

Competition Alert

1 July 2009

Sky no longer the limit in the UK

The United Kingdom's Office of Communications ("**Ofcom**") released a report calling for requirements that British Sky Broadcasting Group plc ("**BSkyB**") allow rival broadcasters access to its premium sports and cinema offerings on terms set by Ofcom. Ofcom says the proposals would benefit consumers by increasing choice and innovation. This Alert highlights Ofcom's recommendations and illustrates how this contrasts with New Zealand's laissez-faire approach to its broadcasting industry despite recent consultation and competition reviews calling for broadcasting regulation in this country.

The UK position:

'BSkyB has market power and should be regulated'

To armchair sports and movie fans in New Zealand the UK may seem like a utopia of television options with two main Pay TV operators, satellite TV operator BSKyB and cable TV operator, Virgin Media Inc. ("**Virgin**"), and legislation that guarantees free-to-air ("**FTA**") broadcasting of sporting events that are considered to be of "major importance to society".¹

Despite this, Ofcom, the independent regulator and competition authority for the communication industries in the UK, stated in its *Pay TV phase three document* released on 26 June 2009 ("**Report**") that there is a case for intervention and proposed measures to improve competition in Pay TV. This Report followed complaints from BSKyB's competitors such as BT Group plc ("**BT**") and Virgin that BSKyB was suppressing competition.

In summary, Ofcom, charged with a statutory duty to further what it considers the interests of consumers by promoting competition in the communications industries, outlined the following findings in its Report:

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- » It has concerns that BSKyB has market power in the wholesale supply of channels containing premium sports and movies (primarily, Premier League football and first-runs of Hollywood blockbusters).
- » Due to this market power BSKyB is suppressing competition such that consumers face a restricted choice of channels and platforms in the short term and that in the longer term new platforms "based on innovative distribution technologies" may be prevented from developing.
- » BSKyB is earning aggregate returns in excess of its cost of capital, and is likely to continue to do so. These returns appear to be higher in BSKyB's wholesale business than its retail business and Ofcom is concerned that they are likely to be reflected in high prices paid by consumers.
- » Currently, BSKyB only licenses its premium content to Virgin and Ofcom considers that this is because BSKyB is making a strategic decision to not maximise its profit in the short term in order to maintain its market power.

The Ofcom solution is to require BSKyB to make its premium channels available for license on a wholesale basis, at a rate fixed by the regulator (the "**wholesale must-offer obligation**"). Ofcom said this solution is necessary to ensure fair and effective competition. Ofcom hopes that these proposals will ensure an increased choice of supplier and of platform for consumers and in the longer term enhanced innovation and investment, especially on non-BSkyB platforms. Ofcom believes that BSKyB's wholesale revenues would increase under the proposed remedy due to its channels becoming more widely available.

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In response, BSkyB accused Ofcom of "unwarranted intervention" and said that it would launch legal action if forced to open its channels to rivals at a set rate. BSkyB's chief executive, Jeremy Darroch, released a press statement saying that "Forcing Sky to sell its channels for less than their true value is a subsidy for companies that have shown no appetite for investment in programmes. BT and Virgin Media do not deserve to be handed a reward at Sky's expense for their repeated failure to invest."

Ofcom is consulting the industry on its proposals, but it is regarded as unlikely to shift from its views. The recommendations could be imposed on BSkyB by the start of next year and, for an appeal to be successful, BSkyB would need to prove that, "as a matter of urgency", the proposals are causing "serious and irreparable" harm to the company. It may, therefore, be difficult for BSkyB to successfully appeal any such ruling from Ofcom.

The New Zealand position:

'Risks to competition but no regulation'

The Ofcom recommendations can be compared and contrasted with recent moves by the National-led Government in the New Zealand broadcasting industry.

The Regulatory Review of Digital Broadcasting ("Regulatory Review") had been commenced in May 2006 by the Labour-led Government to review current regulatory settings, identify relevant issues affecting competition, standards and rights, and key trends and patterns of investment and innovation in this industry. As part of the Regulatory Review a Consultation Paper sought views on the future of regulation for digital broadcasting.

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On 23 September 2008 the *Regulatory Review of Digital Broadcasting: report-back on options following public consultation ("Cabinet Paper")* was publicly released. The Cabinet Paper recommended a competition study to consider potential risks to access to premium content and to platforms. One of the key findings of the Cabinet Paper was that "a majority of respondents supported specific intervention to address perceived dominance" in terms of content and access to platforms. As a result, Cabinet directed the Ministry of Economic Development ("**MED**"), in consultation with the Ministry for Culture and Heritage ("**MCH**"), to conduct a competition study to address access to premium content, and access to platforms and networks for television and related channels and services.

In February 2009 the MED and MCH released their *Report to the Minister of Broadcasting and the Minister for Communications and Information Technology* on competition issues in television broadcasting (the "**Competition Report**"). The key findings of the Competition Report were as follows:

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- » All other main OECD countries take a much more pro-active approach to regulating their broadcasting markets than New Zealand, which appears to be unique in relying on ex-post-application of general competition law to regulate the broadcasting market;
- » The television broadcasting market in New Zealand has less choice than in most overseas markets;
- » Likely market trends include:
 - Continuing increase in the range of information and entertainment options, including over the internet;
 - The continuing "dominance" of SKY Network Television Limited ("**SKY**") in the Pay TV market;
 - Continuing pressure on the revenues of FTA broadcasters from audience fragmentation and market penetration by SKY;
- » There is no strong case at present for the introduction of specific regulation for the broadcasting sector; and
- » There are some risks relating to competition in the broadcasting market in the future, including in relation to access to premium content and transmission platforms.

As a result of this, the MCH favoured an amendment to the Telecommunications Act 2001 to include broadcasting so that a widened Telecommunications Commission could undertake market studies of broadcasting and make recommendations to Ministers as to whether particular services (eg access to broadcasting platforms or premium content) should be regulated. The MCH considered that this option would:

...pro-actively manage risks relating to anti-competitive behaviour by SKY in relation to premium content and terms and conditions for access to the platform (satellite capacity, set-top box and EPG²), including the cumulative effect of incremental increases in SKY's position in the market. The SKY platform is arguably an essential facility as any national television broadcaster seeking to enter the market must have a presence on the SKY platform to be viable, due to the large share of households that access television via that platform.

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On the other hand, the MED favoured taking no further action. It considered that:

There is no strong case for regulating the broadcasting market at this time. The current market appears adequately competitive and there are no compelling indications of future issues.

Despite the preference for regulation by the MCH and the previous Labour-led Government's preference to conduct a competition study to address access to premium content and access to platforms, the Broadcasting Minister, Dr Jonathan Coleman, and Communications and Information Technology Minister, Steven Joyce, announced on 7 April 2009 that the Regulatory Review would not proceed any further. Dr Coleman announced that his office is preparing a new programme of action for broadcasting aligned with National's pre-election commitments, namely a successful digital switch-over and supporting public broadcasting through contestable funding.

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Conclusion

The contrast in approach between Ofcom's calls for regulation of BSkyB and the National-led Government's termination of the Regulatory Review is, on its face, difficult to understand from a purely competition view point. If access to premium content is the route to monetising open access networks,³ then the Ofcom approach may in fact align with the National-led Government's policy objectives for private network infrastructure investment.

The dynamics of the UK industry with two Pay TV operators and guaranteed FTA access to premium sporting events would seem to put BSkyB in a less powerful market position in the UK than SKY is in New Zealand. Whether Ofcom's interventionist approach or the New Zealand Government's hands-off approach will deliver better outcomes for consumers remains to be seen and will be keenly observed by interested parties in the industry both in New Zealand and abroad.

CONTRIBUTED BY TROY PILKINGTON, CRAIG SHRIVE AND SARAH KEENE.

1. As is the case in many other EU states (provided for under the EU's "Television without frontiers" Directive), the UK Secretary of State maintains a list of events that must receive full live coverage (for so-called "Group A" events) or secondary replayed coverage (for so-called "Group B" events) on FTA television. Group A events are as follows: The Olympic Games, The Fifa World Cup Finals Tournament, The European Football Championship Finals Tournament, The FA Cup Final, The Scottish FA Cup Final (in Scotland), The Grand National, The Derby, The Wimbledon Tennis Finals, The Rugby League Challenge Cup Final and The Rugby World Cup Final.

2. Electronic Programme Guides, which provide programme information and may provide interactive features.

3. See, for example, TVNZ's submission to the Commerce Commission on the NGN Discussion Paper, February 2009 (available at: <http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/Inquiries,ReviewsandStudies/ContentFiles/Documents/TVNZ%20Submission%20on%20NGN%20Discussion%20Paper%20190209.pdf>)

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