price differential without significant switching is evidence that retail DVDs and premium movie packages are in separate markets.”

119 In contrast to its analysis of other issues (such as the impact of the growth in take-up of Freeview on demand for premium pay TV services), Ofcom recognises in this analysis that demand may be affected by changes in other variables over time such as “marketing strategies and other industry and economic trends” (paragraph 4.329 of the Consultation Document).

120 Paragraph 4.330 of the Consultation Document.

121 Ibid. Ofcom takes this approach wherever it appears that other products may be important substitutes for those which it is considering.


123 In view of the lack of reliability of Ofcom’s conclusion, Sky does not comment here on the reliability of this analysis. Sky considers that, when considered in real, value-adjusted terms, the price of services that include Sky’s movie channels has also declined over the recent past, which would, according to Ofcom’s test, be consistent with them being in the same relevant product market.

In view of the fact that Ofcom finds declining numbers of subscribers to premium movie channels it is surprising that Ofcom does not consider at all whether at least part of this decline is attributable to a widening of the price differential between the two products (if there has been such a widening). In the absence of such consideration, this analysis cannot be relied upon in support of Ofcom’s conclusion about the scope of the relevant retail market for pay TV packages that include premium movie channels.

More generally, the strength of Ofcom’s conclusion that (a) pay TV services that include premium movie channels and (b) consumers’ ability to buy movies on DVD before, during and after the pay TV window, are services that are supplied in separate relevant markets simply defies common sense.

(iv) Rented DVDs

Ofcom’s consideration of the substitutability of DVD rental with subscription to services that include premium movie channels comprises two brief analyses:

(a) examination of charts related to the “value of films from different formats”\(^{125}\); and

(b) a brief comparison of the characteristics of renting movies on DVD and a subscription to pay TV package that includes premium movie channels.

Each of these is considered below.

(a) Charts related to the “value of films from different formats”

Ofcom’s analysis in relation to this issue is inchoate. Ofcom’s analysis in this section is based on Figure 35 of the Consultation Document, which provides the “Total value of DVD rentals”, both ‘over-the-counter’ and via ‘subscription’. Ofcom states that this chart “when read in conjunction with Figure 27 above… does not appear to suggest a strong degree of substitution between Sky Movies and DVD rentals.”\(^{126}\) Yet Figure 35 simply presents the parts of Figure 27 which relate to the value of DVD rentals. Accordingly, Figure 35 is redundant, and Ofcom’s conclusion about the substitutability of DVD rental and “Sky Movies” relies entirely on a casual inspection of Figure 27 of the Consultation Document.

It is impossible, however, to draw any conclusion about the substitutability of premium movie channels and DVD rental from Figure 27 because that chart does not provide any information about premium movie channels – the only information about movies broadcast on television is a category entitled “Film on

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\(^{125}\) Title of Figure 27 of the Consultation Document.

\(^{126}\) Paragraph 4.338 of the Consultation Document.
TV”, which covers exhibition of movies on free to air, basic and premium pay TV channels.\textsuperscript{127}

Accordingly, the chart examined by Ofcom (i.e., effectively Figure 27 of the Consultation Document) provides no indication at all of the substitutability between “Sky Movies” and DVD rentals. It certainly cannot be regarded as comprising compelling evidence that supports Ofcom’s conclusion about the scope of relevant markets in relation to pay TV services that include premium movie channels at the retail level.

\textbf{(b) Comparison of the characteristics of renting movies on DVD and a subscription to pay TV package that includes premium movie channels}

Ofcom concludes that differences in the characteristics of (a) both over-the-counter DVD rentals, and subscription DVD rental services, and (b) pay TV services that include premium movie channels, mean that “they are not likely to be in the same market”\textsuperscript{128}.

Such a proposition has no regard either to (a) Sky’s submissions on the issue of differences in product characteristics as a basis for concluding that they are supplied in separate relevant product markets, or (b) standard guidance on this matter\textsuperscript{129}. Indeed, earlier in this section, in contradiction to the approach adopted in relation to the assessment of the constraint imposed on retailers of premium movie channel packages from DVD rental, Ofcom states: “we recognise that product characteristics do not need to be identical for products to be included within the same relevant market.”\textsuperscript{130}

\textbf{Ofcom’s consideration of non-movies programming as a competitive constraint on suppliers of pay TV services that include premium movie channels}

While this submission focuses on the evidence and analysis relied upon by Ofcom, proper consideration of the issue of the substitutability of non-movies programming for watching movies is glaring in its absence from Ofcom’s analysis in relation to services that include premium movie channels.

The only references to such substitutability are:

(i) at paragraph 4.268, which quotes from an internal Sky document as follows:

\begin{quote}
Films on TV are an interesting proposition in that their competition is not just other windows, but all other TV programmes that happen to be on (including first run drama etc.).\textsuperscript{131}
\end{quote}

\textsuperscript{127} Even if the chart provided data on the value of movies from different modes of distribution it is unclear how reliable inferences about substitutability among those different modes could be derived.

\textsuperscript{128} Paragraph 4.342 of the Consultation Document.

\textsuperscript{129} See, for example, paragraph 3.5 of ‘Market Definition’, OFT, 2004.

\textsuperscript{130} Paragraph 4.315 of the Consultation Document.

\textsuperscript{131} Quoted at paragraph 4.268 of the Consultation Document.
Despite quoting this statement, Ofcom does not then refer to it, or consider non-movies programming in its list of potential substitutes;

(ii) at paragraph 4.319, which seeks (unsuccessfully) to rebut evidence provided by Sky on substitution by consumers between programming on premium movie channels and non-movies programming; and

(iii) at footnote 236, which discusses the issue of whether movies and non-movies programming can be considered to fulfil the same intended use.

A2.60 Sky discussed Ofcom’s rebuttal of the evidence that Sky submitted on the behaviour of subscribers to premium movie channels who cancel their subscriptions in Section 5 of Sky’s Response to the Consultation Document. This analysis, which is based on reliable data, and a large sample of subscribers, provides robust evidence of consumers’ substitution behaviour. Ofcom’s reasons for rejecting it are spurious. It shows that when subscribers to services that include premium movie channels drop those channels from their subscription, their total television viewing does not decline; instead, they replace viewing of movies on Sky’s premium movie channels with a mix of viewing movies on other television channels, and viewing non-movies programming.

A2.61 At footnote 236 of the Consultation Document Ofcom argues that such substitution should not be regarded as comprising substitution that is relevant in a market definition analysis because watching movies on TV and watching other types of programming, such as television drama series, do not fulfil the same intended purpose. Ofcom argues that such switching is analogous to consumers switching from spending on food to purchasing magazines. In Ofcom’s conception, the only potential substitute for watching a movie on TV is watching a different movie on TV (or watching the same movie on TV via a different type of service). That is simply irrational.

ANNEX 3: SWITCHING BY SUBSCRIBERS AMONG PAY TV PACKAGES

A3.1 Ofcom’s consideration of relevant markets at the retail level does not adequately consider the extent of constraint on suppliers of premium channel packages from the availability of basic-only pay TV services. There is significant switching among premium channel packages and basic-only pay TV services by pay TV subscribers. For example, in the case of Sky’s DTH subscriber base:

- [CONFIDENTIAL]% of current Sky basic-only subscribers have been premium subscribers in the past; and
- [CONFIDENTIAL]% of current Sky Dual Movies, Dual Sports and Top Tier subscribers, respectively, have been basic-only subscribers at some point in the past.

A3.2 Such switching is inconsistent with a view that there are narrow markets for premium sports channel packages and premium movie channel packages at the retail level.