1. INTRODUCTION: UK PAY TV CONSUMERS CAN BE BETTER SERVED

1.1 In January 2007, Virgin Media Limited ("Virgin Media"), together with British Telecommunications plc, Setanta Sport Holdings Limited and Top Up TV Europe Limited (together, "the Parties"), jointly made a submission to Ofcom demonstrating that competition in the UK pay TV market is not working effectively, and calling for Ofcom to make a market investigation reference to the Competition Commission. In this initial submission, a number of subsequent submissions and responses to numerous information request responses, Virgin Media has provided voluminous evidence of market failure and highlighted specific areas of consumer detriment which result from this market failure.

1.2 Consumers would be demonstrably better off if steps were taken to remedy the features of the market which are preventing, restricting or distorting competition in the supply of pay TV in the UK. Against that background, this supplementary submission provides:

(a) further evidence that consumers are not being well served by the current market structure; and

(b) [CONFIDENTIAL], a more detailed explanation of the ways that Virgin Media could innovate (and the types of offerings consumers could expect to see) were the distorting features of the market corrected.

1.3 Ofcom has a discretion under section 131 of the Enterprise Act ("EA") to make a market investigation reference to the Competition Commission where:

"... it has reasonable grounds to suspect that any feature, or combination of features, of a market in the United Kingdom for goods and services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom."

1.4 There can be no question such "reasonable grounds" have been established since the inception of this process approximately nineteen months ago. In short, consumers are being denied the benefits that competition in a dynamic and fast moving market should be expected to deliver. The longer the current market features and Sky's conduct are allowed to persist, the greater the detriment suffered by consumers.

1.5 There are strong grounds for a reference to the Competition Commission and such action is vital and of urgent importance to UK consumers. Ofcom should not further prolong its investigation into the pay TV industry. Instead, it should, as a matter of urgency, exercise its discretion now to refer the pay TV industry for a full market investigation by the Competition Commission.

Structure of the submission

1 [CONFIDENTIAL].

2 Our joint submissions calling for, and supporting, a market investigation under the Enterprise Act 2002 (submitted with British Telecommunications plc, Setanta Sport Holdings Limited and Top Up TV Europe Limited on 16 January 2007, 3 July 2007 and 6 August 2008); our joint response to BSkyB's submission (submitted with BT, Setanta and Top Up on 29 February 2008); our 7 March 2008 response to Ofcom's consultation document of 18 December 2007; [CONFIDENTIAL].
1.6 This submission supplements the arguments made and evidence submitted previously to Ofcom. In particular, we focus on (and provide further evidence in support of) the fact that consumers are not being well served by the current market structure. Additionally, we provide detail demonstrating the ways that Virgin Media could innovate (and the types of offerings consumers could expect to see) were the distorting features of the market corrected.

1.7 In Section 2, we set out our commercial strategy, with a focus on our pay TV offering. A cornerstone of our strategy is delivering innovative new products to more consumers. We aim to do this for both our existing customers and others who do not currently receive the pay TV services, and in particular the sports and movie services, they would like. This Section will demonstrate our commitment to pay TV as part of our quad-play offering (which includes mobile and fixed line telephony and broadband services) and our potential to deliver exciting new products to consumers if effective competitive conditions were introduced.

1.8 Sky's response to Ofcom's Consultation document of 18 December 2007 ("Ofcom's Consultation") suggests that consumers are satisfied. This is incorrect and, in Section 3 of this submission, we provide evidence to rebut this suggestion. We show why consumer detriment should not be assessed by reference to quantitative consumer survey evidence that measures only currently available outcomes. It is a limitation of such surveys that they may detect rationalisations of current spending choices and a limited awareness of real cost and alternatives, especially where product packaging may make these difficult to discern. Such limitations undermine any claim that these surveys provide evidence of consumer "satisfaction" and, still less, "healthy competition". Even accepting such surveys at face value, qualitative tests are needed to supplement them to better explain consumer responses. Consumers or outcomes (i.e. products, services and value) excluded by existing features cannot necessarily be captured in customer surveys. We show that available qualitative evidence identifies consumer detriment.

1.9 Sections 4 and 5 are the key sections that outline what Virgin Media could deliver absent Sky's entrenched stranglehold on premium content (sports and movies). This submission focuses primarily on premium movies; setting out what Virgin Media could deliver but for features of the market that prevent it from doing so. In addition, we note that issues related to premium sports have been covered extensively in prior submissions.

1.10 Section 4 sets out the need for improved access to Sky premium channels (in relation to price and product quality). Reduced wholesale prices for Sky premium channels, coupled with increased security of supply, would enable Virgin Media to reduce retail prices, increase packaging flexibility and increase investment in sales and marketing. This would lead to more intense head-to-head competition with Sky, especially in relation to the retailing of pay TV packages, including premium sport and movies channels.

1.11 Section 5 sets out the need for improved access to video-on-demand ("VOD") content. The shift by viewers away from linear content to VOD content is likely to be delayed and distorted in the UK because of Sky's entrenched dominant position. The offer of VOD movies and, in particular, subscription VOD ("SVOD") movies, is constrained by Sky's exclusivity in the first pay TV subscription window. Sky's exclusivity results from its status as the only UK "compulsory trading partner" of the movie studios. In consequence, Sky is able to extract restrictions on the supply of VOD movies to other pay TV operators and has thereby sought to extend its pay TV dominance to SVOD and new forms of VOD.

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3 Of course, the commercial viability of any new products and services depends on the market conditions at the time. Virgin Media does not, of course, engage in strategic planning in relation to hypothetical market opportunities that would exist in a more competitive pay TV industry. There has been little prospect for those conditions, absent sectoral intervention. Accordingly, there are inevitably limits to the ability of Virgin Media to provide Ofcom with a detailed analysis of the range of services and innovations Virgin Media could offer to consumers if the pay TV industry were competitive.
Finally, in Section 6 we summarise the status of Ofcom's investigation and the compelling reasons to refer the UK pay TV market to the Competition Commission. The evidence demonstrates that it is now incumbent upon Ofcom to make a market investigation reference. Any further delay will allow the market features (i.e. both market structure and conduct) that prevent, restrict or distort competition to become further entrenched. The urgency to make a market investigation reference is reinforced by the fact that consumers continue to suffer loss as a result of the market features identified by the Parties and in Ofcom's Consultation. Consumers are being denied the benefits that competition in a dynamic and fast moving market would deliver. The longer the current market features and Sky's conduct are allowed to persist, the more entrenched the market failures are likely to become, reinforcing and increasing the already significant detriment suffered by consumers. Therefore, in the interests of consumers, Ofcom must now refer the market investigation to the Competition Commission for the detailed review warranted.

2. OVERVIEW OF VIRGIN MEDIA COMMERCIAL STRATEGY – WHAT WE CAN DELIVER

2.1 The "vicious circle" in pay TV which the Parties have described in their submissions (and in particular the underlying restrictions on access to attractive content and other features of the market) dramatically affects Virgin Media’s (and others’) ability to offer consumers a differentiated proposition, develop a brand to rival Sky’s or to drive the development of potentially transformational new services (such as VOD) and technologies (such as Internet protocol TV (“IPTV”)). The effect is particularly profound in relation to Virgin Media as the potential consumer benefits flowing from the fibre/co-axial cable platform have been constrained in the UK. In order to place the detrimental effects in proper context and to help Ofcom assess their impact (and resulting consumer detriment), this section provides an overview of some critical elements of Virgin Media's consumer strategy.

2.2 Virgin Media was launched in February 2007 with the express purpose of bringing consumers more choice, better value for money and a new generation of digital services. Our goal is to fully utilise the latent capabilities of the UK's cable infrastructure, transform the consumer experience and place the UK at the forefront of the digital revolution.

2.3 [CONFIDENTIAL]:

(a) [CONFIDENTIAL];

(b) [CONFIDENTIAL]:

(i) [CONFIDENTIAL];

(ii) [CONFIDENTIAL];

(iii) [CONFIDENTIAL];

(iv) [CONFIDENTIAL].

(c) a fundamental redefinition of pay TV at all levels:

(i) [CONFIDENTIAL] Virgin Media's VOD service, discussed in Section 5 below, which is available free of charge to all of our digital TV customers. Currently some [CONFIDENTIAL] hours of content is available, including catch-up TV from leading broadcasters, a range of popular TV series from both the UK and the US, movies (for an added charge per film), music videos and
children's programming. Earlier this year Virgin Media further strengthened its VOD offering when it became the first operator to make the BBC’s popular iPlayer service available on a TV platform. The popularity of Virgin Media’s VOD service is growing rapidly: some per cent of subscribers now use our VOD service on a monthly basis, with average views per user increasing from per month in the second quarter of 2007 to views per month in the second quarter of 2008. In June 2008 usage reached a record million views. This, and other factors outlined in paragraphs 5.8 to 5.11, strongly suggest that demand for VOD content is fast becoming an important element of mainstream consumer behaviour. It is Virgin Media’s ambition to be a catalyst of the rapid development of this new form of pay TV by bringing new VOD services to consumers. We believe improved and more flexible access to first run movie releases (on transactional and subscription bases) is central to this and that there is significant consumer appetite for such services. The constraints on our ability to meet this demand are outlined in Section 5; and

(ii) as part of its attempt to re-shape entry level and (what has been considered) “basic” TV services, Virgin Media is also working to enrich its “basic” linear TV services with premium content. In August 2007, for example, Virgin Media incorporated eight Setanta Sports Channels into its XL TV service, bringing a range of high quality sporting action, including 46 live Premier League games, to over million customers at no extra charge. The existing wholesale arrangements (outlined again in section 4) for Sky’s premium channels represent a significant barrier to pursuing other such initiatives.

3. **CONSUMERS ARE NOT BEING EFFECTIVELY SERVED BY THE PAY TV MARKET**

3.1 As set out more fully in Section 2 of the Joint response to Sky’s submission to Ofcom of April 2008 dated 6 August 2008 ("the Joint Response"), consumers are not benefiting to the extent they would in a more competitive market (in terms of price, range and quantity of available offerings). If action is taken to correct the pay TV market failure, consumers could expect to see significantly improved innovation and a wider range and number of available offerings (and increased price competition).

**Ofcom’s and Sky’s assessment of consumer satisfaction is incomplete and flawed**

3.2 In its initial assessment of the pay TV market on 18 December 2007 Ofcom stated that:

"Our initial assessment of the pay TV market suggests that it has delivered significant benefits to consumers, growing from almost nothing in the early 1990s to one that now provides services to over 11 million consumers today. It delivers reasonable levels of consumer satisfaction and, at just over £4bn, provides the single largest source of revenue to the broadcast industry. There are however some warning signs, such as areas where consumer choice may be limited."

3.3 Sky, in its April 2008 submission (relying on Ofcom’s research and a report from PwC commissioned by Sky), asserts that the pay TV sector "is functioning well and delivering strong benefits to consumers"6 and that there is "overwhelming evidence of the dynamic and innovative nature of the UK audiovisual sector".5

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4 See paragraph 1, Part I of Sky’s response of April 2008 to Ofcom’s Consultation ("the Sky Response").

5 See paragraph 5, Part I of the Sky Response.
3.4 These assessments of how the pay TV market is serving customers present an incomplete and misleading picture of consumer satisfaction and do not reflect the true and full impact of the lack of competition on consumers.

**Ofcom's assessment of levels of consumer satisfaction is incomplete**

3.5 Quantitative research of the type undertaken by Ofcom can often give rise to misleading indicators of true consumer satisfaction in that consumers rationalise their responses in the context of quantitative surveys. In particular, stated consumer satisfaction is not meaningful where consumers do not know what they are paying for the product or service and/or have a low awareness of comparative prices or service offerings (or in fact, what could be available absent conditions which restrict competition).

3.6 Contrary to Sky's assertions, Ofcom's surveys cannot be safely treated as being evidence of "healthy competition" in the UK pay TV market for three main reasons:

(a) the results of the survey are biased as they only relate to consumers who have chosen to subscribe to pay TV services at current prices. Consumers priced out of access to services because of cost and because the types of bundles on offer are not attractive to them, are not included in the surveys. This is recognised by Ofcom;

(b) Ofcom's survey results as regards consumer satisfaction are not consistent with other recent research. In particular, research carried out by YouGov in January 2008 (and published by youSwitch.com in May 2008) which covered nearly 10,000 digital TV customers, confirmed that one in four digital TV customers are not satisfied with their service and that, as between Freeview, Sky and Virgin Media, Sky was ranked worst for value for money as only 57 per cent of respondents thought that Sky offered good value; and

(c) current consumers of pay TV services may express relative satisfaction with their service because they cannot conceive of the alternatives that would be available in a more competitive market. Again this is recognised by Ofcom.

3.7 In short, whether a market is performing effectively cannot be determined merely by considering the results of consumer surveys. Any assessment of current market conditions as regards factors such as choice, innovation and price carried out by reference to quantitative surveys investigating consumer experiences will be biased and distorted by the perspective and understanding of the surveyed consumers. Such responses do not provide direct evidence as to whether features of the market are preventing, restricting or distorting competition (such as by creating high barriers to entry and expansion), nor whether the experience of consumers would be improved in the absence of these features. For example, surveys of consumer satisfaction levels cannot address whether consumers would be better served if prices were lower or quality or choice greater.

**Sky's claims are unfounded**

3.8 As indicated above, Sky relies on the PWC report to argue that, as regards price, choice and innovation, the UK performs well against 14 other European countries. For the reasons set out in more detail in the Joint Response, Virgin Media considers that, far from supporting Sky's arguments, the PWC evidence actually support the observations of the Parties (and, in particular, the findings set out in the report prepared by LECG and submitted with the Joint Submission). Specifically the PWC evidence shows that UK pay TV consumers face relatively high prices compared with prices paid by consumers in other European countries. In addition, despite these high prices, UK consumers do not have

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6 See, for example, paragraph 7, Part I of the Sky Response.
7 See section 6.
greater retailer choice and do not benefit from more innovation than the average European consumer.

**Further evidence of consumer dissatisfaction**

3.9 Virgin Media recently instructed [CONFIDENTIAL] to undertake a qualitative research project that used focus groups to explore consumers' understanding and perceptions of satellite/cable sports offerings available to the UK consumer. A copy of the report produced by [CONFIDENTIAL] is attached at Annex 1. A number of the relevant findings of the report are summarised below:

(a) **Value for money was not assessed within a competitive framework:**

   (i) very few respondents were able to indicate exactly what they were paying for the premium sports channels;

   (ii) almost no-one in the groups had any comparative cost awareness; and

   (iii) many people questioned the true value for money. Flat sharers indicated that they could only afford to buy if it was a shared cost and they could not do this if they were the sole purchaser;

(b) **value for money was assessed against external factors:** value for money was predominantly judged by external references such as the cost of attending a live game, the cost of visiting a public house to view a game (and associated ancillary purchases) rather than by reference to competing offers;

(c) **interactive functionality is identified as an area for further added value services:** whilst people's views on interactive functionality varied, football enthusiasts and younger men found this enhanced their viewing;

(d) **high definition ("HD") is highly valued amongst HD subscribers:** for those people subscribing to HD channels this was a highly rated service and most people acknowledged that this was the way things were going. For both HD channels and interactive functionality people wanted to buy into a future-proof offer. [CONFIDENTIAL];

(e) **cost is the main barrier for those not subscribing:** non-subscribers identified cost as being one of the major barriers and many complained about the initial price and outlay required. People felt that the cost of Sky had increased over the past few years and they were concerned about the current economic climate, with many referring to the credit crunch;

(f) **consumers feel a need for more competition within the market:** many consumers commented on the lack of competition within the market and the fact that this kept the price for pay TV high. All groups expressed the desire for more competition as ultimately they felt they would benefit by lower prices and a greater, more flexible range of packages; and

(g) **many people purchasing sport wanted to tailor their own packages:** many people felt that the bundles offered were complex and they did not reflect what they really wanted to buy. There was a feeling that by buying a bundle, consumers were frequently paying for what they do not really need and that many people with a sports interest were frequently not interested in other pay TV channels.

3.10 The above findings do not demonstrate general consumer satisfaction. Indeed, quite the opposite. They suggest that:
(a) consumers recognise that there is insufficient competition in the market and want more choice;

(b) that customers such as those of Virgin Media that are denied access to HD and interactive services by the actions of Sky are being disadvantaged;

(c) that there are barriers in switching away from Sky [CONFIDENTIAL]; and

(d) that consumers would welcome greater flexibility in packaging options.

In addition, a number of the findings throw material doubt on the results of Ofcom’s own quantitative consumer surveys. This is particularly demonstrated by the lack of awareness on the part of viewers as to what price they were paying for their sports packages and the price and service offered by rival providers.

4. CONSUMER BENEFITS FLOWING FROM IMPROVED ACCESS TO SKY PREMIUM CHANNELS

4.1 [CONFIDENTIAL], Virgin Media discussed steps it would consider taking if competitive conditions in the pay TV market were to be restored\(^8\). Further details are set out below (noting that the possible innovations mentioned are by way of example only and that the commercial viability of any new products and services depends on the market conditions at the time)\(^9\).

**Stranglehold on premium sport and movie content**

4.2 By way of background and prior to setting out the improved products and services that Virgin Media would be in a position to offer consumers, it is necessary to review the adverse affects on competition arising from Sky’s stranglehold of premium sports and movie content rights, which are summarised below:

(a) prices for pay TV packages are higher than they would be in a more competitive market;

(b) consumers' choice of retail provider for premium sports and movies is limited;

(c) packaging options available for consumers for premium sports and movies are limited;

(d) Sky’s competitors have limited incentives to make investments. [CONFIDENTIAL] This is due in part to relevant features of the pay TV industry identified in the Joint Submission;\(^{10}\)

(e) the entity with market power (Sky) has stronger economic incentives to make investments to foreclose market entry and thereby reinforce its dominance. This can be contrasted to the economics facing new or smaller market players seeking to acquire new customers;

(f) new entrants using alternative technologies, such as VOD, are discouraged such that consumers' access to premium movies and sports content is limited to the technologies Sky deploys; and

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\(^{8}\) Virgin Media does not, of course, engage in strategic planning in relation to hypothetical market opportunities that would exist in a more competitive pay TV industry. Accordingly, there are inevitably limits to the ability of Virgin Media to provide Ofcom with a detailed analysis of the range of services and innovations Virgin Media could offer to consumers if the pay TV industry were competitive.

\(^{9}\) [CONFIDENTIAL].

\(^{10}\) [CONFIDENTIAL].
(g) innovation is stifled in favour of the status quo.

4.3 [CONFIDENTIAL], Sky has:

(a) refused to supply premium sports and movie content at economic rates [CONFIDENTIAL];

(b) refused to supply premium sports and movie content to Virgin Media for IPTV/DSL transmission, [CONFIDENTIAL];

(c) refused to supply, and deterred the launch by third party providers of, enhanced and interactive services and content to Virgin Media, [CONFIDENTIAL]; and

(d) refused to supply HD channels and content to, and deterred the launch of third party HD channels [CONFIDENTIAL].

How remedial action will benefit customers

4.4 Against this background, Virgin Media sets out below ways in which consumers would benefit from a more competitive and dynamic pay TV market in the future. In short, reduced wholesale prices, increased security of supply and access to equivalent content and features (e.g., HD and interactivity) would lead to significant flexibility, innovation and improvements in the pay TV market in the UK. Some of these innovations and improvements are discussed below.

Lower pricing of Sky’s premium sports and movie channels

4.5 [CONFIDENTIAL].

4.6 Accordingly, even if Virgin Media were not to change its packaging options at all (in respect of which, see paragraphs 4.14 to 4.16 below), a reduction in wholesale prices would make it commercially viable for Virgin Media to compete on price and actively to market and promote Sky’s premium channels (i.e. Virgin Media would be incentivised to market and supply Sky’s premium content). This would clearly increase competition and lead to consumer benefits in the form of lower prices (which would, in turn, enable new customers who were previously priced out of the market to access Sky’s premium channels).

4.7 [CONFIDENTIAL]:

[CONFIDENTIAL]

4.8 [CONFIDENTIAL]:

(a) [CONFIDENTIAL];

(b) [CONFIDENTIAL];

(c) [CONFIDENTIAL].

4.9 In summary, reduced wholesale prices to Virgin Media for Sky’s premium channels would enable Virgin Media to reduce prices and increase investment in sales and marketing leading to more intense head-to-head competition with Sky. This would benefit both existing customers and enable new customers, who were previously priced out of the market, to access Sky’s premium channels.
More choice of provider for consumers who are not in cable active areas that want Sky's premium sports and movies channels

4.11 As set out in section 3 of part I of Virgin Media’s Consolidated Response as submitted to Ofcom on a 21 February 2008 ("February Response"), Virgin Media has attempted to acquire wholesale access to Sky Sports and Sky Movies channels in order to provide an IPTV-based service to customers unable to receive service from the cable network (i.e. an "off-net" service). Sky has, however, refused to supply its premium content to Virgin Media for distribution via an IPTV service.

4.12 [CONFIDENTIAL].

4.13 If Sky Sports and Sky Movies were made available to Virgin Media for an IPTV service on a wholesale basis on economic and sustainable terms, [CONFIDENTIAL]. This would enable Virgin Media to compete directly with Sky in non-cabled areas and provide a more seamless service to customers, especially to subscribers who move in and out of cable-areas. In short, this would remove Sky's monopoly as a retail supplier of Sky's premium movie and sports channels in non-cable active areas.

More flexible bundling of Sky's premium sports and movies channels

4.14 On the terms on which Virgin Media is currently able to acquire wholesale access to Sky Sports and Sky Movies channels, Virgin Media is very limited in its flexibility to create attractive product bundles for customers. In particular:

(a) [CONFIDENTIAL];
(b) [CONFIDENTIAL].

4.15 If Virgin Media could obtain access to these channels at a lower wholesale price, and on revised terms, its bundling options would increase significantly, leading to more flexible bundling options for subscribers. For example, Virgin Media could:

(a) [CONFIDENTIAL];
(b) [CONFIDENTIAL];
(c) [CONFIDENTIAL];
(d) [CONFIDENTIAL].

4.16 [CONFIDENTIAL].

Increased diversity in the ownership of premium sports channels

4.17 Currently there is limited diversity in relation to the supply of sports channels. Sky, as the major supplier of sports channels, designs its Sky Sports service for DSat distribution and does not design them to make optimum use technological capabilities of other platforms, such as a cable, which has a high-speed return path. As a result, there is limited investment and innovation in relation to, in particular, interactive services, which would work particularly well on other pay TV platforms, especially those with a "return path" to subscribers, such as Virgin Media’s cable platform.

4.18 With an increased number of sports channel providers, Virgin Media would expect significantly increased flexibility in relation to the packaging of sports content. For example, more channels could be tailored to serve more niche interests (such as cricket or rugby content) in the same way as Setanta has developed the Setanta Golf channel.

4.19 [CONFIDENTIAL]:
Virgin Media also notes that with increased diversity of sports channel ownership, there would be more scope for competition with Sky's interactive betting service, Sky Bet, and other content aggregators could look for opportunities to align themselves or develop connected betting services.

5. RESTRICTIONS ON AVAILABILITY OF VOD MOVIES AND IMPROVED VOD PRODUCTS AND SERVICES VIRGIN MEDIA MAY BE ABLE TO DELIVER

5.1 Virgin Media is [CONFIDENTIAL] well placed to meet the growing demand for VOD services because it can offer high quality "true" VOD services. [CONFIDENTIAL] The ability to offer an attractive pay movie VOD service, [CONFIDENTIAL] is, together with premium sports content, a key driver for subscriber uptake.

5.2 The ability of Virgin Media (and others) to offer movies on a VOD basis and, in particular, the ability to offer a SVOD movie service, is currently constrained. This is because, notwithstanding the fact that Sky cannot provide high quality "true" TV VOD functionality, Sky has sought to extend its dominance in the supply of subscription premium movie channels to SVOD and new forms of VOD delivery.

5.3 Sky has been able to achieve this because it is the only UK "compulsory trading partner" of the movie studios, and has exclusive rights to the 15 month "first pay" TV subscription window. Given its position in the market, Sky is able to (and does) extract restrictions on the supply of VOD movies rights to other pay TV operators.

5.4 Virgin Media understands that when negotiating with the major Hollywood studios and independent movie distributors for linear movie rights in the first pay window, Sky restricts the supply, or requires the holdback, of VOD movie content:

(a) through an explicit or implicit understanding of the concept of "subscription" in its exclusive first pay window agreements, restricting the ability of the rights holders to sell SVOD movies rights in that window or any other prior window (in particular, in what is currently known as the pay per view ("PPV") window); and

(b) through the explicit or implicit scope of exclusivity in its first pay window agreements, restricting the ability of the rights holders to offer subscription movies or PPV movies within that window.

5.5 [CONFIDENTIAL]:

(a) [CONFIDENTIAL];

(b) [CONFIDENTIAL].

5.6 Virgin Media's ability to deliver a compelling VOD movie service has been materially constrained by both the restricted availability of SVOD movie rights and Sky's exclusive rights in the first pay TV subscription window. UK consumers do not, therefore, have access to VOD products that are available or being developed in other countries and that Virgin Media is able and willing to provide in the UK. The range of offerings which Virgin Media could make available but for the restrictions are discussed below in paragraphs 5.45 to 5.50.

5.7 In short, Sky exercises its market power (which arises from structural failings in the pay TV market) in its dealings with the movie studios in order to restrict or hold back the
supply of VOD movie content in the UK. Correction of the market features that give Sky its market power would facilitate improved availability and access to VOD movie content and would allow the UK to emerge as a real leader in innovation in the area of VOD content offerings.

The move away from linear content and increasing demand for VOD services

5.8 Traditionally, TV content has been distributed to viewers on a linear basis (i.e. a scheduled channel broadcast that is streamed to viewers). The major limiting factor of a linear broadcast from a viewer's perspective is that viewers do not have flexibility as to when they watch individual programmes; rather individual programmes are only available at the time slots determined by the broadcaster. Further, linear broadcasts are limited in their ability to offer functionality such as pausing, rewinding and fast-forwarding.

5.9 Consumers are increasingly demanding the ability to choose what content they wish to view and at what time they watch it. They also seek the ability to control the way content is viewed (e.g., pausing, rewinding etc.). This is leading to a shift in demand away from linear television content and traditional fixed time viewing (i.e. viewers organising their activities around a broadcasting schedule) to VOD services (which deliver content in a more convenient and user friendly manner). VOD services increase the choice and flexibility of entertainment options available to consumers. As discussed further below, the pace of this natural shift in consumer demand is not being matched by an equivalent improvement in the VOD services being offered in the UK. More specifically, constraints in the market have reduced the effectiveness and pace at which pay TV providers in the UK have been able to offer VOD movie services.

5.10 The increasing demand for VOD services is indicated by, amongst other things, the following factors:

(a) the steady growth in demand for Virgin Media's VOD services since the launch of the service in 2005. The growth since is demonstrated in the charts attached in Annex 3 which shows the growth of Virgin Media's VOD services (prior to the availability of iPlayer).\(^1\) In June 2008, views of VOD content were the highest since launch, at [CONFIDENTIAL], with approximately [CONFIDENTIAL] subscribers using Virgin Media's VOD service on a monthly basis. This represents about [CONFIDENTIAL] per cent of Virgin Media's customer base;\(^2\)

(b) the report for Ofcom Movie Markets in the UK (Annex 11 of Ofcom's Consultation) indicates that uptake of true VOD services is expected to increase: "By the end of 2011 true VOD enabled homes is expected to have increased from 2.5 million UK households in 2006 to 14.6 million (55 per cent of all UK households). The proportion of nVOD-enabled homes (8.7 million) within this bracket is expected to stagnate, and all digital cable subscribers will be migrated to true VOD";\(^3\)

(c) the proliferation in the UK of VOD services since Tiscali (then HomeChoice) introduced its VOD service in 2004.\(^4\) The report at Annex 11 of the Ofcom's

\(^1\) This is reported in Ofcom's quarterly report released 11 July 2008, The Communications Market: Digital Progress Report, Digital TV, Q1 2008, page 19.

\(^2\) See paragraph 267 of Annex 11 of Ofcom's Consultation. nVOD (near-VOD) is defined below at paragraph 5.13(a).

\(^3\) Since Tiscali (then HomeChoice) launched its TV VOD service in 2004, Virgin Media and BT Vision have launched TV VOD services available directly to viewers. The BBC (via iPlayer), ITV, Channel 4, Five and Sky (via Sky Player) have made TV content available directly to viewers via websites. There has also been a proliferation of VOD viewing devices, including Apple TV and Playstation, and the latest generation of Sony televisions about to come on the market.
Consultation, indicates that the "real take up" of true VOD in the UK happened in 2005 when Telewest and ntl launched their services. The decision of the UK terrestrial channels to launch their own branded VOD service; in markets outside the UK VOD services are expected to grow substantially. This growth is charted across 24 European countries in the NPA Conseil study Video on Demand in Europe 2007, Second Survey of VOD Services ("Second Survey of VOD Services"). At the end of 2007, 258 VOD services (of all types) were listed in the countries included in the study, compared with 142 services at the end of 2006. Even disregarding catch up TV services for which no charge is made, there were 58 new VOD services in the course of 2007. The report concludes that France, the Netherlands and Germany are the VOD leaders in Europe; according to research carried out by Informa plc, "the global VOD market will hit $11.4 billion by 2011". Moreover, US market research indicates that consumers will pay considerably more than present for HD and earlier release VOD fuelling billion dollar growth of the industry.

5.11 The above all suggests that demand for VOD services in the UK can be expected to grow very significantly over the next few years.

Virgin Media has an inherent technological advantage in the supply of VOD movie services

5.12 Unlike its key competitors, Virgin Media offers consumers a "true" VOD experience. True VOD is "always on": more specifically, it uses technology to allow streamed content to be delivered whenever requested by the viewer, via a "return path", directly to the customer's television. In cable's case, this is via hybrid fibre coaxial (or HFC) cable. In contrast, satellite VOD does not have a return path. The Second Survey of VOD Services notes that VOD offers of satellite broadcasters "suffer from comparison with the VOD offers of the broadband and cable operators with which they compete" because they cannot offer true VOD.

5.13 In further contrast to Virgin Media's capabilities, VOD services offered using alternative technology provide a lower quality consumer experience:

(a) nVOD: some TV service providers offer a near-VOD service whereby the content is streamed at a number of different intervals, with each stream actually being a separate linear channel which viewers can access (for example, the same content

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15 See paragraph 266 of Annex 11 of Ofcom's Consultation.
16 Second Survey of VOD Services, pages 4-6.
19 A broadcast satellite network is constrained from offering a return path because of its inability to provide dedicated bandwidth to a subscriber. A satellite transmission network has a significantly higher contention ratio than a cable transmission network. The contention ratio is the ratio of the potential maximum demand to the actual bandwidth. The higher the contention ratio, the greater the number of users that may be trying to use the actual bandwidth at any one time and, therefore, the lower the effective bandwidth offered. The contention ratio of Sky's platform can be estimated at 10,000:1. This means that the effective chance of being able to get enough bandwidth via the satellites used by Sky to watch a programme for each subscriber would be 10,000 to 1 (whilst at the same time delivering hundreds of linear TV channels). Virgin Media's VOD platform is built around a contention ratio of around 16:1 (whilst at the same time delivering hundreds of linear TV channels). Virgin Media achieves this contention ratio through the "segmentation" process by putting video server equipment deep into its network and only sharing bandwidth between 1000-4000 customers. Satellite cannot be segmented in the same way.
is streamed at 15 minute intervals and the viewer can choose to watch the content from the start of any 15 minute interval). However, such services only allow viewers to choose between the, typically very limited, content which is currently being streamed on this basis. Further, viewers that do not have a personal video recorder ("PVR") cannot interact with the content and therefore cannot pause, rewind, or fast-forward while watching the content. This technology is often referred to as "near VOD" or "nVOD". Currently Sky offers a near VOD service over the DSat platform through its Sky Box Office movie service with a limited range of approximately 10 to 13 movies at any time starting at 15 minute intervals;

(b) **Push VOD**: "push" VOD services use the functions of a PVR in a customer’s set top box ("STB"), which enables content chosen by the broadcaster to be downloaded/"pushed" to the viewer's PVR (e.g. over night), where it is typically recorded for a short period on the hard drive and viewers can then interact with the recorded version of the content as stored on their PVR (i.e. including pausing, rewinding and fast-forwarding). This type of service is currently offered by Sky+ Anytime and Top Up TV's service on the DTT platform. In practice, this type of offering is significantly more limited than a true VOD service. In a push VOD service the content in question is selected by the service provider, rather than by the customer. Accordingly, it cannot allow the "impulse" viewing enabled by a "true" VOD service. Further, due to capacity constraints, the choice of content is very limited. By way of example, Sky+ Anytime TV typically offers a choice of 40 hours while Top Up TV typically offers a choice of 100 hours a week. This compares to approximately [CONFIDENTIAL] movie titles available at any one time on Virgin Media’s VOD service; and

(c) **Internet and IPTV**: although a number of different providers offer a VOD service delivered by broadband, the quality of these services can be adversely affected by available broadband speeds, and the fact that they are often viewed on PC monitors and the restrictive economics of wholesale delivery which limit the scope of the service that can be offered. In other words, the distribution and quality of IPTV suffers from the economic and technical bandwidth limitations. This restricts, for instance, the ability of IPTV distribution to offer HD VOD, unlike cable which is already able to offer HD VOD.

5.14 More recently Sky has started to roll out an IPTV capability utilising local loop unbundling. The most recent generation of Sky set top boxes have a built-in Ethernet port which will enable Sky to offer a true VOD service delivered via Sky Broadband to complement the range of linear channels delivered by Sky’s DSat satellite service (and the "push VOD" Sky Anytime service). This service will, however, have several limitations. First, if a customer lives more then a few miles from the exchange, they may not be able to receive the service. Also, there are a number of technological developments which need to occur for the service to be scaleable (i.e. so that there is sufficient bandwidth to enable customers to use broadband at the same time as they are accessing VOD services), such as IPTV extension to the STB middleware needs to be developed; a VOD menu within the existing EPG needs to be established and properly integrated; and the network needs to be upgraded to handle the traffic.

**VOD services require attractive content**

5.15 Just as quality programming drives viewing of linear channels, quality programming drives VOD viewing. According to the Second Survey of VOD Services, feature films account for the majority of titles available via VOD. However, regardless of the VOD technology

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21 For instance see Second Survey of VOD Services, pages 31 to 33.
22 The report at Ofcom's Consultation, Annex 11, recognises that Sky has sought to leverage its dominance in pay TV rights to premium movies into internet VOD, see paragraphs 304 and 352.
being used, a VOD movie service will not be expected to gain a large share of VOD views unless it has access to a range of quality and attractive programming and is offered on an SVOD basis.

5.16 Virgin Media's movie VOD service is Movies On Demand. This is a PPV service offering all Virgin Media's customers the ability to choose from up to 500 movie titles at any one time for which they will typically pay between £2 and £3.95 (£4.50 for HD movie content). The movies available on the VOD service are those available in the PPV window and library titles over 3 years old.

5.17 [CONFIDENTIAL].

5.18 [CONFIDENTIAL] Movies On Demand service is limited to a narrow non-exclusive three month PPV window for new release titles and to "library" or "catalogue" material. This significantly limits the attraction of the services because, as explained below, consumers' primary interest is in new release titles on a subscription basis.

*Demand for new movies*

5.19 The report at Annex 11 of Ofcom’s Consultation indicates that in 2006 of the £248 million spent on VOD about £83 million was spent on movie transactions of which £78m (or 94 per cent) was on blockbusters and just £5m on catalogue titles. This is a very clear demonstration that the consumer demand for movie content is for recently released blockbuster titles and not for library material. [CONFIDENTIAL].

*Consumer preference for subscription services*

5.20 Customers in the UK show clear preference for subscription services over PPV services. [CONFIDENTIAL]:

(a) [CONFIDENTIAL];
(b) [CONFIDENTIAL];
(c) [CONFIDENTIAL].

5.21 [CONFIDENTIAL].

5.22 [CONFIDENTIAL].

5.23 [CONFIDENTIAL]. An SVOD movie service would be an extremely compelling proposition by enabling a consumer to watch a movie of their choice at their convenience and without paying an additional specific fee per movie.

5.24 [CONFIDENTIAL].

*Availability of Movie Content - Background Regarding Windows*

5.25 Before providing further detail in relation to the constraints on access to content, it is necessary to provide background on the manner in which movies are made available to VOD providers.

5.26 Under existing window arrangements, movies have traditionally been released first in cinemas. A DVD rental and sale release currently follows some three months later. Six months after the initial cinema release the movie is released on a PPV basis. Twelve months after the initial cinematic release movies become available via a premium subscription service in the "first pay" TV window. Finally the titles become available on

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24 Paragraph 27.
basic pay TV and free-to-air television and again as library titles on a PPV basis. In other words, after the non-exclusive PPV window, movie VOD rights are not available for a title until all pay windows have been exhausted (i.e. after three years from the initial release date).

5.27 The table below highlights the staggered windows and the amount of time each distribution channel can exploit the window.

<table>
<thead>
<tr>
<th>Window</th>
<th>Distribution channel</th>
<th>Duration of Window Exclusivity</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-3 months</td>
<td>Cinema</td>
<td>3 months</td>
</tr>
<tr>
<td>3-6 months</td>
<td>DVD Rental and Sale, Download to Own</td>
<td>3 months (and continues without exclusivity)</td>
</tr>
<tr>
<td>6 -9 months</td>
<td>PPV: Sky Box Office VOD PPV: Virgin Media Movies On Demand via FilmFlex movies</td>
<td>3 months (can return as &quot;library&quot; title after first pay TV window)</td>
</tr>
<tr>
<td>9 -12 months</td>
<td>“Dark Period” no new release window</td>
<td>3 months (approx)</td>
</tr>
<tr>
<td>12 – 27 months</td>
<td>First pay window: Sky premium movies</td>
<td>15 months</td>
</tr>
<tr>
<td>27 to 36 months</td>
<td>Dark Period (Second pay TV window exists for Universal Picture Box)(^{26})</td>
<td>9 months</td>
</tr>
<tr>
<td>36 months onwards</td>
<td>Free TV window Library PPV (subject to any holdbacks from Free TV licenses)</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>

5.28 An alternative way to present the windows showing the linear duration of each window is:

**MOVIES: Months Following Local Theatre Release (LTR)**

<table>
<thead>
<tr>
<th>Cinema (LTR)</th>
<th>DVD Rental and Sale, Download to Own (LVR)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Day &amp; Date Early Release</td>
</tr>
<tr>
<td>0</td>
<td>3</td>
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<td>3</td>
<td>6</td>
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<td>33</td>
<td>36</td>
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<tr>
<td>36</td>
<td>39</td>
</tr>
</tbody>
</table>

5.29 Currently, Virgin Media’s access to premium movie content is limited to non-exclusive new release movies available on a PPV transactional model within the 6 to 9 month release window and to library titles over 3 years old (also offered on a PPV basis).

**Sky’s status as a compulsory trading partner restricts Virgin Media’s access to VOD movie content**

5.30 The UK pay TV market is not responding in an efficient or dynamic manner to the natural increase in consumer demand for VOD services. As noted above, the range of available movie offerings is severely limited. Further, Virgin Media, as the company with the greatest potential to innovate and lead the way in developing consumer VOD offerings, is constrained by a range of factors from capitalising on its inherent advantage.

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\(^{25}\) Note that Window Exclusivity does not denote licensor exclusivity. The only window exclusively licensed is the first pay TV window.

\(^{26}\) Ofcom’s Consultation, Annex 11 Report, paragraph 93, where it is stated that there is no second or third party window in the UK.
5.31 More specifically, Sky has sought to overcome the inherent limitations of its offering through exerting its purchasing power with the movie studios to deprive its competitors of attractive content for VOD services. As noted above, Virgin Media's ability to offer a VOD movie service that is attractive to consumers and fulfil their requirements is dependent on securing access to attractive content.

5.32 As a result, Virgin Media is only able to access, and offer to consumers, VOD movies on a PPV (transactional model) basis. The lack of availability of movie content in the UK needs to be seen within the context of material changes outside the UK in distribution time slots or "windows" (which is addressed in more detail in paragraphs 5.56 and 5.59 below). The consumer demand for VOD is placing considerable pressure on the traditional definitions, and start and duration, of windows. Outside the UK, this has led to experimentation by the movie studios and pay TV operators with new forms of movie offerings utilising VOD formats. In the UK there is significant risk, as explained below, that new products and consumer offerings will be delayed or prevented as Sky seeks to extend its dominance further to all VOD formats including SVOD and new VOD distribution channels.

**Impact of "First Pay" Exclusivity**

5.33 Within the "first pay TV window" in the UK, Sky has output contracts with all the major US movie studios (Disney, Fox, Sony, Paramount, Universal, Dreamworks and Warner Bros.) under which Sky obtains exclusive pay TV subscription rights. This means that Sky has a 100 per cent share of the wholesale supply of premium subscription movie channels in the UK. All new movie titles from the major studios and most of the significant titles from the independent studios are only available on TV to UK consumers via the Sky Movies channels for the 15 month pay TV window (as indicated in the windows chart above). For that 15 month duration Virgin Media can act only as a distributor for Sky's premium movie channel offerings (which as previously explained) are supplied to Virgin Media only on uneconomic terms.

5.34 In addition, Sky leverages its first pay window exclusivity to restrict the ability of Virgin Media (and other third parties) ability to deal with the premium movie rights holders to develop alternative SVOD movie offerings for UK customers. The report at Annex 11 of Ofcom's Consultation recognises the constraint this places on the ability of Virgin Media to offer VOD programming. The exclusive rights granted to Sky in the first pay window exclude simultaneous SVOD exploitation by any other broadcaster or platform.

5.35 [CONFIDENTIAL]. This is supported by the report at Annex 11 of Ofcom's Consultation, which notes that rights deals which preclude prior or simultaneous exploitation in certain windows (such as Sky's exclusive arrangements for first-pay movie rights) are an obstacle to SVOD and, further, such companies as Sky are using their clout to expand existing deals to include Internet distribution and looking to leverage these rights in an Internet VOD environment...." (paragraph 352) (emphasis added).

5.36 In practice, Virgin Media's believes that Sky employs a deliberate strategy of denying its competitors content:

(a) through what Virgin Media understands is the explicit or implicit understanding of the definition of "subscription" in its first pay window exclusivity agreements, Sky
restricts the ability of the rights holders to sell SVOD rights in that window (or any other window, in particular, what is currently known as the PPV window); and

(b) through what Virgin Media understands is the explicit or implicit scope of exclusivity in its first pay window agreements, Sky restricts the ability of the rights holders to offer premium movies or PPV movies within that window.

5.37 While Virgin Media has unsurprisingly found it difficult to obtain itself documentary evidence of these restrictions (given that any relevant documents will lie in the hands of Sky and the movie studios), there are a number of indications that this is the strategy being employed by Sky. These indications are described below.

5.38 [CONFIDENTIAL].

5.39 [CONFIDENTIAL].

5.40 [CONFIDENTIAL].

5.41 [CONFIDENTIAL].

5.42 [CONFIDENTIAL]:

(a) [CONFIDENTIAL];

(b) [CONFIDENTIAL].

5.43 [CONFIDENTIAL].

**Sky is able to threaten to “punish” the studios**

5.44 The most likely explanation as to why movie studios would not wish to make SVOD rights available to Virgin Media is that if they were to do so, Sky would be able "punish" the studios for doing so by paying sufficiently less for the linear rights such that the aggregate sum achieved by the movie studio from selling the linear rights to Sky and the SVOD rights to Virgin Media would be less than selling both on an exclusive basis to Sky. This would be a clear demonstration of market power on the part of Sky. [CONFIDENTIAL] This supports Virgin Media's understanding that this issue does not arise as a consequence of the wishes of the studios, but rather from the market power of Sky. In other words, Sky is a compulsory trading partner for all major US studios, and is able to punish them financially for seeking to sell SVOD rights to a competitor of Sky. As a result, UK consumers are denied movie SVOD offerings and Sky's status as the dominant provider of premium pay TV movie services is entrenched.

**What Virgin Media could offer if SVOD rights were available or how consumers would benefit**

5.45 Virgin Media is being denied the opportunity to develop an SVOD service which competes effectively with Sky's premium subscription movie offering. In this context, it should again be emphasised that the existing PPV services do not offer a viable substitute for SVOD services. This is demonstrated by the limited consumer demand for PPV movies relative to demand for existing subscription movie services. By way of example, Sky's revenues from its Sky Movies subscription service are very significantly larger than its revenues from its Sky Box Office PPV service.
5.46 UK consumers are currently poorly served by the pay movie offerings available to them. Prices are higher than they would be in a more competitive market; subscription based VOD offerings are not available at all other than via Sky; and VOD premium movies are not available in the first pay TV window (which lasts in the UK fifteen months) other than via Sky.

5.47 In the context of SVOD rights, or the ability to offer VOD movies, Virgin Media has considered a range of pricing and packaging opportunities to compete effectively with Sky and benefit customers by bringing down prices and creating alternative and flexible packages. [CONFIDENTIAL]:

(a) [CONFIDENTIAL];
(b) [CONFIDENTIAL];
(c) [CONFIDENTIAL];
(d) [CONFIDENTIAL];
(e) [CONFIDENTIAL].

5.48 Virgin Media, even within the restricted PPV window, has been innovative. By way of example of Virgin Media has offered "Penny Film Festival" which allowed consumer, to vote on preferred films and purchase them for a penny. This was promotional but indicative of how Virgin Media aims to "shake up" the market.

5.49 In addition, as part of its general TV strategy, Virgin Media is continuing to invest in VOD service improvements and innovations. [CONFIDENTIAL] Given that Virgin Media's overall objective is to offer a number of different movie packages and prices to UK consumers, the most likely VOD options Virgin Media would pursue with the rights holders are:

(a) [CONFIDENTIAL];
(b) [CONFIDENTIAL];
(c) [CONFIDENTIAL];
(d) [CONFIDENTIAL];
(e) [CONFIDENTIAL];
(f) [CONFIDENTIAL].

5.50 The offer of these new SVOD or VOD movie offerings all, however, require reaching agreements with the studio rights holders. [CONFIDENTIAL].

Innovations in VOD offer outside the UK

5.51 As indicated above, Sky's exclusivity arrangements are inhibiting the development of innovative movie VOD services in the UK for which there is demand both from viewers and from movie studios. If this problem is not addressed, the UK will be left behind as other marketplaces around the world develop new and advanced offerings in premium content services and VOD movies.

5.52 In contrast to the situation in the UK, innovative movie VOD services are being developed elsewhere in collaboration with pay TV operators. In the US primarily those innovations have been developed with cable operators, because of their superior technology, and with rights holders who are seeking to compensate for the decline in DVD revenues in the
windows post cinema release. In general, the windows system is less rigid in both Europe and the US than in the UK.31 The trend for innovation and experimentation is recognised by the report Second Survey of VOD Services. That report indicates that the uptake of digital delivery technology, combined with decreasing growth in DVD sales has meant that "copyright holders seem willing, to a certain extent, to experiment with the traditional hierarchy of the exploitation chain".32

5.53 The examples set out below show the willingness on the part of the studios to:

(a) make SVOD offerings available either at the same time or outside of the first pay TV window;
(b) promote VOD offerings by blurring and/or shortening the traditional windows; and
(c) experiment with new models of VOD delivery.

5.54 In contrast, each of these developments is in danger of being stifled in the UK. These examples from the US and elsewhere in Europe are therefore a compelling indication that the movie studios themselves are unlikely to be the cause of the restrictions (see paragraphs 5.30 to 5.44 above). They are an indication that the restrictive feature of UK pay TV is the ability of Sky to use its status as compulsory trading partner to restrict the rights able to be offered within the movie release windows.

Video on Demand in the US

5.55 The importance of SVOD: In the US all three major pay movie networks (HBO, Showtime and Starz!/Encore) provide SVOD movie services. For example, HBO has numerous multiplexed linear networks (which are distributed by both cable operators and satellite) as well as HBO On Demand (which is made available by cable operators). HBO On Demand has both original programming (such as Curb Your Enthusiasm and the Sopranos) as well as movies, both library and movies just entering the first pay TV window (such as the Simpson's and Ocean's Thirteen this month).

5.56 The window periods are being blurred and shortened: SVOD movies are available during the first (and later) pay TV movie windows. US pay movie networks operate independently from distributors and therefore "customise" their services to their distributors, providing many linear networks to satellite distributors and both linear and VOD content to cable and telephone multichannel video distributors. New services are frequently launched simultaneously on a linear and a VOD basis. All the US networks stream their shows through their websites during a period of few weeks that follows their release on the pay TV channel. There are numerous recent examples of blurring window periods:

(a) in May 2008 Time Warner CEO Jeff Bewkes indicated that Warner Brothers will release movies to VOD on the same day they become available on DVD;33

(b) cable and satellite operators may soon offer first-run movies on HD VOD shortly after or even at the same time as their theatrical release - and well before their DVD and Blu-ray release.34 There have been some experiments with HD release of

31 See paragraphs 5.56 and 5.59 below.
32 S Nikoltchev, (ed.), Legal Aspects of Video on Demand, European Audiovisual Observatory, Strasbourg 2007, page 60, citing, "Hollywood is facing a journey into the unknown", Financial Times, August 10 2005: "Studio executives are asking themselves whether a new digital model will emerge ...'The landscape is changing and its going to change' says Rick Finkelstein, president and Chief Operating Officer of Universal Pictures ... 'Eventually we're going to have home networks and people will be able to watch whatever they want, whenever they want on whatever device they want'.
films prior to their theatrical release. For example, Mark Cuban is offering a service called Ultra HD Video on Demand to DirecTV, Time Warner Cable, Charter, Verizon and other cable-network distributors. This service offers HD VOD movies on the same day the picture opens in theatres.\textsuperscript{35}

(c) Viacom president and CEO Philippe Dauman said he is negotiating with cable operators about carrying the new premium TV joint venture between MGM, Lionsgate and his company's Paramount Pictures. He said, "It's going to provide a lot more VOD on the first day of the pay window. That's not the case with our movies now being shown on the incumbent service. We're really reinventing the window to take advantage of all the new technology and to adapt to what consumers are looking for"\textsuperscript{36} and

(d) Cablevision Systems launched a new service in early 2008, Popcorn DVDs On Demand, that offers 24-hour VOD access to movies on the same day studios release them on DVD. Customers buy the VOD view bundled with the DVD, which is mailed to them separately.\textsuperscript{37}

\textit{Video on Demand in the EU (outside of the UK)}

5.57 The importance of SVOD: Several business models coexist in Europe including pay per download, SVOD, purchase (download to own), and free VOD (usually supported by advertising). The importance of SVOD is emphasised in the recent Second Survey of VOD Services where the authors concluded:

"\textit{Observation of VOD Services in the countries surveyed shows that SVOD is gradually starting to take hold among the various players as the best way to ensure client loyalty and increase profitability: SVOD may therefore become the dominant model in the long run}\textsuperscript{38}.

5.58 The growing importance of SVOD is further illustrated by the following recent examples compiled from Second Survey of VOD Services:

(a) in June 2007, French IPTV operator Free launched a subscription VOD service at €5.99 per month, focusing on the cinema and series (offering content from Warner's and Disney's catalogues);\textsuperscript{39}

(b) Alice, the French division of Telecom Italia, has recently launched a €7 per month SVOD service;\textsuperscript{40} and

(c) in Germany, in July 2006 the ProSiebenSat.1 Media group launched its VOD portal Maxdome, which includes SVOD offer of feature films and other content. The Second Survey of VOD Services describes Maxdome as one of the most active European players in terms of SVOD offer.\textsuperscript{41}

5.59 The window periods are being blurred and shortened: The Second Survey of VOD Services indicates that while the rules governing movie "windows" vary between European countries, windows are tending to become shorter. Most European countries with a

\textsuperscript{35} See http://www.variety.com/article/VR1117969989.html?categoryId=13&cs=1&query=movie+studios+VOD.
\textsuperscript{36} See http://www.hollywoodreporter.com/hr/content_display/television/news/e3f918973c48e7dd51ee8ad39f5e6c5ae.
\textsuperscript{38} Second Survey of VOD services, page 45.
\textsuperscript{39} Second Survey of VOD services, page 25.
\textsuperscript{40} Second Survey of VOD services, page 25.
\textsuperscript{41} NPA Conseil \textit{Video on Demand in Europe} 2007, pages 131 to 132.
developed VOD sector are seeing windows move closer to the theatrical release date. VOD release on the same day as the DVD release (in accordance with US "day-to-date" model) is becoming increasingly common:

(a) in France, the producer Gaumont announced in the summer of 2007 that it would open its catalogue to various VOD offers and would offer its films for rental 30 days after they are released on DVD. Gaumont would also accept simultaneous DVD and VOD releases in exchange for a higher remuneration; and

(b) in Norway, VOD release windows were traditionally between 3 and 6 months after cinema release. Norwegian films are now simultaneously released on DVD and via VOD (day-to-date).

5.60 **VOD services are offered at the same time as the first pay TV window**: It is also apparent from the survey of EU countries that rights are not systematically withdrawn from VOD services when the pay TV window opens.

5.61 **New delivery models are developing**: VOD is increasingly being offered not only via television and Internet but also via mobile phones. For example, France's Canal+ has recently reached 250,000 subscribers for its mobile TV services.

6. **MARKET REFERENCE THRESHOLD FOR SUPPLEMENTARY SUBMISSION**

6.1 The time has come for Ofcom to refer the UK pay TV industry to the Competition Commission. UK customers are being denied the benefits that competition in a dynamic and fast-moving market should be expected to deliver. The longer the current market features and Sky's conduct are allowed to persist, the greater the detriment suffered by consumers. Ofcom's investigation into the pay TV market has revealed ample evidence of continuing consumer detriment that indicates a reference should now be made. In particular:

(a) Ofcom initiated its investigation following submissions from the Parties in January 2007 and July 2007. These submissions were prompted by the fact that each of the parties, including Virgin Media, was being significantly constrained in its ability to compete in the supply of pay TV by features of the market and by Sky's behaviour (which was facilitated by the relevant features of the market). We have, individually and collectively, provided detailed and numerous examples of the ways in which competitive behaviour is being constrained;

(b) our joint submissions with the Parties have been supported by responses from each party to a number of detailed questionnaires from Ofcom (the responses of which further illustrate the way in which the parties are being competitively constrained);

(c) in this submission, we have identified specific examples of how consumers would benefit if the competitive constraints in the pay TV market are addressed;

(d) it is clear, from the voluminous material collated and reviewed by Ofcom to date, and the exhaustive analysis undertaken in Ofcom's Consultation document, that Ofcom has more than sufficient evidence to refer the matter to the Competition Commission for a market investigation; and

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42 Second Survey of VOD Services, page 23.
43 NPA Conseil *Video on Demand in Europe 2007*, page 74.
44 Second Survey of VOD Services, page 70.
(e) it is appropriate for Ofcom now to make a market investigation reference to the Competition Commission. In particular, any further delay will perpetuate the market features (i.e. both market structure and conduct) that prevent, restrict or distort competition in a market in the UK for goods and services to the detriment of consumers.

6.2 Given the ongoing distortions of competition in the pay TV market, their impact on Virgin Media, and the resulting consumer detriment, Ofcom should not further prolong its investigation into pay TV. Instead, it should, as a matter of urgency, exercise its discretion now to refer the pay TV industry for a full market investigation by the Competition Commission.

**Further delay will perpetuate customer detriment**

6.3 A review of previous cases show that in the nine market investigation references to the Competition Commission under the Enterprise Act, the average duration of the initial investigations to determine whether to make a reference was approximately seven months. In contrast, Ofcom's first phase investigation into pay TV has already been underway for approximately 16 months.

6.4 Further delay will perpetuate the features of the market that are distorting competition and that are leading to consumer detriment.

**The legal requirements for a market references have been met**

6.5 As noted in prior submissions, Ofcom has a discretion under section 131 of the EA to make a market investigation reference to the Competition Commission where:

"... it has *reasonable grounds* to suspect that any feature, or combination of features, of a market in the United Kingdom for goods and services *prevents, restricts or distorts competition* in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom."

6.6 In order to make a reference, Ofcom needs only "reasonable grounds to suspect" that a feature, or combination of features, prevents, restricts or distorts competition in a market in the UK for goods and services. This threshold is recognised as being a low one, reflecting Ofcom's role as first phase investigator.

6.7 Ofcom need not reach a definitive view on the concerns that have been identified. A full Competition Commission investigation would establish whether there are in fact adverse effects on competition and how competition can be improved (in other words, the determination of appropriate remedies to address the harm identified). A full investigation by the Competition Commission would also reveal the extent to which Sky is taking advantage of existing market features to its benefit and to the detriment of competition and consumers.

6.8 In this context, it should be noted that the Office of Fair Trading's ("OFT") Guidance states that, when undertaking a first phase investigation, it will carry out an appropriate competition assessment, but it:

"... *is not required to reach firm conclusions before making references and it would be inappropriate for it to engage in extensive research. Provided it has reasonable grounds for suspecting that there are market features that adversely affect competition, the reference test has been met and further investigation can be left to the CC*".46

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This approach was put into practice by the OFT last year in respect of BAA. In the report which detailed its reasons for referring BAA to the Competition Commission, the OFT stated that:

"We recognise that our preliminary analysis has not reached firm views on these matters, but consider the analysis appropriate for the first phase and look forward to the outcome of the CC's investigation of these significant issues."

Based on voluminous evidence and material obtained from third parties, and its own detailed investigation, Ofcom found in Ofcom's Consultation (a document running to many hundreds of pages) that:

(a) Sky is dominant in the wholesale supply of premium sports channels and premium movie channels;
(b) Sky is dominant in the retailing of packages containing premium sports channels and packages containing premium movie channels;
(c) barriers to entry in each of the above markets are high;
(d) that Sky, as a vertically integrated operator, may have the incentive to engage in behaviour that forecloses, or marginalises, competition both downstream (input foreclosure) and upstream (customer foreclosure); and
(e) there exist a range of factors which point to Sky's behaviour having had the effect of foreclosing, or marginalising, other market participants at all levels of the pay TV supply chain.

Further, Virgin Media also notes that despite its length and the detail in which some issues are addressed, Sky's Response fails meaningfully to address the substance of the very real concerns and conclusions reached in Ofcom's Consultation and therefore there is still every reason for Ofcom to continue to have "reasonable grounds to suspect" that the market features prevent, restrict or distort competition.

Accordingly, Ofcom has more evidence than could reasonably be required for it make a market investigation reference to the Competition Commission, especially when compared with previous occasions in which regulators have exercised their discretion to make a reference.

In this context, the Competition Appeal Tribunal's ("CAT") judgment in the Association of Convenience Stores case is particularly pertinent. In that judgement, the CAT confirmed that:

(a) the discretion of the OFT (and hence Ofcom) under section 131 of the EA to make a market investigation reference to the Competition Commission must, like all discretions, "be exercised according to law";
(b) a failure by the regulator to take a decision within a reasonable timescale on whether or not to refer is reviewable by the CAT; and
(c) the OFT's proposed timescale in that case of approximately sixteen months for determining whether to make a reference to the Competition Commission was not reasonable.

Specifically, the CAT stated that:

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47 OFT: BAA: The OFT's reference to the Competition Commission, April 2007, paragraph 1.15.
"... There is, if we may say so, some risk that one may mistake the height of the hurdle which s.131(1) presents. It is a "reasonable ground to suspect" test. The scheme of the Act is that a full investigation is carried out at the stage of the Competition Commission not at the stage of the OFT, although admittedly the OFT has to address the matter sufficiently to decide whether there are reasonable grounds "to suspect", and sufficiently in order to consider the question of undertakings under s.154 of the Act in lieu of making a reference. Subject to that, it seems to us that on the presently envisaged timetable it would have taken some 16 months to decide even whether to make a reference in this case and, if a reference was then made, that would be followed by an investigation by the Competition Commission lasting up to two years making a total period of three or four years altogether. That seems to us to be unsatisfactory to all parties on whichever side of this particular argument they happen to be ...".

6.15 Ofcom might, nevertheless, consider that it has a somewhat different role to the OFT in this process as it is a sectoral regulator. In this regard, it is instructive to note that there has already been a reference in April 2007 by a sectoral regulator, the Office of Rail Regulation ("ORR"), in respect of rolling stock leasing. The ORR's first phase investigation in that case took approximately nine months. Certain affected parties argued that the ORR was the specialist sectoral regulator and, therefore, would be better placed than the Competition Commission to address the relevant issues. The ORR responded as follows:

"A more detailed examination of the relevant issues would, in our view, be necessary in order to give robust recommendations on changes to the franchise system to introduce more competition into the leasing of rolling stock. The CC is a specialist second stage investigatory body and so is best placed to carry out a detailed investigation of this sort. Moreover, our sectoral experience will be available to the CC during the course of its investigation".46

"Further, whilst the CC has powers to impose behavioural remedies we can only take undertakings that have been offered voluntarily".49

6.16 Furthermore, the House of Lords Select Committee on Regulators has recommended that:

"Where possible, utility regulators should look to bring more cases to the competition authorities ... and the regulators should work to ensure that the cases most likely to establish useful precedents are bought to the CC".50

6.17 The Government response to this Report stated that:

"The Government agrees with the Committee that regulators should be encouraged to think about whether they can be more pro-active in using competition law, including market investigation references to the Competition Commission".51

**Ofcom should make a reference**

6.18 Finally, Ofcom has previously indicated that in order to take action it must conclude that relevant features of the pay TV market are resulting in consumer detriment in that consumers are not benefiting to the extent that they would in a competitive market. In this context, there is no doubt that substantial consumer detriment has been

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46 ORR: The Leasing of Rolling Stock for Franchised Passenger Services April 2006, paragraph 37.
49 ORR: The Leasing of Rolling Stock for Franchised Passenger Services April 2006, paragraph 38.
51 Government's Response to the House of Lords Select Committee on Regulators UK Economic Regulators 13 November 2007, paragraph 1.22.
demonstrated by the Parties even taking this view of what Ofcom must conclude in order to exercise its discretion to make a reference to the Competition Commission.

6.19 The Joint Submission, the response of the Parties to Ofcom's questionnaires, the Joint Response, and this further submission all identify a range of different yet specific ways in which the features of the market are operating to the detriment of customers, i.e. high prices, reduced choice and reduced innovation. Further, had the market been working well, one would have expected to have seen much more new entry over recent years, a sustained challenge to Sky, and greater innovation and development from parties other than Sky. Due to the features of the market identified by the Parties and in Ofcom's Consultation, and Sky's conduct, this has not happened.

6.20 In conclusion, on the basis of the above, Ofcom has more evidence than could reasonably be required for it make a market investigation reference to the Competition Commission. It is appropriate for Ofcom, in its role as the sectoral regulator, to make that reference. Indeed, Virgin Media considers that this would be the only appropriate course of action absent undertakings being offered by Sky to address all the concerns raised by the Parties.

52 In particular, there is no basis on which such a decision could be the subject of a successful judicial challenge. Such a judicial challenge would be entirely precluded in circumstances in which Ofcom is exercising a discretion and any aggrieved party would have a full opportunity to make representations to the Competition Commission.