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**IN THE COMPETITION**  
**APPEAL TRIBUNAL**

Cases No: 1156-1159/8/3/10

Victoria House  
Bloomsbury Place  
London WC1A 2EB

8 August 2012

Before:

THE HONOURABLE MR. JUSTICE BARLING  
(President)  
PROFESSOR JOHN BEATH  
MICHAEL BLAIR QC

Sitting as a Tribunal in England and Wales

BETWEEN:

**BRITISH SKY BROADCASTING LIMITED**  
**VIRGIN MEDIA, INC.**  
**THE FOOTBALL ASSOCIATION PREMIER LEAGUE**  
**BRITISH TELECOMMUNICATIONS PLC**

Appellants / Intervenors

- v -

**OFFICE OF COMMUNICATIONS**

Respondent

- and -

**TOP UP TV EUROPE LIMITED**  
**RFL (GOVERNING BODY) LIMITED**  
**THE FOOTBALL ASSOCIATION LIMITED**  
**FRESAT (UK) LIMITED**  
**RUGBY FOOTBALL UNION**  
**THE FOOTBALL LEAGUE LIMITED**  
**PGA EUROPEAN TOUR**  
**ENGLAND AND WALES CRICKET BOARD**

Intervenors

Heard at Victoria House between 9 May 2011 and 15 July 2011

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**JUDGMENT (Non-confidential version)**

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## APPEARANCES

Mr Mark Hoskins QC and Mr Gerard Rothschild (instructed by Ashurst LLP) appeared for Virgin Media, Inc.

Miss Helen Davies QC, Miss Maya Lester and Mr Richard Blakeley (instructed by DLA Piper UK LLP) appeared for The Football Association Premier League.

Mr James Flynn QC, Mr Meredith Pickford and Mr David Scannell (instructed by Herbert Smith LLP) appeared for British Sky Broadcasting Limited.

Mr Thomas Plewman SC, Miss Sarah Ford and Miss Sarah Love (instructed by BT Legal) appeared for British Telecommunications Plc.

Miss Dinah Rose QC, Mr Kieron Beal, Mr Josh Holmes, Miss Jessica Boyd and Mr Ben Lask (instructed by the Office of Communications) appeared for the Office of Communications.

Mr Paul Harris QC and Miss Fiona Banks (instructed by the Legal Department, RFL, the Legal Department RFU, Bird & Bird LLP, Onside Law, Denton Wilde Sapte LLP) appeared respectively on behalf of RFL (Governing Body) Limited, Rugby Football Union, The Football Association Limited, PGA European Tour and the Football League Limited.

Mr Daniel Beard QC (instructed by Milbank, Tweed, Hadley & McCloy LLP) appeared on behalf of Top Up TV Europe Limited.

Mr Timothy Ward QC (instructed by SJ Berwin LLP) appeared for Freesat (UK) Limited.

Miss Marie Demetriou (instructed by DLA Piper UK LLP) appeared for the England & Wales Cricket Board.

### **Notes:**

(1) Excisions in this judgment marked “[...][C]” relate to passages excluded having regard to Schedule 4, paragraph 1 to the Enterprise Act 2002

(2) Text in the judgment surrounded by square brackets and marked “[C (substituted text)]”, has been substituted in this non-confidential version of the judgment, having regard to Schedule 4, paragraph 1 to the Enterprise Act 2002.

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## I. INTRODUCTION AND SUMMARY

1. Parts of this judgment contain information which has, in the course of these proceedings, been disclosed only to members of the confidentiality ring established by the Tribunal's order of 31 March 2011 (as amended from time to time), and some of which may be confidential. The Tribunal will therefore need to determine which, if any, passages should be excised before publication, having due regard to the considerations set out in paragraph 1 of Schedule 4 to the Enterprise Act 2002 ("the 2002 Act"), and in the light of any submissions made on behalf of the parties. In the meantime, in advance of the publication of a non-confidential version of the full judgment, this Introduction and Summary is being made publicly available so as to provide an overview of the Tribunal's main conclusions<sup>1</sup> and the outcome of the appeals themselves. Notwithstanding its prior publication, this section is part of the judgment and should be read together with the Tribunal's detailed analysis in the subsequent sections.

### *The contested decision*

2. These appeals arise out of a decision of the Office of Communications ("Ofcom") in which Ofcom decided to vary, pursuant to section 316 of the Communications Act 2003 ("the 2003 Act"), the conditions in the licences granted to British Sky Broadcasting Limited ("Sky") under Part I of the Broadcasting Act 1990 ("the 1990 Act") for certain of Sky's pay television ("Pay TV") channels, Sky Sports 1, Sky Sports 2, Sky Sports 1 HD<sup>2</sup> and Sky Sports 2 HD (the "core premium sports channels" or "CPSCs").<sup>3</sup> The new licence conditions ("the Conditions") require Sky to offer to wholesale its CPSCs to retailers on other broadcasting platforms and, in the case of the standard definition ("SD") versions of the channels, offer

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<sup>1</sup> It is emphasised that in this section the conclusions are in summary form, and are fully set out only in the main part of the judgment.

<sup>2</sup> HD means "high definition".

<sup>3</sup> In addition to the CPSCs, this judgment refers variously to the "premium channels", the "core premium channels", and to specific channels such as Sky Sports 1. This is to some extent inevitable, as although the subject-matter of the WMO is the CPSCs, Ofcom refers to evidence gathered in relation to both premium sports and movie channels, and the subject-matter of the negotiations considered in section VI below was not always limited to premium sports channels. We have, wherever possible, attempted to reflect the same language as it was used by Ofcom, or by the parties in their submissions.

them at wholesale prices set by Ofcom<sup>4</sup> (“the wholesale must-offer obligation” or “WMO”).<sup>5</sup> Ofcom’s decision is contained in a document entitled “Pay TV Statement”, which was published on 31 March 2010 (“the Statement”).<sup>6</sup>

3. The Statement is the culmination of a wide-ranging investigation into the Pay TV sector by Ofcom lasting just over three years. An overview of Ofcom’s investigation and of the main findings in the Statement is at section II below. Fundamental to Ofcom’s decision to introduce the Conditions is its finding that Sky has exploited its market power by restricting wholesale distribution of its premium channels to potential new retailers in a way which is prejudicial to fair and effective competition.<sup>7</sup>
4. At Annex A to this judgment is a brief description of the Pay TV sector and a glossary explaining some of the relevant terminology and different technologies, services and platforms referred to in the main body of the judgment. It may assist the reader to have these to hand while reading the judgment.

### *The appeals*

5. Each of Sky, The Football Association Premier League (“FAPL”), Virgin Media, Inc. (“VM”) and British Telecommunications Plc (“BT” and, together with Sky, FAPL and VM, “the Appellants”) brought appeals<sup>8</sup> challenging the Statement. The Appellants’ grounds of appeal are summarised very broadly in this section, at paragraph 12 below, and are described in a little more detail in section III.

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<sup>4</sup> HD versions of the channels are to be supplied at wholesale prices which are fair, reasonable and free of undue discrimination.

<sup>5</sup> Also on 31 March 2010, Ofcom decided to approve conditionally a request by Sky (together with Arqiva, the telecommunications company which provides infrastructure and broadcast transmission facilities in the United Kingdom and Republic of Ireland) to allow it to launch a new service on the digital terrestrial television platform called “Picnic” (see further para 44 below), and to consult on a proposed decision to refer to the Competition Commission, pursuant to sections 131 to 133 of the 2002 Act, the markets for the sale of premium movie rights and premium movies services. Ofcom ultimately proceeded to refer these markets to the Competition Commission on 4 August 2010.

<sup>6</sup> A non-confidential version of the Statement can be viewed at:

[http://stakeholders.ofcom.org.uk/binaries/consultations/third\\_paytv/statement/paytv\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/third_paytv/statement/paytv_statement.pdf)

<sup>7</sup> Statement, para 1.24.

<sup>8</sup> The Appellants’ notices of appeal were filed on 1 June 2010, with the exception of VM, which filed its notice of appeal on 28 May 2010. All of the Appellants filed amended notices of appeal on 7 September 2010 pursuant to para 7(c) of the Tribunal’s order of 25 June 2010.

### *Sky's application for interim relief*

6. Prior to filing its notice of appeal, Sky applied on 16 April 2010 for interim relief against the Statement pursuant to rule 61 of the Competition Appeal Tribunal Rules 2003 (S.I. No. 1372 of 2003) (“the Tribunal Rules”). Following a hearing, and with the agreement of all the parties then appearing, the President made an interim order on 29 April 2010 pending final resolution of Sky’s proposed appeal or further order (“the Interim Relief Order”). The effect of the Interim Relief Order was to vary the Conditions so as to modify Sky’s obligations under the WMO in respect of the platform operators specified in the order. Otherwise the operation of the Statement was suspended generally. In summary, Sky was required to comply with the WMO as modified, in respect of BT, VM and Top Up TV Europe Ltd (“TUTV”). Those parties who benefited from the WMO undertook to pay into escrow, pending the determination of Sky’s appeal, the difference between the price actually paid under the WMO and the prices contained in Sky’s “rate card” for the same service.<sup>9</sup> The Interim Relief Order was subsequently amended, on 9 November 2010, following an application by Real Digital EPG Services Limited to be included within its scope.

### *The hearing of the appeals and certain procedural matters*

7. At a case management conference on 25 June 2010,<sup>10</sup> each of the Appellants was granted permission to intervene in the other appeals. RFL (Governing Body) Ltd, The Football Association Ltd, Rugby Football Union, The Football League Ltd, PGA European Tour and the England and Wales Cricket Board (together, “the Sports Body Interveners”), together with TUTV and Freesat (UK) Ltd, were also granted permission to intervene in the appeals. In view of the inter-relationship between the four appeals, they were all heard by the Tribunal at the same time, although not formally joined or consolidated. On 25 March 2011, the Tribunal also ordered that the appeals be heard (as regards evidence and documents) with two other appeals brought by Sky in cases 1170/8/3/10 (“the STB appeal”) and 1179/8/3/11 (“the CAM appeal”). In these appeals Sky contested two decisions by

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<sup>9</sup> Sky’s “rate card” prices are described in more detail at para 740 ff below.

<sup>10</sup> A further case management conference took place on 6 October 2010 and a pre-hearing review took place on 23 March 2011.

Ofcom, made following the Statement, that Sky had breached the Conditions in respect of its wholesale supply of the CPSCs to TUTV.

8. The main hearing in these proceedings took place over 37 days between 9 May 2011 and 15 July 2011 and was completed within the time allotted.<sup>11</sup> That a hearing of such logistical complexity, with multiple parties and so many witnesses, should have started and finished on time is very much due to the hard work and cooperation of the parties and their representatives, as well as to the Tribunal's staff. We would like to record our thanks to all involved.
9. The proceedings raised many hundreds of contentious issues between the parties, and an attempt by Ofcom to itemise them prior to the hearing resulted in a non-exhaustive schedule that ran to 254 pages. Over 35,000 pages of submissions and evidence (including nearly 5,000 pages of written pleadings, skeleton arguments and other submissions) were filed in relation to the four main appeals alone, and the Tribunal received testimony from 41 witnesses (including 14 experts), of whom 25 gave oral evidence before us.
10. In view of this multiplicity of issues and sub-issues, and the related arguments, it has been neither possible nor necessary (and certainly not desirable) for the Tribunal to refer to, let alone resolve, each and every issue and argument raised. To have attempted this, even in respect of those grounds of appeal with which we have found it necessary to deal, would have rendered interminable what is already, inevitably, a long judgment. Instead we have focussed on what in our view are the most important issues, together with the main arguments relating to them.<sup>12</sup>
11. Given the interrelationship between the grounds of appeal in the four appeals, and the fact that the appeals were heard together, the Tribunal considers it appropriate to deliver a single judgment.

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<sup>11</sup> Following the oral hearing a number of additional written submissions were lodged with the Tribunal, the final one being received in December 2011 in connection with the STB and CAM appeals.

<sup>12</sup> The Tribunal in this judgment makes extensive use of footnotes, in particular to refer to the underlying evidence in section VI. However, these footnotes should not be taken to be exhaustive in their reference to all relevant evidential material.

### *Summary of the grounds of appeal and of the Tribunal's conclusions*

12. In very broad terms the Appellants' main grounds of appeal consisted of:
- (a) challenges by both Sky and FAPL to Ofcom's jurisdiction to take action under section 316 of the 2003 Act;
  - (b) a root and branch challenge by Sky to Ofcom's findings in the Statement as to the practices on the part of Sky which form the foundations of Ofcom's competition concerns, and to which the WMO remedy is directed;
  - (c) various challenges by all the Appellants to the validity, effectiveness and proportionality of the WMO remedy imposed by Ofcom.
13. The Tribunal has examined the grounds of appeal described at sub-paragraphs (a) and (b) above. The Tribunal's conclusions on the latter aspect of Sky's appeal are sufficient to dispose of the appeals generally, and the Tribunal has therefore not considered it necessary or appropriate to express any conclusion on the grounds referred to at sub-paragraph (c).

### Sky and FAPL's challenges to Ofcom's jurisdiction: Tribunal's conclusions

14. The Tribunal has concluded that neither of Sky's and FAPL's two grounds of challenge to Ofcom's jurisdiction to take action under section 316 in the present case succeeds.
- (i) *The "licensed and connected services" argument*
15. Both Sky and FAPL submit that Ofcom's intervention is outside its powers under section 316 of the 2003 Act on the ground that the intervention is not in respect of "competition in the provision of licensed services or of connected services", as the section requires. Briefly, the main argument is that Ofcom acted with a view to securing fair and effective competition in service provision at the retail level, i.e. as between Sky and competing retailers in their provision of the CPSCs to end users; such retail services are neither licensed services nor services connected with

licensed services, and the imposition of the WMO is accordingly outside the scope of Ofcom's powers under section 316 of the 2003 Act.

16. The Tribunal has concluded that Ofcom's interpretation of the legislation is to be preferred, and that "competition in the provision of licensed services" for the purposes of section 316 includes competition at the retail level and is not confined to competition occurring at the wholesale level. Therefore, to the extent that Ofcom's intervention is aimed at securing that Sky, as the provider of the CPSCs to other retailers, "does not...engage in any practice which Ofcom consider...to be prejudicial to fair and effective competition" in the retail provision of CPSCs to end users, the imposition of the WMO is not outside its jurisdiction under section 316.
17. In the light of the Tribunal's agreement with Ofcom's primary answer to the challenge, Ofcom's alternative contention does not arise, namely that jurisdiction exists under section 316 to impose the WMO because the retail provision of the CPSCs is the provision of "connected services" within the meaning of section 316.

(ii) *The competition argument*

18. The second limb of Sky's and FAPL's challenge to Ofcom's jurisdiction is that in identifying the competition concerns in respect of which it has imposed the WMO remedy in application of section 316, Ofcom has acted in breach of its obligations under the legislation in question by failing to adhere to an approach based on the prohibitions in the competition rules laid down by EU law and mirrored in the Competition Act 1998 ("the 1998 Act"). Essentially the argument is that where the competition concerns identified by Ofcom "traverse the same ground" as the prohibitions in the ordinary competition rules, Ofcom, in assessing whether a practice is prejudicial to fair and effective competition for the purposes of section 316, must (with certain qualifications) adopt the same approach as would be applied under the competition rules and the case law relating to them.
19. The Tribunal has concluded that the interpretation of section 316 for which Sky and FAPL contend is incorrect, and that Ofcom is right in its submission that the section is not to be construed as confined to circumstances which would otherwise

constitute breaches of the competition rules, even with the qualifications acknowledged by Sky and FAPL. Therefore, in identifying practices which are or would be prejudicial to fair and effective competition for the purposes of section 316, Ofcom is not required to analyse them specifically by reference to the principles and case law on, in particular, the prohibition of abuse of a dominant position (or some approximation thereof), in order to establish jurisdiction to act.

Sky's challenge to the findings on which Ofcom's competition concerns are based: the Tribunal's conclusions

*Ofcom's challenged findings*

20. Ofcom's findings about the existence and nature of the practices on the part of Sky, which form the foundations of Ofcom's competition concerns and to which the WMO remedy is directed, are broadly as follows.
21. Ofcom concluded that Sky, in its dealings with other retailers who sought access to Sky's CPSCs, did not engage constructively with their requests and withheld wholesale supply. Ofcom concluded that Sky, in doing so, was: acting on certain strategic incentives; choosing to forego the opportunity to earn the revenue that such deals would have presented; and preferring to be absent from the platforms in question rather than wholesale to them. Sky's strategic incentives, as identified by Ofcom, were (i) to protect its own retail business on the Sky direct-to-home ("DTH") satellite platform and (ii) to reduce the risk of stronger competition in the bidding for content rights.
22. Ofcom maintains that Sky's acting on strategic incentives is an inference to be drawn from the empirical evidence of Sky's "actual behaviour" in the course of the of the various bilateral negotiations which took place between Sky and certain retailers or potential retailers of Sky's CPSCs in the years leading up to the Statement ("the commercial negotiations").
23. Ofcom identified other competition concerns relating to Sky's practices in respect of VM and its corporate predecessors, ntl and Telewest. These concerns were: the

absence of supply of HD versions of Sky's CPSCs, the absence of supply of certain interactive services, and the failure to reach agreement on supply of Sky's premium channels to an off-net (i.e. not on VM's cable network) internet protocol TV ("IPTV") service then in contemplation. In addition, Ofcom identified another competition concern in the level of prices charged by Sky for its current wholesale supply of the CPSCs to VM on the latter's cable network. Ofcom considered that these wholesale prices, albeit not a concern of the same magnitude as the absence of wholesale supply to other retailers, prevented VM from competing effectively against Sky in the retail supply of the CPSCs.

24. Ofcom's analysis of the evidence relating to Sky's conduct and its competition concerns is set out at Section 7 of the Statement, where in particular the following main aspects of Sky's interaction with other retailers, or potential retailers, are considered:
- (a) Negotiations with TUTV for the proposed supply by Sky of its premium channels for distribution by TUTV via digital terrestrial television ("DTT"). (See paragraph 194 ff below.)
  - (b) Negotiations with BT for the proposed supply by Sky of its premium channels for distribution by BT via DTT/IPTV. (See paragraph 260 ff below.)
  - (c) Negotiations with another potential retailer for the supply of Sky's basic and premium channels over a proposed IPTV service. (See paragraph 405 ff below.)
  - (d) Negotiations with VM (and its predecessors, ntl and Telewest (together with VM, "the cable companies")) both as to the terms of the current wholesale supply to those companies and for the supply of HD versions of Sky's premium channels, the supply of certain interactive services, and the supply of Sky's premium channels to a proposed off-net IPTV service. (See paragraph 497 ff below.)

*Sky's challenge to Ofcom's findings*

25. Sky has disputed almost every element of Ofcom's assessment, not least Ofcom's interpretation of the evidence of the commercial negotiations, which is central to the findings described above.
26. Sky also disputes that in the commercial negotiations it was acting on anything other than normal commercial incentives, and in particular challenges Ofcom's finding that it was acting on the strategic incentives identified in the Statement.

*Tribunal's conclusions on Ofcom's core competition concern*

27. The Tribunal has examined the evidence in considerable detail. As already mentioned this evidence includes the contemporaneous documents<sup>13</sup> as well as the written and oral testimony of witnesses (some of whom were subject to extensive cross-examination) as to the relevant events and circumstances. The Tribunal has concluded that Ofcom's core competition concern is unfounded. That concern is based on the finding to which we have referred, namely that Sky has deliberately withheld from other retailers wholesale supply of its premium channels, preferring to be entirely absent from those retailers' platforms rather than to give them wholesale access,<sup>14</sup> and that in doing so Sky has been acting on strategic incentives unrelated to normal commercial considerations of revenue/profit-maximisation.
28. The Tribunal is of the view that Ofcom has, to a significant extent, misinterpreted the evidence of these negotiations, which does not support Ofcom's conclusion. We have found a significant number of Ofcom's pivotal findings of fact in the Statement to be inconsistent with the evidence.
29. Some of the most important issues on which we have differed from Ofcom relate to the respective conduct and motivation of Sky and its counterparties in the various

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<sup>13</sup> These documents relate to the bilateral negotiations between each of the six counterparties referred to in para 24 above. In the case of some counterparties, there were more than one set of such negotiations.

<sup>14</sup> A finding which Ofcom's leading counsel described as "the crucial finding of fact" in the Statement: Transcript 15/20. (Transcript references in the judgment are in the following form: Transcript [Day]/[Page]:[Line]. However, as here, references are not always made to the specific line of the transcript.)

commercial negotiations for access to the channels. For example, while acknowledging the existence of some “regulatory gaming”<sup>15</sup> on the part of other retailers, Ofcom has attributed responsibility for the failure to reach agreement largely to Sky’s failure to engage constructively with its counterparties. However the evidence shows that Sky did, on the whole, engage constructively. On the other hand its counterparties by no means always did so, and in our view regulatory gaming on the part of some of Sky’s counterparties played a much more important role in the commercial negotiations and their progress (or lack of it) than Ofcom has recognised. Although regulatory gaming was not so evident in the case of the retailer to which we refer at paragraph 24(c) above, Ofcom’s findings as to the reasons for ultimate abandonment of those negotiations, and its apparent attribution of significant responsibility to Sky, are again inconsistent with the evidence.

30. Although Sky has a strong preference for having the retail role itself when supplying its premium channels to third party platforms (known as “self-retail”), and acts upon that preference in conducting negotiations for access to the channels, this is not in itself a subject of criticism by Ofcom. Further, leaving aside Sky’s very long-standing wholesale supply to the cable companies, the evidence put before us, including evidence arising out of the commercial negotiations, shows that, contrary to Ofcom’s findings, Sky has no theological objection to wholesale supply of its premium channels, and is, in principle, willing to do so where self-retail is not open to it.
31. Another example of an error of factual assessment is Ofcom’s finding that, because it was unlikely that a competitor would be willing to allow it to self-retail on the competitor’s platform, it was also unlikely that Sky itself would have had an expectation that a competitor might allow this. In our view, this finding is inconsistent with the evidence and wrong in both respects, and has important implications for Ofcom’s conclusions about Sky’s motivations and in particular the disputed strategic incentives.

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<sup>15</sup> This is a reference to the conditioning of a party’s conduct in commercial negotiations by reason of an ongoing regulatory review by Ofcom, and its hope and expectation that this review would produce a favourable outcome.

*Tribunal's conclusions on Ofcom's concerns relating to the cable companies*

32. Ofcom's other competition concerns, relating specifically to the prices for the existing wholesale supply of the CPSCs to VM, and the non-supply to the cable companies of certain new services, are in the Tribunal's view also unfounded. Further, in that connection we have found no evidence to justify Ofcom's finding that Sky has (or has acted upon) an incentive to weaken VM or its corporate predecessors as competitors.

(i) *Current wholesale prices*

33. As for the current terms of supply to VM, and in particular the level of the rate card prices charged by Sky, in the light of the evidence placed before the Tribunal the price level in question does not obstruct (or contribute to the obstruction of) fair and effective competition in the retail of these channels by VM. No doubt a lower wholesale price and a higher margin on packages<sup>16</sup> which contain the Sky channels in question would be welcomed by VM. However, the small negative incremental margin which results when one of VM's subscribers to a package with only basic Pay TV channels "upgrades" to one which includes CPSCs, is not such as to affect to any significant extent VM's incentives to market the latter packages.

34. The evidence makes clear that VM has a strong commercial and financial incentive to win and retain all customers who are interested in the CPSCs, in competition with Sky and others. Ofcom found there is no margin squeeze, and on the evidence we conclude that any cost advantage which Sky enjoys over VM by reason of Sky's larger Pay TV subscriber base, is relatively small. Nor does the evidence justify a finding that the level of the rate card is a significant cause of the persistently lower CPSC penetration on cable. Other factors, unrelated to rate card levels, are at least as likely to be at the root of this phenomenon.

35. In our view the evidence overall demonstrates that VM is rightly regarded by Sky as a serious, well-established rival capable of constraining Sky's actions in the

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<sup>16</sup> The CPSCs are not retailed by either Sky or VM as "stand alone" products, but as part of a package.

market, and that it does in fact compete effectively with Sky in the retail supply of packages which include CPSCs. We therefore conclude that Ofcom's finding as to the effect of the rate card prices on VM's incentives and competitive effort is not justified. Nor indeed is customer choice likely to be adversely affected to any real extent. Existing customers of VM who wish to take CPSCs can do so without switching, and at prices which are comparable with those on DTH satellite.

(ii) *HD, interactive and IPTV*

36. As for Ofcom's specific concerns about Sky's conduct in response to the cable companies' requests for supply of HD and interactive services and for supply of premium channels to a contemplated IPTV platform, the Tribunal concludes that the evidence relating to these issues does not support Ofcom's central finding that Sky was unwilling to engage constructively in negotiating the wholesale supply of the CPSCs. Nor does it justify a finding that Sky's conduct was motivated by a desire to weaken the cable companies as competitors. Neither does the Tribunal consider that the evidence in question reveals any practice which is itself liable to prejudice fair and effective competition in the retailing of the CPSCs, or which would make any significant contribution in combination with other factors.

*Strategic incentives*

37. Given these conclusions, there is no need for the Tribunal to resolve the issues debated before us at some length as to the plausibility or otherwise as a matter of economic theory of the alleged strategic incentives on which Sky was said by Ofcom to be acting in its conduct of the commercial negotiations. Ofcom's position at the hearing was that its findings relating to the strategic incentives were not essential to the existence of its core competition concern, but that the fact of Sky's acting upon these incentives would be revealed when we looked at the empirical evidence of Sky's conduct.<sup>17</sup> However, having examined that evidence with some care we have formed a clear view that Sky was acting for ordinary profit/revenue-maximising commercial motives, and that it cannot reasonably be inferred from the material put before us that the alleged incentives were conditioning Sky's conduct.

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<sup>17</sup> See para 166 below.

### *Ofcom's exercise of its judgment on certain issues – Tribunal's approach*

38. It is to be noted that in relation to two of Ofcom's specific concerns (supply of interactive services to VM and the rate card prices paid by VM) the facts made it appropriate for the Tribunal to consider whether Ofcom was right to conclude that the conduct in question was such as to prejudice fair and effective competition in the retail supply of the CPSCs. In each of those cases Ofcom's decision on that issue was, in our view, wrong. In reaching that conclusion we were mindful that the question was one on which Ofcom, as the specialist regulator, had been required by the legislation to exercise a degree of judgment, and that therefore when reviewing a decision of that kind on appeal we should have regard to certain principles derived from the authorities, and discussed later in this judgment.<sup>18</sup> In particular we should give due weight to Ofcom's decision and its reasoning, and should not interfere with it unless satisfied that it is wrong.

### *Consequences of the Tribunal's conclusions*

#### Other appeals and grounds of appeal

39. The Tribunal's conclusions on Sky's grounds of appeal relating to Ofcom's competition concerns are sufficient to dispose of the four appeals, and it is not necessary for the Tribunal to determine Sky's and the other Appellants' grounds challenging the WMO itself, nor for the Tribunal to determine the STB and CAM appeals.<sup>19</sup> Nor do we consider that it would be appropriate for us to do so.
40. It is sometimes appropriate for a court to express its views on issues even though they have become academic in the light of the court's findings on other matters. This can be the case where, as here, the court has heard evidence and submissions on the issues. The court's views on them might become relevant or helpful in the event of an appeal, and/or they might themselves be appealed contingently, against the possibility of the primary ruling being overturned. However these considerations did not persuade us in the present case. It would be difficult to

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<sup>18</sup> See section IV.

<sup>19</sup> However, as we note at paras 258-259 of the judgment, the Tribunal has considered the documents and evidence in those appeals.

justify the delay in handing down the Tribunal's decision which this exercise would have entailed, as well as the additional expenditure of judicial and other resources on issues which, in the light of our primary conclusions, are academic.

41. The decision not to embark on that exercise was to some extent vindicated by Ofcom's request to the Tribunal on 14 June 2012 not to give judgment yet, but first to reopen the hearing in order to admit further evidence and allow further submissions. This request related to issues which are now academic in that they concern grounds of challenge to the WMO remedy itself. Ofcom's request<sup>20</sup> arose out of the latest FAPL auction of live audio-visual rights to its football matches, the results of which were made public at that time, and which in its view had a bearing on the arguments put before us. Had we acceded to the request other parties would certainly have wished to introduce new evidence and submissions themselves. We declined to reopen the hearing, indicating that our reasons would be contained in this judgment. Those reasons should now be clear.

#### Directions and other relief

42. In the light of the Tribunal's conclusions, Sky's appeal must be allowed, but the Tribunal will hear the parties in due course on the appropriate ruling, in particular as regards (1) any action that Ofcom should be directed by the Tribunal to take for the purposes of section 195(3) of the 2003 Act<sup>21</sup> (as applied by section 317(7)); (2) any other order(s) that should be made in respect of the appeals themselves; and (3) the effect of this judgment on the Interim Relief Order, and generally.

## **II. OFCOM'S INVESTIGATION AND THE STATEMENT**

### ***The joint complaint, the Picnic proposal, and Ofcom's investigation***

43. Ofcom's investigation into the Pay TV sector ("the Pay TV review") was prompted by a joint written submission filed on 16 January 2007 by BT, Setanta Sports Holdings Limited ("Setanta"), TUTV and VM ("the Complainants"). In their

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<sup>20</sup> This was not the first request to the Tribunal to delay its judgment. In May 2012 FAPL asked the Tribunal not to deliver judgment while its 2012 live rights auction was in progress.

<sup>21</sup> See para 67 below.

submission, the Complainants alleged that competition in the Pay TV sector was not working properly and requested that Ofcom investigate the industry and consider whether to make a reference to the Competition Commission for a market investigation under Part IV of the 2002 Act.

44. Separately, on 8 February 2007, Sky announced that it proposed to launch a new Pay TV service, called “Picnic”, on the DTT platform (“the Picnic proposal”). This would have involved the removal of the three existing free to air (“FTA”) channels provided by Sky on DTT, to be replaced with a selection of Pay TV channels.<sup>22</sup> This announcement was followed by formal requests to Ofcom, in April 2007, by each of Sky and Arqiva<sup>23</sup> to vary their respective licences to allow for this modification of Sky’s DTT offering.
45. On 20 March 2007, Ofcom announced that it would investigate the Pay TV market before deciding whether to make a market reference to the Competition Commission. Ofcom stated that it would consult separately on the licence variations necessary for the purposes of the Picnic proposal, but that it would consider the implications of the possible entry of Sky on the DTT platform as part of its market investigation. Ofcom stated that it would also consider whether any concerns would be better addressed using powers under sector-specific regulation or the 1998 Act.
46. The Complainants supplemented their initial complaint with a more detailed submission to Ofcom, dated 3 July 2007, on the need for a market investigation into the Pay TV industry. This submission described the characteristics of the Pay TV industry, the nature of the “competition problem” in the industry and the consumer harm that was alleged to result, before proposing certain potential remedies to that problem. The submission also contained confidential annexes, which outlined the specific issues raised by each of the Complainants. Later in the judgment we refer again to the joint complaint and the July 2007 supplementary submissions when we

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<sup>22</sup> The FTA channels would be replaced by Sky Sports 1, Sky Movies Screen 1 (in the evening) and Sky One (in the evening, including an hour of Sky News content). In addition, the remainder of Sky’s capacity would be used by Sky to retail two further Pay TV channels in the daytime: Discovery Channel and Disney Channel.

<sup>23</sup> See footnote 5 for a description of Arqiva.

are dealing with the various bilateral negotiations between Sky and counterparties including three of the Complainants.<sup>24</sup>

47. Ofcom published three consultation documents as part of its Pay TV review, on 18 December 2007 (“the First Pay TV Consultation”), on 30 September 2008 (“the Second Pay TV Consultation”), and on 26 June 2009 (“the Third Pay TV Consultation”), and received numerous submissions from Sky, the Complainants, and other third parties. Ofcom also commissioned certain market research, prepared pricing and impact assessment models, and engaged external consultants to review certain aspects of Ofcom’s analysis. Ofcom also published two consultation documents in connection with its parallel review of Sky’s Picnic proposal, on 4 October 2007 (“the First Picnic Consultation”) and 30 September 2008 (“the Second Picnic Consultation”).
48. In late 2007 and early 2008, Sky and Ofcom discussed the possibility of Sky offering certain commitments as undertakings in lieu of a reference to the Competition Commission. We return to this issue at paragraph 190 ff below.
49. On 12 September 2008, Sky announced that it had decided to suspend all work on the Picnic proposal, citing Ofcom’s delay in reviewing the proposed service as the cause. Sky did not withdraw its application for approval of the licence condition variations, however, and Ofcom ultimately proceeded to publish its separate statement in relation to the Picnic proposal.<sup>25</sup>

### *Summary of the Statement*

50. In the Statement Ofcom found that Sky had market power in the wholesale and retail markets for Pay TV packages including core premium sports channels.<sup>26</sup> Sky’s market power was said to derive from several factors, and in particular the fact that Sky consistently held a 90% market share.<sup>27</sup> Given Sky’s high market share, Ofcom considered competitors would only materially undermine Sky’s

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<sup>24</sup> Setanta entered administration in June 2009.

<sup>25</sup> See footnote 5 above.

<sup>26</sup> Statement, para 1.22. In this context, Ofcom explains that “core premium sports channels” refers to Sky Sports 1, Sky Sports 2 and ESPN (ESPN is not, of course, the subject of the WMO).

<sup>27</sup> Statement, para 5.390 and para 5.508.

wholesale market position if they (in aggregate) are able to win a large amount of premium sports rights away from Sky.<sup>28</sup> Access to premium sports content, and in particular the acquisition of live Premier League rights, was found to be a barrier to entry and expansion. Sky held the majority of live Premier League rights packages at the time of the Statement and Ofcom expected it to retain those packages.<sup>29</sup> While VM has been a significant outlet for Sky's channels on cable, Ofcom did not consider VM was able to exercise sufficient buyer power to constrain Sky. Ofcom's assessment of Sky's profitability<sup>30</sup> reinforced its overall conclusion that Sky was dominant in the wholesale market and was likely to remain so for the next three to four years.<sup>31</sup>

51. Ofcom also considered that Sky had market power in the retail market for the provision in the UK of packages including core premium sports channels, based on its high market share and the presence of entry barriers.<sup>32</sup> However, Ofcom decided that Sky's retail market power did not imply any additional scope to raise retail prices above the level that would prevail if Sky had only market power in the wholesale market.<sup>33</sup> Ofcom therefore considered that Sky has a stronger incentive to exercise its market power at the wholesale level, rather than the retail level.<sup>34</sup>
  
52. Ofcom found that the Pay TV sector has delivered substantial benefits to consumers since its emergence in the early 1990s, and that Sky has been at the forefront of developing Pay TV services.<sup>35</sup> However, Ofcom also found that Sky had used its market power in the wholesale market for core premium channels to restrict the wholesale supply of those channels to other retailers, a practice which was prejudicial to fair and effective competition. This was said to be Ofcom's "key concern", which was accentuated by the fact that the ability of Pay TV retailers to compete effectively depended on access to the wholesale supply of core premium channels.<sup>36</sup>

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<sup>28</sup> Statement, para 5.493.

<sup>29</sup> Statement, paras 5.393, 5.466 and para 5.509.

<sup>30</sup> Statement, para 5.549.

<sup>31</sup> Statement, para 5.590.

<sup>32</sup> Statement, para 5.336 (market definition) and paras 5.603 and 5.612 (market power).

<sup>33</sup> Statement, para 5.604.

<sup>34</sup> Statement, para 5.611.

<sup>35</sup> Statement, para 1.2.

<sup>36</sup> Statement, para 7.1.

53. Ofcom examined in some detail several sets of negotiations between Sky and other retailers over possible access to Sky's premium sports channels on different platforms. None of these negotiations had led to an agreement for wholesale supply of the channels at the time the Statement was published. Ofcom rejected Sky's explanation as to why these negotiations had not resulted in wholesale supply. Ofcom concluded that this could not be attributed to capacity constraints, security concerns or to regulatory gaming by counterparties, and that the evidence of non-supply, together with Sky's market power and its vertical integration, suggested that Sky was acting on strategic incentives to restrict supply in order to favour its DTH satellite platform and to protect its position when bidding for key content sports rights.<sup>37</sup> Ofcom found that the prejudice to fair and effective competition arising from this restricted distribution of core premium sports channels by Sky had a detrimental effect on consumer choice, platform innovation and consumer prices.
54. As explained below, Sky has for many years provided its premium channels (in SD version) to VM on a wholesale basis, and continues to do so. Ofcom's view was that Sky was deterred from withdrawing supply to VM by the prospect of losing the wholesale revenues which it receives from an established customer base, and also by regulatory risk. However Ofcom had concerns that the terms of Sky's existing supply to VM (i.e. Sky's wholesale rate card prices) do not allow VM to compete effectively with Sky in the retail of Sky's premium sports channels. Ofcom also found that the non-supply of the HD versions of those channels to VM is preventing VM from competing effectively. While the challenges VM faced as a result of Sky's wholesale prices were not a competition concern of the same magnitude as those created by the absence of wholesale supply to other retailers, Ofcom felt that it nonetheless created a situation in which consumer choice was likely to be distorted.<sup>38</sup>
55. Ofcom concluded that the most appropriate way to ensure fair and effective competition in light of its findings was to use its powers under section 316 of the 2003 Act to impose the WMO, requiring Sky to offer its core premium sports channels on a wholesale basis to retailers on other platforms, at wholesale prices set

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<sup>37</sup> Statement, paras 7.7 and 7.201.

<sup>38</sup> Statement, para 7.9.

by Ofcom.<sup>39</sup> Ofcom decided (pursuant to the requirements of section 317<sup>40</sup> of the 2003 Act) that it would not be more appropriate to proceed under the 1998 Act. It also considered that it would not be appropriate to require the structural separation of Sky (as requested by BT, TUTV and VM) or intervene in the sale of sports rights or take specific action to address the concerns relating to what it considered to be Sky's high returns.<sup>41</sup>

56. The WMO would, in Ofcom's view, directly address the restricted wholesale supply and do so in a proportionate manner. Such an obligation would seek to replicate the distribution of sports channels that would be expected in an effectively competitive market. Ofcom also noted that similar remedies had been implemented and been effective elsewhere in the world.<sup>42</sup> Ofcom considered that consumers would benefit from the WMO in terms of choice of platform and new ways of packaging premium channels; that Pay TV retailers would be able to compete effectively and that Sky should benefit in a static sense from the expansion of its wholesale revenues. Ofcom also stated that the WMO had been designed to minimise the effect on the incentives to bid for, and the value of, the rights held by sports bodies.<sup>43</sup>

### III. THE PARTIES' GROUNDS OF APPEAL

#### *Sky's main contentions*

57. By its amended notice of appeal, Sky challenges the imposition of the WMO on a number of grounds, contending that:
- (a) Ofcom misinterpreted and misapplied section 316 of the 2003 Act. In particular, Sky argues that:
- i. Ofcom acted *ultra vires* in imposing the WMO, in that Ofcom can only take action pursuant to section 316 in order to ensure fair and effective competition in relation to the "provision of licensed

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<sup>39</sup> Statement, para 9.249.

<sup>40</sup> See Annex B to this judgment.

<sup>41</sup> Statement, paras 9.2-9.3.

<sup>42</sup> Statement, para 1.38.

<sup>43</sup> Statement, para 1.51, 1.53 and 1.54.

services or of connected services”. Ofcom’s concerns as expressed in the Statement are with competition in service provision at the retail level of the Pay TV market, and retail services are neither “licensed services” nor “connected services”.

- ii. In any event, in identifying the competition concerns in respect of which it has imposed the WMO remedy in application of section 316, Ofcom has failed to adhere to an approach based on the prohibitions in the competition rules laid down by EU law and mirrored in the 1998 Act, which it is bound to do.
- (b) Ofcom erred in finding that, in its dealings with other retailers who sought access to Sky’s core premium channels, Sky withheld wholesale supply and in doing so was acting on certain strategic incentives, was thereby forgoing the opportunity to earn revenue that such deals would present, and preferred to be absent from the platforms in question rather than wholesale to them. Sky contends that it has an incentive to distribute its channels widely, either by self-retail or through wholesale arrangements on satisfactory commercial terms.
- (c) Ofcom erred in assessing the impact and proportionality of the WMO, and erred in its calculation of the maximum wholesale price permitted under the remedy. Sky argues this ground of appeal under a number of sub-headings:
- i. In general terms, Ofcom failed properly to consider the impact and proportionality of a supply obligation by *inter alia*: failing to examine the correct counterfactual; engaging in a flawed and disproportionate assessment of the disadvantages of self-retail and of the benefits to consumers of regulation; and failing to take proper account of the serious adverse effects of regulation on Sky, rights holders and consumers.
  - ii. Ofcom engaged in a deficient and flawed analysis of why it is proportionate that the WMO should be extended to: multiple

providers on a single distribution platform; multiple providers on a single distribution technology (in particular, via internet and satellite); or VM.

iii. Ofcom's assessment of the price of the WMO, both generally and in setting a price adopting a "retail minus" approach, is flawed. Moreover, in adopting a "retail minus" approach, it has failed to justify why it has departed from the orthodox approach under Article 102 TFEU to margin squeeze cases and has failed to have any or proper regard to serious adverse effects on Sky and rights holders.

iv. Ofcom's inclusion of HD and interactive services within the WMO is disproportionate.

(d) Finally, Ofcom acted unlawfully in imposing the Conditions in the terms set out in the Statement. In particular, Ofcom failed to specify the Conditions in terms which are sufficiently certain to allow Sky to know what it needs to do in order to observe the WMO. Further, the terms of the Conditions differ in some respects and are inconsistent with the reasoning in the Statement. Ofcom also failed to consult Sky before imposing the Conditions, as provided by subsection 3(4) of the 1990 Act.

### ***FAPL's main contentions***

58. FAPL challenges the Statement on some of the same grounds of appeal as Sky. In particular, by its amended notice of appeal FAPL submits that:

(a) Ofcom acted *ultra vires* and in breach of the provisions of section 316 in the two discrete respects also argued by Sky, and which we have sought to summarise at sub-paragraph 57(a) above. Although these grounds of appeal were not argued in identical terms by FAPL and Sky, there was considerable overlap in the arguments raised, and they adopted each others' arguments.

(b) Grouping a number of sub-arguments together under a broad umbrella, Ofcom's conclusion that the WMO is necessary and proportionate is manifestly flawed. In particular:

- i. Ofcom failed to consider or apply well established principles applicable to refusal to supply or margin squeeze cases. Instead it applied an entirely novel theory of consumer harm that does not justify the imposition of the WMO. Further, Ofcom committed a number of errors in its approach to identifying harm and in its analysis of whether there were any less onerous means of achieving its aims.
- ii. Ofcom has substantially overstated the beneficial effects arising from the imposition of the WMO due to: adopting a flawed approach to assessing likely demand and consumer surplus; overestimating the extent of dynamic benefits; and erroneously concluding that Sky's revenues are likely substantially to increase.

59. In addition to the grounds summarised above, FAPL's principal focus is upon what it contends are the errors in the Statement relating to the adverse effects of the WMO remedy on rights holders such as FAPL. FAPL contends in this regard, firstly, that Ofcom's conclusion in the Statement that "rights holders are unlikely to see large reductions in rights values" as a result of the WMO due to an inability on the part of other retailers to undercut Sky, thereby reducing its revenues, is misconceived.<sup>44</sup> Secondly, FAPL submits that Ofcom erred in its conclusion that its remedy would be unlikely to have an adverse effect on the value of sports media rights or the incentives of third parties to bid for such rights. (In putting forward these grounds, FAPL received support from the Sports Body Interveners, who also presented evidence, both written and oral.)

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<sup>44</sup> Statement, para 11.186.

60. Finally, FAPL contends that Ofcom's consultation process was flawed because Ofcom did not provide FAPL with either its impact assessment model or pricing model;<sup>45</sup> and Ofcom failed to consult on what is now the WMO.

***BT's main contentions***

61. BT emphasises at the outset that it considers the reasoning and the conclusions in the majority of the Statement to be sound. It specifically endorses Ofcom's findings related to Sky's market power, consumer detriment and the necessity to intervene. However, BT contends that the conditions imposed by Ofcom fail to achieve the statutory purpose of section 316, namely to ensure fair and effective competition.

62. In its amended notice of appeal, BT puts forward two grounds:

- (a) Firstly, Ofcom's decision to exclude Sky Sports 3 and 4 from the scope of the WMO was incorrect. Ofcom did not consider properly whether these channels extend or reinforce Sky's market power. Moreover, not including them within the WMO gives rise to uncertainty, in that the possibility exists for Sky to shift content from Sky Sports 1 and 2 to the other channels.
- (b) Secondly, Ofcom set the actual price of the WMO in a manner which was inconsistent with the principle that prices should be set at a level which would ensure fair and effective competition, but discourage inefficient entry. In particular, Ofcom made a number of errors in determining the price and setting the mechanism by which they will be adjusted including, for example, the misallocation of Sky's costs, adopting an unrealistic churn rate and using an inappropriate financial model.

***VM's main contentions***

63. Like BT, VM accepts the majority of the findings contained in the Statement and limits its appeal to certain specific issues related to the terms of the WMO itself,

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<sup>45</sup> See para 47 above.

both regarding its scope and the price set. By its amended notice of appeal, VM contends that Ofcom made the following errors in the Statement:

- (a) The basis upon which Ofcom decided to exclude Sky Sports 3 and 4 from the scope of the WMO is flawed. In particular, there is no indication in the Statement that separate substantive consideration was given to the question of the effectiveness of the WMO without those channels, especially the issue of the extent to which Sky's bundling of those channels within its retail packages has an impact on the effectiveness of the remedy.
- (b) Ofcom failed to impose any control on the prices that Sky may charge for the supply of Sky Sports 1 and 2 where those channels are bundled with Sky Sports 3 and/or 4 and/or any of Sky's core premium movies channels. As such, the WMO is not fit for the purpose of ensuring that other retailers can compete in the provision of Pay TV bundles.
- (c) The methodology adopted by Ofcom to calculate the maximum prices for the supply of Sky Sports 1 and 2 is flawed, in particular the reliance placed by Ofcom on Sky's current costs as the best available proxy for an efficient retailer.
- (d) Ofcom's mechanism for calculating the maximum prices under the WMO following changes in Sky's own retail prices is flawed. The mechanism does not adequately take account of future changes to Sky's prices, specifically in relation to discounts offered by Sky.

### *The structure of the remainder of the judgment*

64. The remainder of this judgment is structured as follows. In **section IV** below we address briefly the parties' submissions on the role of the Tribunal in these appeals. Then, in **section V**, we consider the two specific challenges by Sky and FAPL to Ofcom's jurisdiction under section 316. After that, in **section VI**, we examine Sky's root and branch challenge to Ofcom's central findings in the Statement as to the practices on the part of Sky which form the foundations of Ofcom's competition

concerns, and to which the WMO remedy is directed. Finally, in **section VII** we explain why, in the light of our conclusions in section VI, the Tribunal does not consider it necessary or appropriate to determine the other issues raised in these appeals, and in particular those relating to the validity, effectiveness and proportionality of the WMO remedy imposed by Ofcom.

#### **IV. THE TRIBUNAL'S ROLE**

65. The nature of the Tribunal's appellate function, under both the 1998 Act and the 2003 Act, has been considered on a number of occasions, including by the Court of Appeal. However, these are the first appeals to reach the Tribunal from the exercise by Ofcom of its powers under section 316 of the 2003 Act, and this subject received some attention in the submissions of the parties. It is therefore appropriate to consider the position of the Tribunal in the present context. Before doing so we set out the statutory provisions governing the Tribunal's powers on appeals such as the present, which are brought under subsection 317(6) of the 2003 Act. By virtue of subsection 317(7) the powers of the Tribunal under subsections 192(3) to (8), 195 and 196 of the 2003 Act apply here, as they do in the case of appeals to the Tribunal under subsection 192(2).

66. By virtue of subsection 192(6) the grounds of appeal must be set out in sufficient detail to indicate:

“(a) to what extent (if any) the appellant contends that the decision appealed against was based on an error of fact or was wrong in law or both; and

(b) to what extent (if any) the appellant is appealing against the exercise of a discretion by Ofcom, by the Secretary of State or by another person.”

67. The relevant parts of section 195 of the 2003 Act for present purposes are:

“(1) The Tribunal shall dispose of an appeal under section 192(2) in accordance with this section.

(2) The Tribunal shall decide the appeal on the merits and by reference to the grounds of appeal set out in the notice of appeal.

(3) The Tribunal's decision must include a decision as to what (if any) is the appropriate action for the decision-maker to take in relation to the subject-matter of the decision under appeal.

(4) The Tribunal shall then remit the decision under appeal to the decision-maker with such directions (if any) as the Tribunal considers appropriate for giving effect to its decision.

(5) The Tribunal must not direct the decision-maker to take any action which he would not otherwise have power to take in relation to the decision under appeal.

...”

68. Section 316 itself provides:<sup>46</sup>

“316 Conditions relating to competition matters

(1) The regulatory regime for every licensed service includes the conditions (if any) that OFCOM consider appropriate for ensuring fair and effective competition in the provision of licensed services or of connected services.

(2) Those conditions must include the conditions (if any) that OFCOM consider appropriate for securing that the provider of the service does not—

- (a) enter into or maintain any arrangements, or
- (b) engage in any practice,

which OFCOM consider, or would consider, to be prejudicial to fair and effective competition in the provision of licensed services or of connected services.

(3) A condition imposed under this section may require a licence holder to comply with one or both of the following—

- (a) a code for the time being approved by OFCOM for the purposes of the conditions; and
- (b) directions given to him by OFCOM for those purposes.

(4) In this section—

“connected services”, in relation to licensed services, means the provision of programmes for inclusion in licensed services and any other services provided for purposes connected with, or with the provision of, licensed services; and

“licensed service” means a service licensed by a Broadcasting Act licence.”

### ***Sky and FAPL submissions***

69. Sky and FAPL submit that the Statement must be subjected to, and be able to withstand, “profound and rigorous scrutiny” by the Tribunal. In this regard they cite *Hutchison 3G UK Ltd v OFCOM* [2008] CAT 11, at [164] and *Vodafone v*

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<sup>46</sup> See also Annex B, which sets out statutory material (including section 316) relevant to the Appellants’ challenge to Ofcom’s jurisdiction.

*OFCOM* [2008] CAT 22, at [46]-[47]. The question for the Tribunal is whether Ofcom has reached the “right decision”. Sky also submits that the Tribunal must determine whether each element of the WMO is justified and correctly specified (paragraph 2.28 of Sky’s amended notice of appeal). This is particularly the case where, as here, the regulator is seeking to make judgments about future events. Sky and FAPL add that the principles to be applied in this case are similar to those applied by the Competition Commission in its determination of price control matters in *Hutchison 3G (UK) Limited v OFCOM* (Case 1083/3/3/07) and *British Telecommunications plc v OFCOM* (Case 1085/3/3/07),<sup>47</sup> at paragraphs 1.30 to 1.31.

70. Sky advances six principal contentions in relation to the role of the Tribunal. First, it was common ground that issues as to the scope of Ofcom’s powers under section 316 are questions of law that the Tribunal is called on to decide. Second, Sky submits that the Tribunal is entitled to, and should, form its own views on matters of judgment. That is the consequence, Sky says, of the Tribunal hearing this appeal “on the merits”. Sky denies that this means that the Tribunal becomes a “shadow regulator, retaking Ofcom’s decision” as the statute directs the Tribunal to determine appeals by reference to the grounds of appeal. Third, Sky contends that any appellant is entitled to raise new points and adduce new evidence in support of such points. It follows that the Tribunal is not confined to considering issues that were before Ofcom at the time of the Statement. Fourth, and conversely, Ofcom must defend the decision it has taken. Fifth, the Tribunal may form its own view of the facts according to the written and oral evidence placed before it. Further, in this case the Tribunal is required to make findings of fact given the extensive disagreement on significant matters in evidence. The sixth contention concerns the interpretation of the principle of proportionality.

### ***Ofcom submissions***

71. Ofcom submits that the correct approach for the Tribunal is to exercise its powers only when satisfied that the regulator’s decision is wrong, not merely because it is

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<sup>47</sup> Competition Commission determination of 16 January 2009, *Mobile phone wholesale voice termination charges*.

not satisfied that the decision was right (*Stepney Borough Council v Joffe* [1949] 1 KB 599, at 602-603, per Lord Goddard CJ). An appeal should not be allowed where an error on Ofcom's part had no material effect on its decision (*Carphone Warehouse Group Plc v OFCOM*, Competition Commission Determination of 31 August 2010, paragraphs 1.59 to 1.65). In Ofcom's submission the approach to be applied by the Tribunal in determining an appeal on the merits depends on the nature of the error alleged. Ofcom accepts that the Tribunal can reach its own conclusions on matters of law and fact, but submits that the position is less straightforward when the Tribunal is required to decide whether Ofcom erred in the exercise of its discretion. Ofcom submits that when Parliament has bestowed the decision-making power on a particular body, then the Tribunal should not substitute its own view, unless it detects errors in the exercise of that body's discretion (paragraph 32 of the Defence).

72. Ofcom emphasises four factors leading to the conclusion that Ofcom should be afforded a reasonable margin of discretion. First, Ofcom is the specialist regulator, chosen by Parliament to make policy decisions involving complex economic judgments. Second, the margin of discretion should be broader in respect of expert evaluation and regulatory judgments as to the public interest, the interaction of complex economic and technical factors or predictions of the future. These are all assessments in relation to which there is no single right or wrong answer, and thus where the regulator is required to make choices. The third factor is the extensive nature of Ofcom's investigation and the detailed reasons given by Ofcom in the Statement. Fourth, the conflict of expert evidence before the Tribunal indicates that there was no single correct approach and thus Ofcom's judgment should be accepted by the Tribunal unless shown to be plainly flawed.

### ***BT submissions***

73. BT submits that the appropriate standard of review must be determined on a case-by-case basis by reference to the nature and subject-matter of the appeal. BT submits that it is evident from the wording of section 316 of the 2003 Act that Ofcom must be permitted a significant measure of discretion both in its analysis of the problem and the remedies to be imposed. However, BT contends that its appeal

does not concern matters of judgment. BT submits that its challenge to the scope of and price set by the WMO are errors which the Tribunal can and should correct, or should require Ofcom to re-examine.

### *The Tribunal's discussion and conclusions*

74. As seen, the relevant legislation requires the Tribunal to decide such appeals “on the merits”. The meaning of “on the merits” was considered by the Tribunal in *British Telecommunications Plc v OFCOM* [2010] CAT 17, (appeal dismissed, [2011] EWCA Civ 245). There the Tribunal stated:

“70. ...the first limb of section [195](2) quite clearly requires that the appeal be conducted “on the merits” and not in accordance with the rules that would apply on a judicial review. This point was very clearly made in *Hutchison 3G UK Limited v Office of Communications* [2008] CAT 11 at paragraph [164]:

“However, this is an appeal on the merits and the Tribunal is not concerned solely with whether the 2007 Statement is adequately reasoned but also with whether those reasons are correct. The Tribunal accepts the point made by H3G in their Reply on the SMP and Appropriate Remedy issues that it is a specialist court designed to be able to scrutinise the detail of regulatory decisions in a profound and rigorous manner. The question for the Tribunal is not whether the decision to impose a price control was within the range of reasonable responses but whether the decision was the right one.”

We consider that this correctly states the legal consequences of section [195](2).

71. That said, Jacob LJ in *T-Mobile (UK) Limited v Office of Communications* [2008] EWCA Civ 1373 made absolutely clear that the Section 192 Appeal Process is not intended to duplicate, still less, usurp, the functions of the regulator. In paragraph [31], he stated:

“After all it is inconceivable that Article 4 [of the Framework Directive], in requiring an appeal which can duly take into account the merits, requires Member States to have in effect a fully equipped duplicate regulatory body waiting in the wings just for appeals. What is called for is an appeal body and no more, a body which can look into whether the regulator had got something materially wrong. That may be very difficult if all that is impugned is an overall value judgment based upon competing commercial considerations in the context of a public policy decision.”

...

77. The nature of the appeal before the Tribunal is similarly made clear in sections [195](3) and (4) of the 2003 Act. These sections make plain that it is not for the Tribunal to usurp OFCOM's decision-making role. The Tribunal's role is not to make a fresh determination, but to indicate to OFCOM what (if any) is the appropriate action for OFCOM to take in relation to the subject-matter of the decision under appeal and then to remit the matter back to OFCOM.”

(In *T-Mobile (UK) Limited v OFCOM* [2008] EWCA Civ 1373, the issue was whether *judicial review* of policy decisions by Ofcom about the process of licensing spectrum was a rigorous enough procedure to comply with EU law. The Court of Appeal held that judicial review was compliant.)

75. It is not controversial that one of the Tribunal's functions in appeals such as these is to decide any points of law which may arise. Two examples which have arisen in these proceedings relate to the nature and scope of Ofcom's jurisdiction under section 316 of the 2003 Act.<sup>48</sup>
76. These appeals, and in particular that of Sky, have also generated numerous disputes of fact, many of which concern Ofcom's interpretation of correspondence and of other material relating to the negotiations between Sky and various retailers for the supply of the CPSCs. Ofcom's findings of fact in relation to these are at the heart of its identification of certain competition problems, including Ofcom's core concern about Sky's attitude to wholesaling the CPSCs to other retailers. It is clear (and appears to be common ground<sup>49</sup>) that in a case such as this the Tribunal has jurisdiction to assess and find the facts in so far as they are relevant to the grounds of appeal, and must do so in the light of the admissible material that is before it. If, having evaluated the evidence, the Tribunal finds that a material finding of fact made by Ofcom is wrong, then it must so hold and proceed accordingly. Although a finding of fact obviously involves an evaluation of the evidence, this is not an exercise of discretion, and there is no margin of appreciation (as that notion is generally understood in this context) in relation to such findings, any more than for decisions on points of law.
77. In regard to the disputes of fact, we have been able to read and consider the same documents as Ofcom. In addition, we have had the benefit of considerable written and oral testimony concerning the facts, including extensive cross-examination of the factual witnesses. We are therefore in at least as good a position as Ofcom, and quite possibly a better one, to interpret the documents and correspondence relating to the negotiations in question.

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<sup>48</sup> See para 92 ff and para 119 ff of this judgment.

<sup>49</sup> See for example Transcript 15/11.

78. Some of the grounds of appeal call into question Ofcom’s conclusion that a specified practice of Sky precludes “fair and effective competition” in the provision of the relevant services. Other grounds of appeal challenge Ofcom’s decision that the WMO is an “appropriate” remedy for ensuring that such a practice is not engaged in. The words of section 316 itself are general in nature, and make clear that Parliament requires Ofcom, as the decision-maker, to exercise its judgment in such matters.<sup>50</sup> Because that role is given to Ofcom, we agree with Ofcom that when reviewing grounds of appeal from the exercise of its judgment, the Tribunal is not (to borrow the expression of Jacob LJ<sup>51</sup>) acting as a “fully equipped duplicate regulatory body waiting in the wings”. An appeal on the merits is not intended to be a re-run of the administrative process or an opportunity to retake the decision (*BT v OFCOM*, above). How then should the Tribunal approach challenges to the exercise by Ofcom of its judgment in such matters?
79. Leading counsel for Ofcom drew our attention to several authorities on the role of an appeal body, albeit in circumstances somewhat removed from the present context. Perhaps the clearest articulation of the appellate function is to be found in the speech of Lord Hoffmann in *Secretary of State for the Home Department v Rehman* [2003] 1 AC 153 and in the judgment of the Court of Appeal in *R (Hope and Glory Public House Limited) v City of Westminster Magistrates Court* [2011] EWCA Civ 31.
80. The question in *Rehman* was whether the Secretary of State was entitled to deport an individual on the basis that he posed a threat to national security. An appeal to the Special Immigration Appeals Commission against the decision of the Secretary of State was upheld. The Commission’s judgment was reversed on appeal, however, on the ground that it had erred in law. Lord Hoffmann noted that the Commission had full jurisdiction to decide questions of fact and law, but that it had not made sufficient allowance for certain inherent limitations on both the judicial power and the appellate process (at pp 191-192, paragraph 49). On the limitations of the appellate process, his Lordship said at pp 194-195, paragraphs 57 to 58:

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<sup>50</sup> “...any practice which Ofcom consider...to be prejudicial” etc.

<sup>51</sup> See para 74 of this judgment.

“First, the Commission is not the primary decision-maker. Not only is the decision entrusted to the Home Secretary but he also has the advantage of a wide range of advice from people with day-to-day involvement in security matters which the Commission, despite its specialist membership, cannot match. Secondly, as I have just been saying, the question at issue in this case does not involve a yes or no answer as to whether it is more likely than not that someone has done something but an evaluation of risk. In such questions an appellate body traditionally allows a considerable margin to the primary decision-maker. Even if the appellate body prefers a different view, it should not ordinarily interfere with a case in which it considers that the view of the Home Secretary is one which could reasonably be entertained. Such restraint may not be necessary in relation to every issue which the Commission has to decide. As I have mentioned, the approach to whether the rights of an appellant under article 3 [ECHR] are likely to be infringed may be very different. But I think it is required in relation to the question of whether a deportation is in the interests of national security.

I emphasise that the need for restraint is not based upon any limit to the Commission's appellate jurisdiction. The amplitude of that jurisdiction is emphasised by the express power to reverse the exercise of a discretion. The need for restraint flows from a common-sense recognition of the nature of the issue and the differences in the decision-making processes and responsibilities of the Home Secretary and the Commission.”

81. Ofcom submits that although the context is different the Tribunal should bear in mind the limitations of the appellate process identified by Lord Hoffmann when reviewing Ofcom's exercise of regulatory discretion. Ofcom contends that it engaged in a complex multifactorial assessment of technical matters, each of which involved an element of appreciation and the exercise of judgment. These are not matters that lend themselves to a single correct answer and a reasonable margin of discretion should be recognised. Ofcom therefore submits that the question for the Tribunal is whether Ofcom's decision is reasonably sustainable, and not whether the Tribunal would have reached a different judgment on particular issues.<sup>52</sup>
82. *Hope and Glory* was an appeal to a magistrates' court against a decision of a licensing authority under the Licensing Act 2003 varying the conditions attached to the licence of a public house in the light of numerous complaints about noise caused by customers taking their drinks outside into the street. The district judge upheld the decision, the Administrative Court refused permission to apply for judicial review of the district judge's decision, and the Court of Appeal dismissed an appeal. It was common ground before the Court of Appeal that the administrative decision of the licensing authority was a relevant matter for the district judge to take into account.

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<sup>52</sup> Transcript 4/46-47.

In considering how much *weight* the district judge should give to that decision, Toulson LJ said at paragraphs [40] and [45]:

“We do not consider that it is possible to give a formulaic answer to the first question because it may depend on a variety of factors - the nature of the issue, the nature and quality of the reasons given by the licensing authority and the nature and quality of the evidence on the appeal.

...

Given all the variables, the proper conclusion to the first question can only be stated in very general terms. It is right in all cases that the magistrates’ court should pay careful attention to the reasons given by the licensing authority for arriving at the decision under appeal, bearing in mind that Parliament has chosen to place responsibility for making such decisions on local authorities. The weight which the magistrates should ultimately attach to those reasons must be a matter for their judgment in all the circumstances, taking into account the fullness and clarity of the reasons, the nature of the issues and the evidence given on the appeal.”

83. Toulson LJ expressly agreed with the following approach of Burton J, who had refused permission to apply for judicial review of the decision of the magistrates’ court:<sup>53</sup>

“What the appellate court will have to do is to be satisfied that the judgment below “is wrong”, that is to reach its conclusion on the basis of the evidence put before it and then to conclude that the judgment below is wrong, even if it was not wrong at the time. That is what this district judge was prepared to do by allowing fresh evidence in, on both sides

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At the end of the day, the decision before the district judge is whether the decision of the licensing committee is wrong. Mr Glen has submitted that the word “wrong” is difficult to understand, or, at any rate, insufficiently clarified. What does it mean? It is plainly not “Wednesbury unreasonable” because this is not a question of judicial review. It means that the task of the district judge – having heard the evidence which is now before him, and specifically addressing the decision of the court below – is to give a decision whether, because he disagrees with the decision below in the light of the evidence before him, it is therefore wrong.”

(See also *British Telecommunications Plc v OFCOM* [2011] EWCA Civ 245, per Toulson LJ at paragraph 65.)

84. Having regard to the parties’ submissions and the authorities to which our attention was drawn, we consider that the following principles should inform our approach to

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<sup>53</sup> [2009] EWHC 1996 (Admin), at paras 43 and 45.

disputed questions upon which Ofcom has exercised a judgment of the kind under discussion:

- (a) Since the Tribunal is exercising a jurisdiction “on the merits”, its assessment is not limited to the classic heads of judicial review, and in particular it is not restricted to an investigation of whether Ofcom’s determination of the particular issue was what is known as *Wednesbury* unreasonable or irrational or outside the range of reasonable responses.
- (b) Rather the Tribunal is called upon to consider whether, in the light of the grounds of appeal and the evidence before it, the determination was wrong. For this purpose it is not sufficient for the Tribunal simply to conclude that it would have reached a different decision had it been the designated decision-maker.
- (c) In considering whether the regulator’s decision on the specific issue is wrong, the Tribunal should consider the decision carefully, and attach due weight to it, and to the reasons underlying it. This follows not least from the fact that this is an appeal from an administrative decision not a *de novo* rehearing of the matter, and from the fact that Parliament has chosen to place responsibility for making the decision on Ofcom.
- (d) When considering how much weight to place upon those matters, the specific language of section 316 to which we have referred, and the duration and intensity of the investigation carried out by Ofcom as a specialist regulator, are clearly important factors, along with the nature of the particular issue and decision, the fullness and clarity of the reasoning and the evidence given on appeal. Whether or not it is helpful to encapsulate the appropriate approach in the proposition that Ofcom enjoys a margin of appreciation on issues which entail the exercise of its judgment, the fact is that the Tribunal should apply appropriate restraint and should not interfere with Ofcom’s exercise of a judgment unless satisfied that it was wrong.

## V. GROUNDS OF APPEAL RELATING TO OFCOM'S JURISDICTION UNDER SECTION 316

### *Relevant statutory provisions*

85. We now turn to the two discrete challenges to Ofcom's exercise of jurisdiction under section 316 of the 2003 Act. In order to follow the arguments in this section, reference will need to be made to the relevant statutory material, which is set out in Annex B to this judgment.

### *The "licensed and connected services" ground of appeal*

86. Both Sky and FAPL submit that Ofcom's intervention is outside its powers under section 316 of the 2003 Act on the ground that the intervention is not in respect of "competition in the provision of licensed services or of connected services", as the section requires. There is considerable overlap in the way this argument is formulated by Sky and FAPL, and to a great extent they adopted each other's submissions. Therefore, we will refer in this section to "Sky/FAPL" collectively, except where there is a reason to differentiate between them.

87. In brief summary Sky/FAPL submit as follows:

- (a) Ofcom's powers under section 316 relate to competition in the provision of licensed services and connected services;
- (b) Ofcom acted with a view to securing fair and effective competition in service provision at the *retail* level (i.e. as between Sky and competing retailers);
- (c) Retail services are neither licensed services nor services connected with licensed services;
- (d) The subsidiary indications in the Statement about the possibility of future entry upstream in the wholesale market cannot be used to justify Ofcom's intervention;

(e) The imposition of the WMO is accordingly outside the scope of Ofcom's powers under section 316 of the 2003 Act.

88. Although this is the first occasion on which the jurisdiction under section 316 has been exercised by Ofcom, there is little discussion in the Statement about the precise nature and scope of the jurisdiction. The Statement declares that the CPSCs are "licensed services" for the purposes of section 316.<sup>54</sup> However there is no unequivocal indication whether the services to which Ofcom's intervention in the form of the WMO is directed (viz the provision of the CPSCs at the retail level) were understood by Ofcom to constitute "licensed services" or "connected services". We were pointed to a number of references in the Statement, including paragraph 3.9, which states:

"In the Third Pay TV Consultation we explained that we considered that fair and effective competition in the provision of the licensed services is not occurring and will not occur in respect of Sky's wholesaling of channels subject to broadcasting licences. We considered it may therefore be appropriate to intervene in the wholesale of Core Premium channels to ensure fair and effective competition through the imposition of licence conditions. We consulted on the form that such licence conditions might take."

Perhaps the clearest statement is in paragraph 9.8, which states:

"Section 316 of the Communications Act 2003 empowers and requires us to impose licence conditions to ensure fair and effective competition in the provision of licensed services. We consider that it is appropriate in this case to impose conditions in the form of a wholesale must-offer obligation so as to ensure fair and effective competition. Under section 317 we must consider whether it would be more appropriate to proceed under the Competition Act 1998 before proceeding under section 316. We have decided that it would not be more appropriate to proceed under the Competition Act 1998 because of the need for a comprehensive solution to a general problem affecting the relevant markets."

89. The assumption therefore seems to be, at least so far as the Statement is concerned, that the supply of the CPSCs, whether at the wholesale or retail level, is a "licensed service", as opposed to a "connected service".

90. The issue of statutory construction which is the subject of the Sky/FAPL appeals was not developed at any length in the openings, although at our request leading counsel for Ofcom did point us to some additional relevant statutory material. It is

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<sup>54</sup> Statement, para 3.8.

fair to say that the main submissions were made only in the closing submissions, and that the arguments were refined to some extent at that stage. In its closing submissions, Ofcom focussed on the fact that Sky could be identified as the “person” providing the licensed service comprising the CPSCs.<sup>55</sup> Its final submission was that Sky’s retail provision of the services in question constitutes the provision of “licensed services”, or alternatively the provision of “connected services”.

91. It also became clear by the end of the hearing that *if* Ofcom was not empowered to impose the WMO for the purpose of ensuring fair competition in the provision of CPSCs at the retail level, Ofcom does not seek to justify its intervention by reference to any benefits to competition the WMO might bring at the *wholesale* level. Although such an argument did at one stage appear to surface, it was not pursued by Ofcom’s leading counsel in closing. Sky’s leading counsel and FAPL’s leading counsel put on record their understanding that it was not being relied upon, and they were not contradicted. This is clearly correct. The *leitmotif* of the Statement is undoubtedly Ofcom’s finding that Sky’s practices are adversely affecting competition in supply of the CPSCs at the retail level.<sup>56</sup> The WMO could not be justified by reference to the state of competition between wholesalers or potential wholesalers without a major reformulation of the Statement, and probably a further investigation.

### Licensed services

92. It is a criminal offence for a person to provide a relevant service without having the appropriate licence under the 1990 Act or the Broadcasting Act 1996 (“the 1996 Act”). By virtue of subsection 316(4) of the 2003 Act “licensed service” means a service licensed by a Broadcasting Act licence. Under subsection 405(1) of the 2003 Act a Broadcasting Act licence is defined as “a licence under Part 1 or 3 of the 1990 Act or under Part 1 or 2 of the 1996 Act”. It appears to be common ground that the particular licensed services at issue here are the provision of Sky’s four CPSCs, and that Sky holds “television licensable content service” licences, granted

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<sup>55</sup> Ofcom’s written closing submissions, Part A, para 21.

<sup>56</sup> See, for example, paras 1.6 and 1.24 of the Statement.

under Part 1 of the 1990 Act, for the *satellite and cable* distribution of those channels (see section 235 of the 2003 Act). Sky is also said to hold a licence under the 1996 Act for the broadcast of the channels in question on *DTT*.

93. Sky/FAPL point to section 232 of the 2003 Act, which defines “television licensable content service” as a service (programmes / electronic programme guides (“EPGs”)) which is “provided with a view to its availability for reception by members of the public”. From this they argue that the service requiring a licence is not the actual supply (or provision) of channels to the consumer at the retail level; rather what must be licensed is the service provided “with a view to” such supply, i.e. in anticipation of, or in expectation of, the channel being at some point in the future made available to the public. In this way, it is argued, section 232 excludes from the definition of “television licensable content service” the services involved in actually making the channel available to the public, and includes the services provided in anticipation of those excluded services.
94. Sky/FAPL draw attention in this regard to the fact that the section expressly contemplates that the broadcasting or distribution of the channel to the public may be performed by the channel provider, or by somebody else (see for example subsection 232(1)(a)). Sky/FAPL also point to the fact that statutory provisions governing other television services that require a licence contain the same explicit distinction between a service “provided with a view to” the channel being made available to the public (which requires a license) and the actual making available of the channel to the public (which does not). They give as examples subsections 211(2)(a) and 211(2)(c) of the 2003 Act.
95. Sky/FAPL argue that since Ofcom accepts that the retail service does not require a licence, then it must follow that the retail service is not a “television licensable content service”; it therefore cannot be a “licensed service” and the subject of intervention by Ofcom under section 316 (unless it is a “connected service”).

96. Sky/FAPL also seek to draw support from the fact that the Television Without Frontiers Directive<sup>57</sup> (“the Directive”) is implemented in part by the 2003 Act. (Section 211 expressly refers to Ofcom’s licensing function in respect of television licensable content services as being “for the purposes of [the Directive]”). The Directive defines “television broadcasting” as the “initial transmission by wire or over the air, including that by satellite ... of television programmes intended for reception by the public.” Thus, it is said, the Directive draws the same distinction between the initial provision of a channel with a view to its being made publicly available, and the subsequent supply of the channel to the public, putting it beyond doubt that the retail of a channel is not part of its broadcast and is not therefore a service that requires a licence. (See e.g. Article 2). This division, it is submitted, chimes with the fact that it is the programming content, including the content of advertising, which the Directive requires to be regulated. The licensee is, therefore, the person with editorial control, i.e. the channel provider. Given that the 2003 Act (along with the 1990 and 1996 Acts) implements the Directive, it must be construed compatibly with it.
97. Sky/FAPL argue that their construction renders the statutory scheme coherent: every company that provides a channel, comprising upstream services such as scheduling, programme compilation, and advertising, and does so with a view to the reception of that channel by members of the public, requires a licence. Such an undertaking is subject to this requirement whether it intends to make the channel available on a FTA or a Pay TV basis, and whether it intends to supply the channel to the public itself or envisages supply by another person. On the other hand, a company which provides only retail services (i.e. actually makes channels available to the public via a Pay TV service) does not require a licence, and is not regulated by Ofcom, *in relation to the provision of those retail services*.
98. Sky/FAPL submit that by contrast Ofcom’s interpretation produces a contrived and unlikely result. We therefore turn to consider Ofcom’s submissions.

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<sup>57</sup> Directive 2007/65/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directive 89/552/EEC on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities.

99. Ofcom's argument relies upon the following propositions. In order to provide a relevant service one must have the appropriate licence. Subsection 362(2) of the 2003 Act states that "the person, and the only person, who is to be treated as providing" a relevant service "is the person with general control over which programmes and other services and facilities are comprised in the service (whether or not he has control of the content of individual programmes or of the broadcasting or distribution of the service)." Subsection 362(1) states that " "provision", in relation to a service, is to be construed ... in accordance with subsection (2), and cognate expressions are to be construed accordingly". Sky is, therefore, clearly the "provider" of the services comprising the CPSCs and, as such, is the person who requires a licence. However, section 362 does not indicate what *acts* constitute the provision of the service which is being licensed. (We interpose to state that so far these propositions are common ground. The following, however, are contentious.) The retailing of Sky's CPSCs, whether by the likes of BT and VM or by Sky itself, constitutes in each case the provision of a licensed service. This is made clear by section 361, which states that the phrase "available for reception by members of the public" includes any service made available for reception only to persons who subscribe to it, "*or who otherwise request its provision*". Thus, argues Ofcom, where a member of the public subscribes to a Pay TV service, that constitutes a request for *provision* of that service. Although Ofcom agrees that BT and VM do not need a licence in order to retail Sky's CPSCs, Ofcom submits that the reason is not because the activity is not the provision of a licensed service. Rather it is because, by virtue of subsection 362(2), the only person "who is to be treated ... as providing the service" (and therefore as requiring a licence) is the content controller, namely Sky in the case of the CPSCs.
100. In response Sky/FAPL contend that Ofcom is reading far too much into sections 361 and 362. In their submission section 361 merely clarifies that channels and services which are intended to be made available on a linear Pay TV basis also require a licence, as well as channels made available FTA. One cannot read the word "provision" when used in that subsection in relation to service as meaning that the retailing of a Pay TV service is "provision of a licensed service". Sky/FAPL reiterate that the identification of services requiring a television licensable content services ("TLCS") licence is to be found in section 232.

101. As for section 362, Sky/FAPL submit that its purpose is to make it clear that the only person to be regarded as providing the service (and therefore as requiring a licence) is the person with general control over which programmes and other services and facilities are comprised in the channel. The reason why BT and VM do not require a licence in respect of retailing Sky's CPSCs is because, by reference to section 232, they do not provide licensed services with a view to their reception by members of the public, and they do not therefore fall within Ofcom's regulatory function. There is no reason for them to do so, as they do not have control over the content of the channels that they retail. The service they provide is the different service of *actually supplying* the CPSCs to the public i.e. retail services. Section 362 merely serves to confirm that this does not require a licence. Thus "licensed service" is a service that requires a licence in order for anyone to provide it. This, say Sky/FAPL, represents a more natural and sensible reading of the statutory scheme than one which interprets section 362 as identifying a separate group of providers who, although they are providing "licensed services" within the meaning of the 2003 Act, are to be treated as not requiring a licence to do so.

*The Tribunal's discussion and conclusions*

102. To call the legislation tortuous would be an understatement, and some support for the contentions of both Sky/FAPL and Ofcom can undoubtedly be found therein. It is on any view unsatisfactory that provisions affording potentially very wide-ranging powers of regulation should be framed in such a way that respectable arguments for diametrically opposed perceptions of the scope of the measure can relatively easily be formulated. However, we have come to the conclusion that Ofcom's interpretation of the statute is to be preferred and that, for the purposes of section 316, competition in the provision of Sky's CPSCs is not confined to their provision at the wholesale level to other Pay TV retailers, but includes competition in their provision at the retail level to end users.
103. Sky/FAPL's interpretation hinges on a perception that two distinct services are referred to in subsections 232(1) and (2). These are (a) a service "provided with a view to its reception by members of the public", which is said to refer to provision of the channel at the wholesale level to a retailer and is said to constitute a "licensed

service”; and (b) the actual making available of the service for reception by members of the public, which is said to equate to retail supply and said *not* to constitute provision of a “licensed service”.

104. However, it is difficult to read those subsections as drawing that distinction, or at least as drawing it with such clinical precision. They contain no explicit reference to wholesaling or retailing, and their purpose appears rather to be to stipulate that in order to constitute the “licensed service” in question (namely a TLCS) a service must fulfil a number of criteria, namely that it: (1) is provided as a service that is to be made available for reception by members of the public; (2) consists of TV programmes or EPGs or both; (3) is to be broadcast/distributed, whether by the “provider” (i.e. the licensee) or another person (i.e. the retailer), for reception by members of the public, from satellite or by radio multiplex or by use of an electronic communications network.
105. Those criteria distinguish between a “provider” (who must hold the requisite licence) and another person who is not the relevant licence holder but who may broadcast or distribute the service. On the other hand the criteria do not indicate that more than one service is envisaged in either case. If a service satisfies the criteria then it is difficult to see why it does not constitute a “licensed service” at the level of the end user, regardless of whether it is supplied to him by the licence holder or by another person. Subsection 361(1) affords some support for this interpretation; it provides that a service is to be taken to be “available for reception by members of the public” for the purposes of *inter alia* section 232 where it is made available for reception “*only to persons who subscribe to the service ... or who otherwise request its provision.*” Thus it is envisaged that a service provided to a Pay TV subscriber is (assuming the other criteria in section 232 are satisfied) a “licensed service” without regard to whether the retailer is also the “provider”/ licence holder.
106. Further, Sky/FAPL’s construction becomes somewhat strained where, for example, Sky retails the CPSCs directly to consumers via its own satellite platform without the intervention of any wholesale transaction. In those circumstances it is difficult to regard Sky as “providing” the service to anyone other than the consumers to whom it retails the CPSCs. Yet, on Sky/FAPL’s interpretation, Sky is not providing

a “licensed service” to its retail customers. The licensed service must on that basis presumably have been “provided” *notionally* at some earlier point, otherwise Sky would not require a licence at all. Yet there is no one to whom it could be provided. A similar question would arise where Sky self-retails on another undertaking’s platform.

107. Therefore in our view Ofcom is right in asserting that Sky is providing licensed services when *retailing* the CPSCs on its own satellite platform, when *self-retailing* them on another undertaking’s platform, and when *wholesaling* them to VM (which then retails them on its cable platform). Ofcom is also right in submitting that the reason VM does not require a licence in relation to that retail service is not because retailing cannot amount to the provision of a licensed service, but because by virtue of subsection 362(2) the only person to be treated as the “provider” of the CPSCs is Sky, as the person with general control over the programmes comprised in the channels.
108. However, assuming (as we judge to be the case) that “licensed services” are capable of being provided to the end user, we see no warrant for limiting the scope of the competition to be safeguarded by intervention under section 316 to competition between “providers” in the narrow sense in which this term is defined in subsection 362(2) i.e. between licence holders. Sky’s competitors in the supply of CPSCs (“licensed services”) at the retail level include those who are not licence holders. It would be perverse to exclude consideration of the position of those actual competitors simply because of a definitional provision apparently designed to identify which undertaking must hold the requisite licence. Nor does the title of section 316 and its related sections (“Competition between licensed providers etc”) lead us to a different conclusion. Although the point was mentioned by Sky/FAPL, it was not heavily relied upon by them. The inclusion of the word “etc” is probably sufficient to dispose of it.
109. Given the broad terms in which section 316 is framed, it is unlikely that such a fundamental limitation on the scope of intervention as would result from Sky/FAPL’s interpretation would not have been made explicit in the statute.

110. It follows that “competition in the provision of licensed services” for the purposes of section 316 can encompass competition at the retail level. Therefore to the extent that Ofcom’s intervention is aimed at securing that Sky, as the provider of the CPSCs, “does not ... engage in any practice which Ofcom consider ... to be prejudicial to fair and effective competition” in the retail provision of CPSCs, the imposition of the WMO is not outside its jurisdiction under section 316.

#### Connected services

111. “Connected services” are defined in subsection 316(4) of the 2003 Act as “the provision of programmes for inclusion in licensed services and *any other services provided for purposes connected with, or with the provision of, licensed services*”. (The Tribunal’s emphasis)
112. As an alternative to its primary contention, Ofcom argued that the retail of CPSCs was the provision of “connected services” within the meaning of section 316 of the 2003 Act. In view of our conclusion that the primary contention is correct, the alternative does not arise, as a service can hardly be a “licensed service” at the same time as being a service which is “connected with, or with the provision of” a licensed service. However in deference to the arguments put before us we will deal with the issue briefly.
113. Ofcom’s argument can be simply stated: “licensed services” in the form of Pay TV channels are only provided on a wholesale basis so that they can be retailed subsequently. Therefore, on a plain reading of subsection 316(4), such services (i.e. the retail services) are provided for purposes connected with the provision of Sky’s licensed services.
114. This does not seem correct. It is decidedly odd to speak of an end product - a retail service - being “*provided for purposes connected with*” or “connected with the provision of” the supply of the same product at the earlier wholesale level. If anything the more natural reading of the language would be that the upstream service would be the “connected service” connected to, and for the purposes of, retailing, rather than the retail transaction. That would also sit more comfortably

with the subsection's single example of "connected services", namely "the provision of programmes for inclusion in licensed services": the provision of such programmes are, by definition, services "provided for purposes connected with, or with the provision of" the channel.

115. Ofcom prays in aid subsection 232(1): by virtue of that provision a "licensed service" is provided "with a view to its availability for reception by members of the public being secured" by its onward transmission; Ofcom submits that under the statutory scheme the downstream distribution of the channels is therefore confirmed as a purpose connected with the prior wholesale provision of the licensed services. Similarly, Ofcom argues that it would be extraordinary if the service of retailing television to subscribers, as defined in subsection 361(1), was to be regarded as a service which was not connected with the provision of a licensed service.
116. In our view these arguments are unconvincing. It is true that the downstream or retail distribution can be said to constitute the "purpose" or "aim" of the upstream supply, but this is not the way in which "purposes" is being used in subsection 316(4): under the subsection the "connected services" (*ex hypothesi* the retail service) must be "provided for purposes connected with" the licensed service (*ex hypothesi* the wholesale supply). The subsection is therefore referring to the purposes for which the *connected services* are provided. As we have said, this would be a somewhat odd usage if the connected services were the services provided to the consumer at the retail level.
117. In the course of its closing submissions, Ofcom referred to an argument by Sky/FAPL that "connected services" are limited to services provided *to* the licensee/provider of the licensed services (any other connection being too remote to be caught by subsection 316(4)), and that since retail services are provided to subscribers and not to the licensee, such services cannot be "connected services". In responding to that and certain other arguments made by Sky/FAPL, Ofcom took us to the legislative history not just of section 316 but also of its precursor provision in the 1990 Act. In particular, Ofcom's leading counsel submitted that subsection 2(2)(a)(ii) of the 1990 Act had been applied so as to put in place rules to ensure fair and effective competition in the provision of advertising airtime; the airtime was

supplied by the licence holders to advertisers in connection with the licensed services. Ofcom argued that Parliament must be taken to have been aware of this use of subsection 2(2)(a)(ii) when enacting section 316, and that the suggested limitation on the scope of “connected services” in the latter measure is therefore unsustainable.

118. Since we are of the view that the retail supply of the CPSCs are not “connected services” within the meaning of subsection 316(4), it is not necessary (even if it is permissible) for the Tribunal to explore the legislative histories in question, nor to decide whether Sky/FAPL are correct that the scope of “connected services” is limited to services supplied to the licensee. Although we do not need to (and do not) decide the latter point, it is not at all clear why the provision by the licensee of advertising airtime on the “licensed service” (i.e. on the channel) should not amount to a “connected service”.

### *The “competition” ground of appeal*

119. We now turn to the second limb of Sky/FAPL’s challenge to Ofcom’s jurisdiction, namely that Ofcom has failed to adhere to an approach to section 316 based on competition law, which it is bound to do. In respect of this point, too, there was considerable overlap between Sky’s and FAPL’s submissions, although there may have been different emphases at different stages of the hearing. In effect, they adopted each other’s arguments.<sup>58</sup> Therefore once more it is convenient simply to refer to Sky/FAPL save where there is a reason to distinguish between them.
120. Although we will need to set out Sky/FAPL’s submission under this head in a little more detail, it is essentially as follows: where the competition concerns identified by Ofcom “traverse the same ground” as the ordinary competition rules, namely Articles 101 and 102 TFEU and the equivalent prohibitions in the 1998 Act (“the competition rules”), Ofcom must adopt the same approach under section 316 as would be applied under those rules and the case law relating to them. Thus, in the present case Ofcom’s intervention covers the same ground as Article 102 because

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<sup>58</sup> FAPL’s leading counsel said that she adopted all of the points made by Sky’s leading counsel in relation to jurisdiction generally (Transcript 37/65:4-8). In relation to the competition argument, she described FAPL’s points as “very similar” to Sky’s (Transcript 37/71:8-11).

the perceived competition concern is in the nature of a refusal to supply and/or a margin squeeze, and the “best guide” for assessing whether a practice may be *prejudicial to fair and effective competition* in such a case is Article 102 and its related jurisprudence. Yet Ofcom did not justify its decisions in the Statement by reference to the Article 102 case-law, with which its decision is inconsistent.

121. Sky/FAPL accept that section 316 is not necessarily coextensive with the competition rules, and that the provision may be able to be used to address competition issues outside their scope. One example given was where competition concerns arise from oligopolistic behaviour in relation to licensed or connected services. It was also accepted by Sky/FAPL that section 316 may be used on an *ex ante* basis prior to any infringement of Article 102, whereas the competition rules are inherently applied *ex post*. In the course of the hearing a number of further differences between the section 316 regime and the competition rules were acknowledged: Sky accepted that Ofcom could use section 316 powers in relation to a licensee who is not dominant in a relevant market, and that section 316 could be applied to practices which are “similar” or “analogous” to infringements of the competition rules. In such cases Ofcom’s analysis should be “in similar terms and reach a remedy that was at least similar” to that of the competition rules, but was not required to match it exactly. However, where a case was within the scope of Article 102, Sky submitted that Ofcom could depart from the approach taken under the case-law applying that Article only where it perceived “a good reason” for doing so. Sky submitted that such reason could not simply lie in a desire to shape a market in a particular way, and in the present case no such reason existed.
122. In relation to the specific conduct in question, namely refusal to supply and margin squeeze, Sky/FAPL identify a number of principles relating to these categories of Article 102 infringements; Sky/FAPL submit that these principles should have been, but were not, applied by Ofcom in order to determine whether any practice of Sky was prejudicing fair and effective competition and therefore whether intervention under section 316 was permissible. Sky/FAPL contend that, had these principles been properly applied, Ofcom ought to have concluded that such intervention was outside its powers. Sky/FAPL’s submissions in this regard were, in summary, as follows.

123. As far as refusal to supply is concerned Sky/FAPL refer to the case law relating to Article 102, including Joined Cases 6/73 and 7/73 *Commercial Solvents v Commission* [1974] ECR 223; Case 27/76 *United Brands v Commission* [1978], paragraph 182; Case 311/84 *CBEM v CLT and IPB (Telemarketing)* [1985] ECR 3261; Case C-7/97 *Oscar Bronner GmbH v Mediaprint* [1998] ECR I-7791, paragraph 41; Case C-418/01 *IMS Health GmbH & co v NDC Health GmbH & Co* [2004] ECR I-5039, paragraphs 28-30; Case T-504/93 *Tierce Ladbroke v Commission* [1997] ECR II-923; and Case T-201/04 *Microsoft v Commission* [2007] ECR II-3601, paragraphs 331-333.
124. Sky/FAPL submit that in the light of that case law an undertaking in a dominant position in the market is only obliged to supply its products or services to another party in very limited circumstances, where otherwise there would be some exceptional harm to competition. This can occur where, without objective justification, a dominant undertaking cuts off supplies of goods or services to an existing customer, or refuses to grant access to an essential facility, i.e. a good or service which is objectively *indispensable* (not just convenient or valuable) in order for operators to be able to compete effectively on the market, and where the refusal is likely to eliminate all competition on the downstream market.
125. Similarly, Sky/FAPL submit that a dominant undertaking is only obliged to license its intellectual property rights in relation to a product or service if there is no objective justification for a refusal, and a licence is indispensable to the exercise of a particular activity on a neighbouring market, such that a refusal would exclude any effective competition on that market, and would prevent the appearance of a new product for which there is potential consumer demand.
126. Sky/FAPL argue that to require supply outside these criteria would itself be prejudicial to competition, referring in particular to the words of Advocate General Jacobs in his Opinion in *Bronner* (above), at paragraphs 57-8 and 62:

“57. ...the justification in terms of competition policy for interfering with a dominant undertaking’s freedom to contract often requires a careful balancing of conflicting considerations. In the long term it is generally pro-competitive and in the interest of consumers to allow a company to retain for its own use facilities which it has developed for the purpose of its business. For example, if access to a

production, purchasing or distributing facility were allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term. Moreover, the incentive for a dominant undertaking to invest in efficient facilities would be reduced if its competitors were, upon request, able to share the benefits. Thus the mere fact that by retaining a facility for its own use a dominant undertaking retains an advantage over a competitor cannot justify requiring access to it.

58. ...in assessing this issue it is important not to lose sight of the fact that the primary purpose of [Article 102] is to prevent distortion of competition – and in particular to safeguard the interests of consumers – rather than to protect the position of particular competitors. It may therefore, for example, be unsatisfactory, in a case in which a competitor demands access to a raw material in order to be able to compete with the dominant undertaking on a downstream market in a final product, to focus solely on the latter’s market power on the upstream market and conclude that its conduct in reserving to itself the downstream market is automatically an abuse. Such conduct will not have an adverse impact on consumers unless the dominant undertaking’s final product is sufficiently insulated from competition to give it market power.

...

62. In assessing such conflicting interests particular care is required where the goods or services or facilities to which access is demanded represent the fruit of substantial investment. That may be true in particular in relation to refusal to license intellectual property rights. Where such exclusive rights are granted for a limited period, that in itself involves a balancing of the interest in free competition with that of providing an incentive for research and development and for creativity. It is therefore with good reason that the Court has held that the refusal to licence does not of itself, in the absence of other factors, constitute an abuse.”

127. Sky/FAPL also refer to the European Commission’s Communication: “Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings” (OJ 2009 C45/7), at paragraph 75. The Commission considers that an obligation to supply:

“...may undermine undertakings’ incentives to invest and innovate and, thereby, possibly harm consumers. The knowledge that they may have a duty to supply against their will may lead dominant undertakings – or undertakings who anticipate that they may become dominant – not to invest, or to invest less in the activity in question. Also, competitors may be tempted to free ride on investments made by the dominant undertaking instead of investing themselves. Neither of these consequences would, in the long run, be in the interests of consumers.”

128. Sky/FAPL submit that there is no express finding by Ofcom of an abuse of a dominant position by refusal to supply in the Statement, and that when, in the course of the consultation process, Ofcom considered Sky’s conduct in the context of the principles relating to that type of abuse, its conclusion was that an abuse by

Sky “might well not have taken place” (see Third Pay TV Consultation, paragraphs 8.19-22). Sky/FAPL also refer to Ofcom’s statements during the hearing that it is “appropriate and good practice” for Ofcom to have regard to competition law principles and to take full account of the established case law. However, in Sky/FAPL’s contention, far from conducting a “thorough and orthodox competition analysis by reference to established economic principles” as claimed, Ofcom has in the Statement simply considered market definition, made a finding that agreements to supply at wholesale level were not reached (that there was a “general stalemate across the market”) and undertaken a cursory analysis of what it considers to be the effects on consumers.

129. Sky also argues that in this regard Ofcom relies excessively on a decision of the European Commission to accept commitments offered by the merging parties in the Newscorp/Telepiù transaction (Commission decision of 2 April 2003 in case no COMP/M.2876 – *Newscorp / Telepiù*). Sky submits that such a decision in a merger case involving the only two Italian Pay TV operators, and where the merged entity was said to face minimal competition from cable, and the prospects for DTT entry in a reasonable time frame were said to be at best unclear, is not comparable with Ofcom’s requirement that Sky, who has a number of competitors including a substantial cable competitor, make its CPSCs available at regulated prices designed to sponsor further entry. Commitments voluntarily offered in the time-pressured bargaining of merger clearance may well go beyond what could be required of a defendant at the end of infringement proceedings. Parties initiating merger transactions do so voluntarily and assess for themselves whether they may wish to compromise in such a manner for commercial reasons. Here, it was incumbent on Ofcom to prove its case in the same way as the European Commission would in infringement proceedings in which commitments were not offered.
130. Sky/FAPL contend that in light of the principles and case law in question, no refusal to supply has taken place, and that the WMO has therefore been imposed inconsistently with these principles and with Ofcom’s own conclusion, and is *ultra vires* and unlawful.

131. As for margin squeeze, Sky/FAPL point to the fact that, in the Statement, Ofcom did not make a finding that the rate card price paid by VM amounted to a margin squeeze but that, on the contrary, Ofcom appears expressly to acknowledge that that price does not amount to an unlawful margin squeeze under competition law principles. In this connection Sky/FAPL refer in particular to the Statement at paragraphs 1.29, 1.59, 2.31, 7.193, 7.266, and 10.262 as well as to the oral evidence of Mr Mark Caines. It probably suffices to cite just paragraph 7.193:

“The rate-card prices are close to what we would expect under an *ex post* margin squeeze test – i.e. assuming Sky’s own scale.”

132. Sky/FAPL reject the suggestion made by Ofcom in the course of the hearing that the rate card price might after all fail to satisfy a margin squeeze test, once an adjustment is made to reflect the less advantageous scale (and thus higher costs) of a notional downstream competitor. Sky/FAPL contend that this suggestion is based on Ofcom’s misreading of the ECJ’s decision in Case C-52/09 *Konkurrensverket v TeliaSonera Sverige AB* (Case C-52/09, judgment of 17 February 2011), a judgment which post-dates the Statement. In their submission the ECJ’s decision does not, as Ofcom appears to believe, depart from the existing ECJ case law on margin squeeze; on the contrary it affirms that the established test for a margin squeeze involves the ‘as efficient competitor’ test, which in turn requires consideration of the *dominant entity’s* costs and prices and not those of actual or potential competitors. In Sky/FAPL’s submission, whatever exceptional circumstances might justify examining the costs of a competitor rather than those of the dominant entity, *TeliaSonera* could not be interpreted as allowing a finding of *infringement* (as distinct from non-infringement) of Article 102 by reference to such costs; such a finding would offend the principle of legal certainty, as it would be impossible for the dominant entity to ascertain whether it was committing an unlawful margin squeeze or was pricing lawfully, given that the necessary data would not be available to it. Sky/FAPL submit that in any event *TeliaSonera* does not provide any justification for assessing margin squeeze by reference to the costs of an *hypothetical* downstream competitor, which was in effect the exercise carried out by Ofcom in arriving at the WMO price – Ofcom admittedly did not assess the costs of any of Sky’s *actual* competitors.

133. Therefore Sky/FAPL contend that Ofcom was right to conclude in the Statement that Sky's rate card pricing did not amount to an unlawful margin squeeze. They contend that in those circumstances intervention under section 316 on this ground is impermissible.
134. Sky/FAPL also make observations on the issue of discrimination, in reaction to the possibility that Ofcom is now seeking to base its section 316 intervention upon the following assertion: that as Sky has supplied VM with the CPSCs for nearly two decades, for Sky not to supply other competitors could amount to an abuse of dominant position by reason of discrimination. In that regard Sky/FAPL essentially contend that no trace of such analysis appears in the Statement and Ofcom cannot rely on it now. In any event, such an assertion proceeds on the disputed premise that Sky was not prepared to supply any other willing and suitable customers for profit and therefore adds nothing to the refusal to supply analysis. Further, Ofcom's own view (reflected in the WMO itself) is that supply of the CPSCs to others on the same terms as Sky has historically supplied to VM viz at the rate card price, is not sufficient to deal with the perceived competition problem. For these reasons, Sky/FAPL submit that an assertion of discrimination is baseless and cannot be relied upon in any way to support Ofcom's intervention.
135. Sky submits that Ofcom has more generally ignored the principles flowing from the competition rules in assessing the effects on competition of the practices of which it complains and of the WMO remedy itself. Nor has it carried out a full and orthodox competition analysis of whether and to what extent those practices cause undesirable effects on consumers. Ofcom's claim to have tested effects by reference to the criteria of price, choice and innovation is vague and simply allows it to conclude that conditions which it observes are not those it would expect to see in conditions of fair and effective competition – a circular and self-fulfilling approach. This failing is all the more serious given the extensive evidence, much of it emanating from Ofcom itself, that the Pay TV sector in the United Kingdom is vibrant, innovative and appreciated by consumers.
136. Sky also complains that, by sidestepping traditional competition law principles, Ofcom has deprived Sky of the right that those principles would afford of making

an appropriate pricing response to undercutting by its competitors. The WMO price adjustment mechanism prevents any such response and thereby in effect assumes, contrary to the Article 102 jurisprudence, that any such response is always abusive.

137. In support of Sky/FAPL's argument about the limits to Ofcom's jurisdiction under section 316, FAPL relied upon a number of other considerations.<sup>59</sup> We set out the principal ones here.
138. First, the competition rules and action under section 316 are both aimed at avoiding prejudice to fair and effective competition. It is therefore commonsense that regard should be had in each case to relevant competition law principles. (We interpose to record that it appears to be common ground that *regard* should be had to such principles: what is in issue is whether under section 316 Ofcom is to some extent bound within the four corners of the principles applicable to the relevant competition rules, as would be the case if Ofcom was operating under the 1998 Act.)
139. Second, FAPL refers to a number of policy statements, including the White Paper which preceded the 2003 Act ('*A new Future for Communications*' Cmd 5010 (December 2000), paragraphs 2.3.1 and 8.9.1), and certain of Ofcom's own documents (e.g. '*Use of s.316 competition powers in broadcasting: ensuring a consistent internal economic approach*' (20 June 2005), pp 4 and 10). It is unnecessary to quote these passages. They emphasise that regulatory powers and 1998 Act powers should be exercised with consistency of approach and in accordance with the principles developed in EU and domestic competition law.
140. Next FAPL prays in aid Article 3(2) of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles [101 and 102 TFEU] ("Regulation 1/2003"). By virtue of Article 3(2) national competition law is not permitted to prohibit agreements which may affect trade between Member States but which either do not restrict competition within the meaning of Article 101(1) TFEU or which fulfil the exempting conditions of Article 101(3). It follows, FAPL submits, that section 316 cannot be used to prohibit

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<sup>59</sup> See, for example, paras 57 to 60 of FAPL's amended notice of appeal.

agreements of that type. Although Regulation 1/2003 does not contain an equivalent prohibition in respect of conduct falling within Article 102 TFEU, and Member States are therefore entitled to adopt stricter national laws regarding unilateral conduct if they so wish, FAPL submits that the question which governs the application of section 316 for a competition purpose is precisely the same for both agreements and unilateral conduct: namely, whether that agreement or conduct is prejudicial to 'fair and effective competition'. This phrase should not be read in one way (i.e. consistently with EU competition law) in relation to agreements, but in a completely different (and broader) way (i.e. as meaning competition which Ofcom considers is effective to promote consumer choice, price, quality of service etc) in relation to unilateral conduct.

141. FAPL also relies upon the European Commission's commitments decision in which the Commission expressly considered the sale of the rights which are said by Ofcom to be the principal reason for Sky's market power, namely the live rights acquired from FAPL (Commission Decision of 22 March 2006 in Case COMP/C-2/38.173 - *Joint selling of media rights to the FA Premier League*). FAPL states that after lengthy and detailed investigation the Commission concluded that, whilst it might otherwise have had a concern about effective downstream competition, the commitments offered by FAPL adequately ensured that the sale of FAPL's live rights (including the number, size, balance, and makeup of the packages sold) did "not restrict output or result in competitors being foreclosed from the relevant markets, to the detriment of consumers." FAPL relies upon the Commission's finding that there was no scope for a conclusion that Sky's acquisition of four or five packages of live FAPL rights could lead to the elimination of competition on the downstream retail markets. Those commitments applied from 2006 and would continue to apply in respect of rights to be exploited until 30 June 2013, and would provide for an open competition for rights monitored by an independent trustee every three years. FAPL contends that the Commission's assessment provide a very strong indication that there is no reason to depart from the established principles of competition law in the present case.
142. By its primary argument Ofcom resists Sky/FAPL's essential submission, and contends that section 316 is not to be interpreted as importing the requirements or

the case law of Articles 101 and 102, nor as requiring Ofcom to identify any infringements of the competition rules, or practices “akin” to such infringements. Ofcom submits that, for example, a condition may be applied prospectively, to ensure that an anti-competitive practice does not arise in the future. In Ofcom’s submission the section is to be interpreted in accordance with its ordinary meaning, which is to require Ofcom to make a judgment as to what licence condition is “appropriate” to secure that a provider of a licensed service does not engage in any practice which “Ofcom consider” to be prejudicial to fair and effective competition in the provision of licensed services or connected services. This is, of course, not to say that in identifying what practices may be prejudicial to fair and effective competition, Ofcom should not have regard to general competition policy analysis; Ofcom accepts that it should do so, and indeed that it should take account not just of principles relating to Articles 101 and 102, but also of the analysis applied in other contexts, including, for example, in merger and market investigations under the 2002 Act.

143. Ofcom also contends, by way of response to the arguments made against it, that its decision to impose the WMO can in any event be justified by reference to the Article 102 case law, and that its analysis is consistent with the caselaw in relation to each of the categories of abuse.

#### The Tribunal’s discussion and conclusions

144. The arguments of Sky/FAPL are not without substance. However, we consider that the interpretation of section 316 for which Sky/FAPL contend is incorrect, and that Ofcom is right in its primary submission that the section is not to be construed as confined to circumstances which would otherwise constitute breaches of the competition rules, even with the variations and qualifications which Sky/FAPL acknowledge.
145. The language of section 316 does not mirror that of the competition rules. There is, for example, no requirement that the licence holder whose “practice” is under consideration be dominant, and it is therefore unsurprising that there is no reference

to an abuse of dominance. The focus is on the prejudicial effect which a “practice” is considered by Ofcom to have on “fair and effective competition”.

146. The competition rules are not mentioned in the section, whether in their EU or in their domestic manifestation. The only specific reference is in section 317, which applies at the stage where Ofcom is considering whether to exercise the regulatory powers in question “for a competition purpose”. Subsection 317(2) requires Ofcom first to consider whether it would be more appropriate to proceed under the 1998 Act. The phrase “for a competition purpose” is defined by reference to the same wording as that of section 316(2) itself, namely in order to secure that a licence holder does not engage in a practice which Ofcom considers to be prejudicial to fair and effective competition in the provision of licensed services etc. This reference to the *ex post* regime is therefore neutral so far as this argument is concerned, and does not advance Sky/FAPL’s case. (Nor do they seek to rely upon it.)
147. Had Parliament wished, whether generally or in specified circumstances, to incorporate within section 316 the same criteria as apply to Articles 101 and 102 or their domestic counterparts in the 1998 Act, then one would have expected the measure to cross-refer to the competition rules or to use the same language. That was the approach taken when framing the Chapter I and Chapter II prohibitions in the 1998 Act; there Parliament reflected closely the wording of Articles 101 and 102, and also included a provision (section 60 of the 1998 Act) designed to ensure that so far as possible corresponding questions arising under the domestic rules would be dealt with consistently with their treatment under the equivalent EU rules.
148. Not only did Parliament not reflect in section 316 the language of Articles 101 and 102 or the 1998 Act, but it retained to a significant extent the wording of the provision which is the acknowledged predecessor to that section, namely subsection 2(2)(a) of the 1990 Act; that provision referred to the discharge of functions “...in the manner which [the Independent Television Commission] consider is best calculated ...(ii) to ensure fair and effective competition in the provision of [the services in question]”). Parliament took this course notwithstanding the fact that the 1998 Act was at that time well-established.

149. It is also worth noting the decision of the Administrative Court (Maurice Kay J, as he then was) in *R v. Independent Television Commission ex parte Flextech plc and others* [1998] EWHC Admin 1050, relied upon by Ofcom. Although neither the issues involved nor the legislative wording were precisely on all fours with the present case, nevertheless it provides some support for Ofcom's approach, if only by analogy.

150. *Flextech* was a judicial review concerning *inter alia* the proper construction of subsection 2(2)(a) of the 1990 Act. The learned judge was of the view, first, that the legislation in question, including subsection 2(2)(a)(ii), was "clear and unambiguous", thereby precluding his having recourse to ministerial statements in Hansard under *Pepper v Hart* principles in order to construe it. He then turned to deal with an argument that the action taken by the Independent Television Commission ("ITC") under subsection 2(2)(a)(ii) was precluded in the circumstances by reference to procedural and other constraints on comparable action contained in other competition statutes in force at the time. (This was, of course, before the coming into force of the 1998 Act.) Maurice Kay J rejected this submission, stating:

"My conclusion that these are clear and unambiguous enabling provisions is also fatal to Miss Baxendale's reliance upon comparison with other legislation including the Fair Trading Act 1973, the Competition Act 1980 and the Restrictive Trade Practices Act 1976. I know of no principle of statutory interpretation which requires or permits me, when construing the clear and unambiguous provisions of one Act, to have regard to other Acts which to some extent impinge upon the same areas of concern but which have their own historical and developmental characteristics."

151. In relation to another argument to the effect that subsection 2(2)(a)(ii) conferred a narrow power to act, and that outside the scope of that power competition issues remained the exclusive concern of other authorities applying other then-applicable competition legislation, the learned judge said:

"Yet again, I do not find the attempted comparison with legislation from other sectors to be helpful. So far as this section is concerned, section 2(2)(a)(ii) confers a wide power to ensure fair and effective competition. It is not limited by the fact that the [other competition authorities or regulators] have concurrent competition powers. Parliament has provided special, sectoral competition powers which can be used in a more specific and less cumbersome way."

152. It is true, as Sky points out, that subsection 2(2)(a)(ii) contained no equivalent to subsection 316(2). However, the subsequent enactment of the latter following the *Flextech* judgment (an authority of which the draftsman should be taken to have been aware) without replacing the broad nature of the test in terms of “fair and effective competition” and without subordinating its application to the 1998 Act or any other competition enactment, militates against Sky/FAPL’s restrictive interpretation.
153. Sky/FAPL’s case encounters another significant problem once it is acknowledged (as Sky/FAPL must, and do) that the criteria in Article 102 and the Chapter II prohibition cannot be applicable in their entirety to action under section 316: how does one determine to what extent and in what circumstances those criteria do or do not apply? As the Tribunal put to Sky’s leading counsel, one is then at risk of venturing onto a slippery slope without the means to stop before reaching the bottom. The suggested tests of practices which “traverse the same ground” or which are “similar” or “analogous” or “akin” to infringements of the competition rules, simply serve to highlight the uncertainty and unworkability of this approach. Equally vague are the proposed tests for the analysis which is to be applied under section 316 (“in similar terms”), for the remedies which are said to be permissible (“similar to”) and for the right to depart from the Article 102 criteria (“good reason”). We agree with Ofcom that the adoption of Sky/FAPL’s interpretation would leave endless scope for argument as to whether a practice is sufficiently “akin” to an infringement, whether Ofcom’s analysis and remedy are sufficiently “similar”, and whether there are “good” enough reasons for departing from the *ex post* principles.
154. There is also force in the point made by VM’s leading counsel that so-called “traditional” competition law is not necessarily restricted to Articles 101/102 and the Chapters I and II prohibitions. The competition authorities are, for example, given formidable powers under the market investigation provisions of the 2002 Act to investigate and devise remedies in respect of any feature or combination of features of a market which prevents, restricts or distorts competition in goods or services in the United Kingdom. That wording is closer to Chapter I/Article 101 than that of section 316, yet there is clearly no requirement to find an infringement

of the competition rules, or a practice “akin” to it, in order to impose what may well be very intrusive remedies: see, for example, the *BAA* decision of the Competition Commission requiring BAA to dispose of three of its UK airports (report of the Competition Commission dated 19 March 2009: *BAA airports market investigation*).

155. In our view the proper approach is, therefore, for Ofcom to apply the language of section 316, and identify practices which are or would be prejudicial to fair and effective competition in the provision of licensed services, without having to analyse them specifically by reference to the principles and case law applicable to Article 102 (or some approximation thereto) in order to establish jurisdiction to act. Neither the language of section 316 nor any other consideration supports the existence of any jurisdictional condition such as that contended for by Sky/FAPL. This, of course, does not mean that Ofcom’s investigation and analysis should be carried out without consideration of those principles. Ofcom must, of course, have regard to such general competition policy analysis as is applied in many contexts, including the competition rules but also, for example, in the merger and market investigation regimes under the 2002 Act.
156. In reaching this conclusion there has been no need or warrant for us to rely upon the ministerial statements in Hansard to which we were referred. Whatever the meaning of “licensed services” and “connected services”, like Maurice Kay J we are of the view that the language “fair and effective competition”, although undoubtedly broad in scope, is not ambiguous or obscure. However, lest it be thought that statements had been made which are inconsistent with our conclusion, we simply record that in the course of the passage through Parliament of what is now section 316, Dr. Howells, the Parliamentary Under-Secretary, Department for Culture, Media and Sport, explained that the Government was enacting the measure because it was

“concerned about cases in which markets should be opened up to greater competition but where the legal tests required by the Competition Act are not met...

...The opponents of that policy want us to leave the broadcasting sector to be determined by the Competition Act, which, I am sure the hon. Member for Maldon and East Chelmsford will agree, has very little broadcasting case law behind it.

The Act is still relatively new. Our policy is to carry over the safeguards that the ITC and the Radio Authority have had to guarantee that Ofcom has that same flexibility to ensure fair and effective competition as the other broadcasting regulators had pre-Ofcom.”

157. During the hearing an interesting debate took place as to whether one of the existing licence conditions in the relevant licences held by Sky (Condition 14) would be enforceable or would breach principles of legal certainty, given that it was framed more or less precisely in the terms of subsection 316(2) so as to prohibit *inter alia* practices “prejudicial to fair and effective competition” in provision of the relevant services. Breaches of licence conditions are potentially punishable with financial penalties and other sanctions under the governing legislation. While it is certainly possible to predict the arguments which might be mounted in the event that such a case were to arise, this is thankfully not an issue we need to resolve. Even if (which we do not determine) the licence condition in question is too uncertain in scope to be the subject of a legal obligation and sanctionable offence, this would not affect the interpretation we attribute to section 316 nor Ofcom’s ability to identify and regulate practices which fall within the section, but would rather reflect on the appropriateness of simply transposing its terms into the form of a licence condition.
158. Our conclusion on the interpretation of section 316 means that it is not necessary for us to explore Ofcom’s fall-back position that its decision to impose the WMO can in any event be justified by reference to the Article 102 principles and case law.

## **VI. SKY’S CHALLENGE TO THE FINDINGS ON WHICH OFCOM’S COMPETITION CONCERNS ARE BASED**

### **A. INTRODUCTION**

159. Ofcom is exercising its “Broadcasting Act powers for a competition purpose” within the meaning of subsections 317(2) and (9) of the 2003 Act<sup>60</sup> and must therefore identify a “practice” which Ofcom considers prejudicial to fair and effective competition in the provision of the licensed services in question, and in which the provider of such services (Sky) is to be prevented from engaging. The next ground of Sky’s challenge with which we must deal relates to the alleged

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<sup>60</sup> Statement, para 3.11.

practices on which Ofcom's intervention is based. These practices have several aspects but the "key concern" is described in the Statement as follows:

"1.6 Sky exploits its market power by limiting the wholesale distribution of its premium channels, with the effect of restricting competition from retailers on other platforms. This is prejudicial to fair and effective competition, reducing consumer choice and holding back innovation by companies other than Sky...

1.24 Sky restricts distribution of its Core Premium channels to potential new retailers in a way which is prejudicial to fair and effective competition. A number of companies have tried and failed, over an extended period of time, to negotiate terms with Sky which would allow them to retail premium channels to their customers...

1.25 Our review of these negotiations reveals lengthy and ultimately fruitless discussions over a number of years between Sky and other pay TV operators over possible wholesale of Sky's premium channels. This impasse has remained despite, as Sky agrees, there being an immediate financial benefit to Sky from wholesale supply. We believe this is because Sky is acting on two strategic incentives – to protect its retail business on its own satellite platform, and to reduce the risk of stronger competition for content rights.

1.26 Sky's behaviour in negotiation has been to respond to requests for wholesale supply with counter-offers to retail its channels on behalf of other retailers. Sky's position has been that it would be unwilling to enter into a wholesale deal unless it could be shown that it would be better off than under a retail arrangement. We accept that other parties' preference for supply should not automatically take precedence over Sky's preferences. There are however legitimate reasons for the reluctance of third parties to enter into retail deals with Sky, and where it has been evident that no retail deal would be reached, Sky appears to have preferred to be absent from the relevant platform rather than to pursue wholesale supply.

1.27 An outcome where Sky was the dominant retailer of premium content across all platforms would not in any event ensure fair and effective competition, as Sky would still have the incentive and ability to manage competition in favour of its own platform(s)..."

160. In addition to the issue of Sky's behaviour when faced with requests for new wholesale supply of its premium channels, Ofcom also has a number of other concerns. These relate in particular to the non-supply to VM of certain new services, and to the price at which Sky wholesales the CPSCs to VM – the rate card price. These are summarised in the Statement as follows:

"1.28 Sky already wholesales standard definition versions of premium channels to Virgin Media, as a result of a commercial agreement reached in the early 1990s when the negotiating positions were more evenly balanced, and following the competition case concluded by the Office of Fair Trading in 2002. However, more recent negotiations over the supply of new services to Virgin Media reveal a similar pattern to that set out above. The non-supply of these services to Virgin

Media – especially high-definition versions of Sky’s premium channels – prevents fair and effective competition.

1.29 Sky supplies standard-definition versions of its premium channels to Virgin Media at a price it believes is compliant with an *ex post* competition law margin squeeze test. Application of this test means that retailing based on this wholesale price should be profitable at Sky’s scale, and at the level of the entire bundle of basic and premium channels. However, Virgin Media’s scale – particularly in terms of premium subscribers – is much smaller than Sky’s, so it is unsurprising if prices set on such a basis do not enable Virgin Media to compete effectively with Sky. This contributes to Virgin Media having little incentive to sell premium channels to existing basic subscribers, which in turn contributes to the low take-up of these channels on Virgin Media’s platform.

1.30 More generally, to the limited extent that Sky enters into any discussions about wholesale pricing with any other retailer, these discussions centre on the prices which Sky currently sets to Virgin Media via the rate-card. We do not believe it to be a reasonable expectation for retailers other than Sky to be prepared to pay the rate card price for Sky’s Core Premium channels, as these prices would not allow them to compete effectively. The rate-card prices are set so as to allow a retailer with Sky’s scale to compete effectively, and there is only room in the market for one such retailer.”

161. Ofcom’s findings about Sky’s behaviour, both as regards requests for new wholesale supply of the CPSCs, and its dealings with VM (as described at paragraphs 159 and 160), are fleshed out in subsequent sections of the Statement, and we will obviously need to consider them in the light of the documents and other evidence. At this stage the core concern, as perceived by Ofcom, can be summarised as Sky’s deliberate denial of wholesale access to its CPSCs to other retailers or platforms, and its preference for absence from a platform rather than wholesaling. To the extent that Sky is prepared to wholesale, this is at prices which Ofcom considers to be unacceptable or unfavourable. Sky acts in this way with a view to protecting its own retail business on the Sky DTH satellite platform and reducing the risk of stronger competition in the bidding for content rights.
162. Almost every element of Ofcom’s assessment is disputed by Sky, not least the accuracy and interpretation of the various bilateral negotiations which took place between Sky and certain operators in the years leading up to the Statement, and which form the main evidential basis for Ofcom’s core concern. Indeed, virtually the only aspect which is common ground is that Sky has a so-called “static”

incentive to supply the CPSCs to other retailers.<sup>61</sup> This incentive consists of the existence of an immediate financial benefit to Sky from supplying the CPSCs to its competitors' platforms, whether by wholesale or retail. Ofcom estimates the extent of the benefit as amounting to £610 million over a period of five years.<sup>62</sup> It is called "static" to distinguish it from the disputed "strategic" incentives upon which Sky is alleged to be acting.<sup>63</sup>

163. Sky agrees, indeed asserts, that it has a clear incentive to distribute its CPSCs widely, either by what is known as "self-retail" or through wholesale arrangements where satisfactory commercial terms can be achieved.<sup>64</sup> On the other hand Sky contends that Ofcom has failed to establish any credible basis for its finding that Sky has the alleged strategic incentives to withhold wholesale supply. Sky argues that neither its preference for self-retail nor the details of the various negotiations support Ofcom's theory that Sky has been acting on any such incentive.
164. The issue of strategic incentives appears to have arisen in the following way. In the earlier stages of the Pay TV review Ofcom was of the view that no immediate or "static" commercial incentive for Sky to wholesale existed. However, in the light of comments from Sky Ofcom revised that view, and formed the belief that such an incentive did exist.<sup>65</sup> In other words Ofcom now accepted that Sky's revenues would increase if it wholesaled the CPSCs to others, and would decrease if it ceased wholesaling to VM. In those circumstances, having rejected Sky's explanations for the (thus far) inconclusive outcomes of the various negotiations for supply to other platforms, and in the light of representations made by some of Sky's competitors, Ofcom concluded that the rationale for what it regarded as Sky's resistance to further wholesale supply lay in the "strategic" incentives not to supply.
165. Much evidence (including expert evidence) and argument have been devoted to the question whether the strategic incentives have been established satisfactorily or at

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<sup>61</sup> Statement, paras 7.43, 7.171-7.201; Sky's (amended) notice of appeal, paras 4.20-4.25; Sky's written closing submissions, Part A, para 6.17.

<sup>62</sup> Statement, para 11.135

<sup>63</sup> Statement, para 7.171.

<sup>64</sup> Sky's written closing submissions, Part A, paras 6.17-6.18.

<sup>65</sup> Statement, paras 7.172-7.201

all. Not only do Sky and Ofcom differ about the answer to that question, but they are also at odds as to its relevance.

166. Ofcom's position is that its finding that in restricting supply of its CPSCs Sky was acting on strategic incentives was a permissible inference drawn from the empirical evidence of Sky's "actual behaviour" in the course of the various negotiations with its competitors. Ofcom's analysis of this evidence, which is set out at Section 7 of the Statement, considered in particular the following specific strands of negotiations:

- (a) Negotiations with TUTV for the supply by Sky of its premium channels for distribution by TUTV via DTT.
- (b) Negotiations with BT for the supply by Sky of its premium channels for distribution by BT via DTT/IPTV.
- (c) Negotiations with Orange Home UK plc ("Orange") and its parent company France Télécom for the supply of Sky's basic and premium channels over a proposed IPTV service.
- (d) Negotiations with VM (and its predecessors, ntl and Telewest) as to the terms of the *current* wholesale supply of Sky's premium channels to those companies on their cable platforms, and also the proposed supply of (i) HD versions of those channels (ii) certain interactive services, and (iii) Sky's premium channels to an off-net IPTV platform which VM had in mind to establish.

167. Ofcom's current position is that the finding of strategic incentives was "not essential" to its conclusion that there was a competition problem.<sup>66</sup> Ofcom also states that neither of the identified strategic incentives "could be demonstrated to be the primary basis" of Sky's actions, and that "it was unlikely that they could be quantified or balanced against Sky's static incentive with an acceptable degree of

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<sup>66</sup> Ofcom written closing submissions, Part 1, para 137.4, 260. See also para 118 of Ofcom's skeleton argument, where it submits that "Sky's reasons for acting as it did were not a necessary element in Ofcom's reasoning and need not be established in order for Ofcom's Decision to stand."

confidence.”<sup>67</sup> Thus “the essential evidence relied upon by Ofcom in concluding that there was a competition problem was the evidence of the history of failed negotiations between Sky and other operators” together with the immediate financial benefit of wholesale supply foregone.<sup>68</sup> Although these statements in Ofcom’s closing submissions reflect to a large extent the position taken in the Statement itself, the latter does not explicitly state that the finding of strategic incentives (as distinct from a quantification of the incentives and a balancing exercise) is non-essential to the finding of a practice which constitutes a competition problem. The finding relating to strategic incentives appears to be firmly incorporated into the conclusion:

“7.198 ...We accept that no one of these possible mechanisms can be demonstrated *prima facie* to be the primary basis of Sky’s incentive to restrict supply. We also consider it highly unlikely that they could be quantified, or that the “balancing exercise” proposed by Sky could ever be conducted with an acceptable degree of confidence.

7.199 However, we do not accept Sky’s view that such a balancing exercise is crucial to our position. Rather, our view that Sky has a strategic incentive to restrict supply is primarily based on our observation of Sky’s actual behaviour:

- Sky has restricted wholesale supply of its Core Premium channels despite having an apparent static commercial incentive to supply them.
- As we have argued above, this behaviour cannot be satisfactorily explained by the commercial and practical rationales that Sky has put forward.
- We have identified credible strategic reasons for Sky’s behaviour.

7.200 We therefore conclude that Sky is acting on a strategic incentive to restrict wholesale supply of its Core Premium channels.”

168. Sky argues that Ofcom needs an explanation or a theory for the absence of supply in order to establish the necessary “practice” on the part of Sky and also to justify the remedy which is to be imposed on the company. Sky submits that it is clear from Ofcom’s approach to the issue of remedies that the whole purpose of the WMO is to address the incentives on which Sky is alleged to have been acting. In relation to possible structural remedies, the Statement refers to the potential for such remedies

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<sup>67</sup> Ofcom written closing submissions, Part 1, para 136.6.

<sup>68</sup> Ofcom written closing submissions, Part 1, para 137.3. See also the submissions of Ofcom’s leading counsel at Transcript 15/17.

to “address the underlying issue of incentives”.<sup>69</sup> Similarly, in relation to the WMO, Ofcom explicitly states in the Statement that the “purpose of requiring wholesale access is to remove the ability of Sky to act on its strategic incentives”.<sup>70</sup> By contrast, in its skeleton argument, Ofcom states that the aim of the remedy was “to break the stalemate” that had emerged in the negotiations between Sky and its counterparties, and that Ofcom was not seeking to penalise Sky on the basis of any finding of fault, but in order to fulfil its statutory objectives under section 316.<sup>71</sup>

169. Whatever the relevance of the alleged strategic incentives, it seems to us that the Tribunal’s consideration of Sky’s challenge to the existence of the practices must first centre on the evidence of Sky’s (and its counterparties’) actual behaviour with respect to the several sets of bilateral negotiations.
170. Ofcom’s conclusions on the reasons for failure of the negotiations were expressed as follows in the Statement:

“7.167 Our view is that if Sky had been motivated purely by a desire to maximise its commercial revenues, it might well have sought retail access to other platforms, but, in the light of a clear and widely-held reluctance by other, smaller, providers to agree to such access, it would have pursued, or at least engaged constructively with requests for, wholesale arrangements rather than accepting an ongoing situation in which it was absent from those platforms. In doing so, we would have expected Sky to seek to establish whether other retailers were efficient by offering wholesale prices to them, and also to consider the option of reducing its wholesale price in order to attract more customers. Finally, we would have expected Sky to engage with retailers to seek to resolve capacity and security issues, and that resolving such issues would have been possible.

7.168 We consider that several other retailers have sought to engage with Sky, and that they had, and have, an incentive to reach agreement with Sky as soon as possible. While some regulatory gaming has taken place on both sides, we do not consider that the failure of negotiations can be attributed to the actions of other retailers.

7.169 We conclude that the reasons Sky put forward do not adequately explain the lack of wholesale supply of Core Premium channels.”

171. Therefore, the core conclusions in this respect are that Sky did not engage constructively with retailers in relation to their requests for wholesale arrangements

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<sup>69</sup> Statement, para 9.50. In this context Sky refers, at paras 6.25-6.27 of its written closing submissions (Part A), to paras 9.49-9.51 and 9.60 of the Statement.

<sup>70</sup> Statement, para 9.78.

<sup>71</sup> Ofcom skeleton argument, para 112.

or in relation to security and capacity issues, preferring to be absent altogether from a platform rather than to agree to wholesale; that, by contrast, the other retailers did seek to engage with Sky, had an incentive to reach agreement as soon as possible, and were not responsible for the failure of negotiations, notwithstanding some regulatory gaming on their part. The clear implication is that the failure of negotiations was as a result of Sky's failure to engage constructively with other retailers on wholesale and on these other issues.

172. Dr Stephen Unger, Ofcom's Chief Technology Officer since September 2009 (formerly, a Director in Ofcom's Competition Group), considers in his evidence each separate bilateral negotiation (described at paragraph 166 above) in considerable detail, and some six related lever arch files of documents were exhibited to his witness statement. Dr Unger states that he reviewed this evidence as the Pay TV review proceeded and also "in the round before the final decision was taken."<sup>72</sup> His view is that the evidence indicated that the various factors put forward by Sky to explain the failure of the negotiations "did not adequately explain the absence of a wholesale arrangement" and "revealed a clear and firm reluctance by Sky to engage constructively in discussions for wholesale supply... What is striking ... is the consistency with which other parties requested wholesale supply and were effectively rebuffed by Sky. The strength of the pattern strongly suggests that, had Ofcom not intervened, the stalemate would have continued. It also suggests that Sky was acting on a strategic incentive to avoid wholesaling its channels to rival retailers."<sup>73</sup> In her closing submissions, Ofcom's leading counsel described the "nub" of Ofcom's case in this regard as being that, in reality, Sky's approach was "self-retail or nothing".<sup>74</sup>
173. As we have said, Sky takes issue in a great many respects with Ofcom's factual findings and interpretation of the negotiations in question, and the Tribunal has been urged by the parties to examine the evidence closely. Ofcom submitted that its observations in relation to those negotiations form the foundation for the finding of the competition problems in question, including the strategic incentives. Ofcom's

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<sup>72</sup> Unger 1, para 101.

<sup>73</sup> Unger 1, paras 103-4, 106.

<sup>74</sup> Transcript 34/48.

leading counsel submitted that although we had heard considerable witness evidence, we should treat the contemporaneous documents as the most reliable guide to what occurred.

174. To examine all this evidence has been no small task. It has entailed consideration of contemporaneous documents, together with written and oral testimony and submissions, relating to bilateral discussions between Sky and six separate counterparties, each of which extended over several years. In some cases more than one set of negotiations took place between Sky and the same counterparty: for example, there were separate negotiations between Sky and BT in 2007/8 and in 2009/10.<sup>75</sup> Given the importance of what took place in the course of these discussions to the findings of Ofcom, and in turn to our own conclusions, we have considered it appropriate to include our narrative of the negotiations in the main text of the judgment rather than, for example, consigning it to an annex. Although this, together with the sheer size of the exercise, has added considerably to the length of this section of the judgment, in our view it is necessary to set out and comment upon the relevant steps in the negotiations, if the basis for our conclusions is to be clear.
175. To assist the reader Annex C to the judgment provides a *dramatis personae* which lists the key witnesses and other individuals to whom reference is made in this section.

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<sup>75</sup> It has already been pointed out that the material as well as the multiplicity of issues put before us in the course of these appeals has been enormous (see para 9 of the judgment). The hearing extended over 37 days and was followed by further written submissions. Lord Macaulay, having reviewed a particularly voluminous work by the historian Dr Nares on the life and times of William Cecil, observed: “There was, it is said, a criminal in Italy, who was suffered to make his choice between Guicciardini [an historian] and the galleys. He chose the history. But the war of Pisa was too much for him. He changed his mind and went to the oar.” At times the oar would have had its attractions for us too.

### ***Background to the negotiations***

176. Before considering the detail of the individual negotiations between Sky and its counterparties, it is important to consider certain aspects of the background against which these negotiations were taking place, in particular:

- (a) The different methods of distributing the CPSCs on other platforms;
- (b) The extent of the distribution of the CPSCs prior to the WMO; and
- (c) The regulatory context in which the parties were operating at the time of the negotiations.

### **Methods of distributing the CPSCs on other platforms: self-retail or wholesale**

177. In his first witness statement, Mr Michael Darcey, the Chief Operating Officer of Sky, described the two main methods by which Sky can distribute its pay TV channels on third party platforms:

“Sky may supply the channels on a *wholesale* basis to other pay TV retailers (as Sky currently does to cable TV operators), who will then sell the channels to their customers; or Sky may seek to gain access to platforms operated by third parties, and then *self-retail* its channels directly to customers on those platforms.”<sup>76</sup> (Emphasis added.)

178. Mr David Chance, the chairman of TUTV, described the manner in which a self-retail arrangement would function:

“...Such an arrangement typically involves the supplier of a channel (Sky in the context of Sky’s premium channels) entering into contractual relationships directly with consumers (including setting the retail price) for the supply of the channel over the third party’s platform. In such arrangements, the supplier of the channel will obtain the necessary personal information about the consumers including, for example, name, address, telephone number and payment details by virtue of the direct relationship with consumers and consequently only requires technical platform services from the third party platform operator (such as conditional access (“CA”) services which are necessary to encrypt and decrypt the channels using the platform operator’s [CA] system and EPG services in order [for] the channels to be listed on the platform operator’s [EPG]).”<sup>77</sup>

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<sup>76</sup> Darcey 1, para 259.

<sup>77</sup> Chance 1, para 24.

179. We note that according to Sky a self-retail deal would typically work as follows (where the platform operator is “X”): an existing or new customer of X would ring X who would act as sales agent for Sky and would sign the customer up to Sky’s retail supply terms and conditions covering the desired premium channels. X would then, on Sky’s behalf, entitle and enable the customer to view the channels in question. The customer would be billed monthly by X, both on behalf of itself and as Sky’s agent, with the charge for the premium channels being shown as a separate item in the bill. X would then account to Sky for the appropriate amount, and recover the relevant access charges from Sky. In specific negotiations Sky appeared willing, where the platform operator so wished, to enter into contractual restrictions on the marketing or promotion of Sky services or products to the operator’s customers.<sup>78</sup>
180. Thus, the key distinction between wholesale and self-retail distribution appears to lie in the platform operator’s ability, under a wholesale arrangement with Sky, to determine the manner in which it packages and prices the channels as part of its direct relationship with the customer. By contrast, in a self-retail arrangement, Sky is itself responsible for these aspects, and has the direct relationship with the customer, subject to any agency arrangements with the platform operator.
181. It is common ground that in relation to the supply of its premium channels on a third party’s platform Sky has a strong preference for a self-retail relationship. Sky states that this is because it considers self-retail to be the most effective way of maximising the take-up of these channels.<sup>79</sup> There is no doubt that this preference was manifested by Sky in each of the negotiations we have examined. Where a potential new platform operator inquired about or requested wholesale supply of premium channels, Sky sought to persuade them to take the channels under a self-retail deal. However, in the case of TUTV a self-retail deal was requested at the outset and no persuasion on the part of Sky was necessary, as will be seen. In addition, we find below that negotiations between Sky and Orange started originally with an Orange request for a self-retail arrangement but that Orange subsequently moved away from this.

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<sup>78</sup> See Ofcom 5/1668-1669.

<sup>79</sup> Sky written closing submissions, Part A, para 6.95; Darcey 1, paras 259-275.

182. In the Statement Ofcom accepts that there is a legitimate argument for self-retail as a means of distribution,<sup>80</sup> and that other parties' preference for wholesale supply should not automatically take precedence over Sky's preference for self-retail. Nor does Ofcom argue that "where it has not been possible to agree a retail deal Sky should offer a wholesale deal immediately and without further negotiation."<sup>81</sup> However, Ofcom also points to other parties' reasonable concerns about entering into self-retail arrangements (for example, reluctance to grant Sky access to their customer bases, and the inability to exploit economies of scope under a self-retail arrangement).<sup>82</sup>
183. The essential finding by Ofcom in this regard is that where a retail deal is not possible, Sky prefers to be absent from a platform altogether rather than to wholesale the premium channels.<sup>83</sup>
184. Sky disputes this and also submits that its efforts to conclude self-retail distribution agreements contradict Ofcom's theory that Sky has deliberately sought to withhold its CPSCs from other platforms.<sup>84</sup>
185. We also note Ofcom's significant finding that the prospect of other retailers agreeing a self-retail deal was unlikely, and therefore Sky was unlikely to have had an expectation of such an agreement materialising.<sup>85</sup>
186. We will return to these issues in the context of the individual negotiations below.

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<sup>80</sup> Statement, para 7.102.

<sup>81</sup> Statement, para 7.72-4

<sup>82</sup> Statement, para 7.94.

<sup>83</sup> Statement, para 7.195

<sup>84</sup> Sky written closing submissions, Part A, para 6.97.

<sup>85</sup> See further, at paras 227 ff and 493 ff.

The extent of the distribution of the CPSCs prior to the WMO

187. In its closing submissions, Sky identified the following channels of distribution by which Sky Sports 1 and 2 were distributed prior to the WMO, and the different methods of distribution in each case:<sup>86</sup>

<b>Channel of distribution</b>	<b>Method of distribution</b>
Sky's DTH satellite platform	Self-retail by Sky
VM's cable network (and that of its corporate predecessors)	Wholesale
ITV Digital (before it went into administration in 2002)	Wholesale
Sky's 'Sky Player' internet application (accessible via the open internet and on other devices such as Microsoft's X-box 360)	Self-retail by Sky
Wight Cable	Wholesale
Smallworld Cable	Wholesale
Newtel Cable	Wholesale
Subscription Management Services	Wholesale
Velocity 1	Self-retail by Sky
Star Systems	Wholesale
TalkTalk's IPTV network <sup>87</sup>	Self-retail by Sky
Each of the 3G mobile phone networks and some WiFi connected mobile devices (such as the Apple iPad and iPod Touch)	Self-retail by Sky

188. Sky submits that the above arrangements confirm its genuine aspiration, "assiduously pursued" to seek to ensure the widest possible distribution of the CPSCs,<sup>88</sup> and that these deals are overlooked by Ofcom, which unduly focuses on the negotiations with TUTV, BT, Orange and VM.<sup>89</sup> In Ofcom's view, however, these concluded deals do not undermine its competition concerns. In addition to its concerns about self-retail arrangements described at paragraphs 182 and 183 above, all of the existing wholesale deals were concluded with cable operators (whom Sky

<sup>86</sup> Sky written closing submissions, Part A, para 6.84.

<sup>87</sup> See further footnote 932 below.

<sup>88</sup> Sky written closing submissions, Part A, para 6.85.

<sup>89</sup> Sky written closing submissions, Part A, para 6.83.

considered itself to have a *de facto* regulatory obligation to supply (see further paragraph 306 below)), and numbers of subscribers on platforms other than VM were very small.<sup>90</sup> Indeed, Ofcom noted in its closing submissions that it had properly recognised the pre-existing extent of Sky’s distribution of the CPSCs, but observed that the availability of these channels only through two major retailers (Sky and VM) stood in contrast to the estimated demand for the channels on new platforms.<sup>91</sup>

### The regulatory context

189. We were urged by the parties to bear in mind various aspects of the regulatory context to these negotiations, in particular the following:

(a) As noted at paragraph 43 above, Ofcom’s investigation was initiated following the filing of a joint complaint by BT, Setanta, TUTV and VM on 16 January 2007, which alleged that the Pay TV sector was not working properly. In Sky’s submission, Ofcom paid insufficient attention to the possible effect of “regulatory gaming” on the negotiations relied upon by Ofcom, given that three of Sky’s counterparties in the negotiations (BT, TUTV and VM) were parties to the complaint and continued to make submissions to Ofcom in this context while engaged in negotiations with Sky.<sup>92</sup> This is an issue to which we refer in more detail in our consideration of the individual negotiations.

(b) Regulation of terms of access to TV platforms had the potential to apply not only to Sky, but to other operators who hosted third party channels or other services on their platforms. As we note at paragraph 247 below, this was a particular issue that arose in the context of the negotiations between Sky and TUTV in relation to the provision of conditional access (“CA”) services<sup>93</sup> by TUTV to Sky in a possible self-retail deal.

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<sup>90</sup> Ofcom written closing submissions, Part 1, para 352.

<sup>91</sup> Ofcom written closing submissions, Part 1, para 354.1-2.

<sup>92</sup> Sky written closing submissions, Part A, paras 6.141ff.

<sup>93</sup> Conditional access is a technology enabling a broadcaster to restrict access to content that it has made available to a digital platform only to those customers that have been authorised to access it (Unger 1, para 115, footnote 75).

(c) The Pay TV review is not the first time that Sky's distribution of premium content has been the subject of regulatory scrutiny. In his first witness statement Mr Darcey referred to a number of reviews between 1995 and 1999 by the Director General of Fair Trading under the provisions of the former Fair Trading Act 1973, as a result of which undertakings were provided by Sky. There was also a subsequent investigation by the OFT under the 1998 Act culminating in a non-infringement decision in 2002. These regulatory interventions are described more fully below, when we consider Ofcom's findings in respect of Sky's negotiations with the cable companies about the terms of Sky's existing wholesale supply of the premium channels, including in particular the possibility of discounting the wholesale rate card prices paid by those companies (see paragraph 511 ff).

(d) In 2007 and 2008, during the Pay TV review, Sky and Ofcom entered into lengthy negotiations in 2007 and 2008 with a view to a potential regulatory settlement.

190. This last item merits further exposition. The Statement records the fact that Sky approached Ofcom in late 2007 to discuss whether there were commitments it could provide to Ofcom to enable an early resolution of Ofcom's Pay TV review and the Picnic review. This led to a series of discussions between December 2007 and April 2008, during which a number of proposals were considered, culminating in the proposal set out at Annex 2 of the Statement ("the Annex 2 proposal"). Ofcom understood this proposal to amount to commitments that Sky was willing to offer and that, if accepted, would have acted as undertakings in lieu of a reference to the Competition Commission under the 2002 Act. The Annex 2 proposal is detailed, but the key element of the proposal (as regards sport content) comprised a commitment to wholesale to a single retailer on each eligible platform (i.e. digital satellite, cable, DTT, IPTV and mobile broadcast) any linear premium sports Pay TV channels including full live coverage of FAPL matches. The pricing for the wholesale offer, for all retailers, was to be based on the base wholesale prices for content applicable at that time to VM (i.e. the rate card price), with certain discounts available for platform penetration.

191. In the Statement, Ofcom explains that the main reason that Ofcom and Sky were ultimately unable to reach agreement on the Annex 2 proposal was price. In particular, Ofcom stated that, assuming moderate levels of platform penetration, the price that was on offer would not have enabled a retailer on DTT to compete with Sky, and that retailers' incentives to achieve very high levels of platform penetration (in order to benefit from an average price at which they were competitive) would have turned them into "pure resellers" of Sky's content. Ofcom sets out its overall conclusion in relation to Sky's proposal at paragraph 9.100 of the Statement:

"9.100 The result was that while what was on offer from Sky might have delivered some benefits to consumers, we were not confident that it would have enabled effective competition (either between different DTT-based platforms, or between platforms on DTT and other platform technologies). We were not in a position to accept Sky's proposed commitments because we did not consider they would provide a comprehensive solution to our competition concerns and their adverse effects on consumers."

192. In his evidence, Mr Darcey provides further context to the discussions with Ofcom,<sup>94</sup> and in particular charts their evolution from an offer by Sky to self-retail certain premium channels to other DTT retailers, to the broader wholesale offer contained in the Annex 2 proposal described above. He stated that it was made clear to Ofcom from the outset of negotiations that (subject to any penetration/performance discounts) Sky would not countenance a wholesale price below the existing cable rate card price, on the basis that this price was consistent with the OFT's margin squeeze test<sup>95</sup> described above, and that Ofcom had - at least at first - willingly negotiated with Sky to achieve as deep a performance discount as possible from the rate card price.<sup>96</sup> He explained that Ofcom subsequently expressed concerns about the wholesale pricing structure, and that this ultimately led to the failure of the negotiations, despite further efforts by Sky to address Ofcom's concerns.

193. With that background we now examine in turn the documents and other evidence relating to each set of negotiations identified above, where appropriate indicating our conclusions on Ofcom's assessment of them.

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<sup>94</sup> Darcey 1, paras 425-478.

<sup>95</sup> See para 160 of this judgment.

<sup>96</sup> Transcript 5/141:12-23.

## B. NEGOTIATIONS WITH TUTV

194. In 2002 Mr David Chance, the chairman of TUTV, founded a company which proposed to launch a Pay TV service called Freeview Plus on DTT, comprising a number of linear channels, to be broadcast on DTT capacity that had come available following the failure of the ITV Digital (formerly ONDigital) venture.<sup>97</sup> Freeview Plus was never launched in this guise, but the “Top Up TV” service ultimately launched in April 2004 as the first subscription service on the DTT platform. TUTV initially targeted ITV Digital subscribers who had retained their set-top boxes (“STBs”), but the service was also made available through the use of compatible conditional access modules (“CAMs”) and digital terrestrial STBs.
195. In addition to our consideration of the documentary and other evidence described at paragraphs 172 to 174 above, the Tribunal heard oral evidence about the negotiations between Sky and TUTV from, in particular, the following witnesses:
- (a) Dr Unger of Ofcom, to whose single witness statement (as we note at paragraph 172 above) the majority of the relevant contemporaneous documentary evidence was exhibited. Dr Unger gave evidence on day 13 of the hearing.
  - (b) Mr Michael Darcey, Sky’s Chief Operating Officer since November 2006, formerly Sky’s Group Commercial and Strategy Director (from February 2006) and Group Director of Strategy (from July 2002). Mr Darcey filed three witness statements in these proceedings (and further statements in the STB and CAM appeals), and gave evidence on days 5-7 of the hearing.
  - (c) Mr Chance of TUTV, who filed a single statement in these proceedings (and further statements in the STB and CAM appeals), and gave evidence on day 12 of the hearing.

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<sup>97</sup> TUTV written closing submissions, para 26; Chance 1, paras 11-12.

### *Discussions in 2003-2004*

196. It is common ground between Sky and Mr Chance that there were discussions between them in 2003-4 about the possible wholesale supply of Sky 1, which is not a premium channel but a basic entertainment channel. It is also common ground that Sky offered to wholesale Sky 1, but that Mr Chance did not agree to the terms of the offer, and no deal was done.<sup>98</sup> Mr Chance states that also in 2003 he made an oral inquiry to a Sky representative, Mr Martin Goswami, whether Sky was prepared to wholesale a single premium sports channel to TUTV, and that he was told by Mr Goswami that this would be “very difficult”.<sup>99</sup> Mr Darcey, the Chief Operating Officer of Sky, in his own evidence expressed surprise at this. Mr Darcey said that although he had not been able to confirm the inquiry with Mr Goswami, who had left Sky several years ago, even if the request had been confirmed it would have been treated with scepticism given the state of development of DTT in 2003 and Mr Chance’s public comment at the time that it would “be lunacy” for TUTV to launch premium Pay TV services on DTT.<sup>100</sup> What does appear to be agreed is that in 2003 Sky suggested to Mr Chance that it be allowed to self-retail its premium channels (or some of them) on the TUTV platform, and that Mr Chance refused because by virtue of regulatory rules such a step would have opened up the platform to Sky’s and other operators’ channels on regulated terms.<sup>101</sup>

### *Discussions in 2005-2006*

197. We can now go forward to the autumn of 2005, when TUTV authorised Mr Matthew Horsman, an independent industry analyst who acted as an intermediary (apparently without formal engagement or payment by TUTV<sup>102</sup>), to explore with Sky the supply of premium channels to TUTV. Mr Horsman was acquainted with Mr Richard Freudenstein, then an executive of Sky, with whom he had a meeting

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<sup>98</sup> Chance 1, paras 27-33; Darcey 1, paras 299-302.

<sup>99</sup> Transcript 12/35:13-23.

<sup>100</sup> Darcey 1, paras 303, 306.

<sup>101</sup> Darcey 1, paras 300-302.

<sup>102</sup> Transcript 12/32:24-25

towards the end of November 2005. Following that meeting Mr Horsman sent Mr Freudenstein an email dated 25 November 2005<sup>103</sup> containing the following:

“To recap: I believe there is a possible deal to be had between Sky and Top-Up TV whereby Sky has a retail deal allowing it to distribute Sky Sports as a retail proposition to Top-Up subscribers. As I mentioned this would allow Sky to have a customer relationship with its subscribers, and may enshrine a retail model as opposed to a wholesale model for multiple platform distribution (eg on DSL platforms).”

198. The email went on to refer to a number of other matters including the possibility of minimum revenue guarantees (“MRG”) to protect TUTV against the possibility that volumes may not be high enough to compensate TUTV for the opening up of its platform to regulation. In the concluding paragraph Mr Horsman said:

“I think the timing might be interesting, as there is a lot of movement at Ofcom on the supply of premium programming to competing platforms – and a retail deal gives Sky more control over the future. Moreover, without a retail deal, it is very likely that all alternative platforms will be asking for a wholesale deal from you...”

199. Mr Chance did not suggest in his evidence that Mr Horsman was requested to propose a wholesale deal to Sky. On the contrary, Mr Chance indicated to the Tribunal that he did not believe that Mr Horsman would have tried to broker such a deal.<sup>104</sup> That accorded with Mr Chance’s own opinion of Sky’s likely reaction to a wholesale proposal. Therefore it seems clear that, with Mr Chance’s blessing, Mr Horsman approached Sky with a proposal that Sky self-retail one or more of its premium sports channels on the TUTV platform.
200. Mr Horsman’s overtures to Sky led to a meeting between Mr Chance and Mr Freudenstein on 16 December 2005. It is not in dispute that the purpose of this meeting, from both parties’ viewpoint, was to discuss the self-retail proposal put forward on TUTV’s behalf by Mr Horsman. This is expressly confirmed by the terms of a non-disclosure agreement which TUTV and Sky entered into in order to protect confidential information which might be disclosed at the meeting and in any negotiations thereafter.<sup>105</sup> It is also clear that the self-retail proposal was in fact what was discussed at the meeting. However, Mr Chance states in his evidence that

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<sup>103</sup> Sky 6/708.

<sup>104</sup> Transcript 12/29:8-19.

<sup>105</sup> PL17/28.

at the outset of the meeting he raised with Mr Freudenstein the possibility of wholesale supply, and that having received the expected discouraging reaction he “didn’t want to push” the matter, and the remainder of the discussion, concerned the original self-retail proposal.<sup>106</sup> Mr Chance did not refer to this oral mention of wholesale supply in his follow-up letter to Mr Freudenstein of 23 December 2005,<sup>107</sup> which was entirely concerned with fleshing out TUTV’s self-retail proposition. Mr Darcey, who did not attend the meeting, states that his understanding was that the discussions between TUTV and Sky had related to a self-retail deal, and he does not recall Mr Freudenstein mentioning that wholesaling had been discussed.<sup>108</sup>

201. In the letter of 23 December 2005 Mr Chance indicated that although TUTV aspired to carry a broader range of premium sports channels for DTT customers, he was limiting the proposal to a single channel in the first instance in the interests of speed. He also emphasised that because a retail deal would open up the platform it only made commercial sense for TUTV if there was a MRG. Attached to the letter were TUTV’s proposed headline terms of supply.<sup>109</sup> These provided for a five year retail agreement for a single premium sports channel using Sky’s existing DTT capacity on Multiplex C. Sky would pay TUTV a monthly sum of £[...] [C] in respect of each subscriber for the CA and related services provided by TUTV. The encryption system would be the platform’s “Nagra” system. The MRG payable by Sky would be based on average subscriber levels of [...] [C] in year one, [...] [C] in year two, and [...] [C] in year three and onwards, at a rate of £[...] [C] per subscriber per month. Launch would be on 1 April 2006 and each party would have the option to renew the agreement for a further five years. The proposal also included a requirement to negotiate in good faith about adding further Sky Sports or other Sky branded products by 1 January 2007.
202. TUTV’s proposal was followed by a meeting which does not seem to have been minuted. Mr Freudenstein responded in detail to TUTV’s proposal by letter dated

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<sup>106</sup> Transcript 12/29:8-10; TUTV written closing submissions, para 37.

<sup>107</sup> Sky 6/710.

<sup>108</sup> Darcey 3, para 263.

<sup>109</sup> Sky 6/711.

30 January 2006.<sup>110</sup> Sky's counter proposal also took as a framework a renewable five year self-retail agreement. However a lower monthly CA charge per subscriber was offered (£[...][C]) and there was no provision for any MRG. Sky indicated that a charge of £[...][C] was on the generous side but it would offer it "in an effort to reach agreement with TUTV in short order". Sky also proposed that TUTV should provide at market rate the required capacity on Multiplex A<sup>111</sup>, rather than Sky using Multiplex C as TUTV had suggested. Sky was to have the option of using TUTV's CA services for other channels, in which case Sky would provide the necessary capacity. Sky's covering letter emphasised that it would need to be satisfied on a number of "high level issues" before the agreement could be made. Three such issues were identified about which Sky sought "as much relevant information as possible": (1) the security of the Nagra CA system used by TUTV – Sky pointed out that the addition of premium sports content to the platform would increase the risk of piracy, and inquired as to the steps which were being or would be taken by TUTV or its CA provider to combat piracy and in the event of a security breach; (2) the technical quality of the capacity that would be used; (3) evidence of sufficient demand for a premium sports service on DTT that would enable Sky to cover costs and a reasonable return.

203. Fairly soon after this letter a further meeting took place at which Mr Chance insisted on a MRG being provided by Sky. We glean this from Sky's letter of 10 February 2006,<sup>112</sup> which states that "some positive progress was made" but that TUTV's insistence on a MRG meant that Sky would need to have "a much clearer understanding of the level of potential demand for a Sky offering before being able to commit to any particular level of minimum guarantee". Sky stated that TUTV's position on this also increased the significance of the question whether TUTV was obliged to afford CA services on its platform at fair, reasonable and non-discriminatory ("FRND") terms, an issue which, Sky said, might otherwise have been put on one side. Sky referred, too, to the outstanding matters of security of the Nagra system and the technical quality of TUTV's capacity.

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<sup>110</sup> Ofcom 6/5.

<sup>111</sup> In relation to multiplex transmitters, see Annex A, para 3(a) of this judgment.

<sup>112</sup> Ofcom 6/9.

204. Further discussions ensued, and Mr Chance replied to Sky's points by letter of 21 March 2006.<sup>113</sup> On TUTV's regulatory obligation in relation to CA services, he invited Sky to confirm with Ofcom that no such obligation had arisen. (We interpose here to note that Ofcom, despite being pressed by Sky during February 2006 did not so confirm, and, according to Sky, it was not until 15 February 2007 (following TUTV's agreement to provide CA services to Setanta) that Ofcom finally took a decision in this regard, publishing a consultation proposing to impose conditions upon TUTV for the provision of CA services.<sup>114</sup>) In relation to the question of demand for Sky's service on DTT, Mr Chance stated that "without sharing the actual results at this stage" TUTV's research indicated levels of demand in excess of those outlined in TUTV's December proposal. Whether it was achieved would depend upon Sky's marketing effort. He noted that Sky had commissioned its own research. On the security of the Nagra system he stated that "we do not suffer from any piracy at present." Should it occur Nagra was committed to counter measures and would ultimately replace the smart cards. In relation to capacity Mr Chance stated that as part of a retail deal TUTV would make available some of its own capacity at market rates, which he put at £10 million per annum. The technical quality of channels transmitted on Multiplex A were said to have been satisfactory. A higher per subscriber charge of £[...]C] per month, and a lower MRG were suggested, rather than none at all. Finally Sky was asked to guarantee a marketing spend of £2 million per annum.
205. In the final section of Mr Chance's letter, under the heading "Next steps", Mr Chance states (twice) that TUTV "have been (and remain) willing to discuss with you the possibility of Sky retailing Sky Sports on DTT". He then refers to a schedule attached to the letter which sets out the evolution up to that time of the parties' respective positions in the self-retail negotiations, including the latest self-retail terms now being proposed by TUTV.<sup>115</sup> However, the same section of the letter also contains this passage:

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<sup>113</sup> Ofcom 6/11.

<sup>114</sup> Sky written closing submissions, Part A, para 7.96 and footnote 604. The full consultation document can be viewed at:

<http://stakeholders.ofcom.org.uk/binaries/consultations/tutv/summary/topup.pdf>

<sup>115</sup> Ofcom 6/14.

“Notwithstanding our efforts to negotiate “a *retail deal*” with you, TUTV’s preferred approach to the distribution of Sky Sports on the DTT platform is for TUTV to be able to include the channel(s) in its own retail offering. In light of the lack of progress to date and Sky’s failure to make what is, in the circumstances, a reasonable offer in respect of retailing Sky Sports itself on DTT, I should be grateful if you would now specify the terms on which Sky would be willing to wholesale Sky Sports 1 and, separately, the terms on which Sky would be willing to wholesale Sky Sports 2 to TUTV for distribution on DTT.”

206. This passage stands in sharp contrast to the remainder of the letter and the schedule, which are dedicated to the continuing negotiations for a retail agreement, and which actually contain TUTV’s amended proposal in that regard. Mr Darcey told us that the request for wholesale terms came out of the blue, and that he regarded it as a negotiating tactic to elicit an improved retail proposition from Sky.<sup>116</sup> If that was the case it was successful as, in a letter dated 5 April 2006,<sup>117</sup> Sky set out a revised retail offer which roughly speaking split the difference between TUTV’s most recent proposal for the monthly per subscriber charge (£[...][C]) and Sky’s previous offer (£[...][C]), and which for the first time offered an MRG element, albeit at lower rates than requested by TUTV. Sky also offered a marketing contribution of £1 million and a retail price cap “to allay the fears that you had expressed in relation to how attractively our proposed offering would be priced.”
207. In relation to other issues, Sky stated that despite its attempts to get Ofcom to confirm TUTV’s regulatory position in respect of CA services, as suggested by TUTV, Ofcom had not verified it. As for levels of demand, Sky stated that its research into this would still need to be completed, particularly in view of the MRG and capacity fees now being offered. Sky also sought further comfort from TUTV about the steps that Nagra would take in the event of a security breach, and asked whether TUTV would accept contractual commitments to ensure that Nagra took the appropriate steps. Finally, the letter expresses Sky’s surprise at TUTV’s request for wholesale terms, stating that this was “not a suggestion that TUTV had made at any time prior to its inclusion in your letter”. Sky pointed out that TUTV had approached Sky for a retail deal, and that Sky’s offers in that regard could not be characterised as unreasonable.

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<sup>116</sup> Darcey 3, para 266. See also TUTV written closing submissions at para 48, referring to Transcript 12/48:8-23.

<sup>117</sup> Ofcom 6/21.

208. Within a few days of this revised offer, on 11 April 2006, Mr Chance, Mr Freudenstein and Mr Darcey had met and shaken hands on the headline terms of a self-retail agreement which essentially reflected that offer. An internal email by Mr Darcey of the same date<sup>118</sup> states that “subject to sign off by finance and JRM [apparently a reference to the CEO of Sky, Mr James Murdoch], we seem to have agreed the outline of a potential deal with David [Mr Chance]”.
209. Following the handshake on 11 April 2006 there were further discussions and Sky gave immediate instructions for the drawing up of a full draft agreement, which was sent to TUTV on 21 April 2006 under cover of an email of that date.<sup>119</sup> It is reasonably clear (and apparently uncontroversial) that thereafter both parties were working in good faith to reach final agreement. Sky’s internal documents at this time support this. They show that Sky was contemplating launch of the service on TUTV’s platform in August 2006.<sup>120</sup> Mr Darcey stated in his evidence that during the period April to July 2006 he believed that a contract would be signed.<sup>121</sup> However this did not occur, and a mixture of reasons are canvassed in the evidence (We discuss these at paragraphs 233 to 249 below).
210. In May 2006 the market research commissioned by Sky (see paragraph 204 above) from Harris Interactive<sup>122</sup> suggested that: the overall pay DTT opportunity for a package including a Sky Sports and a Sky Movies channel was about 300,000 homes of which about one third were from “the most attractive ‘not interested in [Sky’s satellite offering] group’”; that the price cut-off was about £26 for any package – anything over that produced very low demand; and that consumers much preferred bundles rather than single channels.<sup>123</sup> In the light of this research an internal Sky review of the “TUTV financials” based on the contractual terms then under negotiation caused Sky to form a pessimistic view of the commercial viability of a deal. In a report for the Strategic Planning Group dated 9 June 2006 most of the scenarios considered were said to be “unattractive with the net impact only being positive at the lowest price points. However at the lowest price points the risk of

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<sup>118</sup> Sky 6/739.

<sup>119</sup> Sky 6/741.

<sup>120</sup> Sky 6/745 at para 3.1 of the draft agreement dated 21 April 2006.

<sup>121</sup> Darcey 1, para 323.

<sup>122</sup> Sky 6/840-895.

<sup>123</sup> Sky 6/867.

churn from DTH to DTT is much higher making the proposition high risk.”<sup>124</sup> This latter risk was based on Sky’s calculation that if only [...] [C] subscribers churned over [...] [C] years Sky would merely break even on the deal.<sup>125</sup> Churn levels of that order were not considered unrealistic.<sup>126</sup>

211. In an internal email of 21 June 2006, Mr Stephen Nuttall (Commercial Group Director at Sky) referred to “three key points” which Sky had asked Mr Chance to consider in advance of a meeting. These were (1) whether, to what extent and on what terms Sky would be allowed to self-retail third party channels on TUTV’s platform; (2) the arrangements surrounding contract termination rights in the event of a change of control at TUTV; and (3) whether Sky would be allowed to retail a “sports pack” to include some or all of Sky Sports 1, Setanta, Sky Sports News and ESPN within the per subscriber price being discussed.
212. The “bad news” - lack of financial viability for Sky - was broken to Mr Chance on 23 June 2006<sup>127</sup> at which time Sky had begun to consider developing a broader DTT offering than was possible on TUTV’s platform, using Sky’s own STB – the plan which became known as “Picnic” (see paragraph 44 above). A rather fuller explanation was sent to TUTV by email on 6 July 2006.<sup>128</sup> In that email Mr Nuttall refers to a number of “areas of change or continuing difficulty”. “Chief” among these were the results of the market research which “indicated that the opportunity was more marginal than we had hoped.” The other issues mentioned included: capacity (TUTV’s sale of capacity to Channel Five and introduction of a personal video recorder (“PVR”) product changed TUTV’s business model and made it less attractive, in that in particular the advantages of the established base of STBs would be reduced); the issue whether there was regulated access to TUTV’s platform was not resolved; TUTV had introduced restrictions on channels carried or required extra fees for carriage of such channels; there was still an issue whether use of TUTV CAMs and PVRs resulted in Sky Movies content being retained unencrypted

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<sup>124</sup> Ofcom 4/57.

<sup>125</sup> Internal Sky email dated 8 June 2006 titled “TUTV financials” (Ofcom 4/55).

<sup>126</sup> See, for example the internal Sky email dated 9 June 2006 in response to the email above, sent by Mr Jamie Wadham, in which it states that “Only [...] [C] [households] would have to churn (over [...] [C] years) before Net Impact for Sky becomes negative ... Given the low price points, its not difficult to see [...] [C] churning.” (Ofcom 4/59).

<sup>127</sup> Internal Sky email dated 23 June 2006 titled “TUTV” (Ofcom 4/63).

<sup>128</sup> Ofcom 4/75.

by subscribers; and there remained a question as to the robustness of TUTV's CA system from a security point of view, and as to the steps which would be taken to address any security failures that might arise.

213. Discussions with TUTV staggered on until September/October 2006, with Sky in the meantime looking at the financials of a TUTV deal without the capacity element i.e. using their own capacity instead of acquiring it from TUTV at market rates. TUTV expressed itself willing to forego the sale of capacity, and ultimately to forego the MRG.<sup>129</sup> An internal email of 19 September 2006 shows Sky treating this proposal as a possible "simple, low risk" option, to be modelled alongside consideration of Picnic.<sup>130</sup> However, nothing came of this.

#### ***Further contact between TUTV and Sky in 2007***

214. Following the inconclusive self-retail discussions there was no significant contact between Sky and TUTV in the period from October 2006 to the end of March 2007. During this period TUTV had submitted its joint complaint to Ofcom in January 2007 and had struck a self-retail deal with Setanta (which had acquired two of the six Premier League packages). Also Sky had announced the plan to launch Picnic, with its own DTT STB and was talking to Ofcom about the proposal.
215. To the extent that the January 2007 joint complaint dealt with the supply of Sky's channels to TUTV, this was covered in a few paragraphs. TUTV alleged that in 2004 Sky had refused to wholesale Sky 1, a *basic* channel, to TUTV and that the self-retail negotiations in 2005-6 showed that Sky was only willing to supply its premium channels as retailer.
216. The first allegation was inaccurate even on the basis of Mr Chance's own evidence to the Tribunal. His witness statement makes clear that Sky did not refuse to wholesale Sky 1 to TUTV. It was willing to do so but the parties could not reach agreement on the terms, including the price, which Mr Chance regarded as "high".<sup>131</sup>

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<sup>129</sup> See, for example, email from Mr Chance to Mr Darcey dated 20 September 2006 (Ofcom 4/85).

<sup>130</sup> Sky 6/897.

<sup>131</sup> Chance 1, paras 30-33.

217. In relation to the 2005-6 negotiations, it suffices to say that the account given to Ofcom by TUTV did not describe what had taken place, namely that TUTV had actually requested a self-retail deal.
218. On 27 March 2007 Mr Chance wrote to Mr Darcey<sup>132</sup>, referring to Sky's announcement of Picnic and also to a press comment to the effect that Sky was discussing with BT the access of the latter to Sky's content. Mr Chance asked whether in the light of this Sky was prepared to "engage in good faith negotiations with [TUTV] about access to Sky's channels." In his reply of 10 May 2007<sup>133</sup> Mr Darcey referred to two of the unresolved issues which had been raised in the negotiations the previous year, namely first that Sky's market research had shown that a single sports channel, as distinct from a broader service with a mixture of premium and basic channels, was not commercially viable; and second, that security remained of "paramount importance" to Sky and its content licensors, and there was a risk that movies delivered via TUTV's CA system would be retained in unencrypted form on the subscribers' equipment. More generally, Sky stated that it was concerned about the security of the TUTV CA system, and the steps TUTV was willing to take in the event of a security breach. Mr Darcey went on to explain that Sky's concerns on both these issues had since been heightened: first, by the sale of TUTV capacity back to Channel Five ("reducing the scope for TUTV to assist [Sky] in assembling a broad offering"), and in relation to the security question by the "news flow" regarding the integrity of the Nagra CA system. He invited TUTV to let Sky know if there was anything further to say on these issues. Mr Darcey also described the Picnic proposal, and stated that the relevant STBs could be configured so as to enable customers to receive all services available on DTT including TUTV's.
219. In his reply on 23 May 2007<sup>134</sup> Mr Chance referred again to TUTV's own market research, demonstrating strong demand for a stand-alone offering of Sky Sports from DTT households at a price of approximately £20 per month, and noted that Sky had not taken up TUTV's suggestion that Sky and TUTV share their research.

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<sup>132</sup> Ofcom 4/97.

<sup>133</sup> Ofcom 4/103.

<sup>134</sup> Ofcom 4/105.

He also questioned whether Sky's market research postulated a higher price point than TUTV would seek to adopt. As regards security, Mr Chance assured Sky that movies could not be retained by customers in unencrypted form. On the integrity of the TUTV CA system generally, he reiterated that the CA supplier (Nagra) was a leader in the field and asked for details of the reports which had heightened Sky's concerns. Finally he reiterated TUTV's interest in distributing Sky Sports on DTT and referred back to his letter of 21 March 2006 in which he had asked Sky to specify the terms on which Sky would be willing to wholesale on DTT Sky Sports 1 and, separately, Sky Sports 2. The letter concludes: "No such terms were proposed by Sky in response to that letter. Over one year on from that request, I would again ask Sky to specify such wholesale terms."

220. Mr Darcey's lengthy reply dated 29 June 2007<sup>135</sup> can be summarised as follows: (1) Sky declined Mr Chance's offer to exchange each company's market research, stressing that Sky regarded its market research as commercially confidential; (2) TUTV's assurance about the unencrypted retention of movies on customers' PVRs satisfied Sky's concern on that point. Mr Darcey asked for technical information as to the capability of the CA system, the PVRs and the STBs in relation to analogue video outputs; (3) Sky was not satisfied with the security of the Nagra CA technology, which had been widely hacked in the UK, both on DTT and cable; Sky was aware of various websites on which keys for Nagra systems were freely available. Sky still needed to know what steps TUTV and its provider would take in the event of a breach of security; (4) As to the request for wholesale terms, Mr Darcey noted that the earlier request made on 21 March 2006 had been made in the context of self-retail negotiations and had not been repeated until now. He went on to state that, if the other outstanding questions were resolved, Sky would want to make the same commercial assessment as Setanta (which was then self-retailing on TUTV's platform) had presumably made as to which mode of supply was appropriate. The respective costs of each option needed to be known, and therefore Sky asked TUTV to provide the terms on which CA services would be provided, in the light of the cost to TUTV and the price being charged to Setanta, and on the assumption that Sky would use its existing capacity for three Pay TV channels; and

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<sup>135</sup> Ofcom 4/115.

(5) Sky pointed out that in the light of Ofcom's recent announcement (see paragraph 45 above), it might well not allow Sky to launch Pay TV channels on DTT.

221. TUTV did not reply to Sky's letter and no further relevant contact seems to have taken place until after the Statement was issued in 2010. However, about four days after Sky's letter TUTV lodged a supplementary submission with Ofcom<sup>136</sup>, describing Sky's letter as "obfuscatory", and expanding upon its objections to Sky's proposal for Picnic.

### *The Tribunal's discussion and conclusions*

222. A number of specific issues raised in the course of evidence and argument call for comment. We first comment on Ofcom's interpretation of the negotiations between Sky and TUTV (paragraphs 223 to 232 below), before examining the reasons why no deal (whether self-retail or wholesale) was concluded between these parties (paragraphs 233 to 256 below). We then set out our overall conclusions on these negotiations (paragraphs 257 to 259 below).

### Ofcom's interpretation of the negotiations with TUTV

223. We now consider the interpretation placed upon these negotiations by Ofcom in the Statement. Ofcom summarised the position thus:

"7.61 While in some cases, discussions for wholesale supply have restarted, and are ongoing, to date agreements for the wholesale supply of Sky's premium content have not been concluded.

...

- **Top Up TV** and Sky began discussing supply of Sky's premium content over Top Up TV's DTT boxes in late 2005. Top Up TV told us that it first requested a wholesale deal in relation to the supply of Sky's premium content in December 2005, that this was done orally, and that therefore it was unable to provide us with any documentary evidence of this. We did, however, receive documentary evidence that Top Up TV attempted to obtain a wholesale arrangement with Sky in March 2006. However, Sky made it clear that it was only interested in concluding a retail deal for supply. Thereafter, while Top Up TV did attempt to obtain

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<sup>136</sup> Ofcom 4/117.

a wholesale agreement, the parties proceeded to negotiate on the retail supply of Sky's content. However, while that deal appeared to be close to being finalised, it was ultimately never concluded."

224. Even allowing for the fact that it is a summary, we do not consider that this account presents an accurate picture of how the negotiations had proceeded up to this point. It implies repeated efforts by TUTV to persuade Sky to provide wholesale supply, with TUTV reluctantly settling for self-retail in the face of Sky's opposition to wholesale. In fact, as we have seen, the initial approach made on behalf of TUTV was aimed specifically and purely at a self-retail deal, with Mr Horsman pointing out to Sky the benefits of entering into such an arrangement with TUTV (see paragraphs 197 to 198 above). At the most Mr Chance states that he mentioned a wholesale alternative at the beginning of the initial meeting fixed in order to discuss TUTV's retail proposal, but he accepts that he "didn't want to push" it.<sup>137</sup> There was nothing in writing which could be characterised as a request for wholesale supply before the letter from Mr Chance of 21 March 2006. However, this reference to wholesale appears to have come out of the blue, in the midst of the retail negotiations, and was in a letter which in fact contained TUTV's detailed counter proposals for a retail deal. Moreover, strictly speaking it represented an inquiry as to the wholesale terms available rather than a request for wholesale supply, and it was accompanied by an assurance of TUTV's willingness to continue to negotiate the retail deal.
225. In his evidence to the Tribunal Dr Unger queried whether Mr Darcey was correct in interpreting Mr Chance's reference to wholesale supply in this letter as a negotiating tactic to encourage Sky to come up with an improved retail offer. Dr Unger appeared to regard it as significant that Sky did not attempt to establish whether the request was genuine, nor provide the requested wholesale terms nor enter into discussion with TUTV as to wholesale prices, instead of simply making an improved retail proposal, as it did.<sup>138</sup> Dr Unger considered it striking that Sky was willing to improve the offer "in an effort to avoid discussing wholesale supply".<sup>139</sup> Yet no mention is made in his statement or the Defence of the fact that

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<sup>137</sup> Transcript 12/34:2-6.

<sup>138</sup> Unger 1, paras 105, 122-126.

<sup>139</sup> Unger 1, para 126; see also Ofcom written closing submissions, Part 1, Annex 3, para 23.

in the same letter TUTV set out in detail its own revised *self-retail* offer for Sky's consideration.

226. In our view Mr Darcey is most probably correct in interpreting Mr Chance's reference to wholesale supply in this letter as a negotiating tactic to strengthen his position in the ongoing discussions about a retail deal. Mr Horsman had made a similar point in his email to Sky on 25 November 2005 (see paragraph 198 above). Nor do we see anything surprising or significant about Sky's reaction to Mr Chance's request. It is entirely consistent with Sky's admitted preference for self-retail that it should choose to respond positively to TUTV's new self-retail proposal (contained in the same letter as the wholesale inquiry) rather than seek to open up an alternative arrangement. Indeed given the fairly advanced stage the retail negotiations had reached, it would have been surprising if Sky had acted otherwise than it did.
227. Further, we cannot reconcile the facts of the negotiations outlined above with the following passages in the Statement:

"7.94 BT, [Orange], Top Up TV and Virgin Media have shown strong resistance to allowing Sky to retail on their platforms. We asked these firms for their reasons for rejecting a retail deal with Sky, and to provide supporting evidence:

...

**Top Up TV** told us that it would prefer a wholesale arrangement in respect of Sky's premium channels because it would be impossible to package the premium channels with Top Up TV's basic proposition in a compelling and competitive way if Top Up TV were not the pay TV retailer. This had been demonstrated by the lack of take up of the premium pay TV offering on Tiscali's platform:

...

7.98 In summary, and consistent with our analysis in our previous consultations, competitors are deterred from agreeing a retail deal with Sky by the prospect of giving Sky access to their customer bases, a loss of flexibility and control, the potential for customer confusion, and the negative perception of Sky By Wire on TalkTalk / Tiscali.

...

7.103 ...in our view Sky faces a considerable static cost in not being present on other platforms. Nonetheless, the prospect of those other platforms accepting Sky as a retailer appears very unlikely. This suggests that whatever reasons Sky has for

resisting wholesale agreements, such a position is unlikely to be due to an expectation that it will soon be allowed to retail on these platforms. Therefore we consider that notwithstanding the considerable static cost in not being present on other platforms, it appears that Sky would prefer to be absent from a platform than to wholesale.

7.104 Our view: We therefore conclude for the reasons set out above that, while Sky may have an interest in retailing on other platforms, the failure of negotiations for wholesale supply cannot reasonably be attributed to this preference.”

(The Tribunal’s underlining)

228. Ofcom’s assessment is not consistent with the facts, so far as TUTV is concerned. As we have seen, far from showing “strong resistance” or indeed *any* resistance to Sky self-retailing on its platform, TUTV made the first approach to Sky for such a deal and thereafter was active in the negotiations aimed at achieving it. Nor did TUTV ever reject such a deal, as Ofcom suggests.
229. Ofcom’s misstatement of the facts relating to the TUTV negotiation calls into question certain other findings.
230. It is difficult to reconcile TUTV’s overtures to Sky requesting that Sky agree to self-retail its premium channels on TUTV’s platform, and the fact of Mr Chance having willingly reached agreement in principle on the terms of such supply, with Ofcom’s apparently uncritical acceptance of TUTV’s submissions to Ofcom that competitors are deterred from agreeing a retail deal with Sky and with Ofcom’s finding to that effect (see Statement, 7.94, second main bullet point, 7.98 and 7.100).
231. Furthermore, the facts are at odds with Ofcom’s findings in 7.103-104. Ofcom states that because it was unlikely that a competitor would be willing to allow it to self-retail, Sky itself would probably not have had an expectation that a competitor might do so. This is stated to be the basis for Ofcom’s conclusions that Sky’s resistance to wholesale and the “failure” of wholesale negotiations (and consequential loss of revenue) could not be explained by its preference for self-retail, and that Sky preferred to be absent from a platform rather than wholesale (see Statement, 7.103-104). This conclusion, in turn, appears to have contributed to Ofcom’s determination that there must have been some other reason for the absence

of wholesale arrangements, namely the disputed strategic incentives (see Statement, 7.199). In other words, Ofcom concluded that since Sky could not realistically have hoped to persuade other platform operators to allow it to self-retail, Sky's persistent attempts to negotiate such deals were a pretext for not negotiating and agreeing wholesale supply; and this indicated that Sky was willing indefinitely not to supply at all, despite the loss of wholesale revenue which absence from a platform entailed; there must therefore be an ulterior incentive.

232. The negotiations with TUTV indicate that this reasoning is unsound in so far as it is based on the view that Sky must have realised it had little prospect of persuading a platform operator to allow it to self-retail. On the contrary, in the light of *inter alia* TUTV's willingness to allow Sky access to its platform via self-retail, Sky was clearly entitled to consider that there was a reasonable prospect of its being allowed to do so when it embarked on negotiations with a platform operator. Nor are the TUTV negotiations the only evidence to this effect: leaving aside Sky's existing self-retail arrangements with other operators, its discussions with Orange also militate against Ofcom's finding (see paragraph 406 ff below). It is worthy of note, too, that TUTV was willing to allow Setanta to supply its channels by self-retail on TUTV's platform.

#### Why no self-retail deal with TUTV?

233. Since in the Statement Ofcom did not recognise that TUTV was quite willing, indeed eager, to negotiate a self-retail deal, we do not have its views on why, in spite of that, a deal did not materialise.<sup>140</sup>
234. Dr Unger, in his witness statement, referred to the reasons given by Sky in its email to TUTV of 6 July 2006. The email, as well as telling TUTV that the self-retail deal did not work financially for Sky (which had been the main reason discussed in Sky's internal communications at that time), also included reasons relating to the security of TUTV's platform, capacity issues, and an issue whether access charges in respect of TUTV's platform were subject to Ofcom regulation. Dr Unger observed that the email "did not reflect Sky's internal correspondence at the

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<sup>140</sup> Statement, para 7.154 merely states that the reason was *not* capacity.

time.”<sup>141</sup> The basis for that comment is not entirely clear. It may be directed to the fact that the email did not confine itself to the commercial viability of the self-retail deal, and also identified other problem areas. In a similar vein TUTV, in its closing submissions, noted that Mr Nuttall’s internal email of 21 June 2006<sup>142</sup> highlighted “three key points”, none of which related to security. Further, in the Statement Ofcom concluded that neither security issues nor capacity problems were responsible for the lack of wholesale supply to TUTV.

235. In these circumstances we should consider, in the light of the evidence, the reasons put forward by Sky. Mr Darcey summarised Sky’s account of the reasons for the inconclusive self-retail negotiations in his cross-examination. Questioned about an internal email of 8 June 2006 summarising the results of the financial review (see paragraph 210 above) he said:<sup>143</sup>

“...this is the point where we start to think this really isn't such a good idea, because in the end we do manage to get our heads round the cannibalisation and the spin-down and Picnic was a proposal that embodied that. It is true that in this model those factors would have rendered the deal loss-making for us. But what we start to observe here, halfway down the page, under "Financials", and if you go to the third bullet point, you see Top Up TV takeouts are numbers of the order of 40 million. So part of what we're starting to observe here is that when you take into account cannibalisation and spin-down risk, we're going to struggle to break even on the deal, and David Chance is going to make 40 million. So at that point, you start to think: look, what is going wrong here? And the answer is not that we need to control cannibalisation or spin-down. Maybe we need to start thinking about why is an opportunity not attractive. It's because 40 million of opportunity is leaking out to David, and this is when we start to ask ourselves the question: look, do we really need David in this story or will it be better to do this on our own and could we therefore bring that 40 million back in-house and turn the business plan back into something that would add up? So this is the start of the thought process that says: actually, we'd be better off doing this on our own and then we wouldn't have 40 million of financial leakage ... So, because the situation here is we have however many there were at the time -- there were about 10 million DTT-connected homes. That's part of the opportunity. The other part of the opportunity is that Sky has some attractive channels, and we thought there was a business to be made in bringing those together, to the extent that there was a revenue opportunity for making those channels available on that platform. The question that arises is: does David Chance have a useful role to play in that? And at the beginning of 2006 we were working with the idea that he did, and this is the start of us starting to think actually, no, there isn't enough in this to give 40 million to David, and in the end do we really need to go through David anyway; wouldn't it be better to have our own set-top box, a security system we were comfortable with, a box that

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<sup>141</sup> Unger 1, para 138.

<sup>142</sup> Ofcom 4/61.

<sup>143</sup> Transcript 7/21:17-25:25,

we had control over that we could control the development of, and that sort of thing? In the round, that started to seem more attractive, and this is the beginning.

Q. So having the control is important?

A. Control over the set-top box and the development. I think in the end, as you'll see, the Picnic box was to be a PVR, it was to be MPEG-4 compatible, so it would be able to move to HD and all those things. The version of this story which goes through David tended to be a sort of backwards-looking story. It reflected the fact that there was a population of boxes that had been in the market since On Digital went bust, and they were old, quite low spec, SECA 2 protected, and the more we started to think about this -- and I think the financials are really what trigger the thought process -- we preferred to go forward on our own."

236. This interpretation of Sky's thinking at the time, i.e. that ultimately the deal did not stack up commercially for Sky and that for various reasons Picnic provided a more promising option generally, is in our view consistent with the contemporaneous evidence to which we have referred. Although up to that point Sky had clearly been taking forward the retail deal for which TUTV was actively pressing, one gains the impression from the documents available that Sky did not in 2006 consider TUTV or its platform of legacy STBs to be the most attractive vehicle for Sky's first offering on DTT. Mr Darcey's testimony supports this impression. He said that whereas a company such as BT would be expected to expand the total number of customers beyond what Picnic could achieve on its own, TUTV's preference for a very limited offering combined with its small resources meant that Sky viewed it as an ineffective means of exploiting the DTT opportunity, whilst adding to the risk of customer confusion caused by multiple retailers supplying the same channel.<sup>144</sup>
237. In addition to this lack of commercial viability, Mr Darcey told us that there were other reasons why at the time Sky did not believe it made sense to pursue both a deal with TUTV and Sky's own Picnic-type offering.<sup>145</sup> He stated that TUTV was extremely hostile to the concept of Picnic (and had argued, in response to Ofcom's Picnic Consultation, that Sky should be prevented from launching Picnic), and that given such hostility it would have been very difficult to have a constructive dialogue with TUTV about also offering anything like Picnic on TUTV's STBs, whether by wholesale or retail. The hostility to which Mr Darcey referred is confirmed by the joint complaint to Ofcom in mid January 2007, in which TUTV

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<sup>144</sup> Darcey 3, para 337.

<sup>145</sup> See, in particular, Darcey 3, paras 336-337.

participated. A substantial part of TUTV's submission to Ofcom was devoted to arguing that Ofcom should prevent Sky offering Pay TV services on DTT through its own STB. Indeed Mr Chance told us in his evidence that TUTV had made "multiple representations to Ofcom because we didn't agree that Picnic should be allowed to go ahead...".<sup>146</sup>

238. Also prominent among the reasons given by Mr Darcey was the unresolved and controversial issue about the security of the TUTV platform. We need to set out this area of dispute in a little more detail, as it has assumed some importance.
239. It is well-known that Sky's premium channels are particularly attractive to pirates and hackers who wish to have the benefit of access to them without paying the applicable price. Security would therefore invariably be an important issue no matter whether a proposed deal was for wholesale or self-retail, and Ofcom accepts that the concern about security expressed by Sky during the negotiations with TUTV was genuine,<sup>147</sup> but is of the view that the lack of wholesale supply to TUTV and others cannot be attributed to it.<sup>148</sup>
240. Mr Darcey stated in evidence that at the time of these negotiations Sky believed that the CA system being used by TUTV had been hacked outside the UK, that it would have been relatively easy for pirates to do the same to TUTV's system, and that they would have an incentive to do so when Sky's premium content was in place. It appears that at the time he wrote his first witness statement Mr Darcey was under the (now admittedly mistaken) impression that the TUTV system in question was Nagra's "Aladdin" system;<sup>149</sup> Mr Darcey now accepts (and did so in his third statement<sup>150</sup>) that TUTV was using Nagra's "Seca 2" system. Mr Darcey says that the Seca 2 system had also been hacked in other territories,<sup>151</sup> albeit not the implementation of Seca 2 used by TUTV in the UK. So far as we are aware this was not disputed. Leading counsel for TUTV did not suggest otherwise to Mr Darcey in

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<sup>146</sup> Transcript 12/115:11-13.

<sup>147</sup> Statement, paras 7.158-7.160; Unger 1, para 145.

<sup>148</sup> Statement, paras 7.163-5.

<sup>149</sup> Darcey 1, para 325.

<sup>150</sup> Darcey 3, paras 297-298.

<sup>151</sup> Darcey 3, para 289.

cross-examination.<sup>152</sup> Nor did leading counsel for Ofcom. An article in a publication called *Brand Republic* on 27 March 2007 indicated that Setanta's premium sports channel, which was then soon to be launched on TUTV's platform, might be vulnerable to piracy as TUTV used a CA system which had been hacked in Italy. The article stated that in excess of 3 million homes in Italy were estimated to be accessing premium content through use of pirated access cards.<sup>153</sup> Mr Chance told us that he had seen no evidence to show that the system as implemented by TUTV in the UK had ever been hacked. Mr Darcey responded that this was irrelevant, as if the system had been hacked elsewhere it could be hacked in the UK, and the introduction of premium content would create the incentive to do so.

241. Related to this question of the robustness of the CA system was an issue concerning the practical steps TUTV would agree to take in the event that the security system was attacked. Sky had sent a draft long form agreement to TUTV in April 2006 containing a clause requiring TUTV to replace the subscribers' access cards in the event that there was evidence that the TUTV CA system was subject to piracy.<sup>154</sup> When the draft agreement came back from TUTV on 29 April 2006 this clause had been struck out by its lawyers, and replaced by a provision which gave TUTV and its CA provider a discretion whether or not to swap the access cards.<sup>155</sup> The agreement went through further versions before the negotiations petered out in September 2006. In their evidence Mr Chance and Mr Darcey defended their companies' respective stances on the framing of the contractual commitments to be offered by TUTV, and on the security issue generally. However, Mr Chance accepted that this issue (and in particular the contractual question) remained unresolved at that time.
242. In the light of the evidence, like Ofcom we are of the view that Sky's reservations about TUTV's CA system were genuinely held. We also consider that although Sky did not necessarily regard the security issues as insurmountable, the fact that they had not yet been resolved probably contributed to the overall unattractiveness of the self-retail deal which was being negotiated.

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<sup>152</sup> Transcript 7/1:1-47:20.

<sup>153</sup> Ofcom 4/395.

<sup>154</sup> Sky 6/765 at para 3.2 of Schedule 2 to the draft agreement dated 21 April 2006.

<sup>155</sup> Sky 6/813 at para 3.1 of Schedule 2 and also Schedule 9 to the draft agreement dated 29 April 2006.

243. The issue of security was once more the subject of discussion between Sky and TUTV in 2007, but no real progress was made as TUTV did not then pursue with Sky its interest in supply of the channels (see paragraphs 220 and 221 above).
244. Another issue which had arisen in the course of negotiations related to capacity for carriage of Sky's channels. The discussions had originally proceeded on the basis that Sky would be allowed to retail only a single Sports channel, using TUTV's capacity. Mr Chance was later prepared to allow Sky to offer more than just a single Sports channel, using its own capacity or capacity which Sky might acquire other than from TUTV.<sup>156</sup> (Sky maintains that TUTV could not have delivered capacity for more than one linear channel in any event, having disposed of some of its capacity back to Channel Five in November 2005.<sup>157</sup>) Although TUTV had indicated that Sky might be allowed to include third party channels under certain restrictions and on payment of additional charges, at the time the negotiations lapsed the draft agreement under discussion would allow only Sky-owned or Sky joint venture channels to be carried on the platform.<sup>158</sup> Mr Darcey stated in evidence that this would not have enabled Sky to include channels such as Disney and Discovery, which he said were ideal for the broader kind of service Sky wanted to provide.<sup>159</sup>
245. The Statement concludes that the failure of the negotiations for a retail deal with TUTV was not due to a capacity barrier.<sup>160</sup> Dr Unger makes the same point, adding that had Sky been negotiating a wholesale arrangement then capacity would have been the responsibility of TUTV<sup>161</sup> and that, if Sky were concerned with the position on editorial control, there were other routes which Sky could have explored under either a wholesale or retail arrangement.<sup>162</sup>

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<sup>156</sup> Sky written closing submissions, Part A, para 7.139.

<sup>157</sup> Sky written closing submissions, Part A, para 7.137.

<sup>158</sup> In June 2006 there were indications that Mr Chance was prepared to allow third party channels as a fifth channel onwards (i.e. at the same time as Sky joint venture channels), albeit at a charge that Sky appears to have considered unattractive. See Ofcom 4, p.61.

<sup>159</sup> Sky written closing submissions, Part A, para 7.139; Transcript 7/33:6-15.

<sup>160</sup> Statement, para 7.154.

<sup>161</sup> Unger 1, para 181.

<sup>162</sup> Unger 1, para 164.

246. It seems to us probable that, as with the security issues, the capacity constraints under which TUTV was operating, while not necessarily sufficient on their own to condemn the deal in Sky's eyes, played a part in its decision to abandon the self-retail negotiations in 2006 and concentrate on Picnic. Given the nature of the other reasons for that decision discussed above, we doubt that it is realistic to suggest that Sky would have wanted a wholesale deal simply because capacity would become TUTV's responsibility.
247. Finally in his email to TUTV of 6 July 2006 explaining why the deal did not stack up, Mr Nuttall referred to the unresolved question whether TUTV's CA services were subject to price regulation. (As seen, Ofcom did not conclude this question in favour of regulation until February 2007.) In cross-examination Mr Darcey stated that the price for CA services provisionally agreed with TUTV in 2006 was high, and contributed to the overall lack of commercial viability which, together with Sky's embryonic Picnic concept, appears to have been the immediate reason why the deal did not come to fruition.<sup>163</sup> In his evidence Dr Unger argues that if negotiations had been about a wholesale deal instead of a retail one there would have been no CA charge for Sky at all. He also suggests that the issue was not a "deal breaker" as it did not prevent the parties agreeing a charge of £1.70 and TUTV were also willing to offer volume discounts on that price.<sup>164</sup>
248. We did not understand Mr Darcey to be suggesting that the CA charge was a deal breaker, but simply that it contributed to what was overall an unattractive proposition. Dr Unger is correct that there would not have been a CA charge if the parties had been negotiating a wholesale deal. However they were not negotiating a wholesale deal in 2005-2006.
249. In the light of the above we consider that Sky's email of 6 July 2006 is a fair reflection of the issues for Sky which had surfaced in the course of the self-retail negotiations, including the commercial objections to the deal. Even if the issues identified were not all "deal breakers" and if some may well have been capable of being resolved in due course, it is understandable that Sky would wish a formal

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<sup>163</sup> Transcript 7/39:12-20.

<sup>164</sup> Unger 1, paras 173-175.

response of that kind to be comprehensive. Dr Unger's and TUTV's criticism that Sky's email was not confined to the main and immediate reason for the failure of the negotiations is not well founded.

#### Why no wholesale deal with TUTV?

250. As seen earlier,<sup>165</sup> TUTV's reference to wholesale supply in its letter dated 21 March 2006 was in the context of negotiations for a self-retail deal and was accompanied by TUTV's revised proposals for such a deal. The reference was in any event rapidly overtaken by the handshake on the outline terms of a self-retail deal. In his evidence Mr Darcey stated that he regarded TUTV's request for wholesale terms in May 2007 as contrived, and designed simply to bolster the joint complaint lodged with Ofcom a few months earlier. He noted that TUTV did not take up Sky's suggestion that TUTV put together a proposal as to the terms on which CA services would be provided (so that Sky could compare the relative merits of a wholesale and retail deal).<sup>166</sup> He said that had TUTV been serious it would have sought to address Sky's real concerns about the integrity of the CA system. He noted that Mr Chance had failed to respond to his letter of 29 June 2007 which, he suggested, was further evidence that the letter had been used for the purposes of bolstering the regulatory complaint.<sup>167</sup> It seems that sometime in 2007 TUTV had changed its CA security system from the Seca 2 implementation, about which Sky had expressed concern, to an enhanced technology called Merlin Chameleon.<sup>168</sup> Mr Darcey regarded it as significant that TUTV did not mention this development (or planned development) to Sky, and that Mr Chance did not correct Mr Darcey's reference in his 29 June 2007 letter to an earlier Nagra implementation.<sup>169</sup>
251. Mr Chance in cross-examination denied that his letter of 23 May 2007 was designed to set Sky up in the context of the complaint to Ofcom, and said that his primary aim was still to strike a commercial deal. He said that he did not respond to Sky

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<sup>165</sup> Para 197 ff of this judgment.

<sup>166</sup> Darcey 1, paras 355-356.

<sup>167</sup> Darcey 3, paras 269-271.

<sup>168</sup> Chance 1, para 58.

<sup>169</sup> Darcey 3, para 298.

because he felt that he wouldn't get anywhere. He therefore let Ofcom's review process take its course.<sup>170</sup> Dr Unger, commenting on Mr Darcey's evidence, suggested that an alternative view of TUTV's letter of 23 May 2007 was that given the lack of progress on a self-retail deal TUTV was seeking wholesale supply. Dr Unger noted that the internal reaction at Sky to Mr Chance's letter did not indicate any positive incentive to supply TUTV whether by retail or wholesale, and that when Picnic was shelved in 2008 Sky made no effort to re-engage with TUTV.<sup>171</sup>

252. It is conceivable that TUTV's request for wholesale terms reflected *both* a genuine inquiry about wholesale supply of the premium channels, *and* a means of bolstering the regulatory case being put to Ofcom by TUTV and others, to the effect that Sky was restricting wholesale access to those channels. However, we note that if TUTV's prime aim in 2007 was to obtain a commercial deal rather than await the regulatory outcome, it is perhaps surprising that it should have given up on the attempt so soon, and without really engaging actively with Sky. We also note that in 2009 TUTV's adviser was urging BT to take care that any wholesale arrangements entered into between BT and Sky did not jeopardise the hoped-for regulatory outcome (see paragraph 332 below).
253. Be that as it may, it is reasonably clear that, at the time when the self-retail negotiations between TUTV and Sky petered out, there was little enthusiasm on the part of Sky for any deal with TUTV (see paragraphs 236 to 238 above). It is also reasonably clear, as Dr Unger suggests, that Sky's view was the same in 2007. We have already concluded that so far as the 2005/6 negotiations were concerned the immediate reasons for their coming to nothing were that Sky did not believe that the deal stacked up commercially, and took the view that a limited offering on a platform with small resources consisting largely of legacy STBs was not a particularly attractive vehicle on which to exploit the opportunities of DTT, in contrast with its own Picnic proposal, to which TUTV was extremely hostile. We also consider that the security issues probably contributed to the lack of enthusiasm.

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<sup>170</sup> Transcript 12/75:21-76:22.

<sup>171</sup> Unger 1, paras 193-194.

254. In the Statement Ofcom accepted that Sky's security concerns were genuine, but concluded that the lack of *wholesale* supply of CPSCs could not be attributed to those concerns.<sup>172</sup> Dr Unger commented in his witness statement that although equally relevant to retail and wholesale supply, reservations about security had not prevented Sky entering into detailed negotiations for a *retail* deal.<sup>173</sup>
255. It is true that Sky engaged in self-retail negotiations at a time when its concerns about the robustness of TUTV's CA system and about the contractual undertakings required of TUTV, had not been resolved. But that does not mean that the concerns would not have needed to be resolved before a deal could be finalised. Whether or not Sky regarded these issues as surmountable, it is likely in our view that they contributed to the overall unattractiveness of pursuing a deal with TUTV, including a wholesale deal.
256. We consider that the above is the likely answer to Dr Unger's question: why, instead of regarding a deal with TUTV and a "best of Pay TV proposition" (i.e. Picnic) as mutually exclusive, did Sky not negotiate a wholesale supply of a single premium sports channel to TUTV whilst also competing on the merits with its own offering?<sup>174</sup> Given the reasons for the self-retail negotiations coming to nothing, the suggestion that Sky should afterwards have actively sought a wholesale deal with TUTV is not in our view realistic.

#### Conclusion on TUTV negotiations

257. We therefore find that (1) Sky was negotiating in good faith and with reasonable optimism towards a self-retail deal for supply of its premium channels to TUTV – a deal which TUTV had specifically requested. (2) Those negotiations foundered because Sky formed the view, in the light in particular of an assessment of likely demand for the contemplated service on TUTV's platform, that the proposed deal was not commercially attractive. The Picnic plan then being formulated by Sky undoubtedly contributed to the decision to abandon the deal, as probably did the as-yet unresolved security and capacity issues. (3) Sky's lack of enthusiasm for a self-

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<sup>172</sup> Statement, paras 7.157-7.165.

<sup>173</sup> Unger 1, para 147.

<sup>174</sup> Unger 1, para 180.

retail deal extended to an alternative wholesale arrangement, and for similar reasons, including perceived demand and unresolved security issues. (4) TUTV made little effort to pursue the wholesale inquiry it made at the end of May 2007 being, apparently, prepared to await the outcome of the Pay TV review which it had jointly sparked off by its complaint to Ofcom. (5) Sky's negotiations with TUTV confirm Sky's admitted preference for self-retail over wholesale supply of its premium channels. (6) However, the negotiations do not in our view provide any evidence of Sky restricting wholesale supply in order to advance the alleged or any strategic incentives. We consider that Sky's lack of enthusiasm for any deal (self-retail or wholesale) with TUTV was founded on genuinely held commercial considerations relating in particular to the opportunities perceived to be available for Sky's premium channels on TUTV's platform, and reinforced by other considerations including Sky's own ambitions for Picnic and concerns about security. (7) Ofcom's misinterpretation of the facts surrounding these negotiations undermines certain central findings, including the finding that Sky had no realistic expectation that a third party operator would agree to a self-retail deal. These negotiations provide strong evidence to the contrary.

258. Before leaving the TUTV negotiations, we should note that Ofcom, supported by TUTV, submitted that Sky's conduct towards TUTV since the entry into force of the WMO (as amended by the Interim Relief Order) provides support for Ofcom's case in relation to the first strategic incentive (managing retail competition). Ofcom submitted that Sky's attempts to impose contractual limitations preventing TUTV from retailing the CPSCs via linear-only STBs and CAMs (which, as we note at paragraph 7 above, are the subject of two separate appeals by Sky) would limit the scope of the retail competition it faced from TUTV by excluding these distribution methods.<sup>175</sup> Sky contended that it was difficult to see how Sky's conduct post-WMO could shed light on Sky's motivations before that obligation was brought in, and that its actions were intended to preserve the value and premium nature of its channels, not to limit competition from TUTV.<sup>176</sup>

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<sup>175</sup> Ofcom written closing submissions, Part 1, para 280; TUTV written closing submissions, paras 12, 133-144.

<sup>176</sup> Sky written closing submissions in reply, para 2.83.

259. Although the Tribunal has not considered it necessary or appropriate to determine the separate STB and CAM appeals in light of its overall conclusions in this section of the judgment, the Tribunal has considered the documents and evidence in those appeals. This material does not cause us to change our conclusions about Sky's conduct or motivations (whether towards TUTV or any other party) prior to the imposition of the WMO. We consider that this evidence of Sky's behaviour following the imposition of the regulatory obligation throws little, if any, light on the proper interpretation of Sky's behaviour in the period prior to the imposition of that obligation.

### C. NEGOTIATIONS WITH BT

260. Next we turn to consider the various negotiations between Sky and BT. Although BT brought its own appeal in relation to the Statement (described in section III above), BT intervened in support of Ofcom in connection with the practices identified by Ofcom in the Statement as constituting competition concerns. In addition to our consideration of the documentary and other evidence, the Tribunal had the benefit, in particular, of oral evidence in relation to the negotiations between Sky and BT from the following:

(a) Dr Unger of Ofcom (see paragraph 195(a) above).

(b) Mr Darcey of Sky (see paragraph 195(b) above).

(c) Mr Marc Watson, CEO of BT Vision, the division of BT Retail responsible for running BT's retail TV and online services business. Mr Watson filed four witness statements in these proceedings (and further statements in the STB and CAM appeals), and gave evidence on day 9 of the hearing.

#### ***Background – the joint complaint to Ofcom***

261. It is common ground that BT along with TUTV, VM and Setanta had been a party to the joint complaint lodged with Ofcom in January 2007, which led to Ofcom's

Pay TV review and to the Statement.<sup>177</sup> In the joint complaint BT and the other complainants alleged, under a heading “Sky’s conduct”, that Sky had refused to supply its premium channels and its enhanced and interactive services to other retailers/platforms on commercially viable terms and on a basis which was non-discriminatory as compared with Sky’s own downstream services.<sup>178</sup> In a separate annex entitled “Outline of problems encountered by BT”,<sup>179</sup> BT stated that “BT Vision’s customers will not be able to access Sky’s premium channels”, and contrasted the non-availability of those channels on DTT with the conduct of Setanta (a fellow complainant) with whom BT had reached an agreement to make its content available on BT’s STBs.<sup>180</sup>

262. In cross-examination Mr Watson accepted that BT made this complaint before BT had approached Sky to ask about access to its premium channels, or had even launched its own Pay TV service on a full commercial basis. He told us that BT’s Pay TV service was launched only in May 2007 and that at the time of the hearing before the Tribunal BT did not expect to be in a position to distribute linear channels such as the CPSCs on its IPTV platform until about the end of 2011. Mr Watson said that until then BT was limited to using DTT for any linear channels it wished to carry, and that in 2007 it did not have any capacity of its own to carry Sky’s CPSCs on DTT. BT eventually signed a contract for such capacity in February 2010.<sup>181</sup>
263. Mr Watson accepted that the Complainants liaised closely in putting the joint complaint together.<sup>182</sup> He said that as far as BT was concerned the complaints were really directed at structural problems which BT was seeing in the marketplace and which BT considered Ofcom should examine, for example that Sky’s content rights on DTT were being “warehoused” and not made available.<sup>183</sup> BT was not alleging that if BT were to ask Sky for access to CPSCs Sky would refuse.<sup>184</sup> As for the

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<sup>177</sup> See para 43 above.

<sup>178</sup> VM2/1 at page 22, para 4.6.

<sup>179</sup> Ofcom 4/369.

<sup>180</sup> *ibid*, paras 2.3-2.5.

<sup>181</sup> Transcript 9/9:14-13:3.

<sup>182</sup> Transcript 9/23:23-25.

<sup>183</sup> Transcript 9/20:19-21:8.

<sup>184</sup> Transcript 9/21:9-13.

specific allegation of refusal to supply, Mr Watson said that this was referring to Sky's refusal to supply parties other than BT.<sup>185</sup>

264. Mr Watson denied, at least as far as BT was concerned, that the reason for the complaint was that BT had got wind of Picnic and wished to try and block it.<sup>186</sup> On the contrary, he told us that when in February 2007 Sky announced its intention to retail premium channels on DTT he regarded this as a "very positive" development and promptly put in a call to Mr Darcey with a view to exploring the distribution of those channels to BT's customers.<sup>187</sup> (We know, of course, that TUTV took a very different view of Picnic, and that most of its specific submission to Ofcom in the same joint complaint was aimed at preventing any Sky launch of its premium channels on DTT. See paragraph 237 above.)
265. In cross-examination Mr Watson was referred to an email exchange between TUTV and BT in 2009 in the context of certain security issues.<sup>188</sup> In response to a warning from TUTV's adviser that "in its commercial discussions with Sky BTV [should] not prejudice the regulatory process..."<sup>189</sup>, BT states "...we are agreed that the Proposal should reflect the agreed principles of our approach to the Pay TV review..."<sup>190</sup>. In the light of that exchange it was put to Mr Watson that as well as liaising closely with the other complainants in preparing the joint complaint, BT's conduct in the negotiations with Sky was from the outset constrained and conditioned by principles and tactics which had been agreed between them with a view to achieving the desired outcome of the regulatory process which they had put in motion. In particular it was put to Mr Watson that BT and TUTV had coordinated their approach so as not to prejudice that outcome.<sup>191</sup> Mr Watson told us that as far as he could recall the only agreed principles, apart from the common part of the joint complaint, related to security issues, as TUTV was BT's CA supplier.<sup>192</sup> However, he accepted that in relation to the regulatory case the BT legal

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<sup>185</sup> Transcript 9/20:9-18.

<sup>186</sup> Transcript 9/26:3-17.

<sup>187</sup> Transcript 9/27:25-28:6.

<sup>188</sup> Ofcom 5/973-976; Transcript 9/33:2-38:24.

<sup>189</sup> Ofcom 5/974.

<sup>190</sup> Ofcom 5/973.

<sup>191</sup> Transcript 9/36:8-12.

<sup>192</sup> Transcript 9/36:24-38:13.

team were “keeping an eye on what we were doing at that point.”<sup>193</sup> He also referred to a tension between BT and TUTV in that TUTV were not as far advanced as BT in their Pay TV project and BT did not want to be pulled back by them.<sup>194</sup> We will need to return to this area in due course.

### *Negotiations in 2007-2008*

266. On about 15 February 2007 Mr Watson ‘phoned Mr Darcey and suggested a meeting to discuss whether Sky would make its channels available to other platforms such as BT’s.<sup>195</sup> The meeting took place on 28 February 2007. According to BT’s note,<sup>196</sup> Sky outlined the proposed Picnic offering and said that it would be based on the NDS CA system which was a tried and trusted CA solution. BT asked whether Sky would make the channels available to BT and Mr Darcey said that the prior question was how BT would carry them; this led to further discussion about a possible solution to the companies’ different CA systems, with BT questioning (seemingly in response to a Sky suggestion – see below) whether a STB able to handle both NDS and Nagra CA systems was possible, and asking whether Sky might consider “simulcrypting” the channels for both CA systems, enabling the channels to be carried on BT’s STBs. Sky responded that NDS was the only system they were willing to consider at the time. Sky expressed the same concerns about the Nagra technology as they had expressed to TUTV (see paragraphs 238 to 243 above). Sky said that even if they could be persuaded to use Nagra they would require a very full indemnity in respect of potential loss and damage, including foregone football subscription revenues. Sky indicated that, subject to satisfactory security arrangements being made, they were not averse to distribution of their channels. As to the mode of distribution, Sky stated its “very strong preference” for self-retail and BT expressed its own strong preference for wholesale. BT’s note records an agreement that each party would set out its arguments for and against wholesale/retail “with a view to re-engaging” once the issue of security had been resolved. Sky would indicate its requirements on that question and BT would facilitate a discussion between Sky and Nagra.

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<sup>193</sup> Transcript 9/37:20-23.

<sup>194</sup> Transcript 9/38:7-11.

<sup>195</sup> See BT email of 16 February 2007, Ofcom 4/379.

<sup>196</sup> Ofcom 4/381.

267. According to an internal Sky email<sup>197</sup> Mr Watson rang Mr Stephen Nuttall of Sky on 7 March 2007 to say that BT had a more recent and secure implementation of Nagra than TUTV's. He promised to send Sky details of how the system worked, taking note of the concerns expressed by Sky. He asked whether Sky had a CA specification they could send and was told it was unlikely but Sky would check. Mr Watson said BT would explore Sky's idea of running two CA services through the same STB. BT was keen to start commercial discussions now, with Sky sending BT a retail proposal and BT sending a wholesale proposal. According to Mr Nuttall's email, Sky was resistant to this course until security was dealt with. Another internal email of the same date shows Sky putting in hand consideration of various technical solutions to the security issue.<sup>198</sup>
268. We have also seen a copy of a BT file note of 28 March 2007,<sup>199</sup> which refers to an informal lunch between Mr Watson and Mr Nuttall to follow up the meeting of 28 February 2007. (The date on the document of 4 March 2007 is presumably wrong, as the lunch appears to have taken place on 28 March 2007<sup>200</sup>). It appears that by this time Sky had discovered that BT had lodged the complaint about Sky with Ofcom. In the note Mr Watson records that Mr Nuttall had said that Sky was very upset that BT had complained to Ofcom about lack of access to Sky content before they had even spoken to Sky. Mr Nuttall had said that Sky believed the meeting on 28 February 2007 was a device to justify BT's complaint to Ofcom rather than a genuine attempt to engage in good faith with Sky. (An internal Sky email a few days before the lunch records Mr Darcey questioning why BT had complained to Ofcom when BT had not asked (and was not in a position to ask) for supply of the channels over IPTV, and when no DTT versions of the channels existed.<sup>201</sup>) According to BT's file note Mr Watson assured Sky that BT had not complained about Sky's conduct as such but about the structure of the market place and Sky's failure to exploit its DTT rights, and that BT was acting in good faith in seeking a commercial deal. Mr Watson's note concludes by describing Sky as "actively hostile to the idea of [BT] retailing [Sky's] channels or to making them available in

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<sup>197</sup> Ofcom 4/387; Sky 7/1280-1281

<sup>198</sup> *ibid.*

<sup>199</sup> Ofcom 4/399.

<sup>200</sup> See Ofcom 4/395.

<sup>201</sup> Email of 23 March 2007, Sky 7/1279.

anything other than NDS conditional access”. On the day before their lunch meeting Mr Nuttall had drawn Mr Watson’s attention to a news report about the vulnerability of Setanta’s sports channels to piracy.<sup>202</sup>

269. Internal Sky emails from Mr Nuttall dated 28 and 30 March 2007<sup>203</sup> describe the lunch meeting in terms which are consistent with Mr Watson’s note, although fuller in some respects. In particular the emails state that (in Mr Nuttall’s view) Mr Watson was not clear about the difference between TUTV’s and BT’s platforms, but undertook to send Sky a detailed description of BT’s platform, including the CA security level, the remedial steps which would be taken should the system be hacked, and whether movies would be stored on customers’ equipment in unencrypted form. Mr Nuttall noted that Mr Watson had expressed BT’s possible interest in non-linear content as well as channels. There was a debate about wholesale versus retail, but no commercial terms were discussed. Finally Mr Nuttall records that Mr Watson stated that if a deal could be done then BT’s observations to Ofcom about the market would doubtless change. Mr Nuttall is said to have responded “shame that you jumped the gun”.
270. There is then a gap of about two months until an email on 25 May 2007 by which Mr Watson assured Mr Nuttall that BT was hoping to send Sky the promised details of the security architecture on BT’s platform “in the next week or so”.<sup>204</sup> Mr Watson stated that this should be covered by a non-disclosure agreement (“NDA”), and suggested that the NDA already in existence for other purposes could be extended to cover the current negotiations. Mr Nuttall replied on the same date indicating that the NDA might need to be altered to cover the new situation.<sup>205</sup> A NDA was later executed by Sky and BT<sup>206</sup>, and on 28 June 2007 BT sent Sky the description of BT’s platform architecture, giving what Mr Watson described as “a high level view on the delivery of video on demand content over DSL and for encrypted linear content delivered via DTT”.<sup>207</sup> Mr Watson said that as BT was already rolling out its Nagra-based STBs it was keen to meet Sky’s concern about

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<sup>202</sup> Ofcom 4/395.

<sup>203</sup> Ofcom 4/401-406.

<sup>204</sup> Ofcom 4/407.

<sup>205</sup> *ibid.*

<sup>206</sup> Sky 7/1283.

<sup>207</sup> Ofcom 4/411 and Sky 7/1286-1290.

this technology. He also indicated that BT would like to state its position on the retail/wholesale issue as BT was interested in Sky's content, both linear (particularly sports content) and non-linear. He suggested a meeting.

271. Apparently coincidentally, on the same date but before Mr Watson had sent the platform architecture document to Sky, an internal email from Mr Nuttall<sup>208</sup> speculated that BT was the cause of Sky's current regulatory issues, and that these might evaporate if BT "became more amenable to us". Sky's approach could be to discuss a broad range of issues with BT "which would allow them to see some light at the end of the tunnel but also make it clear that the current route would be lengthy." Mr Darcey agreed in cross-examination that the reference to "current route" meant the regulatory process which BT and others had sparked by their complaint. He stated that the approach being discussed within Sky was to seek to persuade BT to do a commercial deal rather than waiting for the regulatory result.<sup>209</sup>

272. A few days after these emails, on 3 July 2007, BT along with the other three original complainants, submitted a supplemental complaint to Ofcom.<sup>210</sup> In the section specific to BT,<sup>211</sup> the following passage appears:

"3.24 Immediately following Sky's announcement of its plans for DTT distribution, BTV approached Sky with the aim of discussing distribution of those channels over the BTV platform. BTV would like to conclude an agreement with Sky on reasonable terms. Although Sky has not yet formally refused, BTV does not believe, based on the discussions held so far, that agreement will be reached and in any case not within a reasonable timeframe. BTV did not approach Sky previously as BTV does not yet control its own DTT capacity to make live linear content available. It was and it is BTV's plan to bid for such capacity when it becomes available. BTV was planning to approach Sky at about that time. These plans were brought forward by Sky's announcement."<sup>212</sup>

273. Mr Watson was asked in cross-examination why, so soon after delivering the promised platform architecture document to Sky, BT had complained to Ofcom that it did not expect agreement to be reached with Sky:

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<sup>208</sup> Ofcom 4/409.

<sup>209</sup> Transcript 6/18:17-19:18.

<sup>210</sup> VM 2/2.

<sup>211</sup> Ofcom 4/413.

<sup>212</sup> Ofcom 4/422.

“Q. Your arrangement from the first meeting was that, while you might set out your respective positions on that, you would engage with that, you would engage with the respective positions on self-retail or wholesale, once the security issues had been sorted out and the debate of principle would be parked. That was what you'd agreed?”

A. It's what we agreed at that original meeting, and noted. As I said, we then realised that the technical -- setting out that technical architecture was going to take a bit longer than we thought, when we agreed that point. I think -- I can't remember now how long I thought then it was going to take to do that, but I believe I didn't think it was going to take very long. It then transpired that it was going to take longer and we tried to push Sky, I tried to push Sky to engage on commercial discussions in the interim. I didn't see any reason why we shouldn't do that. And we were -- as we've said here -- sceptical as to whether something would be done.

Q. Sceptical although you had only just supplied the security document, which you describe in your covering email to it as: quite high level and will invite further questions. So an issue that's known to be of fundamental importance to Sky, to satisfy themselves that you are more secure than the Top Up system, has barely been addressed and only at a high level, and there you are complaining to Ofcom that you don't expect resolution.

A. Well, Sky at that point had a very close association with NDS, which is owned by the same -- or was at that time at least owned by the same parent company. They had an extremely fractious global relationship with Nagra, our supplier. They were in litigation in various -- or at least one territory, I think, and it did take some time to get -- to clarify exactly what it was we would be able to supply to Sky in relation to our security architecture and under what conditions, and that was one of the things that caused -- that took time, and one of the things that we were doing, and that was the reason why it was a high level document in that first instance.”<sup>213</sup>

274. Mr Watson was also asked about the length of time it had taken BT to produce even a high level description of BT's platform systems -- well over three months. He told us that he had been pushing BT's technical people hard but it had taken time to put the document together, plus there was the need to have a NDA in place.<sup>214</sup>
275. The platform architecture document consists of four pages including several diagrams.<sup>215</sup> It states that the DTT CA system is the Mediaguard system operated by BT under licence from Nagra. In another passage it states that the system provides an enhanced level of security compared with that provided by the Nagra Mediaguard CA solution used by TUTV. Following receipt of this document Mr Jeff Hughes, formerly Director of IT at Sky and by then engaged with the Picnic project, suggested in an internal email to Mr Darcey that “...it would be good if we

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<sup>213</sup> Transcript 9/49:12-51:3.

<sup>214</sup> Transcript 9/46:13-47:16.

<sup>215</sup> Sky 7/1287.

can give [BT] something to sort of set the scene and get rid of some of the concerns. Clearly – it must be something we would be willing to give ... I think that we will be able to move pretty close on all issues other than retail v wholesale”. Mr Darcey’s response was “Let’s discuss on Monday. Having just received and read [BT’s complaint to Ofcom] I am not feeling very charitable towards BT.”<sup>216</sup>

276. A few days later Sky emailed BT and suggested a meeting, including technical experts, to discuss BT’s platform architecture.<sup>217</sup> The need for that meeting is, in part, explained by an internal Sky email sent on the same day,<sup>218</sup> which shows that Sky was unclear about the “CA version” being used by BT. That meeting was convened on 24 July 2007, and according to the evidence of Mr Darcey and Mr Watson, as well as the documents, both BT and Sky regarded the meeting as positive and constructive, with progress being made.<sup>219</sup> BT took away a number of further technical questions from Sky, and further questions were added in the following days.<sup>220</sup> A first batch of answers was provided by email dated 31 July 2007.<sup>221</sup> One of these indicated that BT planned to move to “full Merlin” in the first half of 2008, from which time BT would be operating Merlin “end to end”. BT had not yet had confirmation from Nagra that [...] [C]. Answers to other questions were also awaited.
277. In the meantime Mr Nuttall emailed Mr Watson on 30 July 2007<sup>222</sup> suggesting they meet up the following week “to discuss next steps”. He also explicitly noted that “The clean break with TUTV’s CA system is certainly helpful”. The meeting was on 8 August 2007 at the Hospital Club, attended by Mr Nuttall and Mr Hughes for Sky and Mr Watson for BT. Each side produced a note of the meeting. What emerges from these accounts is that each made a very strong pitch for his company’s preferred mode of distribution, BT explaining why retail was unattractive to them and wholesale attractive, and Sky arguing the converse.

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<sup>216</sup> Ofcom 4/431.

<sup>217</sup> Sky 7/1292; Ofcom 4/433.

<sup>218</sup> Sky 7/1291.

<sup>219</sup> Sky 7/1294; Ofcom 4/439-440; 445-446.

<sup>220</sup> Ofcom 4/447.

<sup>221</sup> Ofcom 4/457-458.

<sup>222</sup> Ofcom 4/453.

According to BT's note<sup>223</sup>, Sky did not "absolutely rule out a wholesale deal" and BT "were willing to look at the terms of a retail deal". According to the Sky record,<sup>224</sup> BT was invited "to offer such a lucrative wholesale [deal] that it would be irresistible to us." Sky speculated internally that BT might wait for the regulatory process to take its course.

278. There then follows a series of interchanges between BT and Sky during August 2007 which see both parties exploring how Sky might give BT comfort in relation to the latter's concerns about a retail arrangement. Mr Watson had made it clear to Sky that if that comfort could not be obtained then it would be "a wholesale arrangement or, presumably, no deal."<sup>225</sup> An example of Sky attempting to do so can be seen in an email to BT of 22 August 2007:<sup>226</sup> Sky said it would be willing for BT to bill the customer, and would accept some restrictions on pricing (subject to legality) and on direct marketing to the customer of Sky's other platforms or products (e.g. telephony and broadband). Indicative retail prices were also provided by Sky. Internal Sky emails at about this time indicated a certain cautious optimism based on the fact that BT was discussing what was essentially a retail deal.<sup>227</sup> However, Mr Watson's internal reaction to Sky's suggested solutions to its concerns was "let's discuss, but I don't think this gets us anywhere."<sup>228</sup>
279. On 4 September 2007 there was a breakfast meeting between Mr Dan Marks of BT, the superior of Mr Watson, and Mr Darcey, who was Mr Nuttall's superior. The venue was the Lanesborough Hotel. Judging from BT's meeting note,<sup>229</sup> the wholesale versus retail arguments were rehearsed. It appears from a follow-up email from Mr Marks of 12 September 2007<sup>230</sup> that it was agreed at the meeting that Sky would come up with the best retail deal it could for supply of premium channels, and BT would consider whether it was commercially acceptable. While indicating that he was looking forward to Sky's proposal, Mr Marks took the opportunity to repeat BT's concerns about a retail arrangement, and concluded by

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<sup>223</sup> Ofcom 4/461.

<sup>224</sup> Ofcom 4/463.

<sup>225</sup> Ofcom 4/465.

<sup>226</sup> Ofcom 4/477.

<sup>227</sup> Ofcom 4/473; Sky 7/1296.

<sup>228</sup> Ofcom 4/479.

<sup>229</sup> Ofcom 4/493.

<sup>230</sup> Ofcom 4/499.

referring to BT's submission to Ofcom to the effect that Sky should be obliged to wholesale its channels on reasonable commercial terms.

280. Mr Darcey responded in some detail to the points made by Mr Marks by email on 11 October 2007.<sup>231</sup> He reiterated that Sky had not excluded the possibility of wholesaling to BT, but that it still had a strong preference for retail, and would shortly be sending its proposal in that regard. One of BT's immediate internal reactions was to suggest informing Ofcom that "something has come in".<sup>232</sup> (BT had earlier been to see Ofcom to update the regulator on their discussions with Sky, and had told Ofcom that BT "had received nothing and are unhopeful that we will get anything useful."<sup>233</sup>) BT also considered internally what value should be put on having Sky's channels available on BT's platform.<sup>234</sup> One internal discussant at BT regarded Mr Darcey's email as an indication that Sky was not going to be willing to wholesale to BT.<sup>235</sup> In his evidence Dr Unger expressed the view that, although Mr Darcey had been careful not to refuse a wholesale deal explicitly, the practical effect of Mr Darcey's email was the same as such a refusal.<sup>236</sup> BT noted internally that it was going through Mr Darcey's response "in detail with the lawyers".<sup>237</sup>
281. When asked in cross-examination about BT's approach to distribution of Sky's premium channels, Mr Watson's recollection was that BT had not at this stage shut the door on the possibility of doing a retail deal although it thought it was unlikely to get sufficient comfort in relation to its concerns about that mode of distribution. However he said that BT was happy to hear from Sky what a retail deal would look like.<sup>238</sup>
282. Sky's proposal letter was emailed and faxed on 15 October 2007.<sup>239</sup> In fact the letter contained two alternative proposals: one retail and the other wholesale. The retail proposal was that BT would market Picnic through BT's platform, and that

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<sup>231</sup> Ofcom 4/510-513.

<sup>232</sup> Ofcom 4/510.

<sup>233</sup> Ofcom 4/515.

<sup>234</sup> Ofcom 4/509.

<sup>235</sup> Email from Simon Milner to Marc Watson dated 11 October 2007 (Ofcom 4/510).

<sup>236</sup> Unger 1, para 222.

<sup>237</sup> Ofcom 4/515.

<sup>238</sup> Transcript 9/56-59.

<sup>239</sup> Ofcom 4/519-522.

Sky would agree to contractual arrangements which addressed BT's concerns about allowing a competitor access to its customers, and about pricing. Adequate security protection for the Sky content would have to be ensured. Sky assumed that Sky's DTT capacity would be needed for delivery, and asked what CA and customer billing charges BT would impose on Sky.

283. The alternative wholesale proposal “set out an outline of the terms that would apply in [the event of wholesale supply] in respect of residential distribution.” The letter then identified the current cable rate card terms for Sky's premium channels. The wholesale price quoted for a single Sky Sports channel was £13.48. The letter explained that those rates were for content only, that this reflected the fact that the cable operators provided their own network and transmission, and that since BT did not have its own capacity the rates in question would not be directly applicable. The letter went on to say that the parties would need to discuss the terms for supplying Sky One [a basic channel], and continued:

“One way to progress matters would be for Sky to allow its capacity to be used by BT Vision and to recover a proportion of the transmission costs in addition to being paid the wholesale content rates above. We have done a very rough calculation based upon current DTT channel prices and other relevant costs in the Picnic business plan to try to give you an understanding of the likely level of costs to which you would need to contribute.”

A specific figure was then mentioned which Sky considered would need to be shared equally between Sky and other retailers using Sky's capacity. Finally the need for satisfactory arrangements to ensure security was said to be equally if not more important under the wholesale model.

284. Although in his written evidence Mr Watson appears to play down the significance of Mr Darcey's letter,<sup>240</sup> judging from BT's internal reaction Sky's proposal was clearly very different from what BT had been expecting, and was treated as requiring serious consideration. For example, Mr Watson's immediate response (in an email sent early the next morning) noted “This includes a wholesale offer.” In an email to Mr Marks, Mr Watson noted:<sup>241</sup>

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<sup>240</sup> See Watson 3, para 27.

<sup>241</sup> Ofcom 4/523.

“...the fact that they are offering wholesale is a dramatic shift. We need to crunch these numbers to see if they work. It should, at least, enable us to match cable’s offers.”

An email from Mr Marks states:<sup>242</sup>

“Clearly this is a critically important issue for the business. I think we need to consider Sky’s proposal in very great detail from a financial and commercial point of view [as] well as a regulatory and legal one. We need to do this fast because the DTT inquiry is progressing.”

285. In cross-examination Mr Watson accepted that in the letter of 15 October 2007 Sky had “certainly engaged with us around a wholesale arrangement”.<sup>243</sup>
286. Although Dr Unger describes Mr Darcey’s email of 11 October 2007 as amounting to a refusal to wholesale (see paragraph 280 above), he does not appear to attach much significance to Sky’s wholesale proposal in the letter of 15 October 2007 (in contrast to BT’s own internal reaction at the time). Dr Unger merely points out that the wholesale prices offered by Sky did not reflect the discounted price offered to cable operators with a reduced movie service.<sup>244</sup> Mr Watson took a similar approach, stating that the “bulk” of the letter was dedicated to setting out the retail deal and, “In a short section at the end of the letter, Sky set out an outline of the terms that might apply in respect of a wholesale arrangement. These terms were, however, unacceptable to BT...”.<sup>245</sup>
287. Notwithstanding its wholesale offer, it is clear that Sky still entertained some hope that BT would go for Sky’s preferred retail deal. Mr Nuttall said so in terms in an internal email on the same day the offers were sent: “...we don’t want them to accept the wholesale offer anyway, rather rationally choose the retail deal.”<sup>246</sup> In an earlier internal comment while the proposal letter was in preparation Mr Nuttall had said:<sup>247</sup>

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<sup>242</sup> Ofcom 4/529.

<sup>243</sup> Transcript 9/68:3-4.

<sup>244</sup> Unger 1, paras 222-227.

<sup>245</sup> Watson 3, para 27.

<sup>246</sup> Ofcom 4/517.

<sup>247</sup> Ofcom 4/508.

“We... are preparing a proposal for BT Vision that will set out the merits of a retail deal with Sky whilst simultaneously offering them a wholesale alternative (which we anticipate will be relatively unattractive compared to the retail deal).”

In a subsequent memo sent by Mr Nuttall to Mr Darcey on 19 October 2007,<sup>248</sup> he stated that BT will hopefully conclude that the retail deal should be as lucrative for them as a wholesale deal and less risky, allowing us to progress.” It was put to Mr Darcey in cross-examination that the reason the offer would be unattractive was because Sky was going to weight it so as to make it so. Mr Darcey did not accept that that was what Mr Nuttall was saying:

“No, because the proposal was and always will have been the rate card price. That's what it was. It is true that we felt that the rate card price was not particularly going to be attractive, for all the reasons we've been discussing for a while, that Marc thought that the DTT market required lower prices. This wasn't a proposal assembled for BT to be unattractive. It was the rate card price. It was the market price. We did anticipate that Marc would find it unattractive for the reasons we've discussed.”<sup>249</sup>

288. Mr Darcey stated in his third witness statement that, Sky having made clear in the October offer letter that it was now contemplating a wholesale deal, from November 2007 the focus of negotiations “had shifted firmly” from self-retail to wholesale.<sup>250</sup> He said in cross-examination:<sup>251</sup>

“I think it became pretty clear that we were not going to persuade them on self-retail, and we were now really talking about wholesale and the debate really came down to price.”

289. In the light of Sky's 15 October 2007 proposal letter there had been a high level meeting on 22 November 2007 at the Chancery Renaissance Hotel. It was attended by Mr Ian Livingston and Mr Gavin Patterson, respectively Chief Executive and Managing Director of BT Retail, as well as Mr Marks and Mr Watson, for BT. For Sky there was Mr Jeremy Darroch (then Chief Financial Officer) as well as Mr Darcey and Mr Nuttall. The Tribunal were shown a note of this meeting bearing Mr Watson's name as author; it was contained in an email sent by a BT regulatory lawyer, Ms Beatrice Roxburgh, to Mr Marks on 11 February 2008.<sup>252</sup> Mr Watson

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<sup>248</sup> Ofcom 4/537-539.

<sup>249</sup> Transcript 6/74:7-16.

<sup>250</sup> Darcey 3, para 361.

<sup>251</sup> Transcript 6/74:24-75:3.

<sup>252</sup> Ofcom 4/563.

told us that he had made the note soon after the meeting, and that at some later time, when it was needed, he had typed the note up and sent it across to her.<sup>253</sup> In one respect the note does not accord with Mr Darcey's recollection of what he had said at the meeting.<sup>254</sup> Similarly, Mr Watson disputes a specific statement which Mr Darcey, in his evidence, attributed to Mr Livingston.<sup>255</sup> We do not go into the details of these differences of recollection because we do not believe that anything really turns on them. It would hardly be surprising if both sides at some stage indicated a willingness to "play it long" and await a regulatory outcome. It is quite clear that the meeting in question was one in which each side was negotiating hard for its preferred option. It is also clear from those aspects of the meeting note which are not contentious that the main topic of discussion (discussed in some detail) were the wholesale prices at which Sky would supply its premium channels to BT. This is confirmed by Sky's somewhat briefer note dated 23 November 2007, the day after the meeting.<sup>256</sup>

290. In summary the parties' positions on wholesale pricing, as disclosed in the two meeting notes, were as follows: BT stated that the cable rate card price would not work for it. BT was keen to ensure that its bundle of broadband and Sky channels would be competitive on price with Sky's future Picnic offering. Sky said that it would be willing to depart from the cable rate card price if BT could show that BT would be an effective retailer, and was looking for a guarantee of the level of penetration on the BT platform. In this way it would be possible to distinguish BT from cable. BT agreed to consider a minimum penetration guarantee payment to Sky.
291. About a month after the meeting BT responded to Sky's proposals with a counter-proposal. It was contained in a letter dated 21 December 2007<sup>257</sup> prefaced by an assertion that Sky had an obligation to wholesale its channels on fair and reasonable terms, but that BT was seeking a commercial deal. BT's letter ignored Sky's self-retail proposal and referred only to wholesale arrangements. BT stated that it

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<sup>253</sup> Transcript 9/75:1-7.

<sup>254</sup> Darcey 1, paras 499-500; Darcey 3, paras 448-453.

<sup>255</sup> Watson 3, paras 56-58.

<sup>256</sup> Ofcom 4/571-2.

<sup>257</sup> Ofcom 4/575-578.

wanted a wholesale supply of the following channels at the following prices, for retail to its broadband customers only: the Picnic bundle (less third party channels): £10.50;<sup>258</sup> Sky Sports 1 (standalone): £7.65; Sky Movies (one standalone channel): £2.35; and Sky One (standalone): £0.50. The proposed wholesale prices were said to be based on an assumed Picnic retail price of £30 excluding telephony and line rental, and would go up or down with the Picnic price, on an agreed basis. BT would guarantee Sky fees of £[...] [C] over a proposed contract term of [...] [C] years. BT would make a reasonable contribution to Sky's capacity costs, but not on the basis of the market value of the asset in question – BT would want to pay on the basis of Sky's actual running costs and in proportion to the number of customers/share of revenues.

292. BT's proposal was not well-received by Sky. Mr Nuttall told Mr Watson in an email on 28 December 2007<sup>259</sup> that the offer did not seem "compelling". Mr Darcey's internal comment was that it was "utterly detached from reality".<sup>260</sup> In his witness statements he expanded on this: for the standalone sports channel BT's offer was 43% below the cable rate card price, well below the maximum WMO price (which was £13.27 – roughly similar to the equivalent cable rate card price of £13.48), and below Ofcom's estimate of a cost price; for a single movies channel BT's offer was 81% below the cable rate card price;<sup>261</sup> for a Picnic-type package containing a single sports and a single movies channel, it was 40% below the cable rate card price. Mr Darcey estimated that if the offered prices were applied to VM then that company would have paid Sky £68 million less in 2008. Mr Darcey also regarded the MRG offered (£[...] [C] over [...] [C] years) as very low when compared with the DTT wholesale revenues suggested in Ofcom's impact assessment, or with the revenue that Sky estimated it would receive from BT under the WMO in the first year of supply (£14 million in 2010-11), or with the

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<sup>258</sup> The opening offer price suggested in Mr Watson's internal briefing note for the meeting on 22 November 2007 was £12.75 (Ofcom 4/569). Almost all the difference is the result of a higher suggested offer for the Movies channel.

<sup>259</sup> Ofcom 4/587.

<sup>260</sup> Sky 7/1315.

<sup>261</sup> BT's offer for Sky Movies was not much more than half the amount Mr Watson had suggested as an opening offer in his briefing note. See footnote 258 above.

opportunity cost of sub-leasing the capacity in question to another broadcaster at market rate (£8-10 million per videostream per annum at the time).<sup>262</sup>

293. BT anticipated that Sky would not like the offer. As Mr Watson put it in cross-examination:<sup>263</sup>

“It would have been a poor opening position had they found it attractive ... I knew Sky well enough to understand that they would not like this offer.”

294. Mr Nuttall and Mr Watson met at Sky’s offices to discuss BT’s offer on 8 January 2008. The Tribunal were shown each party’s notes of the meeting. Mr Watson’s (undated) is the more detailed.<sup>264</sup> Sky’s is contained in an internal email from Mr Nuttall to Mr Darcey (and others) sent on the same day as the meeting.<sup>265</sup>

295. According to the latter, Mr Watson began by saying that he did not suppose Sky was “overwhelmed” by BT’s proposal. BT’s longer note does not include reference to this but both notes are generally consistent. Mr Watson explained the basis of the suggested prices. Mr Nuttall said Sky was confident their cable rate card would survive further regulatory scrutiny, and pointed out that the offered price for Sky Movies was below Sky’s variable cost and if the prices offered were applied to cable Sky would lose half its revenues. Mr Nuttall stated that if Sky were to go below cable rate card it would have to be in a position to offer the same deal to cable without making a loss. Mr Nuttall suggested that the key would be the level of guarantee BT would give based on penetration of premium channels across BT’s base. He said that Sky could look at a lower wholesale price than cable rate card for penetration levels over 20-30%. Sky would also consider limiting the base used for the penetration guarantee/discount to BT’s active Pay TV customers.

296. There was then discussion of the basis for BT’s contribution to capacity costs. Mr Nuttall wanted BT to contribute at market rates, not on the basis of actual cost, as Sky had incurred the commercial risk on the original acquisition of capacity.

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<sup>262</sup> Darcey 1, para 501; Darcey 3, paras 376-377.

<sup>263</sup> Transcript 9/83:21-24.

<sup>264</sup> Ofcom 4/591.

<sup>265</sup> Ofcom 4/589.

297. Mr Watson's note records that he agreed to get back to Sky the following week with a revised guarantee and with what BT believed Picnic pricing would need to be to justify BT paying cable rate card. Mr Nuttall's note states that Mr Watson "seems to have accepted that whatever we do with them will need to be offered to cable". He ends by recording "They are going to try again. Whether we can reach a deal partly depends on our planned Picnic pricing."
298. The revised proposal came by email from Mr Watson on 25 January 2008.<sup>266</sup> Essentially the only change was that he offered to increase the MRG to around £[...] [C] over [...] [C] years. This was subject to getting internal approval, and was on the condition that Sky accepted the original channel prices and contribution to capacity costs that had already been rejected by Sky. Mr Watson argued that, based on a customer base of 1 million, premium penetration of 30% would mean revenue of £38 million, which was too much for BT to guarantee. As regards Picnic pricing, Mr Watson noted that BT had "run the numbers" using Sky's cable rate card fees but could not arrive at a Picnic price below £40-£43, excluding any telephone charge, without taking the retail margin down to an unviable level. Mr Watson's email concluded by asking whether – if Sky were self-retailing on BT's platform – Sky would itself give BT a minimum guarantee of greater than 30% penetration on BT's base.
299. In his reply dated 25 March 2008<sup>267</sup> to Mr Watson's proposal, Mr Nuttall emphasised that, although he could not confirm the proposed retail pricing for Picnic, its pricing would be compatible with wholesale rate card prices, and that in Sky's view both would withstand regulatory scrutiny. Cable rates were set so as to enable an efficient operator to make a reasonable return. He also saw no reason why the content value of premium channels was less on DTT than on cable so as to lead to different pricing. In relation to guarantees, Mr Nuttall pointed out that at the wholesale rate of £7.50 offered by BT, £38 million (the figure mentioned by Mr Watson in his latest email) would represent 400,000 subscribers per month, which at 30% penetration assumed BT had a customer base of 1.4 million, or 2 million at

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<sup>266</sup> Ofcom 4/597.

<sup>267</sup> Ofcom 4/637. Although, confusingly, this also appears at Ofcom 4/641 dated 31 March 2008, it seems to have been sent earlier by Mr Nuttall's PA – see Sky 7/1318.

20% penetration. On the other hand £[...] per annum for [...] years equated to an average of [...] premium subscribers at the cable rate card price or [...] at BT's proposed rate. He said that the latter numbers seemed at odds with BT's claim that it would be an accomplished retailer of Sky's channels. Given that BT's wholesale price offer was so far below cable, it was difficult to see how a volume discount scheme could be constructed which would both satisfy BT and, when offered to cable, would not result in Sky losing a significant amount of existing wholesale revenue. In response to Mr Watson's question about whether Sky would itself be prepared to guarantee a minimum penetration of more than 30% on BT's platform under a self-retail arrangement, Mr Nuttall said that Sky "would certainly consider it". Finally, Mr Nuttall reiterated that Sky's previous offer had made capacity available to BT at a fraction of market rates. The letter ends: "Look forward to hearing from you."

300. In his evidence to the Tribunal Mr Darcey emphasised that the penetration guarantee/discount that Sky was suggesting was not a specific, absolute monetary figure, nor was it one which reflected a particular number of BT customers who subscribed to Sky Sports; it would be linked to the *percentage* of BT's total Pay TV subscribers (however large or small that total was) who took Sky Sports; thus in return for the guarantee (at whatever rate was agreed) Sky would provide an agreed discount off the cable rate card in respect of subscribers to Sky Sports in excess of the agreed penetration level; therefore, provided the appropriate percentage of subscribers took Sky Sports, the discount arrangements would apply even if BT acquired very few subscribers. Mr Darcey stated that such a mechanism was capable of benefiting a new entrant from day one.<sup>268</sup> He also said that the nature of the proposed arrangements was made clear to BT at the time, giving Mr Nuttall's email of 25 March 2008 as an example of an "attempt at clarity". He nonetheless suggests as a possibility that Sky and BT may have been talking at cross-purposes.<sup>269</sup> However, as Dr Unger points out, BT itself internally considered the possibility of offering to relate the wholesale price to the percentage penetration achieved by BT: see paragraph 231(a) of his witness statement.<sup>270</sup>

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<sup>268</sup> Darcey 3, paras 371-374.

<sup>269</sup> Darcey 3, paras 383-385.

<sup>270</sup> See the document at Ofcom 4/565 ff, paras 2.2 and 3.9.

301. It is noteworthy that BT did not ever seem to have really engaged with Sky on its suggestion of a penetration discount off the cable rate card prices. In cross-examination Mr Watson accepted that a penetration discount had been discussed as well as a minimum penetration guarantee, with a view to distinguishing this deal from the arrangements with the cable companies. However, he maintained that Sky did not make a proposal for a discount but rather “talked about making a proposal”:<sup>271</sup>

“A. In fact it looks like they [penetration discounts] were raised. I accept that.

Q. That's what the discussion was about and that's what your earlier note also --

A. The discussion was about a fixed payment based on -- or a payment based on a fixed penetration of Sky Sports channels across our base of customers. That was what the substance of the discussions was around. You're right, it does look like there was a question raised about whether there might be some discounts to the rate if we hit certain penetration levels, but I don't recall those conversations being of substance and I don't recall anything being proposed to me.”<sup>272</sup>

302. It is clear from Mr Watson's own notes of the meetings on 22 November 2007<sup>273</sup> and 8 January 2008,<sup>274</sup> as well as from Sky's email of 25 March 2008,<sup>275</sup> that Sky had indicated a willingness to discount the cable rate card price by reference to BT's success in retailing Sky Sports channels on its platform. Mr Watson also appears to confirm this in his third witness statement.<sup>276</sup> We do not therefore understand why he suggests that the discussion of a discount did not amount to a proposal, given that he accepts that the discussion of a guarantee *did* so amount. At this stage in negotiations each seems to have been as much a “proposal” as the other.

303. In his third witness statement,<sup>277</sup> Mr Watson sets out a number of reasons why BT maintains it would not have been viable or appropriate for BT to agree to a penetration guarantee at a higher rate than was being achieved by VM. None of these points was put to Sky, there having apparently been no response to its email of 25 March 2008. However, one of the reasons had already been ventilated in the

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<sup>271</sup> Transcript 9/87:4-88:5.

<sup>272</sup> Transcript 9/93:5-16.

<sup>273</sup> Ofcom 4/563.

<sup>274</sup> Ofcom 4/591.

<sup>275</sup> Ofcom 4/637.

<sup>276</sup> Watson 3, para 81.

<sup>277</sup> Watson 3, para 80.

earlier negotiations and had been conceded by Sky: Sky had stated at the meeting on 8 January 2008 that it would consider limiting the customer base used for penetration guarantee/discount to BT's active Pay TV customers (see paragraph 295 above).

304. As noted, BT does not appear to have replied to Mr Nuttall's 25 March 2008 email, and this series of negotiations, in Mr Watson's words, "petered out", with BT turning its attention to other projects.<sup>278</sup> In submissions to Ofcom on 25 February 2008,<sup>279</sup> BT expressed its "strong belief that an agreement with Sky will not be reached within a reasonable timeframe or at all. That belief is based on BT Vision managers' commercial judgment and experience in dealing with Sky ever since discussions began." In May 2008 Mr Marks observed to other BT personnel that commercial negotiations had "stalled" and the regulatory process "grinds on".<sup>280</sup> Negotiations between Sky and BT for supply of Sky's premium channels did not commence until June 2009.

***The Tribunal's discussion and conclusions: negotiations in 2007-2008***

305. Although there were further negotiations between Sky and BT beginning in 2009, it is appropriate at this stage to consider some of the findings in the Statement against the evidence of the bilateral negotiations in 2007-2008 which we have set out at length above.
306. The Statement contains the following conclusions of Ofcom:

"7.42 In our Third Pay TV Consultation (paragraphs 6.90 to 6.96), we set out our view that Sky had strongly and successfully resisted attempts by other retailers to secure wholesale deals. Sky had not offered any discounts on the rate-card in the course of commercial negotiations, or pursued wholesale supply on other platforms even when there had clearly been no prospect of the retailer agreeing to let Sky retail on its platform.

...

7.63 We can see from our review of the evidence that none of these negotiations led to:

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<sup>278</sup> Watson 3, para 32.

<sup>279</sup> Ofcom 4/619-628.

<sup>280</sup> Ofcom 4/643.

- Sky making a firm offer of a wholesale deal for its Core Premium channels.
- Sky offering prices other than those on the rate-card for its Core Premium channels.
- Sky reaching an agreement with the other provider for the wholesale of its Core Premium channels.

...

7.69 In each of the cases described above, the outcome has been a collapse of negotiations. Sky has not attempted to negotiate wholesale supply arrangements after it has become clear that providers were not going to accept a retail agreement with Sky. We have seen no evidence from internal Sky documents that when Sky did not expect the other party to accept a retail deal (as in the quote in paragraph 7.66 above), it considered making a wholesale offer.

...

7.76 Our concern arises because Sky's assertions that it favours a retail deal (and that it will not accept a wholesale deal unless the other retailer can demonstrate, to Sky's satisfaction, that Sky will be better off under such a deal) effectively amount to a restriction of wholesale supply.

7.77 Even if Sky's preference for retail supply over wholesale supply can be justified by legitimate commercial considerations, we consider that Sky's actions indicate that it has a preference for **no** supply to third party retailers rather than wholesale supply. As a result, its only wholesale supply arrangements are with cable firms, which it considers itself under a regulatory obligation to supply.

...

7.79 Negotiations with Sky and third parties have included relatively limited discussion of the wholesale **price**, and any such discussion has been based on Sky's rate-card of prices to cable firms.

7.80 Sky did not make an offer of the rate-card price for wholesale supply before 2010, although it indicated that it was willing in principle to do so. It provided the rate-card to Orange "to better inform discussion", and in 2008 Sky made a tentative suggestion to BT of discussions of wholesale supply with the rate-card as a starting point.

7.81 Sky expressed a willingness to depart from the rate-card if BT could "prove it would be an effective retailer". Sky did not subsequently offer any discount to BT.

7.82 Sky told us that BT has recently, for the first time, indicated a willingness to take Sky's premium channels on rate-card terms. Sky said this was "predicated on an expectation raised by the Consultation Document". In March 2010, Sky sent BT a draft agreement for wholesale supply of Sky Sports 1 and 2 at rate-card prices.

...

7.143 As regards price negotiations between Sky and BT:

- It is normal business practice for a party to a price negotiation, to have counter-offered with a price substantially below Sky's original offer.
- BT's differing view of the appropriate price had a basis in its assessment of the planned Picnic retail price.
- It is possible that BT would have agreed to a higher price than that which it quoted. However Sky did not respond by offering a discount of less than 40%. Instead it claimed that its rate-card prices were fair and reasonable, and that if it offered a discount to BT, it would also have to offer a discount to cable providers – i.e. it did not respond by seeking to negotiate further in any form.
- As noted (see paragraph 7.67) internal Sky emails indicate that Sky did not expect, or wish, BT to accept its wholesale offer because it thought BT would find the retail offer more attractive.

...

7.167 Our view is that if Sky had been motivated purely by a desire to maximise its commercial revenues, it might well have sought retail access to other platforms, but, in the light of a clear and widely-held reluctance by other, smaller, providers to agree to such access, it would have pursued, or at least engaged constructively with requests for, wholesale arrangements rather than accepting an ongoing situation in which it was absent from those platforms. In doing so, we would have expected Sky to seek to establish whether other retailers were efficient by offering wholesale prices to them, and also to consider the option of reducing its wholesale price in order to attract more customers. Finally, we would have expected Sky to engage with retailers to seek to resolve capacity and security issues, and that resolving such issues would have been possible.

7.168 We consider that several other retailers have sought to engage with Sky, and that they had, and have, an incentive to reach agreement with Sky as soon as possible. While some regulatory gaming has taken place on both sides, we do not consider that the failure of negotiations can be attributed to the actions of other retailers.

7.169 We conclude that the reasons Sky put forward do not adequately explain the lack of wholesale supply of Core Premium channels.” (Emphasis in the original)

307. Thus, in these passages Ofcom made some specific findings in relation to the BT negotiations, and also reached some general conclusions on the basis of the evidence of all the negotiations, including those with BT. The general conclusions are summed up in paragraphs 7.167-169 of the Statement. In particular Ofcom found that Sky did not engage constructively with other retailers (including BT) in relation to requests for wholesale arrangements or in relation to security and capacity issues, that Sky preferred to be absent altogether from platforms (including BT's) rather than to agree to wholesale on them, that, by contrast, the other retailers

*did* seek to engage with Sky, had an incentive to reach agreement as soon as possible, and were not responsible for the failure of negotiations, notwithstanding some regulatory gaming on both sides. It is clearly implied in these paragraphs that any failure to reach a wholesale deal was due to Sky's failure to engage constructively on wholesale supply and other issues such as security.

308. In certain important respects these findings do not in our view represent a full, fair and accurate reflection of the negotiations with BT in 2007/8. In particular, we consider below the following propositions advanced by Ofcom in the Statement:

(a) Sky failed to pursue or offer wholesale or generally to engage with BT in relation to wholesale when there was no prospect of a self-retail deal, preferring to be absent from BT's platform rather than grant wholesale supply.<sup>281</sup>

(b) Sky did not offer discounts on the rate card price nor offer that price before 2010.<sup>282</sup>

(c) The breakdown of negotiations was not due to regulatory gaming on the part of BT.<sup>283</sup>

Sky failed to pursue or offer wholesale or generally to engage with BT in relation to wholesale when there was no prospect of a self-retail deal, preferring to be absent from BT's platform rather than grant wholesale supply (Statement, paragraphs 7.42, 7.63, 7.69, 7.77 and 7.143<sup>284</sup>)

309. The statements in paragraph 7.42 record and apparently confirm findings in the Third Pay TV Consultation, including that "Sky had not ... pursued wholesale supply on other platforms even when there had clearly been no prospect of the retailer agreeing to let Sky retail on its platform".

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<sup>281</sup> Statement, paras 7.42, 7.63, 7.69, 7.77 and 7.143

<sup>282</sup> Statement, paras 7.42, 7.63, 7.81-2 and 7.143.

<sup>283</sup> Statement, para 7.168.

<sup>284</sup> Set out at para 306 above.

310. This conclusion is plainly at odds with the facts as presented in the documents. In the face of BT's firm resistance to Sky's self-retail proposals, Sky gave way and sent a clear message to BT that it was prepared to wholesale the CPSCs, notwithstanding its own strong preference for a self-retail deal. It is true that Sky did so in conjunction with a retail offer which it hoped BT would find more attractive than a wholesale arrangement based on the cable rate card. Sky certainly took the view that BT would not find the latter attractive, and that this might steer BT towards the preferred self-retail option. Nevertheless BT's internal reaction to the offer letter of 15 October 2007<sup>285</sup> confirms that the message was understood by BT as Sky being willing, indeed offering, to wholesale. Thereafter the focus of the negotiations was almost entirely on wholesale, and the major hurdle to a deal was price; this is shown by, for example, Mr Watson's email to Mr Darcey of 23 June 2009 (see paragraph 327 below), and also by BT's response of 4 December 2009 to Ofcom's 29 October 2009 information request.<sup>286</sup> In the latter document BT told Ofcom that in 2007/8 Sky had offered to wholesale CPSCs to BT at cable rate card prices but that BT was not willing to pay those prices. As we have noted (paragraph 286 above), Dr Unger and Mr Watson in their evidence appeared to place little significance on Sky's willingness to abandon self-retail and to concede wholesale.
311. In the light of this, we conclude that, in so far as it was concerned with the BT negotiations, the Statement is also wrong in concluding in 7.69 that "Sky has not attempted to negotiate wholesale supply arrangements after it has become clear that providers were not going to accept a retail agreement with Sky." Further, it is puzzling that Ofcom should make a finding that there is "no evidence from internal Sky documents that when Sky did not expect the other party to accept a retail offer... it considered making a wholesale offer". The fact is that Sky *did* offer to wholesale to BT, as Mr Watson accepted.<sup>287</sup>
312. There is a slightly different emphasis in the first bullet of paragraph 7.63, which states that "none of these negotiations led to ... Sky making a *firm* offer of a wholesale deal for its Core Premium channels". (The Tribunal's italics) It is not

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<sup>285</sup> See para 284 above.

<sup>286</sup> Ofcom 5/1019-1022.

<sup>287</sup> See para 285 above.

clear what Ofcom would regard as “firm” in this context. We repeat that in our view a fair reading of the negotiations with BT shows that Sky did, or was clearly prepared to, offer wholesale supply of the CPSCs to BT, and was understood by BT to have done so.

313. The opening sentence of 7.42 (referring to a conclusion in the Third Pay TV Consultation<sup>288</sup>) also strikes us as conveying a misleading picture of the BT negotiations. It is true that no wholesale deal had been agreed at this point (spring 2008) but even at this intermediate stage it is not fair to state that “Sky had strongly and successfully resisted attempts by [BT] to secure” such a deal. Our clear impression from the evidence is that once it had given up hope of a retail arrangement, Sky was trying to make progress on a wholesale deal. The reason the negotiations petered out when they did was in no small part due to BT’s apparent lack of motivation to explore possible ways (e.g. by penetration discounts) of addressing Sky’s concerns about the implications for its existing cable revenue of an outright price reduction. Dr Unger accepted that the wholesale prices being offered by BT were “low”.<sup>289</sup> Sky says the prices were absurdly low,<sup>290</sup> ranging from about 40% to 80% below cable rate card prices. (They were apparently even lower than the opening offer suggested by Mr Watson in his internal briefing document for the 22 November 2007 meeting.<sup>291</sup>)
314. Ofcom speculates at 7.143 of the Statement that BT might have offered a higher price, but that Sky “did not respond by offering a discount of less than 40%.” The problem with this is that BT had had plenty of opportunity to move from the admittedly very low wholesale prices it had originally offered. Instead BT decided to leave those prices unchanged in its revised offer of 25 January 2008. That offer was little different from the original one which Sky had internally considered to be divorced from reality, and which had led Sky to conclude that BT was not serious about engaging with Sky and had decided to await the outcome of the Pay TV review. When Sky explained why the revised offer was unacceptable, BT did not

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<sup>288</sup> Although this is a conclusion reached by Ofcom in the Third Pay TV Consultation, Ofcom does not state that it has modified its view.

<sup>289</sup> Unger 1, para 235.

<sup>290</sup> Darcey 1, para 502.

<sup>291</sup> See footnote 258 above.

accept Sky's invitation to continue the discussions or reply at all to Sky's email of 25 March 2008. Although there was apparently a meeting between Mr Watson and Mr Nuttall in early May 2008, according to BT "it was clear from the discussion at that meeting that the gap between the parties was too large to be bridged through further negotiation".<sup>292</sup> There was apparently no further relevant contact between the parties thereafter until the middle of the following year.

315. In its assessment of the negotiations Ofcom did not attach any significance to BT's conduct in effectively terminating communications, or indeed refer to it at all. Rather, as we have seen, it attached significance to the fact that "Sky did not make a counter proposal" to BT's revised offer of 25 January 2008.<sup>293</sup> Dr Unger suggested in his evidence that the fact that Sky did not pursue BT after the breakdown of negotiations in March 2008 is inconsistent with Sky's comment that where it cannot retail it considers wholesale.<sup>294</sup> We disagree. What happened during the negotiations was consistent with that comment: having tried and failed to persuade BT to accept self-retail access, Sky gave in and offered wholesale. The wholesale negotiations broke down because the parties were very far apart on price. Given the circumstances in which they broke down it would in our view have been unrealistic for Sky to have pursued the matter further at that stage.
316. For these reasons the statement in 7.77 that "Sky's actions indicate that it has a preference for **no** supply to third party retailers rather than wholesale supply", is not in our view supported by the evidence of the 2007-2008 negotiations with BT. The fact that Sky declined to agree a wholesale price which was some 40-80% below prices already being paid by cable operators, and which if extended to those operators would reduce annual revenue from them by some £68 million, can hardly provide evidence of a preference not to supply at all. We should also record that 7.79 of the Statement<sup>295</sup> is not accurate so far as these negotiations are concerned. There appears to have been a good deal of discussion about the wholesale price with BT.

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<sup>292</sup> See BT's 7 April 2009 response to Ofcom (Ofcom 4/699-707).

<sup>293</sup> Unger 1, paras 200, 243.

<sup>294</sup> Unger 1, para 257.

<sup>295</sup> Set out at para 306 above.

317. In the light of these aspects of BT's conduct (together with other evidence to which we shall refer in due course) we consider that Ofcom has underestimated the significance of the joint complaint and related regulatory process which formed the backdrop to the negotiations. This is something to which we will return below.

Sky did not offer discounts on the rate card price nor offer that price before 2010 (Statement, paragraphs 7.42, 7.63, 7.81-2 and 7.143<sup>296</sup>)

318. As far as price is concerned, there is a finding in 7.42 that "Sky had not offered any discounts on the rate card". In the second bullet of 7.63 Ofcom makes a similar finding, that "none of these negotiations led to ... Sky offering prices other than those on the rate card". Again, in 7.80<sup>297</sup> Ofcom states: "Sky did not make an offer of the rate-card price for wholesale supply before 2010, although it indicated that it was willing in principle to do so ... and in 2008 Sky made a tentative suggestion to BT of discussions of wholesale supply with the rate-card as a starting point." In paragraph 7.81 of the Statement, Ofcom asserts that "Sky did not subsequently offer any discount to BT."

319. In our view these statements do not provide a fair reflection of Sky's approach in the negotiations with BT up to the end of March 2008. It is true that the wholesale price arrangements proposed by Sky were for prices based on the cable rate card. However, as has been seen, Sky on several occasions indicated to BT that it would be prepared to discount those prices by reference to penetration levels on the BT platform. BT did not seem to pursue anything other than an unconditional (and substantial) reduction in that price subject only to an MRG reflecting low penetration of the premium channels. Further, it is hardly fair to describe Sky's suggestion as "tentative" when it was made on more than one occasion but not actively taken up by BT.

320. In his evidence Dr Unger agrees that price was an important factor in the breakdown of negotiations, but he does not accept that Sky was justified in insisting

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<sup>296</sup> Set out at para 306 above.

<sup>297</sup> Set out at para 306 above.

on cable rate card prices.<sup>298</sup> He says that it was not realistic for Sky to expect other retailers to pay those prices, pointing to Ofcom's assessment in the Statement that a retailer smaller than Sky would not generate a reasonable return at that price.<sup>299</sup> Nor does he accept that Sky should have been deterred from exploring a price cut because of a concern that it would then have to be offered to VM, causing an adverse impact on Sky's wholesale revenues. He argues that a differentiated approach should have been considered.<sup>300</sup> In that regard Dr Unger draws attention to the fact that Sky did not in the letter offer to BT the discounted price offered to small cable operators who received only a reduced movie service.<sup>301</sup> (Mr Darcey explained in evidence that this had been a mistake;<sup>302</sup> Dr Unger notes that the same mistake was repeated again in 2009,<sup>303</sup> and both BT's leading counsel and Ofcom's leading counsel in submissions also referred to the fact that this discount featured prominently in discussions that Mr Darcey was conducting with Ofcom in 2007.) Alternatively Dr Unger suggests that if a differentiated approach could not be adopted Sky could have considered whether a cut to cable rate card prices across the board would ultimately have been profitable.<sup>304</sup> He therefore concludes that the breakdown of negotiations on price was not caused by a lack of willingness on the part of BT to make progress.<sup>305</sup>

321. In making these points it seems to us that Dr Unger is failing to take into account that although Sky was insisting on cable rate card prices as the starting point (because of its concern about the knock-on effect on existing supply arrangements), it showed itself willing to explore ways in which those prices could be reduced in BT's case by reference, for example, to penetration discounts. BT, on the other hand, showed little interest in such discounts or in anything other than an outright price cut. Sky's failure to offer the specific capacity-related discount afforded to certain cable operators does not alter that fact. Moreover, we are doubtful whether it is commercially realistic to expect Sky to have offered an *across the board* price cut on its premium channels (i.e. including to existing wholesale customers who had

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<sup>298</sup> Unger 1, para 298.

<sup>299</sup> Unger 1, paras 299-300.

<sup>300</sup> Unger 1, paras 301-302.

<sup>301</sup> Unger 1, paras 225-226; 302.

<sup>302</sup> Darcey 1, para 496.

<sup>303</sup> Unger 1, para 227.

<sup>304</sup> Unger 1, paras 303-307.

<sup>305</sup> Unger 1, para 308.

long been paying cable rate card prices), particularly when in its revised offer BT had not even been willing to increase its admittedly very low opening price.

322. Also in 7.143 Ofcom gives the impression that Sky was unwilling to offer a discount to BT because it would have to offer the same discount to cable providers. However that is not what we understand Sky to be saying in, for example, its 25 March 2008 email.<sup>306</sup> Sky was saying that the level of discount it could afford to offer to BT was conditioned by the fact that it would be necessary also to offer the same discount to cable customers. Sky was also saying that, at the discounted prices upon which BT was insisting, Sky would lose significant revenue if that discount was extended to cable.

The breakdown of negotiations was not due to regulatory gaming on the part of BT (Statement, paragraph 7.168<sup>307</sup>)

323. To what extent does the evidence relating to the negotiations in 2007-8 support Ofcom's conclusion that their breakdown was not due to regulatory gaming on the part of BT? This is an issue which has assumed some importance in the evidence and submissions put before us, and we have already indicated that in our view Ofcom has underestimated the significance of the joint complaint and related regulatory process (paragraph 317 above). We have come to the conclusion in the light of all the evidence, including in particular the conduct of the parties, that a major reason for the breakdown of the negotiations in 2007/8 was the impact of the regulatory process upon BT's incentives to reach a wholesale deal with Sky at that stage and thereby upon BT's negotiating position. We set out our reasons in the following paragraphs.
324. Despite Mr Watson's evidence (for example at paragraph 52 of his third witness statement) and in contrast to Ofcom's view expressed in 7.168, we do not consider that BT was acting as one would expect a company to act which had an incentive to reach agreement as soon as possible. It seemed to be proceeding in a leisurely way. For example, it took upwards of three months to provide a four page "high level"

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<sup>306</sup> See para 299 above.

<sup>307</sup> Set out at para 306 above.

description of its CA system, which it had agreed to provide to Sky in order to move the negotiations forward; it took some two months from 15 October 2007 to make a counter offer consisting of wholesale prices which were admittedly very low and which it expected to be rejected by Sky; it then took a further month to produce a revised offer which contained the very same prices albeit with an increased MRG; and it did not even take up the offer to continue discussions thereafter. As a result, there was no further relevant contact between the parties for well over a year.

325. BT was well aware that a commercial deal – particularly one reached in the early stages of the Pay TV review – might well affect its outcome. For example, at a lunch meeting with Sky in March 2007 Mr Watson had apparently stated that if a deal could be done then BT’s observations to Ofcom about the market would doubtless change (see paragraph 269 above).
326. It is common ground that by June 2009, when contact was re-established, it was becoming clear (confirmed in Ofcom’s Third Pay TV Consultation which was published on 26 June 2009) that Ofcom was very likely to impose on Sky a WMO with significantly reduced wholesale prices in respect of the CPSCs.<sup>308</sup> By this time Setanta had gone into liquidation and the Setanta Sports channels had ceased to be broadcast on BT’s DTT platform. Mr Watson’s evidence is that in these circumstances he was now “prepared to enter into negotiations on the basis that Sky would wholesale their channels to BT at the cable rate card prices until Ofcom’s anticipated decision at which point the prices determined by Ofcom would apply.”<sup>309</sup>
327. Mr Watson made the initial contact by telephoning Mr Darcey and followed this up with an email on 23 June 2009.<sup>310</sup> He offered to pay cable rate card prices for Sky Sports 1 and any other Sky sports channels which BT took, on the assumption that

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<sup>308</sup> From BT’s 16 December 2008 response to Ofcom (Ofcom 4/665-682), BT appeared to have eschewed the possibility of achieving anything through negotiation by this stage: “Evidence submitted by all parties to date regarding the experience of “negotiating” access and pricing to these channels with Sky demonstrates that any solution involving negotiation is not practicable.” Sky stressed that BT had appeared to favour the regulatory route in its own response to Ofcom on 14 January 2009 (Ofcom 4/685-698) – see in particular paras 2.37-2.39.

<sup>309</sup> Watson 3, para 34.

<sup>310</sup> Ofcom 4/717.

this price would be superseded by an Ofcom regulated price. He indicated that BT would arrange and pay for its own capacity and CA system. Distribution would be via DTT, subject to obtaining capacity at a reasonable rate. Mr Watson said that BT would like to proceed quickly in order to launch as close as possible to the new season.

328. Mr Watson was asked in cross-examination about an internal email of 15 June 2009<sup>311</sup> when BT was formulating its new proposal to Sky. The email, from Mr Sean Williams who led BT's regulatory and strategy teams, requested sight of "the carriage proposal before it goes to Sky, just to check consistency with our arguments". Mr Watson accepted that this was a reference to BT's arguments to Ofcom in the Pay TV review, and that Mr Williams and his teams were "keeping an eye on" any implications for the regulatory process, although it was "not a key driver in the commercial discussions that we were having with Sky...".<sup>312</sup>
329. In his evidence Mr Darcey suggested that this volte face by BT over a year after negotiations had petered out indicates that what he referred to as BT's "long regulatory game" was coming to a successful conclusion, and that BT no longer feared that by reaching a wholesale deal with Sky it might jeopardise that outcome.<sup>313</sup> He suggested that BT's reluctance to engage with Sky on the wholesale terms offered in 2007-2008 might well have been because BT felt that this would have undermined Ofcom's Pay TV review.<sup>314</sup> Mr Watson, however, strongly disputed that BT was playing a "long regulatory game", and that in the 2007/8 negotiations BT was unwilling to reach a deal with Sky until it was clear that Ofcom would resolve the price issue. He was emphatic that BT was at that time keen to reach a commercial deal with Sky.<sup>315</sup>
330. Mr Watson maintained this position when shown in cross-examination<sup>316</sup> an internal Sky email chain on 30 June 2009<sup>317</sup> in which Mr Nuttall recounted a

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<sup>311</sup> Ofcom 4/709.

<sup>312</sup> Transcript 9/164:13-165-10.

<sup>313</sup> Darcey 3, paras 392-395.

<sup>314</sup> Darcey 3, para 389.

<sup>315</sup> Watson 3, paras 51-67.

<sup>316</sup> Transcript 9/100:24-103:12.

<sup>317</sup> Ofcom 4/751-756.

telephone conversation he had had that day with Mr Richard Young, Business Development Director at BT, seeking clarification of BT's renewed approach. Mr Nuttall recorded Mr Young stating that BT had "elected to take a pragmatic approach (deal now on currently available terms and continue to object to Ofcom) as opposed to their prior position (no deal until Ofcom resolves pricing)." In answer to one email addressee who inquired whether this remark could be quoted back to Ofcom, Mr Nuttall responded that he had "paraphrased the discussion". He was then asked: "Ok, but did he [Mr Watson] (one way or the other) confirm that it was BT's prior position that it was not prepared to negotiate a deal until Ofcom resolves pricing?" To this Mr Nuttall responded: "Yes. And Mark Watson and Dan Marks previously told me (and Mike [Mr Darcey]) that this was their position too."

331. Mr Watson's response to this in oral evidence was:

"A. He's [Mr Nuttall] certainly misunderstood our position because that was not our position.

Q. Your position was?

A. Our position was that we wanted a sustainable, viable rate for the channels, and if we got one we would have very happily gone ahead. It was not our intention to wait until 2010 to launch these channels. We wanted to get access to them much earlier, and had we been able to do so on viable terms, we would have taken it, very happily."<sup>318</sup>

332. The initiation of the complaint to Ofcom had been jointly coordinated with other operators, and thereafter its progress was no doubt carefully monitored by all of them and also by BT's regulatory team. The documents show that in 2009 BT was warned by TUTV's adviser that "in its commercial discussions with Sky BTV [should] not prejudice the regulatory process...."<sup>319</sup>, and they record BT confirming that "...we are agreed that the Proposal [i.e. the proposed wholesale arrangement with Sky] should reflect the agreed principles of our approach to the Pay TV review...."<sup>320</sup> (see paragraph 265 above). Even if the "agreed principles" related simply to CA security issues between BT and TUTV as its CA provider, as Mr Watson stated, the warning not to prejudice the regulatory process appears to be quite general (see also paragraphs 362 to 368 and 394 below). It is reasonable to

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<sup>318</sup> Transcript 9/102:8-17. See also Watson 3, paras 61-63.

<sup>319</sup> Ofcom 5/974.

<sup>320</sup> Ofcom 5/973.

assume that in 2007/8 BT and its co-complainants would have been at least as sensitive to the concerns which led to such warnings in 2009 when the Pay TV review was much further advanced.

333. Further, in carrying out the Pay TV review Ofcom itself was submitting to BT fairly regular requests for additional information and updates on developments in the commercial negotiations, which would have helped to remind BT of the significance which such developments could have. BT's commercial people must have been keenly aware throughout the material period of the need to be very circumspect and cautious in their dealings with Sky. As Dr Unger confirmed in his evidence, if a wholesale deal had been done between Sky and a new retailer such as BT, this would have been an indication that Ofcom's central concern in the Pay TV review was unfounded.<sup>321</sup> We note that there is an obvious tension between this statement by Dr Unger and the suggestion later in his evidence that "even if BT had assumed it would get a positive outcome from the regulatory process the rational course would have been to conclude a deal as quickly as possible in order to get the service up and running, whilst reserving its position on pricing."<sup>322</sup> For if Dr Unger's first statement is correct (as BT clearly believed to be the case) the regulatory process might well not have resulted in a WMO.
334. BT had been telling Ofcom from at least July 2007 that in its view no agreement with Sky would be reached or at least not within a reasonable timeframe. Reaching an agreement would obviously have undermined that assertion. When updating Ofcom in October 2007, BT had reported that it was not expecting to receive "anything useful" from Sky (see paragraph 280 above). When sending Ofcom the correspondence between the parties at the end of 2008 (in its response of 7 April 2009), BT submitted that "this correspondence clarifies...that there was no reasonable prospect of Sky and BT concluding a wholesale deal for Sky channels on terms that would have been viable for BT." When it did receive a wholesale proposal from Sky the dilemma facing BT is clearly visible in its internal reaction to Sky's 15 October 2007 letter (see paragraph 284 above), and in the admonitions of BT's own regulatory team in June 2009 (see paragraph 328 above).

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<sup>321</sup> Unger 1, para 251.

<sup>322</sup> Unger 1, para 287.

335. An indication of the importance attributed by BT to the joint complaint and the regulatory process generally is that BT complained to Ofcom about Sky *before* it had even asked Sky for access to the CPSCs, and well before the time when it expected that it would need to ask. For it seems that in January 2007 BT was still some months from starting a Pay TV service and several years from launching an offering which included linear channels. BT/Mr Watson said that BT had brought forward the time of its request to Sky only when Sky publicly announced the Picnic proposal.<sup>323</sup> It is therefore clear that BT was placing a good deal of reliance on the regulatory outcome.
336. In these circumstances it would hardly be surprising if BT was wary of putting at risk a beneficial regulatory outcome unless Sky could be persuaded to give it a deal the advantages of which outweighed that risk. We believe that this may well have been the thinking behind the 21 December 2007 offer by BT. BT knew Sky would be unlikely to accept it, in which case Sky's rejection could be expected to reinforce BT's allegation of intransigence on the part of Sky. But if Sky accepted the offer, then BT would be well-compensated for the risk to the outcome of Ofcom's Pay TV review. It is significant that when BT's offer was rejected, BT re-offered the same prices a month later, and did not take Sky up on its suggestion that the rate card prices could be discounted by reference to BT's penetration. BT simply ceased to engage with Sky.
337. When in June 2009 BT re-established contact, it adopted a pragmatic approach by offering the rate card price on condition that this would eventually be replaced by a regulatory price. It had clearly been open to BT to adopt such an approach at any time from October 2007 onwards. Mr Watson has explained in his evidence why it chose to do so in June 2009. There is no reason to doubt that explanation, which is perfectly rational. On the other hand we do not accept that BT's perception of the risk of prejudicing the regulatory outcome by reaching a wholesale deal with Sky was not a factor in the breakdown of negotiations in 2007/8. For the reasons we have outlined we consider that it was a significant factor, which is likely to have influenced BT's conduct at that time by making BT nervous about reaching a deal with Sky.

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<sup>323</sup> Transcript 9/28; Darcey 1, para 486; Darcey 3, para 349.

338. Therefore we do not agree with Ofcom's conclusion at paragraph 7.168 of the Statement that "while some regulatory gaming has taken place on both sides, ...the failure of negotiations" cannot be attributed to the actions of (in this case) BT. We are of the view that BT should bear no small responsibility for the breakdown at this stage (i.e. at the end of March 2008), and that regulatory issues were a much more significant influence on BT's conduct than Ofcom thought to be the case.

#### Tribunal's general conclusion on the 2007-2008 negotiations

339. More generally, and in contrast to Ofcom's core conclusions in paragraphs 7.167-9 of the Statement, our view is that Sky engaged constructively with BT in relation to the latter's request for wholesale arrangements. Ofcom appears to accept that "other parties' preferred form of supply should not automatically take precedence over Sky's preferences", and has "not suggested that where it has not been possible to agree a retail deal Sky should offer a wholesale deal immediately and without further negotiation."<sup>324</sup> Thus Sky was entitled to seek to persuade BT to agree to its preferred supply model. It is certainly true that Sky attempted to do so. However, once it was clear to Sky that BT was unlikely to give way on self-retail, Sky reasonably promptly indicated its willingness to wholesale and thereafter engaged with BT in wholesale negotiations. As we have already said, we do not consider that Sky's engagement in that regard was any less constructive than BT's. If anything it was more so. Sky was willing to supply by wholesale at the same price as other operators were already paying to Sky (or even at a discounted version of that price), whereas BT was only willing to take wholesale supply at a very much lower, and probably unrealistic, price. As already noted, we consider that BT's negotiating stance was likely to have been significantly influenced by the ongoing regulatory process.

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<sup>324</sup> Statement, paras 7.72 and 7.73, which state:

"7.72 We accept that other parties' preferred form of supply should not automatically take precedence over Sky's preferences. Sky's preference for a retail deal may be legitimate in the sense that it may be based on a commercial judgement by Sky that its own revenues and profits from supply to a particular platform would be higher with a retail deal than with a wholesale deal. We consider Sky's reasons for preferring retail supply further in paragraphs 7.89 to 7.104.

7.73 However, there are also legitimate reasons for the reluctance of third parties to enter into retail deals with Sky. We describe these further at paragraph 7.94."

### *Negotiations in 2009-2010*

340. We now continue our analysis of the evidence of the negotiations between BT and Sky, starting from June 2009 when Mr Watson resumed negotiations with an offer to pay the cable rate card price. Sky internal reaction via email referred to BT's new offer as "Overall positive...". There was also reference to the possibility that loss of the Setanta channels may have provided the stimulus for the approach, and that it could indicate BT was very confident of substantial price cuts by Ofcom. Mr Nuttall speculated that in making an offer previously made to it by Sky, BT might just be being pragmatic. He also stated that Sky should ask for "robust commitments on picture quality and security (and what happens in the event of a breach), per all the prior conversations with TUTV."<sup>325</sup>
341. Mr Darcey's email response to Mr Watson on 24 June 2009<sup>326</sup> was in positive terms and spoke of "seeing if we can get a service up." The email flagged "a couple of thoughts/questions that it would be useful to discuss when we meet." Among the topics raised were capacity and security. In relation to capacity, Sky would want to make sure that the amount of bandwidth allocated to Sky Sports was sufficient for the quality expected of the Sky brand. Sky would also want to "understand whether there have been any changes to the broadcast CA system you would be using over DTT. I had understood that there had been a proposal to swap out the old system and replace it with a newer version which was not hacked, so it would be useful to understand if this has been done."
342. In the light of this last comment by Mr Darcey, we pause to recall that in the 2007/8 negotiations BT had told Sky that its CA system for DTT was the Mediaguard system operated under licence from Nagra. This was said to provide an enhanced level of security compared with that provided by the Nagra Mediaguard CA solution used by TUTV (see paragraph 275 above). BT had also stated that it planned to move to "full Merlin" in the first half of 2008 (including replacing the

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<sup>325</sup> See the various emails at Ofcom 4/719-426.

<sup>326</sup> Ofcom 4/727.

Mediaguard conditional access kernel (“CAK”)<sup>327</sup> with the full Merlin CAK), from which time BT would be operating Merlin “end to end”. BT had not at that time had confirmation from Nagra that [...] [C] (again, see paragraph 275 above). Mr Darcey told us that it was Sky’s understanding in 2007/8 that while BT’s STBs were using the Mediaguard CAK there was a risk that BT’s platform was no more secure than TUTV’s. Mr Darcey also told us that as a result of its own talks with BT and TUTV Ofcom, too, was of the view in early 2008 that BT’s partial Merlin CA system needed to be upgraded.<sup>328</sup> Mr Darcey’s evidence<sup>329</sup> was that in 2007/8 progress had been made in relation to Sky’s security concerns, but that they had not yet been resolved. In this latter regard he disagrees with Mr Watson, who says that Sky’s concerns had been dealt with.<sup>330</sup> Both witnesses agreed, however, that the 2007/8 discussions did not get to the stage of identifying the procedures which BT would be contractually bound to take in the event of piracy.<sup>331</sup> This had been a bone of contention in the negotiations between Sky and TUTV.

343. Returning to the narrative, BT personnel (not Mr Watson) reacted internally by saying they suspected that CA would be the key issue, and in particular Sky’s “known issue with our edition of the Nagra CA: they will continue to use this as a sticking point in the negotiations I suspect...”<sup>332</sup>
344. Externally Mr Young replied to Mr Darcey by email of 29 June 2009<sup>333</sup> accepting the offer of a meeting and stating that in the meantime BT would flesh out its proposal and that arrangements should be made for the companies’ respective teams to get together to discuss the CA arrangements and other technical and security matters raised. This led to the telephone conversation between Mr Nuttall and Mr Young on 30 June 2009 to which we have already referred (see paragraph 330 above). Mr Nuttall reported on that conversation internally to Mr Darcey and others

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<sup>327</sup> Mr Darcey explained in his evidence (Darcey 3, para 292 and footnote 206) that the CAK is software in a STB which is required to extract and process “entitlement management messages” (“EMMs”) and “entitlement control messages” (“ECMs”) from the broadcast stream and thus allow a viewer to see the broadcast. See also Watson 3, para 10.

<sup>328</sup> Darcey 3, paras 467-471.

<sup>329</sup> Darcey 3, para 472.

<sup>330</sup> Watson 3, para 21.

<sup>331</sup> Darcey 3, para 473; Watson 3, para 21.

<sup>332</sup> Ofcom 4/729.

<sup>333</sup> Ofcom 4/737.

within Sky by email of 30 June 2009.<sup>334</sup> According to Mr Nuttall, Mr Young gave an indication of the channels required by BT (Sky Sports 1 and Sky One, and possibly Sky Sports 2) and by when (start of the “new” [presumably 2009/10] football season). BT did not yet require Sky Movies due to capacity constraints and they already had an “extensive” video on demand (“VOD”) offering. Technical matters “on which we [Sky] would need comfort” were then discussed. These included picture quality and CA system. On the latter “he [Mr Young] was being a bit evasive about what they have implemented and whether it does in fact differ from the CA used by TUTV except for the additional protection afforded by the broadband connection”. There was also discussion about “measures that would need to be taken in the event of a breach of security. We agreed that a separate group would be established to look at the first two questions and we would talk through the third matter.” In the penultimate paragraph of his email, Mr Nuttall noted: “Next step is the security/CA/picture quality workstream. Marek [Rubasinski], can you tee up the usual suspects for this please?”

345. On 3 July 2009 Mr Young sent to Mr Nuttall by email the promised “fleshing out” of BT’s proposal in the form of a letter.<sup>335</sup> So far as relevant to the issues before us, the contents of the letter were as follows.

- (a) It stated that the offer was for an interim deal pending full implementation of Ofcom’s WMO.
- (b) BT’s intention was to purchase channels wholesale from Sky for retail to BT’s residential customers. “For the avoidance of doubt we would not look to retail your channels beyond the BT broadband base...”. (The Tribunal notes that this last statement is apparently related to the security of BT’s platform – according to the evidence it was both parties’ understanding that delivery of encrypted channels to customers whose STBs were connected to BT broadband was more secure.)

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<sup>334</sup> Ofcom 4/751.

<sup>335</sup> Ofcom 4/757-764.

- (c) The letter stated that subject to agreeing price and other terms BT would like Sky Sports 1, Sky Sports 2, and Sky One, each on a standalone basis. BT would also like to discuss buying another sports channel as well as bundles of these channels.
- (d) BT would like to see prices on the basis of both standalone channels and bundles. BT would not pay more than rate card price, and would like prices benchmarked against current charges to VM. There would be no minimum guarantee for premium channels as Sky did not receive one from VM or Tiscali.
- (e) BT proposed a term of two years renewable for a further year on same terms, subject to the outcome of Ofcom's Pay TV review.
- (f) BT "would like to explore whether it is at all possible to do something in time for the start of the 2009 football season." (The Tribunal notes from internal BT emails at about this time<sup>336</sup> that BT did not actually regard this as achievable.)
- (g) As to distribution of the channels, BT stated "We would like to distribute the channels via DTT capacity that BT would look to acquire with a view to launching if possible in August 09." (The Tribunal notes that the 2007/8 negotiations had assumed that BT could use Sky's intended Picnic capacity. By 2009 Picnic had been shelved and the assumption was that BT would need to acquire its own capacity to carry Sky's channels.)
- (h) In relation to the CA system, the letter stated that Nagra encryption was proposed to be used, suggested a meeting of technical teams to discuss, and sought sight of any "standard terms and/or requirements that you [sic] in place with other suppliers so that we can review these." (The Tribunal notes that in what appears to be a draft of the letter,<sup>337</sup> there is reference to BT investigating the use of a different (named) encryption technology.)

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<sup>336</sup> Ofcom 4/783.

<sup>337</sup> Ofcom 5/1028.

346. Following a joint meeting on 13 July 2009, the parties allocated a number of tasks to each other.<sup>338</sup> These included the exchange of various technical details, mainly relating to quality and security. In particular, Sky was to provide a “minimum requirements document” as regards the technical platform and security, and BT was to facilitate a conversation between Sky and Nagra.<sup>339</sup>
347. By email of 15 July 2009<sup>340</sup> Sky sent the relevant rate card prices to BT, stating that it was “happy to supply our premium channels on the basis of the attached rates, subject to contract and provided that both security and other technical issues can be satisfactorily resolved.” This email also noted: “Now that, for the first time since you initiated channel discussions with us, you appear to have (or are close to having) DTT capacity to enable the transmission of those channels, we are keen to progress these discussions so as to enable the rapid launch of our channels on DTT.” (The Tribunal notes that, in fact, BT was far from having acquired the necessary DTT capacity: it was not until October 2009 that BT obtained internal approval to negotiate seriously with Arqiva for the purchase of capacity (see below).)
348. Under cover of an email of 20 July 2009<sup>341</sup> Sky sent to BT (1) an initial technical due diligence questionnaire for supply of Sky channels to third party platforms and (2) a further document summarising Sky’s security and anti-piracy requirements to be implemented by any platform over which Sky’s channels are distributed.
349. What appears to have been a technical meeting between BT and Sky took place on 29 July 2009. An email of that date from Mr Chris Alner (BT) to Mr Marek Rubasinski (Sky)<sup>342</sup> records the parties’ “Agreement in principle to distribution on BT STB G2 using Merlin”. Sky was to send a series of follow up technical questions. There were to be “Additional discussions ... on the use of G1 and Mediaguard within the restricted Vision base subject to: Further detail to be

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<sup>338</sup> See the emails at Ofcom 4/801-807.

<sup>339</sup> Mr Young’s view, as at 6 July 2009, appeared to be that that the two key issues (from BT’s perspective) were CA and “whether they could use capacity should they wish to retail over dtt” (Ofcom 4/783).

<sup>340</sup> Ofcom 4/809-810.

<sup>341</sup> Ofcom 4/825-833.

<sup>342</sup> Ofcom 4/837.

provided on the additional technical measures we would take for extra security .... Mitigation measures in the event of commercial hacking will also be added to the questionnaire i.e. where we can provide that further layer of comfort.” (The “restricted Vision base” appears to refer to BT’s earlier statement that only its broadband customers would be supplied with Sky’s channels.)

350. By email on 6 August 2009 Mr Rubasinski responded.<sup>343</sup> On the point relating to “Agreement in principle on distribution of the channels on BT STB G2 using Merlin”, he said “to be clear, the principle that we can agree on is that we can consider distributing to secure, non-pirated platforms, and that at this time and with the information we have, we believe that G2/Merlin will qualify as such.” This was said to be subject to Sky understanding the answers to questions it had posed about the “CAC implementation issues below, and the overall technical due diligence process.” Attached to the email was an addendum to the security and anti-piracy requirements document already sent (see paragraph 348 above), containing follow-up questions. The email went on to suggest how and in what detail the answers should be provided. A working session was suggested to review and discuss the answers. Sky’s email continued “...we look forward to receiving your proposals in relation to any potential launching of Sky services on the G1/Mediaguard platform. As per your mail, these would fall into the categories of: - Additional technical measures that you would take to secure the platform; - Action that would be taken in the event of piracy; - ...sharing details of your G2 roll-out plans, especially swap out of G1s and any plans for a sunset date for G1s.”

351. In his third witness statement Mr Watson says that in the email of 6 August 2009 Mr Rubasinski “records that there was “Agreement in principle on distribution of the channels on BT STB G2 using Merlin” from August 2009”.<sup>344</sup> For the avoidance of doubt, we do not consider that that is an accurate interpretation of Mr Rubasinski’s email. When one reads that email together with Mr Alner’s, it is clear that in referring to the “Agreement in principle” etc Mr Rubasinski is simply identifying the point in Mr Alner’s email to which he is responding. The extent of

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<sup>343</sup> Ofcom 4/845-846.

<sup>344</sup> Watson 3, para 37.

Mr Rubasinski's agreement with the point is contained in the passage beginning "to be clear, the principle that we can agree on is...".

352. The addendum attached to Mr Rubasinski's email<sup>345</sup> included a number of technical questions. Question 1 was "Can you please provide full details of how the Merlin "wrapper" implementation works, and in particular confirm whether legacy Mediaguard support is either required or supported in both the G1 and G2 implementations, both pre- and post-Merlin implementation?" At the end of the questions the addendum states: "Q5 to Q7 may require a discussion with Nagra as we want to ensure that the [...] [C] in Merlin is much more secure than that in older versions of their CA. ([...] [C].)"
353. The next communications are two chasing emails from Sky to BT (10 and 20 August 2009<sup>346</sup>) seeking the outstanding technical information (BT having provided details of its STB specification on 10 August 2009<sup>347</sup>), and seeking to convene a discussion. Mr Alner replied on 20 August 2009<sup>348</sup> that the BT technical team would be having a review of their completion of the documents the following week and once these had been finalised he would get in touch to set up the next meeting with Sky.
354. On 7 September 2009 BT appears to have given a presentation to Sky on its IPTV project known as Canvas, and in particular in the context of a request by BT that supply of the Sky channels should be not only for their current generation of STBs but also for the future IPTV supply.<sup>349</sup> It appears from BT's (Mr Young) email to Mr Nuttall the next day<sup>350</sup> that there was a brief discussion at that presentation about the main negotiations. Mr Young states: "I just wanted to let you know that we are now at the point where we will be engaging with our CA supplier Top Up TV regarding our plans to acquire DTT capacity. I am presuming there are no issues but do get back to me if you want to discuss."

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<sup>345</sup> Ofcom 4/873-874.

<sup>346</sup> Ofcom 4/845; Ofcom 4/885.

<sup>347</sup> Ofcom 4/849-855.

<sup>348</sup> Ofcom 4/885.

<sup>349</sup> See the note prepared by Mr Middleton (Sky) at Ofcom 4/909-910.

<sup>350</sup> Ofcom 4/897.

355. A week later, on 15 September 2009, there is an exchange of internal emails between those involved in the commercial negotiations on behalf of BT.<sup>351</sup> We set them out at some length, as they provide an idea of the state of BT's own preparations and extent of commitment to carry Sky's channels at this stage of the negotiations.
356. The internal emails begin with one sent by Mr Williams to Mr John Petter (Managing Director of BT Retail's consumer division) and to Mr Watson.<sup>352</sup> Mr Williams says:

"I just wanted to confirm ... my understanding of our approach in relation to Sky's apparent willingness to enter into a supply arrangement for premium channels with us. It is clear that Sky are only entering into these discussions in earnest – if they are in earnest – because they are under threat of intervention from Ofcom. It is always possible that they are still negotiating in the usual way, namely never saying no they will not supply but always having some apparently good reason why they do not supply. However let us suppose for now that they could be willing to enter into a contract. It is worthwhile for us to invest our effort in resolving any possible reasonable grounds for not supplying us, whether on grounds of security or signal quality, or any other non-price terms that might excuse them from not supplying, in ways that do not prejudice our ability to compete and gives us enough security of supply that we could build our business in the long run. So let's continue to conduct the negotiations with a view to a contract and bring the matter to a head with Sky in due course."

There is then a passage in which Mr Williams states that the cable rate card is not sustainable for BT's business in the long run but that there might be a benefit in marketing Sky's channels in advance of the WMO, provided it is not for long. Finally he says: "So, ideally, we should continue to work to resolve the non-price issues with Sky. It is likely to take some time before we and they are ready to sign a contract. By that time we may have greater clarity from Ofcom on the probable timing and outcome of the regulatory solution we need in the long run." Mr Watson emailed his "agreement with the rationale and approach." So did Mr Petter.

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<sup>351</sup> Ofcom 4/901-907.

<sup>352</sup> Ofcom 4/901-902.

357. The next of these internal emails on 15 September 2009 is from Mr Young to Mr Petter, copied to Mr Watson and others.<sup>353</sup>

“I think we are now at the point where we really need to get sign on approval to engage with Arqiva, Sky and Top Up in a [sic] more meaningful negotiations so we can understand whether our plans are real or hypothetical. In particular I would be looking to confirm: - Whether Arqiva will commit to providing the capacity to us for 2 Sports pay channels and at what price. At this stage I would recommend going in at £[...][C] with approval for no more than £[...][C] p.a./per channel with a condition precedent on Sky approval and full BT exec approval – Pushing Sky to commit to allow us to distribute Sky and be clear on their conditions (e.g. security) – Discussing potential for capacity sharing with Top Up ... Pushing on with Sign On ... won't result in any more additional costs other than Design work that will need to be carried out as part of this assessment. Delaying Sign On will put our DTT delivery plan back and increases the risk of Arqiva selling off the capacity. Given the amounts, the Sign On call will require senior executive involvement, so I would be grateful if you can let me know your view.”

358. Mr Watson replies,<sup>354</sup> noting “...this is on the assumption that the WMO with revised pricing will apply from 2010. We are sufficiently confident on this to proceed but will continue to monitor.” Mr Petter then agrees to the “Sign On” call,<sup>355</sup> and adds “Before we got into any discussions that could in any way commit us to anything I would want to have a view of the financials for next fiscal which was part of an agreed consumer shape.” Mr Young replies that he will arrange a Sign On call as soon as possible.<sup>356</sup> A little later Mr Watson emails Mr Young<sup>357</sup>: “We thought it a good time to get ian [Livingston, Chief Executive of BT Retail] to talk to Jeremy [Darroch - Sky's Chief Executive Officer]. Aim to establish whether they [are] serious about supply. Do you agree now is the right time?” Mr Young replies:<sup>358</sup> “Initial call with Jeremy from Ian might be useful although we may want to think about timing given Pay TV consultation submissions next Friday and our engagement. This is current plan of engagement with Sky: ....” He then suggests a timetable of technical and commercial meetings with Sky, ending with a top level handshake “around mid/end Oct”.

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<sup>353</sup> Ofcom 4/903-904.

<sup>354</sup> Ofcom 4/903.

<sup>355</sup> Ibid.

<sup>356</sup> Ibid.

<sup>357</sup> Ofcom 4/905.

<sup>358</sup> Ibid.

359. The BT internal “Sign-On” approval process took place on 6 October 2009, and the key points and actions resulting from it are summarised in an email from Mr Young to the participants on 7 October 2009.<sup>359</sup> In essence it was agreed within BT that negotiations with each of the three counterparties, Arqiva, Sky and TUTV, should continue at the same time “to ensure interlock”. After 2 weeks there was to be an update and approval sought before proceeding further. The deal with Sky was to be conditional on Sky agreeing to supply premium channels using existing G1 and G2 STBs and current Nagra CA system.
360. A number of points emerge from this exchange of emails, which we deal with below at paragraph 390.
361. To continue the saga, Sky and BT made arrangements<sup>360</sup> for a technical meeting to take place between them in November 2009; BT stated that a TUTV representative would also attend in its capacity of BT’s CA provider. The meeting was fixed for 3 November 2009. At the time the meeting was arranged, in the second half of October, BT had not yet provided Sky with responses to the documents and request for further technical and other information submitted by Sky about three months earlier (see paragraph 348 above).
362. Before the planned November meeting, in late October 2009, there was an exchange of emails between BT, TUTV and Mr Michael Rhodes.<sup>361</sup> Mr Rhodes was formerly Sky’s head of regulatory affairs and later formed a consultancy which provided advice to TUTV amongst others (and who, according to Sky, was responsible for drafting the joint complaint to Ofcom). This exchange is significant and we therefore set it out in some detail.
363. The exchange begins with an email of 23 October 2009 from Mr Young of BT to Mr Nick Markham of TUTV.<sup>362</sup> This refers to four draft documents that BT is proposing to supply to Sky in the context of the outstanding information requests, and on which BT is first seeking further comments and input from TUTV. The

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<sup>359</sup> Ofcom 5/967-968.

<sup>360</sup> See Ofcom 5/969-972.

<sup>361</sup> Ofcom 5/973-976.

<sup>362</sup> Ofcom 5/975-976.

email refers to their “common approach in terms of technology level”, and in this context states that Mr Young has spoken to BT’s regulatory team “and I think we may have an approach that could work for all parties.” He then describes the four proposed documents: (1) a covering letter “setting out our intentions and that explains that we have detailed our proposal around security ... Aim of this letter will be to ensure the debate focuses on the security principles rather than detail at this stage (albeit that we have provided them with the detail)...”; (2) “Proposal from BT setting out approach [Can you mark up as per above]”; (3) “Marked up security requirements [BT to do additional turn on the attached document that TUTV have marked up]”; (4) “Questionnaire filled [BT to do first draft]”. Mr Young closes: “Keen to progress quickly, do let me know if you think this plan may work...”.

364. Mr Rhodes replies on behalf of TUTV on the same day.<sup>363</sup> He refers to his understanding that:

“...there is a concern on BTV’s part that there may be a mismatch in our objectives over the issue of MSRs [Minimum Security Requirements] in that TUTV (and I) are apparently focused solely on the regulatory outcome whereas BTV wishes to try to conclude a commercial arrangement with Sky ahead of Ofcom’s decision on the [WMO]. In practice I do not believe that is an entirely fair assessment of our position. At the outset I would confirm that neither TUTV nor I are seeking to determine how BTV approaches its negotiations with Sky. It is, however, important that in its commercial discussions with Sky BTV does not prejudice the regulatory process or depart from the agreed principle that BTV and TUTV are seeking to ensure that both Parties can meet the MSRs.”

He goes on to say that whether they obtain supply of the channels through the WMO or commercial agreement, a prerequisite will be the minimum security requirements (“MSRs”) which the Nagra CA technology will have to meet.

365. Mr Rhodes then turned to the draft documents sent by BT. He stated that the draft containing BT’s Proposal was not consistent with the agreed principle, for two reasons. First, it emphasised features of BT’s platform “which are not supported by TUTV.” These included the references to the role of the broadband connection in respect of security. Mr Rhodes noted that BT had agreed to amend the draft to modify these references. (The Tribunal notes that BT’s decision not to adhere to its assurance to Sky that the premium channels would only be retailed to BT’s

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<sup>363</sup> Ofcom 5/973-975.

broadband customers is said by Mr Darcey to have caused some uncertainty in 2010 when Sky became aware of BT's change of heart in this regard. See paragraph 345(b) above.<sup>364</sup>) Second, the Proposal contained ambiguous language, which should be clarified before being sent to Sky.

366. Mr Rhodes had further concerns. Sky had sent BT its "Security and Anti-Piracy Requirements" in August 2009,<sup>365</sup> with a request for BT to mark the document up. Mr Rhodes was concerned that if, about three months later, BT "responds with an entirely different document of its own" then Sky might argue that it too needed time to consider and respond and that in the meantime Ofcom should not involve itself in these complex technical discussions. Further, Mr Rhodes understood that BT's aim in responding with its own document was to agree points of principle with Sky rather than determine the details of the MSRs; yet in the light of Sky's email of 6 August 2009 Sky had already agreed in principle to the level of security provided by BT's G2/Merlin STBs subject to further consideration of the details; thus, although Sky's approach to BT's G1 STBs was more qualified, it appeared "that BTV already has as much of an agreement in principle from Sky to the use of Nagra as it is likely to obtain prior to addressing the details."
367. In the light of all this Mr Rhodes was of the view that it was "important for us to engage with Sky on its own "Security and Anti-Piracy Requirements" document (as it has requested) and to clarify the ambiguous expressions that exist in that document in order to be sure that BTV, TUTV and Nagra can meet these requirements. This seems to me to be the best route to specifying the MSRs which will be needed for both the commercial and the regulatory solution." Finally Mr Rhodes said that a final view on whether to submit to Sky BT's new Proposal document (i.e. the second document referred to in paragraph 363 above) as well, about which he "remained a little nervous", could be addressed when all the documents were prepared. A way forward would be agreed in a call between BT, TUTV and Mr Rhodes.

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<sup>364</sup> Darcey 1, para 521; Darcey 3, para 479-480.

<sup>365</sup> Although this is what Mr Rhodes says, the document appears to have been provided in July 2009, with an addendum provided in August.

368. Mr Young (BT) replied by email of 26 October 2009<sup>366</sup> indicating that “we are closely aligned in our objectives and therefore the main question outstanding would appear to be a tactical one.” The approach would be agreed in a call. As for the Proposal document, “we are agreed that [it] should reflect the agreed principles of our approach to the Pay TV review and should therefore be marked up accordingly.” He also stated that BT’s legal and regulatory teams were reviewing the documents.

369. Mr Watson, who was an addressee of these emails, stated in cross-examination that they were about security, as TUTV had the exclusive rights to Nagra CA in the UK, and was BT’s CA supplier. As to the “agreed principles”, he said:

“Q. The agreed principles to the Pay TV review, which must go wider than the security issues, that’s not something you’ve referred to in your evidence anywhere?”

A. Well, there were no agreed principles that I can recall beyond the conversations that we were having around security, and I guess beyond the common parts of the submissions to Ofcom, but insofar as you would call them principles, I don’t know. But certainly we were having our own conversations with Sky, they were going on their own track, and from our perspective we wanted to be in market.”<sup>367</sup>

370. We comment on this exchange of emails below at paragraph 394.

371. The final versions of the promised documents were sent to Sky on 2 November 2009,<sup>368</sup> the day before the meeting at which they were due to be discussed. The documents were described by BT as follows in the covering email:

“BT\_Sky proposal – Our overall proposal for retailing your premium channels on our service, including the technical background on the platform itself and the outline of the launch plans

BT\_Sky\_Security and Anti-Piracy requirements – marked up as you had requested of us – It would also be good to receive a copy of the other terms within the contract so that we can start to review those

BT\_Sky Addendum – Details on the further questions that you had previously asked of us.”

372. The “Security and Anti-Piracy requirements” document, in particular, had undergone a substantial mark-up, with several new appendices. A BT note of the

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<sup>366</sup> Ofcom 5/973.

<sup>367</sup> Transcript 9/38:14-24.

<sup>368</sup> Ofcom 5/983-1004.

meeting the next day between BT, Sky and TUTV<sup>369</sup> (as BT's CA provider) records that Sky had complained that the technical documents were short on detail and had taken a long time to prepare. Sky had also complained that it had not expected that BT would mark up the Security and Anti-Piracy document into "legalistic language" when it had been intended to be used as a way to cover off principles. In relation to technical details, the team from TUTV explained how the "Merlin wrapper" worked i.e. that it [...] [C]. Sky drew a distinction between use of a Merlin (G2) STB with a Merlin smartcard plus a Merlin CAK, which Sky said was acceptable, and use of an STB with a Mediaguard CAK (as then still in use), about which Sky had reservations. BT/TUTV agreed to provide Sky with details of functional differences between the two CAKs. They also agreed to investigate with Nagra, and then inform Sky, whether and to what extent [...] [C] was possible under the existing CA system i.e. before full Merlin was implemented. TUTV said that [...] [C] was possible but accepted that it was not as secure as it would be with a Merlin CAK. TUTV would provide details and Sky could evaluate the position. It was agreed that issues as to the status of material recorded on the PVR, and remedial action to be taken in the event of piracy, were to be postponed to the commercial negotiations. Sky indicated that when it had reviewed the documents which BT had just provided it might have further questions, and would need to have dates, timelines and plans to "sunset" the G1 STBs.

373. Mr Darcey stated in his evidence that it was only at the meeting on 3 November 2009 that it was explained to Sky that the significance of having Merlin encryption with a Mediaguard CAK was that it allowed less functionality. Mr Darcey stated that this lesser implementation of Merlin was referred to as "Chameleon". He says that although this meeting increased Sky's understanding of BT's CA system, it was not until April 2010 that certain aspects of Chameleon were made clear, in particular its inability to [...] [C].<sup>370</sup> We note that Sky had been told by BT in July 2007 that BT would be moving to full "end to end" Merlin, including a Merlin CAK, by mid 2008 (see paragraph 276 above). As Mr Watson stated in his evidence, this was not achieved, although Sky ultimately became "comfortable"

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<sup>369</sup> Ofcom 5/1005-1006.

<sup>370</sup> Darcey 3, paras 477-478.

with the Chameleon implementation.<sup>371</sup> According to Mr Darcey, there is a provision in the supply agreement ultimately entered into that commits BT to implementing Merlin in full by the end of [...] [C].<sup>372</sup>

374. On 9 November 2009 BT and TUTV appear to have submitted a “non-binding” joint proposal to Arqiva,<sup>373</sup> aimed at purchasing DTT capacity sufficient to retail Sky Sports 1 and 2 in MPEG2 by August 2010. BT/TUTV asked for “an initial exclusive negotiation period of three (3) months” commencing from Arqiva’s acceptance of the non-binding proposal, to enable BT to finalise necessary agreements with Sky and other third parties. The offer price was an average of £[...] [C] over [...] [C] years.
375. On 18 November 2009 BT emailed Sky<sup>374</sup> and *inter alia* asked Sky when it might be in a position to send BT a draft commercial contract, and to identify any further technical questions. BT suggested a technical session with TUTV and Nagra could be arranged if Sky wished. According to Mr Darcey, Sky responded that a draft agreement would more likely be available in January than December.<sup>375</sup> Sky also set out further questions in relation to the security issue.
376. On 22 November 2009 BT submitted to Ofcom,<sup>376</sup> in a Response to an Ofcom Information Request of 29 October 2009, that “It remains BT’s position that Sky themselves have had no serious intention of reaching a commercial agreement for the wholesale distribution of premium channels.” The Response also stated that:

“Towards the end of June 2009, BT again sought a wholesale arrangement with Sky. This approach was prompted by concerns over timing – although it seemed

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<sup>371</sup> Watson 3, paras 102-4.

<sup>372</sup> Darcey 3, para 481.

<sup>373</sup> Ofcom 5/1007-1010.

<sup>374</sup> Sky 17/390.

<sup>375</sup> Darcey 3, para 503. In an internal email from Ms Victoria Molony (BT Legal) to others at BT (BT4/24/1-2), she identifies issues that need to be addressed in the contract with Sky. On the second page, she addresses the likely timing, and acknowledges that there was likely to be delay as Mr Middleton at Sky had a heavy workload and was required to draft a bespoke contract for DTT supply. She goes on to state: “if we don’t receive something from him til Xmas, we are unlikely... to be in a situation where Marc / Steve can agree a handshake deal on the basis of which we could consider going ahead with Arqiva ... before early / mid-February.” She advised against a deal that allowed BT to proceed with Arqiva without the contracts actually being signed, “as what little negotiating power we would have with Sky would instantly evaporate”. She stated “Early February is very aggressive, and I think to have a signed deal will take significantly longer”.

<sup>376</sup> Ofcom 5/1015-1017.

likely that Ofcom would proceed with its proposed [WMO] remedy, BT was concerned that the remedy may not be in place in time for BT to launch premium pay TV sports services for the start of the next FAPL season (August 2010). As a consequence, BT sought to address certain issues in discussions with Sky ahead of any decision by Ofcom on the [WMO] remedy – for example, the specification of [MSRs]. In addition, it appeared to BT that, solely due to Ofcom’s proposed intervention, Sky may have an incentive to enter into a wholesale arrangement with BT in order to try to demonstrate that it was willing to wholesale its channels to new pay TV retailers and thus claim that the [WMO] remedy was not warranted.”

In a later Response to Ofcom dated 1 February 2010,<sup>377</sup> BT referred to Sky as “creating new hurdles [to wholesale supply] at every stage in order to avoid concluding commercial terms with BT.”

377. The next step seems to have been a meeting between Sky and BT on 19 January 2010 at which it was confirmed that BT was working towards a launch in July 2010.<sup>378</sup> Mr Darcey states that thereafter Sky and BT proceeded with that target in mind.<sup>379</sup> From BT’s note of that meeting,<sup>380</sup> Sky is said to have confirmed that there were no major technical issues outstanding, depending on further discussions around security and anti-piracy. Mr Young is said to have “reiterated that BT was looking for real progress on the commercial conversations, and to move to getting a development plan in place to launch”; Mr Middleton is also said to have remarked that Sky was “sensitive to concerns that Sky used security issues to deny access but that that was not [Sky’s] intent. Security was not supposed to be a platform differentiator, and [Sky] would not be trying to hold anyone to a higher standard than on their own platform.”
378. In February 2010 there are chasing emails from BT to Mr Andrew Middleton,<sup>381</sup> Sky’s Deputy General Counsel, to whom preparation of the draft carriage agreement had been assigned by Sky. It is clear that there was some slippage on the part of Mr Middleton in drafting the agreement (see footnote 375 above). On 24 February 2010 he replied to the chasers<sup>382</sup> with a plangent email apologising profusely for not getting the draft out sooner, and explaining that he had also been

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<sup>377</sup> Ofcom 5/1023-1025.

<sup>378</sup> See BT4/24/3-6.

<sup>379</sup> Darcey 3, para 505.

<sup>380</sup> BT4/24/4-6.

<sup>381</sup> See Sky 17/393; also BT4/24/8-10.

<sup>382</sup> Sky 17/393.

working 15 hours per day on another project. He promised to get a 95% complete draft to BT by 2 March 2010, which he said should be “sufficient to satisfy you that there are no show stoppers (including the security requirements) in the form of contract we propose...”. In the event Mr Middleton missed his deadline by two days, providing the draft on 4 March 2010.<sup>383</sup>

379. The negotiations were overtaken by the publication of the Statement (and details of the WMO) on 31 March 2010. Notwithstanding, Mr Middleton circulated a revised draft on 8 April 2010.<sup>384</sup> Although he remarked that negotiations were taking place “in the shadow” of the Statement, he stated that Sky was “happy to continue these negotiations with a view to concluding an agreement as rapidly as possible on the assumption that you remain prepared to do a deal based on the discussions to date.” There followed an application to the Tribunal by Sky for interim relief in late April 2010 seeking suspension of the WMO on certain terms. This application was ultimately resolved by an order of the Tribunal to which all the parties agreed (see paragraph 6 above). BT appears to have reached an agreement with Arqiva for the purchase of the necessary DTT capacity in May 2010.<sup>385</sup> On 18 June 2010 Ofcom granted the necessary regulatory approval for Sky Sports 1 and 2 to be broadcast on BT’s DTT capacity.<sup>386</sup> The wholesale deal between BT and Sky was concluded on 25 June 2010, in time for the new football season, and within the desired timescale confirmed to Sky in January 2010.<sup>387</sup> Mr Watson thanked Mr Middleton in his email of the same day.<sup>388</sup>

### *The Tribunal’s discussion and conclusions: negotiations in 2009-2010*

380. In the following sections, we consider two particular issues arising out of the negotiations between Sky and BT in 2009-2010, namely whether Sky was negotiating wholesale supply in good faith (paragraphs 381 to 388 below) and whether there was further evidence of regulatory gaming by BT (paragraphs 389 to

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<sup>383</sup> Sky 17/392-445.

<sup>384</sup> BT4/24/15.

<sup>385</sup> Watson 3, para 114.

<sup>386</sup> Darcey 3, para 518.

<sup>387</sup> Darcey 3, para 519.

<sup>388</sup> Sky 17/359.

394 below). We then set out our general conclusions on the 2009-2010 negotiations between Sky and BT at paragraphs 395 to 404.

Was Sky negotiating wholesale supply in good faith?

381. Mr Watson suggested in his evidence that

“Sky only entered into a wholesale supply agreement with BT following the introduction by Ofcom of the WMO obligation and following Sky’s unsuccessful attempt, during the Interim Relief proceedings before the Tribunal, to obtain a stay of that obligation and to avoid having to wholesale channels to BT.”<sup>389</sup>

382. This interpretation of Sky’s approach was strenuously denied by Mr Darcey in his evidence. He maintained that even if the Statement had not intervened when it did, Sky would have entered into an agreement with BT on commercially agreed terms, based on the rate card price and subject to whatever regulatory price emerged from the Pay TV review. He told us that the arrival of the Statement actually delayed the completion of the deal, because those intimately concerned with the negotiations were diverted to work on interim relief and the formal reference offers which the WMO condition required to be in place by 14 May 2010.<sup>390</sup>

383. Mr Watson’s interpretation sums up the suspicions harboured by him and others at BT as to the genuineness of Sky’s motives in engaging in negotiations. These suspicions permeated Mr Watson’s evidence, and informed the periodic updates on progress provided by BT to Ofcom. In these updates BT, in essence, informed Ofcom that in BT’s view Sky had no real intention of concluding a wholesale deal with BT, and would only do so if obliged to by regulatory action (see paragraph 376 above).

384. Having examined the contemporaneous documents (some of which were not, of course, available to BT at the time, e.g. Sky’s internal communications) and having carefully considered the witness evidence and the submissions, we have not found anything which substantiates the suspicion held by BT, and repeatedly communicated by it to Ofcom. On the contrary, our assessment of the available

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<sup>389</sup> Watson 3, para 126. See also para 6(ii).

<sup>390</sup> Darcey 3, para 511.

material leads us to conclude that Sky was at all times genuinely engaging with BT, and that its aim was to have a wholesale deal in place by the time that BT needed to launch the service, whether or not the WMO was imposed in the meantime.

385. We also consider that Mr Watson is wrong to suggest that Sky's application for interim relief is evidence of an intention on the part of Sky not to wholesale to BT. We have seen nothing that would lead us to believe that Sky was intending, if successful in its application for interim relief, to change its approach to the negotiations and to a wholesale deal with BT. In his evidence to the Tribunal in support of the interim measures application Mr Darcey stated that the negotiations were continuing and that they were likely to culminate in a supply agreement "relatively quickly", as indeed proved to be the case.<sup>391</sup> Perhaps more significantly, as part of that application Sky offered to undertake to keep its most recent wholesale offer to BT open and to "negotiate in good faith with a view, where reasonably possible and consistent with respecting Sky's legitimate interests including security, to allowing supply to commence in time for the 2010/2011 Premier League season."<sup>392</sup> It is also clear from Mr Middleton's email of 8 April 2010 (see paragraph 379 above) that Sky was willing to move forward. We see nothing inconsistent in being willing to reach a wholesale deal of the kind envisaged by the parties from June 2009 onwards, and seeking to suspend a regulatory order such as the WMO in the context of a legal challenge to it. The one is a commercial agreement, freely entered into with a counterparty of one's choice; a contract based on the WMO is obviously of a different nature.
386. As seen, on 1 February 2010 BT complained to Ofcom of "the protracted nature of the negotiations and the inability of the parties to reach a commercial agreement due to Sky's continued stalling tactics".<sup>393</sup> These complaints were accepted by Ofcom and characterised by Ofcom's leading counsel in the course of her submissions to us as unexplained and prolonged procrastination.<sup>394</sup> Although Sky was at times guilty of delay, we must say that, in general, we consider the complaints by BT of Sky's alleged prevarication and delay to be (putting it mildly)

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<sup>391</sup> PL17/16 at para 24.

<sup>392</sup> Sky 17/446.

<sup>393</sup> Ofcom 5/1025.

<sup>394</sup> Transcript 35/11:20-12:3.

a considerable exaggeration. Further, it can be seen from the contemporaneous documents to which we have referred that BT was itself on occasions the author of significant delay in the progress of the negotiations, both in 2007/8 and in 2009. For example, in late October 2009 Mr Rhodes (TUTV's adviser) suggested to BT that, having been in receipt of Sky's request for further information on security for about three months, BT ought now to address it (see paragraph 366 above.)

387. The fact is that BT had confirmed to Sky in January 2010 that its aim was to have the premium channels up and running by summer 2010<sup>395</sup> and it is clear that was what the parties were working towards, and in fact achieved. In his apologetic email of 24 February 2010<sup>396</sup> Mr Middleton (Sky) was able to provide BT with the reassurance that in the draft contract he was preparing there were likely to be “no show stoppers (including the security requirements)”.
388. As regards the security issue generally, the available material provides no justification for a finding that this issue was used by Sky as a pretext for blocking or delaying wholesale supply to BT. Indeed, as already noted, Ofcom itself accepts that Sky's concerns in this regard were genuine. We also consider that there is force in Mr Darcey's assertion that some of the doubt and misunderstanding that arose in relation to the precise nature and functionality of the CA system used by BT is likely to have been caused by the lengthy chain of communication that existed from Nagra to TUTV, from TUTV to BT, and thence to Sky. It is clear from the documents that BT was dependent on TUTV for detail on technical issues, and TUTV was dependent on its licensor, Nagra. Whether and to what extent Sky's concerns in relation to security could be satisfactorily addressed was not fully exposed in the 2007/8 negotiations, which came to an end for different reasons; the real issues were only clearly identified towards the end of 2009.

#### Further evidence of regulatory gaming by BT

389. We have also formed the clear view, contrary to the general thrust of Mr Watson's evidence and Ofcom's findings in the Statement, that BT's thinking and conduct in

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<sup>395</sup> See BT4/24/5.

<sup>396</sup> Sky 17/393.

the 2009/10 negotiations continued to be conditioned to a significant extent by the ongoing regulatory process.

390. The internal exchange of emails at BT on 15 September 2009, set out at paragraphs 355 to 358 above, is instructive in a number of respects. The following points emerge:

(a) While not excluding the possibility that Sky might be playing them along, BT appeared to acknowledge internally that to all intents and purposes Sky was negotiating with BT “in earnest”.

(b) This being so, BT was in the process of making up its own mind whether it was now prepared to commit to: acquiring the necessary capacity from Arqiva (which BT had not yet secured and which it was not even sure Arqiva could supply or at what price); negotiating a capacity sharing arrangement with TUTV; and continuing to negotiate with Sky with a view to, in particular, seeking to resolve Sky’s “reasonable” non-price concerns. The approach adopted by BT (somewhat tentatively, it must be said) was to continue to negotiate with Sky.

(c) As regards timing, BT (Mr Williams) acknowledged that it was likely to be “some time” before BT (as well as Sky) would be ready to sign a contract. He seemed to derive comfort from this, apparently because with the passage of time (i) the period would be shorter during which cable rate card prices would be payable: (“...there might be a benefit in marketing Sky’s channels in advance of the WMO, provided it is not for long”) and (ii) “By that time we may have greater clarity from Ofcom on the probable timing and outcome of the regulatory solution...”.

(d) BT’s assumption was that the WMO and therefore the anticipated revised pricing would come into force in 2010, but this would need to be monitored.

391. It is clear from these emails that there was not 100% enthusiasm on the part of BT about bringing the negotiations with Sky to a conclusion in the form of a contract *in*

*advance of the WMO*, and that BT's plans were not yet fully formed. BT was clearly not at this stage in a tearing hurry – or indeed in a position – to finalise a deal with Sky. Further, Mr Young was seemingly concerned about the timing of any attempt by BT to seek a high level commitment from Sky to supply its channels: his concern appears to have been connected with the “Pay TV consultation submissions next Friday” – presumably a reference to further submissions BT was going to make to Ofcom.

392. BT's main concern was to ensure that Sky's premium channels were able to be broadcast on BT's DTT platform by the start of the next Premier League season i.e. by about July/August 2010. Given this aim it would have been risky to wait for the introduction of the WMO before starting to make progress with Sky on outstanding issues such as security, which could take time to resolve. BT made this point in its Response dated 22 November 2009 to Ofcom's Information Request.<sup>397</sup> BT told Ofcom that concerns over timing had led it “to address certain issues in discussions with Sky ahead of any decision by Ofcom on” the WMO (see paragraph 376 above). It is reasonable to deduce that BT did not mind, and might even have preferred, if the negotiations were overtaken by the WMO, as was to be the case.
393. There is also an internal tension in that Response which illustrates the ambivalence of BT's position: BT was telling Ofcom that Sky had “no serious intention of reaching a commercial agreement” while stating in another part of the Response that Sky might have an incentive to enter into such an agreement “due to Ofcom's proposed intervention”. Mr Watson went further in his evidence and stated that a deal was only ultimately concluded “due to the intervention of Ofcom”.<sup>398</sup> BT's allegation in the Response to the effect that Sky was not negotiating in good faith is also inconsistent with BT's internal assessment only about a month earlier, which refers to Sky's “apparent willingness to enter into a supply agreement” (paragraph 356 above). This ambivalence may well have been due to the difficulty of reconciling the strong indications that Sky was willing to enter a wholesale deal with BT, with BT's (and its co-complainant's) apparent concern that by acknowledging this to Ofcom and/or entering into such a deal, the hoped-for

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<sup>397</sup> Ofcom 5/1015-1017.

<sup>398</sup> Watson 3, paras 5-6.

regulatory outcome might be jeopardised. It may have been some concern of this kind which led BT to present a picture to Ofcom which did not fairly represent what was actually happening.

394. We also note the exchange of emails between BT and TUTV's adviser, Mr Rhodes, in late October 2009 (paragraphs 362 to 368 above). The scope of Mr Rhodes' anxiety that BT's commercial negotiations with Sky should not "prejudice the regulatory process" is not entirely clear. In particular it is not clear whether it extended beyond his concern that BT should comply with the "agreed principle" that the aim should be to ensure that both BT and TUTV could meet Sky's MSRs. He was certainly keen to ensure that any documents sent to Sky by BT did not raise new issues which might deflect Ofcom from giving due consideration to the technical aspects of the Pay TV review, or which might lead to infringement of the agreed principle. Mr Rhodes was apparently successful in securing BT's agreement to modify one of its negotiating documents by altering or removing the offending passages relating to the effect of broadband connection on security. On any view these emails show that as a result of the Pay TV review BT was subject to external as well as internal pressures in relation to its ongoing negotiations with Sky, and that the contents of its negotiating documents were capable of being conditioned by the interests of another complainant and potential beneficiary of the Pay TV review, namely TUTV.

#### The Tribunal's general conclusions on 2009-2010 negotiations with BT

395. In the light of the evidence we cannot agree with the implications of paragraph 7.4 of the Statement, which finds that:

"A number of operators – including...BT Vision...have tried and failed to obtain wholesale access to Sky's premium channels. Despite lengthy negotiations and the apparent opportunity for Sky to increase its revenues and profits, wholesale supply has not been agreed; nor does it appear that much meaningful progress has been made towards agreement."

396. That finding, recorded as at the end of March 2010, gives a false picture of the actual negotiations that were taking place. It clearly implies that BT was negotiating in vain opposite an unwilling and foot-dragging Sky which was passing-up the

opportunity to add to its profits; that BT was therefore making no real progress towards an agreement, and that its attempt to obtain access to the channels had failed. This, of course, is what BT had been repeatedly telling Ofcom (although Sky too was putting its own case to Ofcom). In reality, not only had Sky indicated a willingness to supply by wholesale in the earlier 2007/8 round, but BT had been in possession of a “subject to contract” offer for wholesale supply of the premium channels since 15 July 2009, and the parties were working through the outstanding issues with the express aim of having the agreement in place by about July 2010. We have already said that in our view Sky’s intention was to proceed to that end whether or not the WMO intervened before the contract was actually signed. (It should be noted that the originally stated ambition of launching in time for the preceding season was never on the cards, as BT itself acknowledged at an early stage in the 2009 negotiations.<sup>399</sup>)

397. As for Ofcom’s more specific findings, the conclusion in 7.63 of the Statement that none of the negotiations led to a firm offer of a wholesale deal cannot stand. Moreover one of the other conclusions in that paragraph, namely that Sky had not reached agreement with BT at the time of the Statement, although literally true, is at best of little significance and at worst positively misleading, in the light of the fact that the parties were at that time progressing towards a timely agreement.
398. The points we made at paragraph 311 above in respect of Ofcom’s findings in 7.69 in the context of the 2007/8 negotiations, are reinforced by Sky’s conduct in the 2009/10 round. When BT renewed its approach to Sky in June 2009, Sky did not attempt to revisit the retail versus wholesale question, and proceeded immediately to discuss the terms of a wholesale deal. Ofcom’s finding that insistence on self-retail by Sky resulted in collapse of the negotiations is no more supported by the facts of the 2009/10 round than by those of the negotiations in 2007/8.
399. Similarly, the finding in 7.77 that “Sky’s actions indicate that it has a preference for **no** supply to third party retailers rather than wholesale supply” is not supported by Sky’s conduct in 2009/10 any more than it is supported by the circumstances of the 2007/8 negotiations.

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<sup>399</sup> See Ofcom 4/783.

400. The finding in 7.80 that “Sky did not make an offer of the rate-card price for wholesale supply before 2010, although it indicated that it was willing in principle to do so”, is not a fair assessment in the light of Sky’s “subject to contract” offer in the email of 15 July 2009 (paragraph 347 above).
401. As to the effect of regulatory gaming, if the general conclusion in 7.147 is intended to reflect the position as regards BT (which is not entirely clear), then for the reasons we have given in relation to both the 2007/8 and the 2009/10 negotiations, we would not agree. We are of the view that regulatory gaming by BT may well have had an effect on the timing of wholesale supply of the channels in question. It is quite possible that absent BT’s concern about jeopardising the regulatory outcome, it could have received supply at an earlier stage, assuming always that it was itself then, commercially and in other respects, in a position to retail the channels.
402. Revisiting Ofcom’s overall conclusions in 7.167-9, we consider that the assessment we set out at paragraph 308 ff above in the context of the 2007/8 negotiations is reinforced by the 2009/10 round. As far as the latter round is concerned, we conclude (contrary to Ofcom’s findings, express or clearly implied) that Sky did engage constructively with BT’s request for wholesale supply; that Sky did offer wholesale prices to BT; and that Sky did engage with BT to seek to resolve capacity and security issues (and these issues were resolved in time for the envisaged launch). We do not agree that BT acted as a company would act which wished to reach agreement with Sky as quickly as possible; in fact it is clear in the light of the evidence that in 2009 and early 2010 BT was ambivalent about the prospect of reaching agreement with Sky in advance of the introduction of the WMO, and at times allowed the negotiations to drift for significant periods. The course and timing of these negotiations (as with the 2007/8 ones) might well have been affected by regulatory gaming on the part of BT.
403. In our view Ofcom’s and Dr Unger’s view of the negotiations is encapsulated in a passage in his witness statement where he is referring to a discussion in July 2007 about Sky’s security concerns. Dr Unger says: “This further supports the view that these concerns do not explain *Sky’s failure to conclude a deal with BT* over the

following three years.”<sup>400</sup> (Tribunal’s emphasis). It is clear from that passage, and indeed from the Statement itself, that Ofcom attributes responsibility for the alleged failure to Sky. However, it takes two to tango, and for the reasons given above we do not agree with Ofcom’s or Dr Unger’s assessment of responsibility. Nor do we agree with Dr Unger’s premise that the negotiations “failed”. As we have explained, the parties in fact reached agreement by the deadline set by BT and confirmed to Sky in January 2010.

404. It follows from the above that Sky’s negotiations with BT provide no support for Ofcom’s finding that Sky was acting on the alleged or any strategic incentives by restricting or withholding wholesale supply of its premium channels.

#### D. NEGOTIATIONS WITH ORANGE / FRANCE TELECOM

405. We now consider the commercial negotiations between Sky and Orange. In some instances, Sky negotiated directly with Orange’s parent company, France Télécom. Where it is important to distinguish between them, we will refer to “Orange (UK)” or “Orange (France)” as the case may be. Otherwise we will simply refer to “Orange”. Orange was not a party to these proceedings, and none of the parties advanced witness evidence from Orange. In addition to the relevant documentary and other evidence before the Tribunal, the principal oral evidence about these negotiations was given by Dr Unger of Ofcom (see paragraph 195(a) above) and Mr Darcey of Sky (see paragraph 195(b) above).

#### *Discussions in 2005*

406. In 2005 there were discussions between Sky and Orange (France). Mr Darcey described the 2005 discussions in his evidence.<sup>401</sup> They were about the possible provision of Sky’s channels, including its premium channels, over an IPTV platform which Orange was looking at setting up in the UK. The talks began with a meeting in Paris in the latter part of 2005 between Sky’s Mr Nuttall and Mr Herve Payan of Orange.<sup>402</sup> Mr Payan indicated that Orange was contemplating the UK

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<sup>400</sup> Unger 1, para 311(b).

<sup>401</sup> Darcey 1, paras 546-583.

<sup>402</sup> Darcey 1, para 550.

launch of an equivalent to its successful Ma Ligne TV service, an IPTV platform in France upon which a number of channel providers including TPS, Canal, and CanalSat retailed their own packages of channels to Ma Ligne TV customers. In a similar arrangement Sky was already retailing its premium channels to Tiscali (now TalkTalk), and Sky was interested in the opportunity Orange's IPTV plan might present to extend its channels' coverage.

407. A further meeting took place in December 2005 attended by Mr Griffin Parry, Corporate Development Director of Sky, Ms Isabelle Mitsch of Orange, and possibly by others. Following this meeting Sky sent Orange on 8 December 2005<sup>403</sup> a set of slides indicating what a Sky by Wire package (i.e. self-retail) on Orange IPTV might look like. The illustrations gave various options based on either 25 or 40 channels. Each included ten premium channels (sports and movies) and a range of basic and third party channels. It is therefore clear that the original discussions with Orange were about a self-retail package of some kind.

#### *Discussions in 2006-2007*

408. These possibilities do not appear to have been further pursued by Orange at this time, and the next development was an announcement by Orange on 1 June 2006 that it was planning to launch a TV service in the UK which would combine a DTT STB enabling receipt of FTA channels and an IPTV service including VOD.<sup>404</sup> Mr Eric Abensur, Vice-President of Orange (UK), was quoted as saying at the time of the announcement that he would like Sky and Setanta to put their premium sports channels onto the Orange service. On the same date Orange also announced that from then onwards all phone, internet and TV services would be offered under the Orange brand in France and the UK.<sup>405</sup>
409. Soon after the announcement Mr Nuttall contacted Mr Payan and Mr Abensur to see whether the earlier discussion about the supply of Sky's channels could be reactivated. We were shown an internal email from Mr Nuttall of 5 June 2006.<sup>406</sup>

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<sup>403</sup> Darcey 1, para 551; Sky 8/1467-1472.

<sup>404</sup> Darcey 1, para 552.

<sup>405</sup> See, for example, the press coverage at Sky 8/1473-1475.

<sup>406</sup> Sky 8/1476.

According to this email Mr Nuttall was told by Mr Payan that Orange intended to come to Sky “to do a commercial deal along the lines of the one that they have with Canal+/TPS (pay-TV platform is the retailer) and will likely want to talk to [sic] about mobile content as well as IPTV.” Mr Nuttall recorded that Orange had agreed to get back to Sky to arrange a meeting in a few weeks.

410. A meeting was duly arranged for July 2006 for the purposes of exploring the supply of Sky’s channels on the proposed Orange platform. On 21 June 2006, well before the meeting was to take place, Mr Abensur wrote to Mr Nuttall<sup>407</sup> saying that although the technology of the proposed platform would be based on that already deployed in France the business strategy must take into account “local conditions”. Having reviewed Sky’s 2005 Sky by Wire proposal, Orange had concluded that an agency approach (i.e. self-retail) would not be appropriate given the companies’ respective positions in the UK telecoms market. Orange therefore wished to discuss the provision of Sky’s channels, including its premium channels, by wholesale, and requested a revised proposal.
411. Mr Darcey told us that this response took Sky by surprise, as the discussions hitherto had been about self-retail.<sup>408</sup> Mr Nuttall replied to that effect by letter of 3 July 2006.<sup>409</sup> The letter explained the reasons for Sky’s “clear preference” for self-retail, and asked whether Orange was still interested in discussing supply on that basis.
412. The planned meeting took place on 28 July 2006 and Mr Nuttall attended for Sky, with Mr Abensur and others for Orange. We have seen two notes of the meeting: a more detailed one prepared by Orange<sup>410</sup> and a shorter one in an internal email from Mr Nuttall to Mr Darcey and others at Sky.<sup>411</sup> In essentials the two notes are consistent. Sky expressed a strong preference for a self-retail deal, explaining that it had various advantages that were not available with a wholesale arrangement.

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<sup>407</sup> Ofcom 5/1113.

<sup>408</sup> Darcey 1, para 554.

<sup>409</sup> Ofcom 5/1115-1116.

<sup>410</sup> Ofcom 5/1117-1120.

<sup>411</sup> Ofcom 5/1121.

Orange explained why it wanted wholesale and was unwilling to do a self-retail deal.

413. The Orange minutes record Mr Abensur asking why, given that Sky was planning to launch a broadband service, Orange would agree to a deal which allowed Sky access to its customer base. Mr Nuttall responded by pointing out that it was Orange who had proposed a self-retail arrangement. He referred to the fact that wholesale had not worked well in the case of cable, and said that Sky was not looking to replicate such arrangements on new platforms; wholesale did not offer pricing flexibility – a rate card is set and departure from it needs regulatory approval. Asked whether the only option open to Orange is self-retail, Mr Nuttall is recorded as stating that Sky “prefers” self-retail for reasons which he explained. He said that in his view Orange and Sky could work together to address the concerns which Orange had, in particular with regard to Sky marketing to Orange’s broadband customers. Orange agreed to produce a list of its concerns with self-retail, which Sky would then seek to address. Mr Nuttall identified his concerns with the wholesale model. Orange’s minute states: “Sky does not want to do a wholesale deal with Orange as this could be used as a precedent for other IPTV providers, and this is not a desired position for Sky.” Mr Abensur said that Orange would review the options internally and respond.
414. In his internal email describing the meeting<sup>412</sup> Mr Nuttall stated that he invited Orange to make a retail offer that would meet Orange’s concerns and would work for them. He said that he was invited to make Orange a wholesale offer that would work for Sky. “I declined given that we would want to have a retail relationship with customers, be able to count such subscribers in our base, be able to set price and packaging ... amongst other factors. If we believe a retail deal works best and would like to explore the options for that.”
415. On 9 August 2006 Mr Abensur wrote to Mr Nuttall.<sup>413</sup> Mr Abensur stated: “In the meeting you confirmed that whilst Sky is keen to distribute content as widely as possible, a wholesale agreement is not acceptable to you. You stated that the

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<sup>412</sup> Ibid.

<sup>413</sup> Sky 8/1481; Ofcom 5/1123 (the latter reference appears to carry the wrong date).

wholesale access granted to the cable operators under Ofcom regulation has not worked for Sky for many reasons, and therefore Sky will not apply this model to any new platforms going forward ... In Sky's view, adopting a wholesale model with Orange would set a precedent for other platform providers and it is upon this basis that Sky refuses to offer a wholesale arrangement to Orange and proposes an agency/retail agreement." The letter went on to say that self-retail was not a viable business model for Orange because of the ability of Sky to market directly to Orange's customers. It concluded: "Steve, in order to move forward to an approach which is mutually satisfactory, we proposed that you detail Sky's concerns with the wholesale model and that we detail Orange's concerns with the retail model. We also noted your proposal that Orange raises with Ofcom Sky's refusal to offer a wholesale arrangement. We are now reviewing our options internally and will be in contact in due course." (The Tribunal notes that this was broadly the same position that BT and Sky arrived at early in their negotiations, i.e. an agreement that each side would present the case for their preferred form of distribution (see paragraph 266 above).)

416. On receipt of this letter Mr Nuttall emailed Mr Darcey and others at Sky on 10 August 2006<sup>414</sup> as follows: "I've received another letter from Orange that purports to summarise the meeting that I had with them ... I am copying it to you and I think we should rebut it for the record. It would appear that we are set fair for negotiation by letter."
417. The "rebuttal" letter was dated 9 October 2006.<sup>415</sup> In it Mr Nuttall said that Mr Abensur's account of the meeting "is not a summary that I recognise and in particular you wrongly attribute a number of statements to me. I do not propose to go through these individually but I must point out that at no point did I refuse to offer a wholesale arrangement to Orange." After reiterating that Orange's request for a wholesale deal was a *volte face* from its previous request, and that self-retail remained Sky's "preferred route for the distribution of Sky content over new platforms", Mr Nuttall asked Orange to provide the promised explanation of the

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<sup>414</sup> Ofcom 5/1125.

<sup>415</sup> Ofcom 5/1127-1128.

reasons for changing its mind, and the protections Orange would like to see in a self-retail agreement to address its concerns.

418. Mr Abensur's reaction to this was contained in a letter dated 2 January 2007 (nearly three months later).<sup>416</sup> It is expressed in terms which, at least in places, appear to have been drafted by a competition lawyer. Noting Sky's position that it had not refused to wholesale its premium channels, Mr Abensur said "for the avoidance of doubt I now request that you do so ... on reasonable terms..." He said that there was no legitimate reason for Sky to refuse such supply, and he set out the reasons why Orange now required a wholesale rather than a retail arrangement. In essence it was because the two companies had not been broadband competitors in 2005 when Orange requested a retail deal; Sky's launch of a broadband offering had changed the position. In any event a self-retail deal would weaken Orange's ability to compete in the downstream Pay TV market. Mr Abensur stated that "in refusing to provide a wholesale agreement for its premium channels [Sky] would be leveraging ... its dominant position in the upstream market in order to preserve and increase its dominance downstream." In a later passage he went on: "Given that [Sky] is already supplying downstream competitors ...with premium content on a wholesale basis, a failure to provide such content on a wholesale basis to [Orange] would be a refusal to supply, discriminatory and without objective justification. We trust that this can be avoided ...I would therefore ask that [Sky] supplies [Orange] with the premium content channels referred to above on a wholesale basis, with the agreement in relation thereto to be agreed within a period of three months and supply to commence one month thereafter." Finally he sought Sky's agreement to these terms "within 14 calendar days from the date hereof."
419. On 8 February 2007 Mr Nuttall wrote in reply.<sup>417</sup> He reiterated that Sky's preference was to supply the premium channels by way of a Sky by Wire proposition i.e. as a self-retailer, as this provided the best opportunity to "maximise our revenues from the distribution of our channels". He identified two principal concerns with wholesale: first the mere availability of the channels on a platform has considerable value to the platform operator that was "difficult to capture

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<sup>416</sup> Ofcom 5/1129-1131.

<sup>417</sup> Ofcom 5/1145-1147.

through a per subscriber charging mechanic or the imposition of enforceable marketing obligations”; second, the difficulty of ensuring contractually that the operator adequately promoted and marketed the channels so as to maximise penetration. The letter continued: “This is not to say that we are implacably opposed to a wholesale model on new platforms...Were [Orange] to put forward a wholesale proposal in respect of our premium channels that could be expected to be equally or more attractive from a revenue perspective, then we would have to give it active consideration.”

420. Mr Nuttall then invited Orange, before formulating a wholesale proposal, to consider two alternative self-retail propositions. The first was a ‘Ma Ligne TV’-style service under which Sky would develop a “full bouquet” of Sky and third party channels to be retailed directly by Sky in the same manner as TPS, Canal+ and Canal Sat. Alternatively Orange could develop its own Pay TV bouquets selecting, packaging and retailing channels to its customers, and also offering to them as Sky’s agent various packages of Sky’s premium channels. Sky as principal would control the packaging marketing and pricing of the latter packages. The letter then provided examples of prices which Sky had charged for propositions of this kind on another network.
421. Finally, Mr Nuttall gave a brief response to the competition law arguments in Mr Abensur’s letter, and indicated that a fuller answer on those matters would be sent to Orange by Mr Nuttall’s regulatory colleague. That reply was ultimately set out in a letter from Ms Vicky Sandry, Sky’s Head of Legal (Regulatory & Competition) to Mr Simon Persoff at Orange.<sup>418</sup> Mr Nuttall ended by repeating that although Sky preferred to go forward with one or other of the self-retail proposals, it remained open to a wholesale proposal that offered equivalent or greater revenues.

### *Negotiations with Orange from 2007 onwards*

422. Following this exchange of correspondence arising out of the July meeting (which was the subject of certain submissions, as to which see paragraph 459 ff below) Mr Abensur and his team dropped out of the picture, and in February 2007 Sky was

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<sup>418</sup> Ofcom 5/1151-1153.

approached by different personnel from Orange (UK). This resulted in a meeting of 26 February 2007 between Mr Nuttall and Mr Marc Overton, the Group Strategy Director of Orange (UK). Judging from Mr Nuttall's internal email on the same day,<sup>419</sup> together with Orange's minutes of the meeting,<sup>420</sup> there appears to have been a full and open discussion about each party's ambitions (including Sky reiterating its position on self-retail vs wholesale), aims and perceptions in relation to the mobile, broadband and Pay TV markets. Mr Overton suggested that Orange would like a "special relationship" with Sky covering multiple areas. These included the repackaging and marketing of Sky content for IPTV as part of Orange's multiplay, the possibility of Orange marketing Sky DTH satellite and DTT (i.e. Picnic) services to Orange customers, Sky content distribution on Orange's mobile network, retail distribution of Sky products in Orange stores, and sharing broadband infrastructure. Mr Darcey stated in his evidence that some of these possibilities (e.g. Orange marketing Sky's DTH satellite service to its customers) implied that Orange might not go ahead with an IPTV platform. According to Mr Nuttall's note, Mr Overton also indicated that the Orange (UK) people with whom Sky had been negotiating up to this point would not have much, if any, say in these proposals.

423. Internal reports by Mr Nuttall to Mr Darcey between February and 30 March 2007<sup>421</sup> indicate that a further meeting was planned for the latter date to discuss a proposal by Sky to supply Orange with its basic channels by wholesale and its premium channels by self-retail. Mr Nuttall said he believed that this structure would be acceptable to Orange. Further discussion of other areas of cooperation between the two companies was also envisaged. Following the meeting, at which a wide range of issues had been discussed, Mr Nuttall recorded in his report of 4 April 2007<sup>422</sup> that Mr Overton's team's mandate was to prepare a brief for Mr Sanjiv Ahuja, Orange (France) CEO, who would then meet Sky's CEO, Mr James Murdoch. Mr Nuttall records that Orange are "clearly looking for a friend and see Sky as a natural given the high penetration of Orange customers in our base and the

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<sup>419</sup> Ofcom 5/1149.

<sup>420</sup> Ofcom 5/1154A-D.

<sup>421</sup> Ofcom 5/1159-1165.

<sup>422</sup> Ofcom 5/1167-1168

good brand fit between us. It appears that they are having doubts about whether to pursue their own IPTV service.”

424. In his first witness statement Mr Darcey described a meeting on 19 April 2007,<sup>423</sup> which he and Mr Murdoch attended for Sky, and at which Orange was represented by Mr Ahuja, Mr Overton and Ms Anne Bouverot (Executive Vice-President of International Business Development for Orange (France)). Mr Darcey said that the purpose of the meeting was to see whether a strategic alliance was possible, and that a number of potential tie-ups were discussed, including cross-selling of products and the possible launch of Sky mobile TV on Orange devices in the UK. Sky asked whether Orange was still planning an IPTV platform in the UK, as if it was then Sky was keen to wholesale Sky basic channels and to provide premium channels on a self-retail basis. Mr Darcey said that Mr Ahuja replied that whilst Orange had not given up on a UK launch of IPTV the copper network was not up to the French standard and the project’s schedule kept slipping. Mr Ahuja pointed to the technical problems encountered by Tiscali and to the fact that even BT had not launched a linear channel on IPTV. According to Mr Darcey, Mr Ahuja said that there was “a low probability” of a UK launch but Orange was having another look at it. In the light of these comments Mr Darcey concluded that, outside a local UK group perhaps including Mr Abensur, there was little support for IPTV within Orange (UK) and particularly not within Orange (France).
425. In his written evidence Dr Unger told us that he was unable to comment on that conclusion because he had not seen any documentary evidence of the meeting on 19 April 2007.<sup>424</sup> During cross-examination<sup>425</sup> an internal email of Mr Nuttall dated 19 April 2007 to Mr Darcey and others describing a meeting between Sky and Orange was put to Dr Unger as constituting such documentary evidence.<sup>426</sup> It is entitled “Content Syndication” and states:

“Orange – we met Orange to discuss a wide range of issues. In the short term we will look to progress discussions around the supply of channels (wholesale basics and retail premiums) with Sky sending out a term sheet; the supply of Sky’s FAPL content to Orange with Orange to make an offer; and, working to refine a possible

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<sup>423</sup> Darcey 1, paras 561-562; Darcey 3, para 532.

<sup>424</sup> Unger 1, para 354.

<sup>425</sup> Transcript 13/78:21-82:5.

<sup>426</sup> Ofcom 5/1169-1171.

co-marketing or bundling arrangement that would see us promote Orange's mobile services to our customers. In the medium term, it is entirely possible that, in view of technical concerns and time to market, Orange will scrap its IPTV plans and go with a Sky solution instead. A further JRM [James Murdoch] meeting is planned for mid-May."

426. Mr Darcey told us that he understood "Sky solution" to mean a broader Sky/Orange relationship meeting Orange's desire to have a UK TV offering without launching its own service.<sup>427</sup>
427. However, there remains some confusion as to whether that document relates to the meeting on 19 April 2007 described by Mr Darcey in his first witness statement or to another meeting at about the same time. The confusion arises in part because, having referred to the meeting between Mr Murdoch, Mr Ahuja and others, Mr Darcey continues "At least two further meetings followed between the Sky and Orange commercial teams (on 30 March 2007 and in mid April 2007)...". Obviously a meeting on 30 March could not follow the April meeting he had just described. It is therefore possible that there was only one mid April meeting - the contents of the 19 April 2007 report are such that it could be a terse summary of the 19 April 2007 meeting described by Mr Darcey. The fact that Mr Darcey would not need a report of a meeting at which he had been present is not particularly significant, as the report in question was sent to others as well as to Mr Darcey. Moreover it ends: "A further JRM meeting is planned for mid-May." which could imply that the meeting which had just taken place was itself a high level one attended by Mr Murdoch, the CEO, as described by Mr Darcey. We think it probable that there was only one meeting and not two; and in any event it appears that Sky was made aware of a sizeable question mark over Orange's plans to launch an IPTV service in the UK.
428. An internal report of 27 April 2007 by Mr Nuttall<sup>428</sup> indicates that Sky was preparing "term sheets" for the wholesale supply of basic channels and the retail of premium channels with a view to agreeing terms within 2 weeks. Also, Sky had become aware that Mr Ahuja was no longer going to be CEO of Orange (France) but Sky had been "assured that [his departure] will not affect the deal as France

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<sup>427</sup> Darcey 1, para 563.

<sup>428</sup> Ofcom 5/1173-1174.

Télécom is very supportive. In parallel Orange are working on proposals to Sky for (i) FAPL content from next season and (ii) a mobile proposition that Sky could market to its customer base”.

429. In May 2007 draft agreements were sent to Mr Overton by Mr Nuttall.<sup>429</sup> There were exchanges between Sky and Orange in relation to the drafts in June and July 2007.<sup>430</sup>
430. On about 5 July 2007 there was a meeting between Sky and Orange. Mr David Rey, Commercial Director with Sky, reported internally to Mr Darcey<sup>431</sup> that “Orange seems to have accepted that Sky will retail its Premium channels over their network, and that Basics would be wholesaled. However their preference is to lead with a Sports channel offering, with Movies and Basic channels to follow. They weren’t willing to disclose much more at this stage.” Mr Rey commented that Orange’s plans for IPTV were “at best modest”.
431. Meanwhile the discussions about a possible strategic alliance were continuing. There was a meeting in June to discuss the launch of a Sky TV / Orange Mobile bundle.<sup>432</sup> On 24 July 2007 Mr Nuttall sent Ms Bouverot a possible agenda for a planned high level meeting the following week.<sup>433</sup> The proposed agenda included: Orange’s request for a package of premium channels, which Sky had offered to supply by retail and which was now being “progressed” (this excluded movie channels, which Orange did not want); Sky’s offer of its basic channels via wholesale, which offer was “not being progressed presently as Orange’s plans are evolving and its network capacity is yet to be finalised”. Also suggested for discussion at the meeting were Sky’s three suggested alternative (but not mutually exclusive) approaches for “wider cooperation”: Sky could provide all linear and VOD content for Orange’s IPTV service; Sky could provide its proposed DTT premium service (Picnic) to Orange via a retail deal; Orange could market Sky’s DTH satellite service either instead of an IPTV platform or where IPTV was not

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<sup>429</sup> Darcey 1, para 564. Mr Nuttall’s email sending the draft agreement in relation to the premium channels can be seen at Sky 7/1504-1548.

<sup>430</sup> See Ofcom 5/1177 and Sky 7/1549-1551.

<sup>431</sup> Ofcom 5/1179-1180.

<sup>432</sup> Darcey 1, para 565.

<sup>433</sup> Ofcom 5/1185-1186.

available. The proposed agenda also stated that Sky and Orange had agreed the terms of a new three year deal that would see Sky's mobile football content (live and on-demand) available on the Orange mobile network via a retail deal.

432. Mr Darcey told us that on 26 October 2007 he spoke to Ms Bouverot on the telephone<sup>434</sup> about areas of possible cooperation. Mr Darcey recalled that Ms Bouverot said Orange saw itself as a (fixed and mobile) network provider rather than content provider, and that she indicated Orange was "happy" taking basic channels on a wholesale basis and premium channels by self-retail. Orange was also interested in DTT and in particular Sky's proposed Picnic offering. Mr Darcey told us that pursuant to these discussions, between October and December 2007 Sky offered a group of its customers a discounted Sky+ HD STB if they subscribed to particular Orange tariffs.<sup>435</sup>
433. Apart from the above, nothing much seems to have happened during the autumn of 2007. Mr Darcey notes in his evidence that a meeting scheduled for 30 October 2007 was proposed, but this ultimately never occurred and was postponed. He states that he, together with Ms Mai Fyfield (the head of Sky's Strategic Planning Group), did meet with Mr Bart De Roover (Orange's Vice President of International Business Development) in December 2007, although no detail was provided of the nature of that meeting.<sup>436</sup> In early January 2008 Mr Nuttall comments in an internal email "[Orange's] TV plans still seem to be very vague."<sup>437</sup> At about the same time a new team at Orange, in which Mr Anand Shah and Mr De Roover were prominent, were discussing internally how to approach changes which had recently taken place in their requirements for Sky content. An internal discussion document dated 8 January 2008,<sup>438</sup> titled "Content for IPTV from BSkyB" referred to the fact that the negotiations with Sky about content for the IPTV service had become "clouded" by the strategic partnership discussions, and that:

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<sup>434</sup> Darcey 1, para 568.

<sup>435</sup> Darcey 1, para 565.

<sup>436</sup> Darcey 1, para 568.

<sup>437</sup> Ofcom 5/1188.

<sup>438</sup> Ofcom 5/1191-1201.

“The position of the [Orange (UK)] IPTV team in terms of content and approach, in light of numerous changes both externally (notably with the announcement of Picnic over DTT from [Sky]) and internally, has evolved many times. At the end of December 07, a new set of requirements has been built by the [Orange (UK)] IPTV team which changes the stance of previous discussions with [Sky].” According to the document, one of the evolutions was that hitherto the parties had been talking about the supply of 4 channels (3 basic and 1 premium) all on a retail basis, whereas “subsequent changes in [Orange (UK)] thinking (management, market evolutions, recent market research) have been apparent since October. A revised position has now been established by [Orange (UK)] teams which puts forward two basic channels on a wholesale basis and a Sports pack on a retail basis also injecting new cost parameters for [Sky].”

The document also noted that a “response to Ofcom will be submitted with regards to the launch of Picnic... Subsequent regulatory action could be followed if [Orange (UK) / France Télécom] wished to become more aggressive towards [Sky].” That response alleged that Sky had “already (constructively) refused to provide premium Pay-TV content to Orange on a wholesale basis.”<sup>439</sup>

434. In line with its new requirements Orange began to prepare a summary of terms to reflect this changed thinking.<sup>440</sup> On 15 January 2008 Mr De Roover emailed Sky,<sup>441</sup> stating that one of the reasons Orange had not been in touch or sent a summary of terms was because they had been reviewing their approach in the light of market developments and Picnic. He now wished to proceed and to introduce the new Orange team to Sky. A meeting with Sky was fixed for 23 January 2008. On 21 January Mr Shah sent to Mr De Roover<sup>442</sup> a draft summary of terms which was said to provide “a clear indication on what [we] now want from Sky in order to get the ball rolling.” It is clear that even as late as on the morning of the meeting the draft summary of terms<sup>443</sup> provided for 2 basic channels to be supplied on a wholesale basis and a package of Sky Sports channels to be supplied on a self-retail basis.
435. The meeting on 23 January 2008 was attended by a Sky team including Mr Rey, and an Orange team including Mr Shah and Mr De Roover. Orange updated Sky on the changes to its IPTV plans which included a launch of its main service in summer 2008. Mr Shah undertook to send Sky a proposal for the scaled down

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<sup>439</sup> Ofcom 5/1141.

<sup>440</sup> Ofcom 5/1203-1216.

<sup>441</sup> Ofcom 5/1220-1221.

<sup>442</sup> Ofcom 5/1218-1219.

<sup>443</sup> Set out in an internal email sent by Bernard Guillou: Ofcom 5/1217-1218.

package of Sky channels which were now required. Mr Darcey's understanding was that the scaling back was due to capacity constraints.<sup>444</sup> An internal note of the meeting by Orange<sup>445</sup> records that there was a discussion of Picnic and Orange's interest in acquiring that package if Sky obtained clearance from Ofcom. There was also discussion about the Sky by Wire (self-retail) deal that was preferred by Sky for delivery of the Sky Sports pack. In a possible reference to a wholesale alternative Sky is recorded as stating that "if a player could make a financial proposal that ensured the outcome would drive customer numbers they would be happy to see this."

436. The promised summary of terms was delayed, and was not sent to Sky until 19 February 2008 (an internal email from Mr Nuttall on 1 February 2008<sup>446</sup> referred to the delay as "unsurprising news"). Between 23 January and 19 February 2008 the Orange proposal changed from a partially self-retail deal to an entirely wholesale one.<sup>447</sup> In that period there had also been internal discussions between the Orange negotiating team and Orange's regulatory personnel about "the Ofcom response re [Sky]".<sup>448</sup> It also appears that Orange had been contemplating whether to play the regulatory card in its negotiations with Sky, but decided that "at this stage and for now we should treat this as any standard negotiation."<sup>449</sup>
437. The Orange proposal, which was sent by Ms Angie Mee (Head of Content Acquisition at Orange) to Mr Rey (of Sky) by email on 19 February 2008,<sup>450</sup> was that the wholesale fee paid to Sky for the premium channels should be a specified percentage (90%) of the retail price charged by Orange, the level of which would be set at Orange's "absolute discretion".
438. Sky responded (by email from Mr Rey to Ms Mee) on 22 February 2008<sup>451</sup> noting that Orange had moved away from the basis of supply underpinning discussions over the previous months. Mr Rey also questioned how it was thought the proposed

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<sup>444</sup> Darcey 1, para 569.

<sup>445</sup> Ofcom 5/1229.

<sup>446</sup> Ofcom 5/1246.

<sup>447</sup> Contrast the "Deal Basis" in the document set out at Ofcom 5/1207 with that at Ofcom 5/1287.

<sup>448</sup> Ofcom 5/1237.

<sup>449</sup> Ofcom 5/1285.

<sup>450</sup> Ofcom 5/1296-1300.

<sup>451</sup> Ofcom 5/1313.

terms could work commercially and financially for Sky. Sky's concern was that the proposal would have allowed Orange to charge as little as it liked for Sky's premium channels at no risk to itself as the fee paid to Sky would fall with the retail price. Mr Darcey said in his evidence that Sky regarded this offer as wholly unrealistic and as demonstrating a lack of understanding of the commercial realities of Pay TV.<sup>452</sup>

439. Orange's initial response, in an email from Ms Mee on 25 February 2008,<sup>453</sup> was that Orange had always favoured "a wholesale/retail offering where Orange owns the customer." Her email also explained briefly the thinking behind the change of channel line up being requested. A meeting was arranged to discuss the proposal.
440. Internal documents at this time show Orange debating whether to put more regulatory pressure on Sky, and wondering when a decision by Ofcom might be available. It intended to seek an explanation from Sky as to why Sky did not prefer wholesale and on what terms it would accept it. Orange would press for wholesale but recognised that it might ultimately have to accept self-retail, at least for an interim period, in which case it would have ammunition for a regulatory argument.<sup>454</sup>
441. The meeting took place on 6 March 2008. According to two separate Orange records of the meeting,<sup>455</sup> the merits and demerits of wholesale and retail in relation to premium channels were discussed at length. Orange preferred wholesale, Sky self-retail. Sky is recorded as indicating that it was not "completely averse to wholesale for premium channels but needed to be convinced and would be looking for an MRG: they would be happy with wholesale if it gave them the same return." Sky was asked about penetration and said that "better than cable is good." When asked by Orange whether Sky itself would consider an MRG in a self-retail deal, it indicated that it would. It was agreed that Sky would send a draft contract for the wholesale of basic channels and the latest version of a contract for the self-retail of

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<sup>452</sup> Darcey 1, para 572.

<sup>453</sup> Ofcom 5/1331.

<sup>454</sup> See, for example, Ofcom 5/1343-1344; Ofcom 5/1367; Ofcom 5/1377; Ofcom 5/1383.

<sup>455</sup> Ofcom 5/1391-1393; Ofcom 5/1399-1400; a brief summary of the meeting from Sky's perspective is set out at Ofcom 5/1409.

premium channels so that Orange could understand how the arrangement worked. Orange would consider whether it wanted to make an MRG proposal in a wholesale deal. There would then be a further discussion in just over a week.

442. On 11 March 2008 Mr Middleton sent Orange<sup>456</sup> the same draft agreements which Sky had sent to Mr Overton in May 2007, expressing the view that, subject to certain necessary amendments, “the drafts reflect our current approach on all the main issues”. On 14 March 2008 the parties met again. Orange made a revised wholesale offer<sup>457</sup> in respect of Sky’s premium channels: Sky’s percentage share of Orange’s retail price was reduced from 90% to 80%, but an MRG of £2.5 million over two years was offered. In Mr Darcey’s view,<sup>458</sup> Orange did not address Sky’s concern that there was nothing to stop Orange retailing at £1 and accounting to Sky for less than 70p (ex-VAT), as compared with, for example the cable wholesale price for Dual Sports of £17.39 (ex-VAT) at the time. According to an internal Sky email circulated on the same day by Mr Middleton,<sup>459</sup> this was identified as an “obvious flaw” of the proposal at the time, and Sky is said to have told Orange that Sky would need a minimum charge per subscriber. Overall, Mr Middleton’s view of Orange’s wholesale offer was that it “hardly seems compelling”. Sky also noted that the MRG represented less than Orange had agreed to pay for Sky’s content on its mobile phone network. Sky indicated that a more formal response to Orange’s revised wholesale offer would be made.<sup>460</sup>
443. At the meeting Orange had requested a copy of Sky’s cable rate card, and this was supplied later the same day by Mr Middleton.<sup>461</sup> In his cover email, Mr Middleton stated that the rate card was being provided to Orange in order to better inform the parties’ discussions, but that its supply should not be taken as an indication that Sky was willing to do a wholesale deal for the distribution of its premium channels by means of Orange’s IPTV service. On distributing Sky’s rate card to colleagues

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<sup>456</sup> Ofcom 5/1405 (full version at Sky 8/1561-1606).

<sup>457</sup> See the proposal at Ofcom 5/1421

<sup>458</sup> Darcey 1, paras 575-576.

<sup>459</sup> Ofcom 5/1423.

<sup>460</sup> See Mr Rey’s email of 18 March 2008 (Ofcom 5/1437) in which he made it clear that Sky was reviewing Orange’s wholesale proposal and would come back to Orange the next week.

<sup>461</sup> Ofcom 5/1415-1416.

within Orange on 17 March 2008<sup>462</sup> Ms Mee commented: “This does not necessarily mean they will agree the same ... but are open to discussion.”

444. Thereafter, Orange worked through the draft contract for basic channels,<sup>463</sup> and the parties began to address the technical aspects of supplying the requested channels to Orange.<sup>464</sup> In response to a colleague’s suggestion that Sky might be dragging its feet, Ms Mee replied, also responding to a query about whether the MRG applied to the whole Sky bill (i.e. both basic and premium channels) or just premium channels:

“Surprisingly these guys have been quite good on the follow up as it was they who suggested the next meeting on 14 April ...The MG we proposed of £2.5m over 2 years is relevant to premium sports channels only. If we reach £2.5m they receive a revenue split of 80% (ex VAT) in their favour. We didn’t propose any minimum deemed fees for the premiums. It was Sky who said if they were to consider a w/sale proposal with an mg, they would have to include a minimum deemed fee otherwise we could undersell their product (which is understandable). They sent the cable rate card as a guide for a minimum deemed fee.”<sup>465</sup>

445. Sky’s more formal response to Orange’s revised wholesale offer came in the form of a letter from Mr Rey dated 10 April 2008,<sup>466</sup> ahead of a meeting scheduled for 14 April 2008. Sky provided a detailed response to Orange’s proposal for basic channels, and a shorter response in relation to premium channels. In respect of the latter, Sky reiterated that it was willing to consider a wholesale deal if supplying on that basis would create more value for Sky. Mr Rey made the additional point that the proposed MRG of £1.25m per annum equated to fewer than 6,000 subscribers per month at the rate card price (assuming all subscribers took only Dual Sports – it would be fewer still for a bundle including Sky Sports Xtra). On the basis of a planned IPTV launch nationally, including marketing to Orange’s 1.5m broadband and 15m mobile customers, this level of take up would not suggest much success in retailing Sky’s premium channels. It would not be close to cable penetration rates. Mr Rey suggested that Orange either review Sky’s self-retail proposal or significantly increase the MRG.

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<sup>462</sup> Ofcom 5/1429-1431.

<sup>463</sup> See Ofcom 5/1439-1490.

<sup>464</sup> See Ofcom 5/1487; Ofcom 5/1499-1500.

<sup>465</sup> Ofcom 5/1493-1494.

<sup>466</sup> Ofcom 5/1501-1504.

446. The immediate internal reaction within Orange (by Ms Mee<sup>467</sup>) was that the choice was between pressing Sky further on wholesale or seriously considering self-retail, in order to get the premium channels onto the Orange platform in the course of 2008. She expressed frustration that Orange could not ascertain what would be an acceptable wholesale deal to Sky even if Orange were to offer a higher MRG, as Sky had not provided any indication.
447. The same day Orange sent Sky a document containing a number of questions relating to the self-retail draft agreement sent to Orange. Sky answered these by email the next day,<sup>468</sup> and the parties met again on 14 April 2008. Orange's note of that meeting<sup>469</sup> records that Orange asked Sky what MRG was acceptable. Sky said it was difficult to answer without knowing plans for rollout, proposed retail prices, numbers, demographics etc. Each side reiterated its own better claim to act as the retailer of these channels. Little progress was made.
448. Following the meeting Orange pondered internally the options of: increasing the MRG at the risk of little or no return, playing a long game and not launching the Sky channels that year, or adopting self-retail and picking up regulatory issues after launch. The regulatory team considered there was mileage in pushing for wholesale now, as it was in Sky's interest to give-in in order to get Picnic.<sup>470</sup>
449. Orange's formal reply following Sky's letter of 10 April 2008, and the 14 April 2008 meeting was sent on 22 April 2008.<sup>471</sup> Much of the letter related to the supply of basic channels; in relation to premium channels, Orange stated that the MRG offered was one that Orange felt comfortable with although they expected to exceed that amount, so that "overages" at 80% would become payable to Sky. If something similar to the cable rate card were payable Orange would need to ensure a margin which would be difficult as the rate could fluctuate. Orange was unsure what MRG would be acceptable to Sky. Orange was also unsure of the penetration levels expected on self-retail versus wholesale. The penetration level on DTH satellite did

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<sup>467</sup> Ofcom 5/1509.

<sup>468</sup> Ofcom 5/1513-1519.

<sup>469</sup> Ofcom 5/1529-1531.

<sup>470</sup> Ibid.

<sup>471</sup> Ofcom 5/1569-1572

not appear to be an appropriate comparator. Orange needed a response on this point at the next meeting in order to decide between self-retail and wholesale. In the meantime Orange would respond further when it had reviewed the draft agreements and thought further about the way forward on premium channels.

450. By email of 25 April 2008 Ms Mee sent Sky a number of questions about the self-retail proposal, and how it would work in practice.<sup>472</sup> She stated that data control was the issue about which Orange was most concerned, and suggested a possible way to address it, asking for Sky's comments on the proposed solution. Internal emails over the next few days show Orange exploring the self-retail deal.<sup>473</sup> On 2 May 2008 Ms Mee asked Mr Rey for a specimen of a Sky retail customer agreement to assist Orange in its review of the self-retail model, which was provided the same day.<sup>474</sup> An Orange internal assessment dated 15 May 2008,<sup>475</sup> as part of its planning for a further meeting with Sky on 22 May, indicated that, despite its preference for a wholesale deal, Orange may be taking forward only the self-retail deal for premium channels. There appeared to be no consideration of making an improved wholesale offer to Sky.
451. On 21 May 2008 Sky sent answers to the questions posed by Orange about the working of a self-retail arrangement.<sup>476</sup> Sky also suggested some wording for a restriction on Sky's ability to carry out marketing and promotion of telephony and broadband services to Orange's customers. A meeting took place the next day, and thereafter Orange internal emails show the company continuing to work through the detail and practicalities of the draft agreements for both wholesale supply of basic channels and self-retail of premium channels. Orange was planning to send a re-draft of the self-retail agreement to Sky on 13 June 2008.<sup>477</sup> In fact only the marked-up draft agreement for basic channels was sent that day, and the covering email said that Orange would respond on the self-retail draft the following week.<sup>478</sup>

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<sup>472</sup> Ofcom 5/1585.

<sup>473</sup> See for example Ofcom 5/1589-1609.

<sup>474</sup> Ofcom 5/1619-1624.

<sup>475</sup> Ofcom 5/1653-1660.

<sup>476</sup> Ofcom 5/1667-1670.

<sup>477</sup> Ofcom 5/1729.

<sup>478</sup> Ofcom 5/1739.

An internal comment from Orange (France) to Mr Shah on 18 June 2008<sup>479</sup> stated: “Apparently discussion [sic] are progressing well with Sky in UK.” On 30 June 2008 Mr Shah emailed Sky to say that he hoped to have a redraft of the self-retail agreement available soon.<sup>480</sup> On 15 July 2008 Orange informed Sky<sup>481</sup> that it would be a further couple of weeks before the redraft of the agreement was ready and suggested that the parties press ahead separately with the deal for basic channels. On 31 July 2008, Orange responded to an Information Request from Ofcom. In the confidential Response Orange stated that Sky’s approach to the negotiations amounts to a constructive refusal to supply its TV content by wholesale, and that – despite Orange’s objections and stated requirement to secure wholesale supply – Sky had continued to push negotiations towards supply under its Sky by Wire model. Meanwhile progress continued on the agreement for basic channels.

452. Mr Darcey stated in his evidence that Orange never came back to Sky with the promised comments on the self-retail draft agreement, and in November 2008 there were reports in the press that with a change of CEO at Orange (UK), its roll out of an IPTV service was likely to be shelved. Orange (UK)’s new CEO had apparently told Reuters that the planned service was too similar to BT Vision’s, and that different business models would be considered, including mobile TV.<sup>482</sup>
453. In an internal presentation containing “preliminary conclusions” in December 2008 Orange referred to “UK TV market: a “locked” market landscape”.<sup>483</sup> The presentation went on to describe what it meant, describing “FTA controlled by public service broadcasters” and “pay TV controlled by BSkyB”. It referred to Sky having a “stranglehold on premium content rights (sports and movie)” and speculated that certain “expected discontinuities” could unlock the market within five years; these were: the DTT upgrade from Freeview to Canvas, regulatory action in the form of a WMO, and further development of catch-up, i.e. non-linear, TV. The presentation identified an opportunity for Orange to reach a preferential wholesale deal with Sky for its premium content prior to the imposition of a WMO,

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<sup>479</sup> Ofcom 5/1743.

<sup>480</sup> Ofcom 5/1813.

<sup>481</sup> Ofcom 5/1815.

<sup>482</sup> Darcey 1, paras 580, 582; Sky 8/1462-5.

<sup>483</sup> Ofcom 5/1847-1856.

as part of a wider TV offering. The presentation appeared to be seeking approval to explore this, among other options.

454. Almost the final contact between Orange and Sky was an email from Ms Mee on 19 December 2008:<sup>484</sup> “I thought it was time we owed you an update following our discussions in the summer. Apologies this has taken longer than expected but this has been caused by internal delays and we’re expecting an outcome in the New Year. Let’s pick up again in 2009.”
455. On 19 March 2009 Ms Mee emailed Sky again:<sup>485</sup> “As we have been discussing terms with you for a number of months, I wanted to update you on our position regarding our digital TV product. Regrettably, at this time, we are not proceeding with a digital TV product and therefore we are not in a position to progress discussions further. I realise that this is disappointing given the level of mutual effort that has been invested to date but due to a number of factors, we have decided to take this course of action.” In a confidential internal email to the Consumer Business Unit sent on 12 March 2009<sup>486</sup> (and subsequently forwarded to Ofcom for its information on 12 May 2009), Orange expanded on the factors leading to its decision. These included “...cost and associated pay-back, an incredibly aggressive marketplace and the current UK economic environment...”.

### ***The Tribunal’s discussion and conclusions***

456. A number of specific issues raised in the course of evidence and argument call for comment. We will deal with these under the following headings:
- (a) 2005 discussions and Sky’s initiation of discussions in 2006.
  - (b) Sky “refusal” to wholesale in July 2006?
  - (c) Sky should have identified/negotiated wholesale terms earlier?

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<sup>484</sup> Ofcom 5/1889.

<sup>485</sup> Ofcom 5/1909.

<sup>486</sup> Ofcom 5/1905-1906.

- (d) Sky's letter shows it wanted to avoid giving other operators access to its channels?
- (e) Sky's approach to negotiating supply of premium and basic channels were different?
- (f) Sky did not provide Orange with appropriate guidance on price etc?
- (g) How committed was Orange?

We then refer to Ofcom's reliance in the Statement upon the negotiations between Sky and Orange.

#### 2005 discussions and Sky's initiation of discussions in 2006

457. On more than one occasion in the course of her closing submissions Ofcom's leading counsel submitted that, although one would have expected to see Sky seeking to widen the distribution of its channels and thereby increase the company's profits, Sky never proactively approached any other party to negotiate supply of its premium channels whether by wholesale or self-retail.<sup>487</sup> Dr Unger, in his evidence, also treats the June 2006 contact as having been initiated by Orange rather than by Sky.<sup>488</sup> However, this does not appear to be accurate. Although we cannot be sure who originally approached whom in 2005, the initial meeting was held in Paris which suggests that the invitation may have come from Orange; however, the presentation shows that Sky made a fairly enthusiastic pitch to Orange. More to the point, the evidence concerning the contact in June 2006 appears to controvert counsel's submission. Mr Nuttall contacted Orange immediately after the latter's public announcement of a possible Pay TV launch, to see if Orange was interested in reviving the discussions about supply which had taken place about six months earlier in 2005.<sup>489</sup>

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<sup>487</sup> Transcript 34/95:5-6; Transcript 35/6:14-20.

<sup>488</sup> Unger 1, para 319.

<sup>489</sup> See para 409 above.

458. Ofcom also submits that there was no evidence that the parties “commenced negotiations” prior to June 2006, nor of any “mutual understanding” as to the nature of the agreed supply arrangement at that time.<sup>490</sup> Dr Unger refers to the 2005 discussions and to Mr Nuttall’s email of 5 June 2006, but appears to attach little significance to either, describing these contacts as “limited” and “preliminary”.<sup>491</sup> However, it is clear that - at Orange’s suggestion - the 2005 discussions were about a possible self-retail deal; and self-retail still seems to have been the model which Orange was interested in pursuing in early June 2006 when contacted by Mr Nuttall.

#### Sky “refusal” to wholesale in July 2006?

459. In the course of her cross-examination of Mr Darcey,<sup>492</sup> and afterwards in submissions,<sup>493</sup> Ofcom’s leading counsel referred to an issue which arose in the correspondence between Mr Nuttall (of Sky) and Mr Abensur (of Orange). The issue was whether Mr Abensur was accurate in stating in his letter of 9 August 2006 that at the meeting on 28 July 2006 Mr Nuttall had “refused” to offer a wholesale deal to Orange. Mr Nuttall had written to Mr Abensur on 9 October 2006 rebutting that assertion (paragraph 417 above). The main points made by Ofcom’s leading counsel were (1) that Mr Abensur’s letter dated 9 August 2006 in fact accurately reflected what was said at that meeting, as revealed in the parties’ written records, and it was therefore significant that Mr Nuttall wanted to rebut it; (2) in his internal email dated 10 August 2006 Mr Nuttall indicated that Mr Abensur’s assertion should be rebutted “for the record” but did not actually state that it was inaccurate; (3) that Mr Nuttall’s alleged explanation to Mr Darcey (as set out in Mr Darcey’s third witness statement at paragraph 553) of the reason why he had “declined” to make Orange a wholesale offer when requested, namely that he was not prepared to be “ambushed” at a meeting which had been set up to discuss a self-retail proposal, was untrue. This was because it was clear that Mr Nuttall had been aware since Orange’s letter of 21 June 2006 that Orange wanted to discuss wholesale. Moreover, this was not the reason given in Mr Nuttall’s internal email of 28 July

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<sup>490</sup> Ofcom written closing submissions, Part 1, Annex 3, para 329.

<sup>491</sup> Unger 1, paras 325 and 395.

<sup>492</sup> Transcript 7/80:3-94:2.

<sup>493</sup> Transcript 35/26:25-47:20; Ofcom written closing submissions, Part 1, Annex 3, paras 259-269.

2006. It followed, Ofcom's leading counsel submitted, that either Mr Darcey was naïve in accepting Mr Nuttall's explanation in the face of the documentary evidence to the contrary, or Mr Darcey's evidence about his conversation with Mr Nuttall was untrue.

460. As to point (1), we consider that the position Mr Nuttall took at the meeting, as revealed by both parties' contemporaneous records, was more nuanced than one would assume from the account in Mr Abensur's letter of 9 August 2006. Although Orange's detailed minute records that Sky "did not want to do a wholesale deal as this could be used as a precedent for other IPTV providers", it also notes that when specifically asked whether the only option for Orange was self-retail Mr Nuttall replied that Sky "prefers" a partnership arrangement of that kind. Later in the discussion Mr Nuttall again refers to self-retail as the "preferred" model. Similarly, Mr Nuttall's own contemporaneous record confirms that he "explained our clear preference" for this model, and Sky's "reluctance" to do a wholesale deal. In our view it is in this context that one should read his words: "I was invited to make them a wholesale offer that would work for us. I declined given that ....we believe a retail deal works best and would like to explore the options for that." The impression conveyed is that Mr Nuttall was expressing reluctance to agree to supply by wholesale, much preferring self-retail, and was not willing to get into the detail of what a wholesale offer might look like before the self-retail model had been "explored". In other words the possibility of a wholesale deal was not necessarily being excluded, but Sky wished to see whether an acceptable retail deal could be reached first. By contrast the language of Mr Abensur's letter paints the picture of an outright refusal to wholesale.

461. As to point (2), in the light of the above it is understandable that Mr Nuttall should wish to place on record that Sky had not refused to wholesale, particularly given Sky's sensitivity to the regulatory background. His caution was perhaps justified in the light of Mr Abensur's next letter of 2 January 2007 which, as seen, was expressed in lawyers' language and asserted that refusal by Sky to wholesale its premium channels to Orange on fair, reasonable and non-discriminatory terms would amount to an abuse of a dominant position.

462. As to point (3), it is correct that Mr Nuttall was not “ambushed” in the sense of being taken by surprise by the subject of wholesale supply being raised by Orange at the meeting on 28 July 2006. He had been aware since 21 June 2006 or thereabouts that the issue was likely to be raised. However we do not consider that this is the sense of what Mr Darcey is attributing to Mr Nuttall in the passage in question in his third witness statement. In his first witness statement Mr Darcey had already referred to the fact that the July meeting had been set up on Sky’s initiative in order to reactivate the 2005 discussions about self-retail, and that the “volte face” letter of 21 June 2006 had come as a surprise.<sup>494</sup> In his third witness statement he said: “Sky believed that the meeting had been set up to discuss the self-retail proposal. Sky was therefore keen to ensure that this was the discussion that took place at that meeting and Mr Nuttall was not willing to be ambushed and required to produce an alternative proposal off the top of his head.”<sup>495</sup>
463. We do not read that as Mr Nuttall suggesting that he was surprised at the subject of wholesale being raised by Orange. We read it rather as Mr Nuttall meaning that the meeting had been suggested and set up by Sky in order to discuss a self-retail arrangement and not wholesale, and that he had not come prepared to discuss the latter. It should be borne in mind that this was the first meeting between the parties since Orange changed its mind about self-retail. Both sides were negotiating hard for the model they wanted, and one can appreciate that at this stage neither party would wish to send a signal that it was ready to concede the other party’s preference. It is interesting to note that when a few months later Sky was negotiating with BT, as soon as Sky indicated to BT the terms of an alternative wholesale deal, BT never reverted to a discussion of self-retail although it remained Sky’s preference.
464. We do not therefore consider that Mr Darcey was either naïve or untruthful in the respects suggested by Ofcom’s leading counsel. The point made against him was not in our view a good one.

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<sup>494</sup> Darcey 1, paras 554-556.

<sup>495</sup> Darcey 3, para 553.

Sky should have identified/negotiated wholesale terms earlier?

465. In his evidence Dr Unger seems at times to suggest that in the face of a request for wholesale supply, Sky should have identified at an early stage the wholesale terms on which it might be willing to supply Orange, and should have engaged in wholesale negotiations, rather than first seeking to persuade Orange to adopt a self-retail model.<sup>496</sup>
466. We do not consider that such an approach would have been at all realistic in a tough commercial negotiation of this kind for the reasons given above. As already noted, in the BT discussions the dynamic of the negotiation changed significantly once Sky had identified the terms on which it would consider wholesaling. Further, there is a tension between Dr Unger's comments and what is said in the Statement. In the latter Ofcom appears to accept that "other parties' preferred form of supply should not automatically take precedence over Sky's preferences", and states that Ofcom has "not suggested that where it has not been possible to agree a retail deal Sky should offer a wholesale deal immediately and without further negotiation."<sup>497</sup> In other words the Statement acknowledges that Sky, as well as its counterparty, is entitled to seek to persuade the other to agree to its preferred supply model.
467. This being so, two points should be made. First, the opportunity to persuade must surely be commercially realistic rather than just a formality. It must be expected that, as a hard-headed commercial enterprise, Sky will use negotiating tactics which entail a positive chance of success, rather than doom it to failure. It is unrealistic to expect Sky (or the other party) to cave-in at the first sign of resistance. Second, for substantial periods in the course of the negotiations Orange gave the appearance of being either persuaded, or at least still very much open to persuasion, so far as self-retail was concerned. We have already referred to the 2005/6 self-retail discussions prior to Mr Abensur's letter of 21 June 2006. When talks were resumed with a different Orange team in February/March 2007, it is clear that self-retail was very much back on the table in the context of a possible overarching strategic

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<sup>496</sup> See, for example, Unger 1, paras 328, 329, 336 and 340.

<sup>497</sup> Statement, paras 7.72 and 7.73.

relationship. From this time onwards Sky believed (a belief expressed internally on several occasions) that if Orange went ahead with its plans for an IPTV platform – which was increasingly in doubt so far as Sky was concerned – self-retail of premium channels would be acceptable to Orange. Orange seems to have allowed Sky to continue to believe this throughout the remainder of 2007 right up until February 2008 – a period of approximately one year. Indeed, in late January 2008 Orange (UK) itself appears to have been making preparations for a self-retail deal with Sky. However, in February 2008, after yet further changes of personnel and evolution of its channel requirements, Orange reverted to a wholesale proposition. There may have been some discussion of a wholesale alternative at the meeting on 23 January 2008, but the first clear proposal by Orange was made on 19 February 2008.

468. The wholesale proposal put forward by Orange on 19 February 2008 does not seem to have been acceptable on any view, and the revised version of 14 March 2008 was not much more appealing. There is some acknowledgment of this on the part of Orange itself. Ms Mee of Orange commented internally that it was “understandable” that Sky should want a minimum per subscriber fee for its premium channels in case of underselling by Orange (see paragraph 444 above), but Orange never offered one. Dr Unger accepted that an average of 6,000 subscribers per month (i.e. the number Sky derived from the MRG of £1.25 million per annum for two years) would be an “unimpressive” performance.<sup>498</sup> Orange was invited by Sky to increase the MRG, but did not do so, although it expressed the expectation that Orange’s performance would exceed that implied by the existing MRG offer.
469. Given the circumstances, it would hardly be surprising if Sky believed that it was worth continuing to pursue their preferred self-retail model.

Sky’s letter shows it wanted to avoid giving other operators access to its channels?

470. In his evidence Dr Unger described as “significant” one of Sky’s principal concerns with the wholesale model of supply, which Sky had identified in its letter to Orange of 8 February 2007. The concern in question was that the mere availability of Sky

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<sup>498</sup> Unger 1, para 383(b).

channels on a platform had considerable value to the platform operator which was “difficult to capture through a per subscriber charging mechanic or the imposition of enforceable marketing obligations”, and that the self-retail model provided Sky with the best opportunity to maximise its revenues. (See paragraph 419 above.) Dr Unger said that this “suggests that Sky wanted to avoid giving other platform operators access to its channels because this would make them stronger players in the retail market.”<sup>499</sup>

471. With great respect to Dr Unger, we do not see how that suggestion can be derived from Sky’s remark. Sky is arguing that there is an inherent value in having the Sky premium channels on one’s platform, and that the self-retail model is better placed than the wholesale model to enable Sky to maximise a return from the supply of that valuable asset. Sky’s remarks are comparing, from Sky’s perspective, the two alternative models of giving access; the remarks are not comparing access with non-access; still less do they provide any basis for the suggestion that Sky “wanted to avoid giving other platform operators access”. As has been seen, the evidence relating to the negotiations with Orange show that in June 2006 Sky was sufficiently interested in making its premium channels available on Orange’s planned platform that it took the initiative in approaching Orange with that aim.

Sky’s different approaches to negotiating supply of premium and basic channels?

472. Dr Unger draws attention in his evidence<sup>500</sup> to the fact that in attempting to reach agreement for the supply of basic channels the parties moved closer together than they did in the case of premium channels. Mr Darcey responded by pointing out that channel providers and broadcasters do not have the same concern about platform operators underperforming in relation to basic channels, provided they are included in the most widely distributed and popular basic package. This, said Mr Darcey, was emphatically not the case with premium channels, which in Sky’s case are sold on an à la carte basis. It is a major concern for producers of such channels

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<sup>499</sup> Unger 1, para 345.

<sup>500</sup> Unger 1, paras 380-382.

to ensure that selling effort is expended to drive take up. This was one reason why Sky preferred self-retail.<sup>501</sup>

473. We are not sure where this particular issue takes one. It is clear that Sky's premium channels are different from its basic channels. Indeed the whole basis for the Statement and WMO is that they are different and that access to the premium channels is necessary for a viable Pay TV offering. They are undoubtedly very expensive for Sky to produce in terms of content acquisition, and represent the Crown Jewels of Sky's service. It would therefore be surprising if Sky did not adopt a different approach to their supply to other platforms.

Sky did not provide Orange with appropriate guidance on wholesale price, appropriate comparators for penetration rate, etc?

474. In this connection Dr Unger also made a number of comments on Sky's letter to Orange of 10 April 2008, in which Sky explained its reasons for rejecting the revised wholesale offer made by Orange at the meeting on 14 March.
475. First, Dr Unger stated that it was not clear against what benchmark Sky was indicating that an appropriate MRG should be identified.<sup>502</sup> If its purpose was to ensure that fixed costs were covered, then the MRG could be set well below the expected level of take up. On the other hand if it was to ensure that Orange's performance as a retailer was as good as Sky's would be in a self-retail deal, then Sky ought to have told Orange what it considered it could achieve itself. Dr Unger stated that Sky did not do this, nor did it provide any guidance on what a minimum charge per subscriber should be, despite having indicated to Orange that such a charge would be required.
476. Dr Unger's criticism seems misplaced in that on 14 March 2008 Sky provided Orange with the cable rate card "so as to better inform our discussions". Ms Mee acknowledged to her colleagues at Orange that "[Sky] sent the cable rate card as a guide for a minimum deemed fee." (See above at paragraph 444.) As to the level of

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<sup>501</sup> Darcey 3, paras 554-560.

<sup>502</sup> Unger 1, para 383(a).

MRG, it is true that Sky did not name an absolute amount that would be acceptable and simply said that the MRG offered by Orange would need to be “significantly increased”. When asked about the rate of penetration required, Sky had said that “better than cable is good.” Mr Darcey makes the point that Sky had a limited understanding of Orange’s plans for its IPTV network except that it was to be on a national scale including promotion to 15 million Orange mobile users and about 1 million broadband homes. It was on this basis that Sky considered that the MRG offered represented a very low penetration rate (under 3% or 6000 premium subscribers out of 250,000 broadband customers assumed to have subscribed to Orange’s Pay TV service).<sup>503</sup>

477. Dr Unger also argued in his evidence that the appropriate comparator for penetration rates was Tiscali or Sky’s own Sky by Wire service (3,500 and 6,500 subscribers respectively), rather than Sky’s DTH satellite platform or cable.<sup>504</sup> Mr Darcey’s response was that it is not the absolute numbers of subscribers that are indicative of success, but the proportion of the total Pay TV customers on a platform who subscribe to premium channels. An approach based on absolute numbers of subscribers would not take account of, for example, the geographical extent of the platform. He also said Sky had never suggested that Orange should have to emulate the penetration achieved by Sky’s own DTH satellite platform, but he accepted that Sky would have hoped for a better rate than cable was achieving, which Sky regarded as poor. There were, he said, specific financial and technical reasons for Tiscali’s lack of success in this respect and it was not an appropriate benchmark.<sup>505</sup>

478. Again, it must be borne in mind that this was a commercial negotiation in which Sky still believed (correctly, in the light of Orange’s internal emails which indicate that they were in fact contemplating agreeing to self-retail) that there was still some mileage in continuing to push for their preferred supply model. As it happened Orange, too, was being advised by its regulatory team that it should persist in holding out for wholesale, as Sky might well concede defeat in order to obtain

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<sup>503</sup> Darcey 3, para 563.

<sup>504</sup> Unger 1, para 383(c).

<sup>505</sup> Darcey 3, para 564.

consent for Picnic. Why, it may be asked rhetorically, should it be expected that Sky would identify as the appropriate comparator a platform whose penetration rate might logically imply a lower MRG and a lower financial return for Sky, and render the wholesale model (which Sky did *not* prefer) correspondingly more attractive to Orange? To expect Sky to act in that way in negotiating with another powerful multi-national organisation seems to us to be commercially naïve.

### How committed was Orange?

479. A major theme which emerged in both Mr Darcey's and Dr Unger's evidence related to the extent to which Orange was committed to putting in place an IPTV Pay TV service in the United Kingdom, and how that commitment or lack of it affected Orange's and Sky's conduct in the negotiations, and ultimately Orange's decision not to proceed. In his first witness statement Mr Darcey summed up Sky's perception as follows:

“...there was little that was compelling about Orange's proposition. In particular, Sky had doubts throughout the negotiations about whether France Telecom/Orange was really prepared to make an appropriate investment in a UK IPTV network, given that it did not seem to be engaging with Sky as a single company or with a single objective in mind; the conversations lurched between different models with no consistency which made progress difficult and which led Sky to believe that the prospect of earning significant revenue ... under either a wholesale or a retail deal, was low. Indeed Orange's senior executives were expressing views as early as April 2007 that the service may not be technically viable ... and even the UK strategy team did not appear to be fully behind the project...

...when Orange actually made an offer to Sky of the terms on which it proposed to take wholesale supply ... that offer was wholly unrealistic ... Given the apparent lack of sponsorship for the project at a senior/parent company level, and lack of commitment to the project even in the UK team ... it seemed likely to Sky that even if the project did ever launch, it would not be a key priority of the company to invest in its success and in particular to promote take up of Sky's channels...

...periods of negotiation were interspersed with long periods in which there was no contact from Orange. Discussions were hampered by changes in Orange personnel and more than once Sky was contacted by new teams, in the last case who seemed to be unaware of the discussions that had previously happened ... What became apparent... was that those individuals involved in strategy and also those at Group level of France Telecom favoured a retail deal and, at times, a broader strategic relationship, whilst those at Orange Home UK favoured a wholesale deal...”<sup>506</sup>

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<sup>506</sup> Darcey 1, para 548.

480. In his third witness statement Mr Darcey explained how this perception of Orange's lack of commitment affected Sky's actions:

"Sky was particularly concerned that, in circumstances where it offered a wholesale deal for Sky's premium channels to a new platform, Sky would be faced with the argument by another platform operator that they too wanted to have a wholesale arrangement, because to do otherwise would discriminate against them. With such consequences in mind, it did not seem at all sensible, when Sky was unconvinced that France Telecom/Orange would ever launch an IPTV platform, to commit to a wholesale supply of Sky's CPSCs in this instance. As such Sky held out for a self-retail arrangement ... this does not mean that Sky would never have offered France Telecom/Orange a wholesale arrangement, it just meant that Sky was comfortable in holding out for a self retail deal for longer ...If France Telecom/Orange had ever demonstrated genuine commitment to launching a platform, then Sky would have needed to consider its position further. But this never arose."<sup>507</sup>

481. It is clear that, based on his own reading of the available evidence, Dr Unger did not agree with Mr Darcey's assessment of Orange's commitment. For example, he refers to documents discussed by the parties' respective technical teams in April 2008, and observes:

"The level of technical detail in these documents would suggest that Orange was serious in its proposals to launch a new platform, contrary to Mr Darcey's view..."<sup>508</sup>

Referring to Orange's internal email of 10 April 2008 (paragraph 446 above) Dr Unger says:

"Thus notwithstanding its strong preference for a wholesale deal, Orange was again prepared to consider a retail deal if this was necessary to ensure that Sky's premium sports channels were available on its proposed IPTV platform. This undermines Mr Darcey's suggestion that there was a lack of commitment to the IPTV project on the part of Orange."<sup>509</sup>

In relation to Orange's wholesale offer to Sky, Dr Unger says:

"...I do not agree that one can detect from Orange's offer a "lack of commitment to the project" as Mr Darcey suggests ...Put simply Sky did not test that level of commitment by making a counter-proposal on either the MRG or on price."<sup>510</sup>

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<sup>507</sup> Darcey 3, para 571.

<sup>508</sup> Unger 1, para 379.

<sup>509</sup> Unger 1, para 385.

<sup>510</sup> Unger 1, para 389.

Dr Unger summed up his assessment as follows:

“...the evidence does not...demonstrate a lack of commitment on Orange’s part. On the contrary, it sought to engage with Sky over a period of between 18 and 24 months. During that time, it made a series of requests for wholesale supply. Moreover, despite its strong resistance to a self-retail deal it was prepared to negotiate on that basis once it came to believe that this was the only way it could “get these channels on the Orange UK platform this year.” To my mind a company that lacked commitment would have been unlikely to expend such time and effort, or make such concessions, in an attempt to conclude an agreement.”<sup>511</sup>

482. On carefully reviewing the evidence and in particular the contemporaneous documents, we prefer Mr Darcey’s assessment to that of Dr Unger. Although the various teams who had conduct of the project in the UK were clearly very much engaged in seeking to progress it, we are left with a clear impression that Orange as a Group was never completely committed to the project in the sense of having unequivocally decided to implement it. It is clear that over the course of the negotiations it was not just the Orange personnel dealing with Sky who had been subject to repeated change. Orange’s ideas about what they wanted to achieve in the UK, and about what they wanted from Sky, had been subject to, in Orange’s own words, “numerous changes” and “evolved many times”. This had resulted in “a new set of requirements ... which changes the stance of previous discussions with” Sky. (See paragraph 433 above.) Orange acknowledged that the negotiations with Sky had become “clouded” by discussions relating to a possible strategic alliance with it.
483. This reference to the strategic alliance is significant. When in February 2007 Sky was approached by a new Orange team headed by Mr Overton, with a view to exploring such an alliance, Mr Darcey told us that some of the possibilities being discussed implied that Orange might not go ahead with its own UK platform, and the fact that Sky held this belief is confirmed by an internal report of 4 April 2007 by Mr Nuttall (see paragraph 423 above). Further, according to Mr Darcey, Mr Ahuja (CEO of Orange (France)) had stated at a meeting that there were technical issues with the copper network and a UK launch was a “low probability”.<sup>512</sup> Mr Nuttall’s internal note of 19 April 2007 records it as “entirely possible that in view

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<sup>511</sup> Unger 1, para 403.

<sup>512</sup> Darcey 1, paras 560-563.

of technical concerns and time to market Orange will scrap its IPTV plans and go with a Sky solution instead.” (See paragraph 425 above.) In January 2008, at the point when a different Orange (UK) team with new requirements were about to come on the scene, Mr Nuttall observed in an internal report that Orange’s “TV plans still seem to be very vague”. (See paragraph 433 above.) In his witness statement Mr Darcey stated that Orange did not order or even specify the STBs they were intending to use for the delivery of the IPTV service, and that in his view the plans did not progress beyond infancy.<sup>513</sup>

484. We note Ofcom’s submission<sup>514</sup> that it would have been unreasonable for Sky to expect Orange to have ordered STBs before commencing wholesale supply (without any assurance of acquiring content). However, we still find in light of the evidence that Sky had good reason to doubt, and did doubt, whether this project would ultimately go ahead, notwithstanding the efforts and enthusiasm of the Orange teams on the ground in the UK.
485. In his evidence Dr Unger referred to the Orange internal presentation of December 2008 (see paragraph 453 above). He said that the reference to Sky having a “stranglehold on premium content rights (sports and movie)” suggested that “the difficulties experienced by Orange in obtaining access to Sky’s premium channels were a contributing factor in Orange’s decision not to proceed with its IPTV platform (although clearly there were other factors involved).”<sup>515</sup>
486. Dr Unger’s interpretation is not necessarily inconsistent with the “stranglehold” comment mentioned in the document, although the overall approach of the document is rather wider in content. It suggested that there was scope for a “preferential wholesale deal” with Sky in the window before the anticipated WMO made such a deal available to all-comers, and sought approval to explore such a deal. Given that Orange was pushing at an open door so far as obtaining access to Sky’s channels on a self-retail basis was concerned (with wholesale supply also at least on the cards as an alternative model), and given also that Orange apparently believed that a WMO was likely to materialise in due course, it would be surprising

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<sup>513</sup> Darcey 3, paras 566-568.

<sup>514</sup> Ofcom’s written closing submissions, Part 1, Annex 3, para 340.

<sup>515</sup> Unger 1, para 407.

if Sky's stance in the negotiations had been a material factor in Orange's decision not to proceed at all. Rather, we consider it likely that the doubts expressed by Orange at a senior level about the viability from a technical and a commercial point of view of an Orange IPTV platform in the UK, ultimately prevailed. We observe that Orange made no attempt to take advantage of the interim relief application before the Tribunal, nor has Orange participated in the substantive proceedings. We note too Mr Darcey's evidence of his conversation in October 2010 with Mr Bruno Duarte, head of Orange's fixed broadband operation.<sup>516</sup> Mr Duarte's comments indicate that Orange's reasons for abandoning the project were entirely extraneous to the specific negotiations with Sky. That is consistent with the view we have formed in the light of the evidence.

#### Ofcom's reliance in the Statement upon the negotiations between Sky and Orange

487. In the light of our findings on these issues arising out of the negotiations with Orange, we turn to consider the Statement in so far as Ofcom places reliance on them in section 7.

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<sup>516</sup> Darcey 3, para 537.

*Statement, paragraphs 7.61-7.63;*<sup>517</sup> *Figure 108*<sup>518</sup>

488. Bearing in mind that these paragraphs are in a very summarised form, they are generally accurate. However it may be noted that Sky's ground for rejection of Orange's wholesale offer of April 2008 was not just "that it would prefer a retail deal" (7.62) or "that Sky By Wire deal would be higher value" (Figure 108). Sky stated at the time that Orange's wholesale offer did not make commercial sense in its own terms, in that the MRG implied very low penetration levels and no minimum per subscriber charge to protect Sky against the risk of underselling was offered.

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<sup>517</sup> Para 7.63 of the Statement is set out at para 306 above. Paras 7.61-2 of the Statement provide as follows:

"7.61 While in some cases, discussions for wholesale supply have restarted, and are ongoing, to date agreements for the wholesale supply of Sky's premium content have not been concluded.

· A potential IPTV entrant [Orange] and Sky negotiated for between 18 and 24 months from around June 2006 for a supply agreement of basic and premium channels over the potential IPTV entrant's [Orange] digital platform. The potential IPTV entrant's [Orange] preference was to lead with a sports channel offering, followed by movies and basics offerings. It also preferred to enter into a wholesale supply agreement, whereas Sky's preference was a retail option, that is, providing its channels to the potential IPTV entrant [Orange] via its Sky By Wire (SBW) service. Sky indicated that it would be willing to negotiate a wholesale deal for the supply of its basic channels, but this did not materialise for a variety of reasons. Sky did not reject outright the potential IPTV entrant's [Orange] request for a wholesale deal for its premium channels. However, because of Sky's clear preference for a retail deal, the parties entered into negotiations on that basis. In March 2009, the potential IPTV entrant [Orange] advised Sky that it would not be proceeding with a digital TV product, due to a number of factors, and no agreement was reached.

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7.62 Figure 108 provides specific examples of:

- Retailers asking Sky for wholesale access to its Core Premium channels (BT Vision in February/March 2007, June 2007, December 2007; [Orange] in June 2006, January 2007, February 2008; Top Up TV in March 2006, May 2007; Virgin Media in May 2007, June 2007).
- Sky responding to such requests with counter-offers to retail its channels on the provider's platform, or rejecting specific proposals on the grounds that it would prefer a retail deal (to BT Vision in August 2007, October 2007, March 2008; to Virgin Media in June 2007, August 2007).
- Sky pointing out that it was not ruling out the possibility of a wholesale arrangement (to BT Vision in August 2007; to [Orange] in October 2006, February 2007, March 2008).
- Sky using the rate-card, implicitly or otherwise, as a basis for wholesale price negotiation (to BT Vision in January 2008; to [Orange] in March 2008)."

<sup>518</sup> Figure 108 of the Statement is too detailed to set out in this judgment but is summarised in para 7.62 of the Statement, set out in the previous footnote.

*Statement, paragraph 7.69*<sup>519</sup>

489. In that paragraph Ofcom stated that the outcome of Sky's response to requests for wholesale supply:

“...has been a collapse of negotiations. Sky has not attempted to negotiate wholesale supply arrangements after it has become clear that providers were not going to accept a retail agreement with Sky.”

490. This does not in our view reflect what happened so far as Orange is concerned. The negotiations with Orange did not “collapse”, but were progressing up to the point where a decision was made by Orange at Group level to abandon the whole project for reasons unrelated to the negotiations. Therefore the point was never reached where it became clear that a retail deal would not be achieved; at the point of abandonment a retail deal was still being actively considered by Orange. Thereafter there was no possibility of any deal whether wholesale or retail, and so the implied criticism of Sky is misplaced.

*Statement, paragraph 7.77*<sup>520</sup>

491. For the same reasons, the Orange negotiations cannot provide support for Ofcom's finding in this paragraph that:

“Even if Sky's preference for retail supply over wholesale supply can be justified by legitimate commercial considerations, we consider that Sky's actions indicate that it has a preference for **no** supply to third party retailers rather than wholesale supply.”

492. The abandonment of the project occurred before any such question arose. We do not believe that on the available evidence one could justifiably assume that, had the negotiations reached the point where it was clear that self-retail was not going to be agreed, Sky would not then have offered a wholesale deal. On the contrary, in our view the evidence tends to indicate that, as in BT's case, Sky might well have done so. The regulatory team and others at Orange apparently took the same view on more than one occasion (see paragraphs 448 and 453 above).

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<sup>519</sup> Set out at para 306 above.

<sup>520</sup> Set out at para 306 above.

*Statement, paragraphs 7.103-104*

493. A similar point may be made in respect of paragraphs 7.103-4, which state:

“7.103 However, in our view, Sky faces a considerable static cost in not being present on other platforms. Nonetheless, the prospect of those other platforms accepting Sky as a retailer appears very unlikely. This suggests that whatever reasons Sky has for resisting wholesale agreements, such a position is unlikely to be due to an expectation that it will soon be allowed to retail on these platforms. Therefore, we consider that notwithstanding the considerable static cost in not being present on other platforms, it appears that Sky would prefer to be absent from a platform than to wholesale.

7.104 **Our view:** We therefore conclude for the reasons set out above that, while Sky may have an interest in retailing on other platforms, the failure of negotiations for wholesale supply cannot reasonably be attributed to this preference.”

494. Again, the evidence relating to the Orange negotiations provides no support for these conclusions. There was no “static cost” in relation to Orange’s platform because in Sky’s view there was a considerable question mark over the existence of that platform from the early stages of the discussions with Orange. The evidence also contradicts Ofcom’s finding that Sky was unlikely to have had any expectation of being able to agree a retail deal with Orange. Subject to its doubts about the project going ahead at all, Sky’s internal communications clearly indicate that it believed there to be a reasonable prospect that Orange would reach a retail agreement with Sky. Indeed, Orange (UK) was still very much contemplating such a deal when the plug was pulled on the project. It follows that the circumstances of the Orange negotiations do not advance Ofcom’s case that Sky preferred absence rather than agree to wholesale. The conclusion in paragraph 7.104 equally has no bearing on Orange’s case.

*Statement, paragraphs 7.167-9; 7.195*

495. No support for these important conclusions<sup>521</sup> is provided by the evidence relating to the negotiations with Orange. In this case there was no question of Sky choosing to remain absent from a platform, or “allowing negotiations to break down”, rather

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<sup>521</sup> For Statement, paras 7.167-9, see para 170 of this judgment. Statement, para 7.195 is in the following terms: “When it is clear that a third party will not accept a retail deal, Sky has allowed negotiations to break down rather than seeking to negotiate terms for wholesale supply. On the basis of this evidence, we consider that if there is no prospect of a third party agreeing a retail deal, Sky would rather be absent from that party’s platform indefinitely than agree to a wholesale deal.”

than negotiating on wholesale. The platform did not exist and its coming into existence was in doubt throughout most of the negotiations. From Sky's perspective if the platform was to materialise there was still a reasonable prospect of a self-retail deal being agreed. We do not consider that the absence of a wholesale supply agreement with Orange can be attributed to Sky's conduct, any more than the absence of a self-retail agreement can be so attributed. The reason there was no agreement of any kind is first and foremost because Orange decided that there was to be no platform.

***Tribunal's observations on the negotiations with TUTV, BT and Orange***

496. At this stage we have considered three out of the four sets of negotiations which together form the essential foundation of Ofcom's competition concerns and of the WMO. These three platforms, TUTV, BT and Orange, are in a different position from VM and its corporate predecessors, in that at the time the Statement was published Sky was not already supplying the premium channels to them, whereas the cable companies had been in receipt of wholesale supply for many years. As can be seen from our detailed conclusions earlier in the judgment, the evidence relating to the negotiations with TUTV, BT and Orange, far from providing support, shows that a significant number of Ofcom's pivotal findings in the Statement are wrong. The findings in question relate in particular to the conduct and motivation of Sky and its counterparties in the context of the negotiations, and to the reasons for their breakdown or the failure of the negotiating parties yet to reach a supply agreement for access to Sky's premium channels. Nor in our view does the evidence which we have considered up to this point enable an inference properly to be drawn that Sky preferred its premium channels to be absent from the platforms of other operators rather than grant wholesale access to them, or that in conducting such negotiations it was acting on the alleged strategic incentives rather than for ordinary profit/revenue maximising commercial motives. Clearly our findings so far are significant. However, it is appropriate to draw final conclusions on these issues once we have examined the evidence relating to the negotiations with the cable companies. We therefore turn to that now.

E. COMPETITION CONCERNS RELATING TO VM AND ITS CORPORATE PREDECESSORS: COMMERCIAL NEGOTIATIONS ABOUT NEW SERVICES AND EXISTING TERMS OF SUPPLY

497. In this section E we consider the negotiations that took place between Sky and VM (and its corporate predecessors Telewest and ntl). These negotiations were about certain innovative features of Sky’s premium sports channels, and also involved attempts to reach agreement on new wholesale arrangements, including a proposed price discount structure which would have provided for performance-based reductions in the rate card price. In section F we consider Sky’s challenge to Ofcom’s findings about the level of the rate card price itself.

498. Where it is not important to distinguish between them, we will refer to one or more of VM, Telewest and ntl as “the cable companies”, “the cable operators” or simply “cable”.

499. Like BT, VM brought its own appeal in respect of the Statement (described in section III above), and intervened in support of Ofcom in connection with the practices identified by Ofcom as competition concerns.

500. As with the other sets of negotiations, a large amount of documentary and other evidence was put before us concerning the commercial discussions between Sky and the cable companies and also the wholesale prices charged to those companies. The Tribunal heard oral evidence, in particular, from:

(a) Dr Unger of Ofcom (see paragraph 195(a) above).

(b) Mr Darcey of Sky (see paragraph 195(b) above).

(c) Ms Katharine Burns, Executive Director of Multi-screen Content Acquisition at VM, and formerly Managing Director of Content Acquisition and Strategy (from January 2007). Ms Burns joined Telewest in November 1999, prior to its merger with ntl in 2006 and the later rebranding to VM.

Ms Burns filed four witness statements in these proceedings, and gave evidence on day 10 of the hearing.

(d) Mr Richard Guest, VM's Director of Commercial and Customer Strategy (since September 2008). Mr Guest filed four witness statements in these proceedings, and gave evidence during day 11 of the hearing.

501. As can be seen from the evidence referred to below, Ms Burns was involved in the discussions between Telewest and Sky in 2004 and 2005 and both Ms Burns and Mr Darcey were involved directly in discussions between VM and Sky from 2007 onwards. However, neither Mr Darcey nor Ms Burns participated in the commercial discussions between ntl and Sky in 2004 and 2005.<sup>522</sup>

***Background to the negotiations between Sky and the cable companies***

502. The background to these various negotiations differs from the negotiations between Sky and each of TUTV, BT and Orange in two main respects.

503. First, as we noted earlier, at the time of the Statement Sky had already been providing its premium channels on a wholesale basis to the cable companies for many years. Indeed, Sky has provided these channels to the cable companies at all times since the channels came into being (the movie channels having been encrypted from 1990 and the sports channels from 1992).<sup>523</sup>

504. Second, the negotiations between Sky and the cable companies relied upon by Ofcom were carried out in circumstances where relations between the parties were for considerable periods affected by intense and at times acrimonious litigation in the High Court. This involved a dispute between VM and Sky about the terms of the supply to VM of Sky's *basic* channels, and a further dispute about the charges

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<sup>522</sup> Ms Burns made it clear in her evidence that she had no direct experience of these negotiations, but had made observations in relation to the relevant documentary material based on her industry experience and her understanding and interpretation of that material. She also stated that, where possible and appropriate, she had confirmed her understanding and interpretation with ntl employees from that period (Burns 3, para 6). Mr Darcey accepted in cross-examination by leading counsel for VM that, although he had a broad knowledge of what was going on in the commercial discussions with ntl and Telewest, his role in 2005 was in the strategy group, and the main commercial team that would have led the discussions reported to Mr Freudenstein (Transcript 5/9:2-23).

<sup>523</sup> Darcey 1, para 641.

payable by Sky for the carriage of VM's channels on Sky's DTH satellite platform. In the absence of agreement about these terms, Sky's basic channels ceased to be carried on VM's platform on 1 March 2007, as a result of which VM began High Court proceedings alleging that the failure to supply the basic channels amounted to an abuse of a dominant position by Sky. Sky too commenced proceedings against VM, seeking payment of sums in respect of lost advertising revenue. In November 2008 both sets of proceedings were settled and Sky's basic channels were once more carried on VM's platform. There seems little doubt that this litigation and the underlying disputes resulted in a breakdown of trust between the two sides.<sup>524</sup> It would be surprising if this had not had some impact on the negotiations with which we are concerned, and which were taking place between them at the time.

Ofcom's competition concerns relating to wholesale supply of premium channels to VM

505. In view of Sky's long-standing wholesale supply of premium channels to the cable companies, Ofcom's concerns about the absence of wholesale supply to new retailers, which are central to Ofcom's findings in respect of TUTV, BT and Orange, are not directly in point. However, Ofcom identifies in the Statement a number of aspects of the relationship between Sky and VM that are said by Ofcom to reveal a similar pattern to its attitude to wholesaling to new entrants, and also to give rise to discrete competition concerns. We have already noted these at paragraph 160 above, and Ofcom summarised them at paragraph 7.9 of the Statement:

“... we consider that the terms of Sky's existing supply to Virgin Media have the effect of weakening Virgin Media's ability to compete with Sky. The non-supply of the various enhanced or alternative versions of Sky's premium channels to Virgin Media – in particular HD – is and will remain of significant prejudice to fair and effective competition. The challenges Virgin Media faces as a result of Sky's wholesale ratecard prices are not a competition concern of the same magnitude as those created by the absence of supply to other retailers. However, they nonetheless create a situation in which consumer choice is likely to be distorted.”

506. In addition to these concerns, Ofcom referred at paragraph 7.49 of the Statement to an allegation by VM that Sky had refused to wholesale its premium channels for distribution by VM on an “off-net IPTV service” i.e. on a network other than VM's

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<sup>524</sup> See Statement, para 9.244.

existing cable network. This IPTV network did not exist at the time of the alleged refusal, but was said by VM to be in contemplation.

507. Although Ofcom also considered in the Statement the wholesale supply by Sky of its core premium channels for retail (by VM and other third parties) to *commercial* premises,<sup>525</sup> the WMO does not extend to such premises and the Tribunal's attention was not drawn to significant evidence relating to any negotiations for such supply.

508. At paragraphs 7.324 to 7.327 of the Statement, Ofcom set out its conclusions on the effect on competition of these specific aspects of Sky's wholesale supply to VM (with the exception of the IPTV issue, which Ofcom deals with separately<sup>526</sup>):

“7.324 ...we are concerned about the effect on competition of a number of features of Sky's existing supply to Virgin Media. This view is based on:

- Internal documents from Sky indicating that it has an incentive to weaken Virgin Media's effectiveness as a competitor.
- Sky's wholesale prices are, in our assessment, close to the highest Sky could charge while passing a margin squeeze test based on Sky's scale. Virgin Media's scale is much smaller than Sky's, so it is unsurprising that prices set on such a basis do not allow Virgin Media to compete effectively with Sky.
- One specific consequence of this approach to pricing is that Virgin Media's incremental margin on the SD versions of Sky's Core Premium channels is negative. Virgin Media therefore has little incentive to sell premium channels to an existing basic subscriber. This is reflected in the relatively weak incentives offered to Virgin Media sales staff for selling Sky Core Premium channels.
- The failure, to date, of negotiations between Virgin Media and Sky for the wholesale of HD versions of Sky's Core Premium channels, and also interactive services.

7.325 In combination, these factors contribute to the substantially lower penetration of Sky Core Premium channels on Virgin Media's platform as compared with Sky's own penetration.

7.326 We have a particular concern that the non-supply of HD versions of Sky's Core Premium channels, and also interactive services, prevents Virgin Media from competing effectively.

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<sup>525</sup> Statement, paras 7.328-7.348.

<sup>526</sup> See para 707 ff of this judgment.

7.327 The challenges Virgin Media faces as a result of Sky's wholesale rate-card prices are not a competition concern of the same magnitude as those created by the absence of supply to other retailers. However, they nonetheless create a situation in which consumer choice is likely to be distorted."

509. We address the remaining issues relating to the cable companies as follows:

- (a) First we set out the regulatory background to Sky's negotiations with the cable companies, including the origins of the wholesale rate card prices charged in respect of Sky's premium channels (paragraphs 510 to 512).
- (b) Second, we describe the ultimately unsuccessful attempts by Sky and VM's predecessors to negotiate new wholesale supply agreements which would have included a price discount structure reducing the rate card prices by reference to the cable companies' performance in obtaining subscribers to Sky's premium channels (paragraphs 513 to 527).
- (c) Third, we consider in turn the three specific aspects of Sky's supply of its premium channels to VM which have caused Ofcom concern. We deal with the supply of interactive services at paragraphs 528 to 631, the supply of HD versions of the premium channels at paragraphs 632 to 706, and supply of the channels to VM's possible IPTV network at paragraphs 707 to 730.
- (d) Finally, in section F below, we address the challenge to Ofcom's finding that the wholesale rate card prices do not allow VM to compete effectively with Sky in relation to the premium channels (paragraphs 731 to 823).

Regulatory background to Sky's negotiations with the cable companies – origin of the wholesale rate card prices

510. Although we will need to consider Ofcom's findings in respect of Sky's rate card prices in detail later in this judgment, it is helpful to see how those prices came into being and remained applicable to the cable companies before examining the negotiations about other specific features of channel supply.

511. In his evidence, Mr Darcey referred to the background to Sky's early dealings with the cable operators, and the associated regulatory interventions.<sup>527</sup> From his and other evidence the following points emerged:

(a) In 1995 Sky had introduced a price discount scheme to encourage cable operators to market its premium channels. The cable companies complained about the scheme to the Office of Fair Trading ("OFT")<sup>528</sup> under the monopoly provisions of the Fair Trading Act 1973 and the OFT accepted informal undertakings from Sky in lieu of a monopoly reference to the Monopolies and Mergers Commission. The undertakings required Sky to conclude new contracts for distribution on cable of its channels only in accordance with a rate card, the discount structure of which had been cleared in advance by the OFT. A second OFT review in 1996 resulted in new undertakings replacing those of 1995. These included a similar obligation to obtain the OFT's advance approval of rate cards and discount structures for Sky's basic as well as premium channels, and to supply all operators only on the basis of those rate cards and discounts: no discrimination or departure from the rate cards was permissible. There were periodic reviews of those undertakings by the OFT in 1998 and 1999. By 2000 only the premium channels were subject to the rate card undertakings.

(b) Between 2000 and 2002 the OFT carried out an investigation (under the 1998 Act, which entered into force on 1 March 2000) of the wholesale pricing of Sky's premium channels. In December 2002 the OFT published a formal decision ("the 2002 decision"). It concluded<sup>529</sup> that there were insufficient grounds to find that Sky had abused a dominant position either by imposing a margin squeeze on its retail competitors in relation to those wholesale prices, or by engaging in anti-competitive mixed bundling, or by foreclosing market entry by other channel providers through the application of discounts to the wholesale prices. In relation to the allegation of margin

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<sup>527</sup> Darcey 1, paras 181-215.

<sup>528</sup> We refer for convenience to "the OFT" as indicating both the Office of Fair Trading as currently constituted and its predecessor body, headed by the Director General of Fair Trading.

<sup>529</sup> Decision of the Director General of Fair Trading No CA98/20/2002 of 17 December 2002, *BSkyB investigation: alleged infringement of the Chapter II prohibition*.

squeeze, the OFT concluded that although Sky's downstream operation would have incurred intermittent losses during part of the period examined if it had paid the rate card prices charged to third parties, these losses were relatively small, and after a certain point in time the retail operation would have been profitable at all relevant rate card price levels. As for the discounts, the penetration discounts were not likely to foreclose entry as purchases by the retailers had not approached a level where the discounts were likely to have that effect, and no penetration discount had in fact been earned. In so far as volume discounts were being earned, they were being paid at a similar level to all distributors, so that no distortion of competition had occurred.

(c) Following the 2002 decision, ntl and ONdigital applied to the OFT in February 2003 pursuant to section 47(1) of the 1998 Act, requesting that the OFT vary its 2002 decision to find that Sky had infringed the Chapter II prohibition. ntl and ONdigital submitted that the OFT's 2002 decision in relation to margin squeeze should be varied for four reasons: (1) the model used by the OFT to determine the profitability of Sky's retail distribution arm ("DisCo") was not robust, and significantly overstated its profitability; (2) the return that the OFT specified that DisCo needed to earn for Sky to avoid an unlawful margin squeeze was too low; (3) the OFT explicitly took into account a period of apparent profitability outside the period of the investigation; and (4) the OFT failed to consider the effect of the margin squeeze identified in the Decision on the downstream market. On 29 July 2003, the OFT published its decision rejecting the applications by ntl and ONdigital.<sup>530</sup>

512. After the OFT's 2002 decision the discounts were withdrawn by Sky, and Mr Darcey told us that as a consequence of regulatory intervention Sky had operated on the assumption that whatever wholesale terms for premium channels it offered to one platform it must offer to others, and that there are significant regulatory risks associated with discounting wholesale supply. In this connection he observed that the OFT decision had not indicated that if the penetration discounts had actually

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<sup>530</sup> [http://www.offt.gov.uk/shared\\_offt/ca98\\_public\\_register/decisions/sky2.pdf](http://www.offt.gov.uk/shared_offt/ca98_public_register/decisions/sky2.pdf).

been earned (whether at or below the critical level referred to by the OFT), Sky's pricing would still have been regarded as not abusive. Sky told Ofcom in the course of the Pay TV review that the rate card prices at which it supplies cable operators are checked to ensure that they pass a margin squeeze test similar to that used by the OFT in 2002, and that Sky considered that it would be discriminatory to offer to other retailers wholesale prices below the price at which it supplied VM (and notionally supplied its own platform).

Attempts to reach a new agreement for wholesale supply

513. During and following the OFT's 2000-2002 investigation there were attempts to negotiate new wholesale contracts with the cable companies which, among other things, would have offered lower wholesale charges in return for improved performance in selling Sky's premium channels. We now outline those attempts.

*Attempts to reach a new agreement for wholesale supply with **Telewest** in 2003 to 2004*

514. In his evidence, Mr Darcey described negotiations that took place between Sky and Telewest in 2003 with a view to reaching a new wholesale supply agreement for Sky's premium channels:<sup>531</sup>

“Sky wished, through this agreement, to incentivise Telewest more actively to market the availability of Sky's premium channels to Telewest's residential subscribers. The agreement would have achieved this by introducing a modified wholesale pricing structure which offered Telewest deductions from Sky's rate card in return for uplifts in its sales of those channels.”<sup>532</sup>

515. Mr Darcey explained that the proposed agreement had been based on a non-binding term sheet on which Sky had received confidential guidance from the OFT earlier in 2003.<sup>533</sup> On 4 March 2003, Sky had written to the OFT<sup>534</sup> seeking guidance on whether the arrangements in the term sheet between Sky and Telewest infringed either the Chapter I or II prohibition in the 1998 Act. The OFT had responded on 21 May 2003,<sup>535</sup> stating that the OFT considered Sky was in a good position to take a

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<sup>531</sup> Darcey 1, paras 206-208.

<sup>532</sup> Darcey 1, para 206.

<sup>533</sup> Darcey 1, para 207.

<sup>534</sup> Ofcom 6/1997-1998.

<sup>535</sup> Ofcom 6/2005-2006.

view itself on whether the proposal might infringe the 1998 Act, but offering to provide further guidance if both Sky and Telewest provided further information. Sky and Telewest each replied in some detail on 17 June 2003<sup>536</sup> and the OFT thereafter concluded<sup>537</sup> that, on the basis of that information, the proposed distribution agreement was “unlikely to infringe either the Chapter I or Chapter II prohibitions”.

516. The OFT’s guidance stated, however, that further specific information would be required if the parties wished to pursue the agreement. The parties accordingly agreed to notify it formally under the old system of notification under the 1998 Act for a decision, and finalised a joint application to the OFT in January 2004. However, ultimately this was not submitted.
517. Mr Darcey told the Tribunal that this was a result of concerns that had emerged on the part of both parties in relation to the agreement. Telewest had informed Sky that it was unable to proceed with the proposed agreement on the terms that had been negotiated due to an unspecified concern. Following this Sky too developed second thoughts, linked to its growing concerns about piracy on Telewest’s network. Telewest was informed that Sky was not prepared to enter the agreement until these concerns were resolved. Thus, Mr Darcey stated that ultimately the failure to reach agreement with Telewest was not the result of lack of regulatory comfort. However he did not accept that the notification process which had been adopted to obtain clearance from the OFT was anything other than entirely legitimate, and he emphasised that it was being pursued by both companies.<sup>538</sup>
518. Ms Burns in her evidence stated that some individuals at Telewest had serious misgivings as to the approach of Sky to the request for regulatory comfort, and that in particular Sky appeared to be using the request for regulatory approval as a “device to query and re-open a number of issues arising from the 2002 Decision, with which Sky was unhappy.”<sup>539</sup> She referred to an internal email from her

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<sup>536</sup> Ofcom 6/2007-2020.

<sup>537</sup> Ofcom 6/2021-2023.

<sup>538</sup> Darcey 1, para 208; Darcey 3, paras 830-831.

<sup>539</sup> Burns 3, para 28. See also the internal Telewest email dated 9 June 2003 at VM 5/2/D/149-151.

colleague, Mr Matthew Copeland, dated 5 November 2003<sup>540</sup> in which he reported on a conversation with the OFT about Sky's proposal. According to that email, the OFT had informed Mr Copeland that the OFT did not consider that Sky was required to seek or obtain any clearance for the agreement to go ahead, and that, should the parties proceed to notify the agreement, the OFT would not treat any request for clearance as a priority in light of the extent of guidance that had already been given by the OFT. The OFT is also said to have expressed the view that Sky was seeking to roll back the parameters of the OFT's decision in 2002.

519. Ms Burns said that Telewest reached the conclusion that Sky's position in relation to obtaining regulatory comfort was unreasonable and that the deal had reached deadlock. Accordingly, there was no basis on which the deal might progress and it ground to a halt.<sup>541</sup>
520. Ms Burns noted that discussions about a premium marketing incentive agreement were reopened later in 2004 (between Mr Eric Tveter of Telewest and Mr Richard Freudenstein of Sky), but never progressed beyond a draft term sheet.<sup>542</sup> This term sheet would have included an agreement by Sky to "deduct a set discount from the gross wholesale fees paid by Telewest for each Telewest customer subscribing to Sky's premium channels in excess of a predetermined threshold."<sup>543</sup> Ms Burns stated that, despite this offer presenting problems to Telewest (including the fact that the gross wholesale fees could be varied unilaterally by Sky on short notice), Telewest was interested in pursuing the deal, but was not able to persuade Sky to proceed with the transaction due to regulatory issues.<sup>544</sup>

*Attempts to reach a new agreement for wholesale supply with ntl in 2003 to 2005*

521. At around the same time as the discussions with Telewest, Sky was in discussions with ntl, similarly with the aim of achieving a new wholesale carriage agreement. On 21 February 2003, Sky circulated a draft proposal to ntl,<sup>545</sup> which contained the

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<sup>540</sup> VM 5/2/F/167-168.

<sup>541</sup> Burns 3, para 35.

<sup>542</sup> Burns 3, para 36.

<sup>543</sup> Burns 3, para 38.

<sup>544</sup> Burns 3, para 39.

<sup>545</sup> VM 5/2/C/141-145.

same key element as the 2004 Telewest deal, namely that Sky would deduct from wholesale fees a certain sum in relation to each subscriber to a premium channel above a particular threshold. Ms Burns stated in her evidence that ntl and Sky met and corresponded about this proposal on a number of occasions between February and September 2003.

522. On 15 September 2003, Mr Shai Weiss of ntl circulated an internal email<sup>546</sup> describing a meeting that had taken place with Mr Goswami of Sky earlier that day. He stated that they discussed “the makings of a Premium deal”, and Mr Goswami is said to have outlined three elements that would have to be included in any revised deal, namely (1) that “any offer must pass the tests imposed by the regulators but not necessarily requiring regulatory approval”; (2) that any deal awarded to one party in the UK must be awarded to all other participants and should therefore “stack up financially when applied across the industry”; and (3) that the logic for the deal was based on ntl’s ability to “up sell” the product to existing customers, rather than necessarily newly acquired customers.”
523. A term sheet was agreed on 29 July 2004.<sup>547</sup> The key financial term of the agreement envisaged by the term sheet reflected the draft February 2003 proposal, namely that Sky would deduct from its wholesale charges a sum in respect of each premium channel subscriber above a certain threshold.
524. Mr Darcey stated in his evidence that, for the reasons already discussed in connection with the proposed Telewest agreement, Sky considered that it was necessary to seek informal guidance from the competition authorities in relation to the proposed agreement with ntl. Ofcom had become jointly responsible for application of competition law in the communications sector by this point, and so Sky sought guidance from Ofcom on the basis of the term sheet that had been agreed with ntl. The nature of the guidance provided by Ofcom is summarised by Dr Unger in his evidence.<sup>548</sup> While stating that it had no “prima facie concerns about the discount structure being offered” Ofcom went on to say that this did not apply to the levels of prices or to “whether the relationships between, and the

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<sup>546</sup> VM 5/2/E/155-164.

<sup>547</sup> Burns 3, paras 40-41. The term sheet itself can be found at Ofcom 6/2209-2219.

<sup>548</sup> Unger 1, para 508ff.

relative levels of, wholesale and retail prices may have any anti-competitive effects.” Further, Ofcom was not “necessarily content with the underlying pricing structures and levels in the market, as between the wholesale or retail prices or their relationship to each other.” If these “structures were found to be problematic from a competition perspective then the discount structures might be considered to be problematic too.” Finally Ofcom identified that it could have concerns if the availability and nature of discounts were made on an arbitrary basis.”<sup>549</sup>

525. Sky’s reaction to Ofcom’s response was that it was “unhelpful and disappointing”.<sup>550</sup> In January 2005 Sky had a meeting with Ofcom, and Sky wrote to Ofcom in February 2005 seeking further guidance in relation to the price discounting structure proposed in the agreement with ntl, in order to assist Sky in assessing the regulatory risk. Ofcom agreed to consider further the questions posed by Sky. Although there were some meetings at a technical level between Sky and ntl, little progress was made in other respects pending Ofcom’s response. In March 2005 Sky indicated to ntl that the new carriage agreement might not go ahead, and the same pessimism was expressed internally within Sky.<sup>551</sup> Ofcom’s response in April 2005 did not provide the guidance on the discount structure requested by Sky for reasons which Ofcom set out, including the fact that it would require a good deal of data from ntl which Ofcom was unwilling to ask for at that stage. Ofcom considered it had gone as far as it could short of conducting an actual investigation.<sup>552</sup>
526. In the event Sky decided not to enter into the new agreement with ntl “in the absence of clear guidance from Ofcom”,<sup>553</sup> and the cable rate card system remained in place.
527. With that background we now consider the specific aspects of Sky’s arrangements with the cable companies which have caused Ofcom concern. First we examine the issues about supply of interactive services, supply of HD versions of premium

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<sup>549</sup> Ofcom 6/2567ff.

<sup>550</sup> Ofcom 6/2571.

<sup>551</sup> Ofcom 6/2571, 2593-8, 2617, 2619-20.

<sup>552</sup> Ofcom 6/2687-90.

<sup>553</sup> Darcey 1, para 214

channels, and supply of the premium channels themselves to a possible IPTV network. After dealing with those matters we will return to the question of Sky's continued use of the rate card price, including the suggestion that Sky was unreasonable in seeking regulatory comfort (see paragraph 731 ff below).

***Supply of enhanced or interactive services***

528. At paragraph 7.235 of the Statement, Ofcom identifies the specific question that it is considering in relation to interactive services, namely:

“Whether Sky has sought to avoid supplying its premium HD and interactive content to Virgin Media, and if so whether this is prejudicial to fair and effective competition.”

529. We will look at HD separately in due course. Ofcom's specific conclusion on *interactive services* is at paragraph 7.317 of the Statement:

“We consider that Sky's reluctance to allow access to interactive services, in particular to coverage of football matches which are subject to scheduling clashes, is also likely to inhibit the effectiveness of Virgin Media as a competitor to Sky's satellite service.”

(See also Statement, paragraphs 7.9, 7.324, and 7.326 - all set out at paragraphs 505 and 508 above.)

530. Sky challenges this finding in a number of respects. Essentially it disputes the implication in the Statement that its conduct in the relevant negotiations supports Ofcom's case that Sky is acting on a strategic incentive to weaken the cable companies as competitors. Sky asserts that the significant cost and effort involved in translating interactive services to a different platform technology has been underestimated by Ofcom and VM, and that the likely impact of those services on the level of penetration of CPSCs on the cable platform or on the effectiveness of VM's competitive position, was not such as to justify the necessary investment. In addition, Sky was concerned that the complexity of the translation process would inhibit its own innovative efforts.<sup>554</sup>

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<sup>554</sup> Sky's amended notice of appeal, 4.84-4.86; Darcey 1, 610-621; Darcey 3, 627-642 and 704-746.

531. In order to assess Ofcom's conclusion in the light of Sky's challenge, we will need to refer to the relevant negotiations with VM and its predecessors as revealed in the contemporaneous documents. Before summarising those negotiations, we should explain what "interactive" in this context entails, and describe "Football First", the interactive service which has figured prominently in the evidence. It is convenient to take this largely from Mr Darcey's evidence.
532. A range of interactive services currently accompany Sky's CPSCs on its DTH satellite platform. Viewers can access these services by pushing the 'red button' on their remote control. Interactive services essentially comprise two forms of interactivity. The first is where viewers wish to access applications which are included in a broadcast stream; an example would be a viewer wanting to watch a football match from different camera angles; receive 'goal alerts' or review match statistics. The second form of interactivity is where a viewer wishes to watch a different television service altogether, such as a live sports event, and that service is made available via the 'red button', but not on Sky's channels. On a technical level, interactive services are software applications that transmit numerous video and data streams to STBs. Mr Darcey explained that there is a high degree of operational complexity in delivering interactive services to Sky's own platform. For example, in the case of Sky Sports, the infrastructure which supports the interactive service consists of two main applications that provide Sky with flexibility to run a range of interactive services using multiple audio and video streams across two satellite transponders. This capacity supports the equivalent of 18 video streams.
533. Football First is one of Sky's interactive services. It was launched in August 2004 following the Premier League's decision to auction not only the rights to broadcast matches live but also on a delayed basis. Sky bid for, and acquired, the rights to this 'near live content' for the football seasons in 2004/5 to 2006/7; 2007/8 to 2009/10 and 2010/11 to 2012/13. Football First is the programme that shows these delayed Premier League matches as well as extended highlights of matches. Mr Darcey stated that, in 2010, the average viewing figures for Football First were 138,000 (as compared to 3,299,000 for Match of the Day on BBC1).

Discussions between Sky and each of ntl, Telewest and VM about enhanced (interactive) pay TV services, in particular Sky's "Football First" programme

534. The draft revised terms of carriage that had been under discussion between Sky and Telewest made provision (at clause 7.1) for the parties to use their reasonable endeavours to establish the technical means by which Sky might provide (and Telewest distribute) any "Channel Enhancements", subject to agreeing commercial terms.<sup>555</sup> Similarly the term sheet negotiated between Sky and ntl included a section titled "Enhanced TV services",<sup>556</sup> which provided that Sky and ntl would: (1) use their reasonable endeavours to establish the technical means by which Sky would provide (and ntl distribute on its platform) any "Channel Enhancements" in connection with relevant channels; (2) on a non-binding basis, aim to establish and facilitate such technical means by 1 January 2005; (3) discuss in good faith the commercial terms upon which the enhancements would be provided.
535. We now consider the evidence as to the commercial discussions about these interactive services.

*Discussions between Sky and ntl*

536. In about May 2004 Sky and ntl began discussions about the enabling of interactive services on ntl's platform. At an early stage Sky suggested a feasibility study, which would take the form of a one-off trial with a single application in order to test the relevant systems and their functionality, as well as the "mechanics of the interface arrangements".<sup>557</sup> The discussions soon focussed on whether Sky's "Football First" near-live content, due to start on Sky's DTH satellite platform in mid-August 2004, would also be made available on cable. As regards ntl's customers, Mr Goswami of Sky stated:

"Once we have together established how to deliver Sky Sports interactivity on ntl's networks and negotiated the associated terms and conditions, I would envisage ntl being able to offer its customers this interactivity as soon as it has been able to implement the requisite systems to Sky's satisfaction."<sup>558</sup>

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<sup>555</sup> Ofcom 6/2051-2052.

<sup>556</sup> Section 7 of the term sheet.

<sup>557</sup> Ofcom 6/2201.

<sup>558</sup> Ofcom 6/2221.

537. A difference arose as to how the interactive content should be delivered. ntl were keen to have it sooner in less-than-full interactive or even non-interactive form, regarding it as a content issue rather than interactivity. ntl suggested that if Sky supplied them with the basic linear content feed (referred to as a “clean feed”), ntl could within a few weeks provide customers with the “key elements” of the service using ntl’s own “template”.<sup>559</sup> Sky, on the other hand, stated that Sky Sports were integrated channels and that it was not acceptable from Sky’s perspective for customers to be unable to access “the whole service”. Sky was unhappy about the prospect of creating “anything other than a functionally and editorially equivalent version” of Sky Sports interactivity on ntl’s networks. ntl subscribers should have available an equivalent interactive experience to that which they would receive on digital satellite, and not a partial reflection of that service.<sup>560</sup>
538. Sky also stated that the technical means for achieving this were “both complex and dependent on access to scarce technical resources”. Whilst Sky would make “steady progress” on the project, it could not give the work a priority “higher than the associated benefits merit”. Sky inquired whether ntl could supply any projections on uplift in Sky Sports premium subscribers once this functionality had been implemented. ntl responded that this was difficult to predict, but ntl was confident the additional content would enhance its ability to promote the channels.<sup>561</sup>
539. In a letter sent to Mr Thatcher of ntl on 27 August 2004,<sup>562</sup> Mr Goswami (for Sky) indicated that necessary changes required to “ntl middleware and networks” to support the interactive applications could be implemented within a reasonable timescale, with the relevant costs met by ntl. The first phase of the project would be the feasibility study to audit the current capabilities of ntl’s infrastructure against the requirements of Sky’s interactive applications, and to review planned developments of ntl’s structure “against the future development strategy for Sky interactive applications”. There would then be a report outlining the extent to which ntl’s infrastructure could support Sky interactivity (and the extent of any necessary changes required), and the compatibility between ntl’s infrastructure development

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<sup>559</sup> Ofcom 6/2233.

<sup>560</sup> Ofcom 6/2239.

<sup>561</sup> Ofcom 6/2223, 2231, 2233 and 2239.

<sup>562</sup> Ofcom 6/2239.

strategy and Sky's interactive development strategy. Preparing and costing plans for the feasibility study would take six to eight weeks (there was said to be an overlap of Sky resources required for the feasibility study and those engaged in developing and operating the interactive applications on DTH satellite). ntl was asked to confirm the objective and assumptions, and Sky proposed that a specific non-disclosure agreement should be prepared to cover the project.

540. In his response of 14 September 2004,<sup>563</sup> Mr Thatcher expressed disappointment with the proposed timetable, and also continued to question whether in relation to Football First the level of interactivity on cable needed to be equivalent to that on DTH satellite. It is clear from an internal ntl presentation in September 2004 that ntl was concerned about the differentiation of platforms resulting from the absence of Football First on cable.<sup>564</sup>
541. At about this time there was a change of relevant personnel at Sky, and the interactive project was to some extent swept up in delays and issues affecting the wider commercial negotiations with ntl for a new wholesale agreement described above.<sup>565</sup>
542. Interactivity was picked up again in November 2004 when Sky confirmed it would revert to ntl with an idea of the scoping work required for the feasibility study as well as an estimated time line to complete this and an estimate of the costs to be borne by ntl. Sky also asked ntl to answer certain specific questions already put earlier in 2004. It was envisaged that these aspects would be included in the long form agreement then being negotiated. ntl emphasised the need for speed. The proposed scoping timetable was supplied by Sky on 25 November 2004. It identified the additional work required to scope the feasibility study and produce terms of reference and a proposal for ntl, with details of personnel and timeframe. The work was to be carried out within six to eight weeks beginning early 2005. ntl expressed surprise at the extent of the work and Sky agreed to see whether it was

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<sup>563</sup> Ofcom 6/2241-2242.

<sup>564</sup> Ofcom 6/2247-2345.

<sup>565</sup> Ofcom 6/2243, 2245, 2247-55, 2269, and 2347-55.

possible to shorten the process. In the event a shorter timeframe was not agreed, although it appears that scoping work began in December 2004.<sup>566</sup>

543. By December 2004 the parties had agreed to focus in the first instance on “trying to get Football First ready for launch by August 2005.” The launch of Football First was said by Sky to be subject to ntl and Sky first agreeing a schedule of dates by which ntl would commit to launch all other “Channel Enhancements”, and to financial terms being agreed. This was to allow the parties “to defer until a later date debate of ntl’s position that it does not expect to pay any more for carriage than the Licence Fees payable for the Channels off which the relevant Channel Enhancements run”. However Sky’s comment on clause 7.1 of the draft long form agreement was that “ntl will be responsible for the costs of getting each Channel Enhancement technically ready for launch”.<sup>567</sup>
544. On 20 December 2004 Sky received a letter from Ofcom<sup>568</sup> in response to its request for informal guidance on various aspects of the draft long form agreement being discussed with ntl, including in particular the proposed new discount arrangements for supply of Sky’s channels. As regards “enhanced TV applications” the letter indicated that Ofcom did not have concerns about the proposed obligation on Sky and ntl to use reasonable endeavours to provide and distribute those services. However, Ofcom would not consider itself fettered from opening a formal investigation if it received representations that Sky was acting anti-competitively by not providing enhanced TV applications to one of its distributors.
545. We have already mentioned that Sky expressed disappointment with Ofcom’s response, and that an attempt to obtain additional guidance from Ofcom in 2005 ended unsuccessfully with a negative response from Ofcom in April 2005 (see paragraph 525 above).
546. This response marked the end of the negotiations towards a new carriage agreement with ntl, which had been intended to incorporate any arrangement concerning interactive services. In May 2005, in a letter from Mr Weiss of ntl to Mr

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<sup>566</sup> Ofcom 6/2445, 2449-51, 2557, 2459-63, 2579, and 2587-91.

<sup>567</sup> Ofcom 6/2561-4.

<sup>568</sup> Ofcom 6/2567-9. This is the Ofcom guidance letter referred to earlier in this judgment at para 524.

Freudenstein of Sky,<sup>569</sup> ntl revisited the supply of these services – now on a free-standing basis. As before, ntl treated the services as an “integral part” of Sky’s existing content offered to ntl customers, and again suggested that ahead of a broader deployment of Sky’s full interactive services, Sky should provide ntl with a “clean feed” of all additional games and highlights available as part of Football First. In his reply,<sup>570</sup> Mr Freudenstein said that Sky had assumed the clean feed proposal was no longer being pursued by ntl given Sky’s editorial objections. He said that Sky however remained willing to assess the technical feasibility of making available to cable customers an equivalent version of the enhanced services provided on DTH satellite.

547. At a subsequent meeting in June 2005 to pursue this, Sky is recorded by ntl as stressing that Sky had spent a considerable amount of time and effort into looking at how it could deliver interactive services to the ntl platform, but that it did not want to produce two versions of the enhanced content, given that the interactive applications were “woven” into the production process. It would only deliver a complete package of its services. The following action points were recorded, namely that by 1 July 2005 Sky would: (1) provide ntl with a “terms of reference document” outlining what was required from the feasibility study, to be based on the Football First content; (2) propose commercial terms for the provision of this content; (3) confirm the nature of its “immovable” principles for the provision of interactive content.<sup>571</sup>
548. Soon after the meeting ntl (Mr Weiss) wrote to Sky (Mr Freudenstein) saying: that ntl had not abandoned its proposal that the Football First content should be provided via a “clean feed”, that it regarded this content as an integral part of the content already purchased from Sky, and that it did not regard Sky’s reasons for refusing to supply a clean feed as reasonable. ntl requested Sky to supply a clean feed of the enhanced content as an “interim solution” pending the companies working together on a combined package of enhanced content and interactive applications.<sup>572</sup>

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<sup>569</sup> Ofcom 6/2691-2692.

<sup>570</sup> Ofcom 6/2695-2696.

<sup>571</sup> Ofcom 6/2699 and 2701-2703.

<sup>572</sup> Ofcom 6/2705-2706.

549. In its response Sky stated that “an absolute pre-requisite” for any decision by Sky to supply interactive services to ntl (which it did not consider itself to be under any duty to supply) was that Sky’s editorial control of those services, especially their “look and feel” and integrity, were not compromised. Sky did not consider that ntl’s “clean feed” proposal satisfied that pre-requisite. Sky stated that an assessment of the technical feasibility of ntl retransmitting Sky’s enhanced services as transmitted to DTH satellite customers, was ongoing. However, a key consideration was the extent to which “supplying ... rapidly changing and evolving enhanced services in a form compatible with ntl’s platform will hinder the pace at which Sky can develop and innovate in relation to those services generally”. Sky was therefore also assessing whether the benefits of supplying the services to ntl outweighed “those potential detriments”. Further, Sky did not consider that its enhanced services were an “integral part” of the content acquired by ntl from Sky, and in its view the wholesale prices paid by ntl did “not include any payment for enhanced services”.<sup>573</sup>
550. Thereafter the documents show that there were meetings between Sky and ntl on a number of issues but that no further progress was made on interactive services. An ntl note following a meeting in August 2005 records that “it became clear that what Sky are actually doing is a business assessment of whether they want to provide enhanced content to ntl ... Sky could give no indication of when they might make a decision”.<sup>574</sup>

*Discussions between Sky and Telewest*

551. Over the same period, Telewest and Sky were also engaged in discussions about interactive services. Like ntl, Telewest was keen to obtain the interactive content connected with Sky’s acquisition of the “near-live” FAPL rights.
552. On 27 August 2004, Ms Burns, then Director of Business Affairs and Business Development at Telewest, wrote to Sky<sup>575</sup> in connection with Football First. In that letter she complained that cable customers were unable to access content that was

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<sup>573</sup> Ofcom 6/2713-2714.

<sup>574</sup> Ofcom 6/2719-2720.

<sup>575</sup> VM 5/2/1/191.

made available to Sky's DTH satellite subscribers. She stated: "We pay full price for premium sports content via the rate card, and are more than willing to supply the considerable bandwidth required to deliver this key content to our Premier League fans. Instead we have a significantly impaired version of the Sky Sports premium offering." She proposed that a meeting should take place between the companies' technical teams, referring to "extensive feasibility [completed last year] by our respective companies which should provide a basis to quickly begin the application and development work". She explained that Telewest's preferred solution was the provision of a "clear feed"<sup>576</sup> for the premium content, stripping out references to the exclusive interactive content, with the additional (interactive) content then to be provided via separate linear feeds.

553. Sky responded on 16 September 2004,<sup>577</sup> noting that the discussions between Sky and Telewest for a new carriage agreement had included a commitment to establish the technical means by which Telewest may be able to distribute interactive content, but that Telewest had informed Sky that it was unable to proceed with that agreement. Sky stated that it was not prepared to "attempt to implement applications which only partially reflect the range and attributes of those present on digital satellite" and explicitly rejected Telewest's proposal for "a non-standard application for Football First in isolation". However, Sky remained willing to explore with Telewest the technical means by which the full range of interactivity present on Sky Sports could be replicated, "although any such implementation would need to form part of a premium carriage deal". The letter referred to recent correspondence with ntl about how such a project would take shape, the first phase of which would be to prepare and cost plans for a feasibility study. Ms Burns was asked to confirm that Telewest agreed with the objective of the project, and that the parties should enter into a specific non-disclosure agreement to cover it.

554. In her evidence Ms Burns referred to a meeting that took place in November 2004 at which the terms of the feasibility study were discussed, and at which Sky is said to have made it clear that it would set the parameters of the feasibility study and the audit of Telewest's technical standards, and that Telewest would need to fund this

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<sup>576</sup> Presumably this is a reference to the "clean feed" discussed between Sky and ntl.

<sup>577</sup> VM 5/2/J/195.

work.<sup>578</sup> Following that meeting, Ms Burns sent a letter to Sky on 18 November 2004,<sup>579</sup> seeking from Sky “a commitment to launch interactive services on the Telewest platform.”

555. Ms Burns noted in her evidence that the envisaged feasibility study in relation to interactive services had still not been carried out by August 2005, and at a meeting on 10 August 2005, Sky delayed the study further, stating it was reviewing its position and would revert in mid-September. Ms Burns sent a letter to Sky on 19 September 2005,<sup>580</sup> in which she summarised certain “follow up” items from the meeting on 10 August 2005, including a request that the companies agree a “development term sheet for interactive applications, beginning with Football First”. She explained that Telewest had continued to assess previously completed due diligence and proposed certain changes, including the use of a third party developer at Telewest’s cost and that “[f]undamental to the proposal is an interim solution to provide access to the content for our subscribers via additional linear feeds”.
556. Sky responded to that letter on 28 October 2005,<sup>581</sup> setting out its view that the content available to Telewest customers was “substantially similar” to the content available to DTH satellite customers. Sky did not consider that it was under a duty to supply its enhanced services or any of the content included within those services, to Telewest. Telewest’s “interim proposal” was not acceptable to Sky, but Sky was willing to assess the technical feasibility of Telewest retransmitting Sky’s enhanced services. This part of the letter concluded in identical terms to those used in responding to ntl (see paragraph 549 above), namely that Sky remained to be convinced that the benefits of supplying its enhanced services to Telewest outweighed the potential detriments in relation to the general development and innovation of those services. Sky’s overall assessment was continuing and Sky had not ruled out the possibility of supplying enhanced services to Telewest at that

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<sup>578</sup> Burns 3, para 111.

<sup>579</sup> Ofcom 6/2448.

<sup>580</sup> VM 5/2/K/203.

<sup>581</sup> VM 5/2/L/207.

stage. In her evidence, Ms Burns stated that Telewest was never informed of the outcome of the assessment referred to in this letter.<sup>582</sup>

#### *Discussions between Sky and VM*

557. After the merger of Telewest and ntl and the subsequent rebranding of the merged entity as “Virgin Media”, discussions with Sky about *inter alia* interactive from 2007 took place against the background of the litigation to which we have referred,<sup>583</sup> and the joint complaint to Ofcom, to which VM was a contributor.
558. There had been a meeting between Sky and VM on 9 May 2007 involving Mr Darcey (who had by this time succeeded Mr Freudenstein as Sky’s Chief Operating Officer), and Mr Malcolm Wall, VM’s Chief Executive Officer for Content. Ms Burns states in her evidence<sup>584</sup> that the discussion at that meeting was about Sky’s premium channels. This was disputed by Mr Darcey in his evidence – he stated that the focus of the meeting and his priority at the time was to try to secure the return of Sky’s basic channels to the VM platform.<sup>585</sup>
559. At any rate, on 8 June 2007, in a letter which Sky maintains was written more with the joint complaint to Ofcom in mind than a genuine attempt to negotiate,<sup>586</sup> Mr Wall (for VM) had suggested to Sky that discussions should take place about a new agreement for the carriage of Sky’s premium channels, and that one of the assumptions underpinning such discussions was that the scope of premium content supplied should match the DTH satellite offering, including as regards interactive services.<sup>587</sup> Mr Darcey replied on 30 August 2007 that Sky was happy to re-engage in discussions which had not been pursued beyond 2005, and noted that at that stage VM had been unable to confirm that the cable platform was technically capable of supporting interactive services in the same format as provided on the DTH satellite platform, and capable of adapting to rapid evolution of those services.<sup>588</sup> Mr Wall’s 7 November 2007 response for VM stated that the cable platform was technically

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<sup>582</sup> Burns 3, para 113.

<sup>583</sup> Para 504 of this judgment.

<sup>584</sup> Burns 3, para 54.

<sup>585</sup> Darcey 3, para 586.

<sup>586</sup> Darcey 3, para 587.

<sup>587</sup> Ofcom 7/3329-3330; Sky 8/1625-1626.

<sup>588</sup> Ofcom 7/3403-3405; Sky 8/1627-1629.

capable of supporting interactive and enhanced services in a manner which would address Mr Darcey's concerns, and in particular allow VM to "mirror" content so that any difference in offering would be "negligible". Negotiations could address any concerns about hindering Sky's ability to innovate.<sup>589</sup>

560. Mr Darcey stated in his evidence that Sky was considering its response to VM's letter when he was contacted by Mr Wall, who suggested that they meet in the New Year to discuss Sky's *basic* channels. A without prejudice meeting relating to the settlement of the High Court litigation took place on 11 January 2008. Mr Darcey stated that VM made it clear at this meeting that it was not seeking to talk about premium channels, but to resolve the issues surrounding the basic channels. He explained that, in light of this meeting, he did not respond to VM's letter of 7 November 2007 and Sky continued to focus on the issue of basic channels. He said that premium channels did not feature in the discussions between Sky and VM during 2008.<sup>590</sup>

561. In November 2008 the High Court litigation was settled, and in 2009 the relationship between Sky and VM took a new turn when negotiations began in connection with a proposal for Sky to acquire VM's branded television channels (known as "VMtv") and to enter into an agreement for the long term supply by Sky to VM of Sky's *basic* channels together with the VMtv channels (an arrangement known as "Project Kestrel"). According to Ms Burns, VM identified these discussions as an opportunity for it to use leverage in respect of the terms on which it was supplied with, *inter alia*, Sky premium channels. In particular VM sought to make its continued participation in the Kestrel sale process conditional on Sky entering into negotiations in relation to the supply of Sky's premium channels, as well as interactive services.<sup>591</sup>

562. As part of the agreement eventually reached between Sky and VM in June 2010 for the purchase by Sky of the VMtv channels, Sky agreed to provide VM with access to some, but not all, of its interactive services. These consist initially of five services to be delivered to VM's customers who have the "Liberate" STB platform

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<sup>589</sup> Ofcom 7/3465-3467; Sky 8/1630-1632.

<sup>590</sup> Darcey 3, paras 589, 590, and 677.

<sup>591</sup> Burns 3, para 67.

and, later, to those acquiring VM's future "TiVo" STB platform. The five services in question included Football First and a "lite" version of the Champions League service for the knock out stages of that competition. Development work started in July 2010. At the time of the hearing before the Tribunal delivery of these services was subject to delays as a result of technical problems on the VM network and platform.<sup>592</sup> We return to this at paragraph 575 below.

### The Tribunal's discussion and conclusions – interactive services

#### *Preliminary observations*

563. We have referred to Ofcom's findings (a) that Sky's reluctance to allow access to certain enhanced services is likely to inhibit VM's effectiveness as a competitor, (b) that Sky's conduct conforms with a pattern also said to be visible in negotiations with other operators for wholesale supply of the premium channels, and (c) that therefore by implication this supports Ofcom's conclusion in relation to those other negotiations that Sky was acting to weaken rival retailers' competitive effort with a view to furthering strategic incentives (see paragraph 160 above, referring to the Statement, 1.28).
564. In relation to these conclusions, Ofcom does not in the Statement discuss or refer to any particular evidence of Sky's reluctance to supply interactive services, or of the failure of negotiations in that regard. This is left almost entirely to Dr Unger in his evidence in these appeals, supported by Ms Burns, with detailed comment by VM in its submissions to the Tribunal.<sup>593</sup> The Statement refers instead (in the substantive section that considers these services) to the views of VM about the importance of interactive services to viewers, and to Ofcom's own research on this topic, which led Ofcom also to conclude that "while interactive services are important to a proportion of Sky customers, they are relatively less important than HD services" and that "Sky's reluctance to allow access to interactive services, in particular to coverage of football matches which are subject to scheduling clashes,

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<sup>592</sup> Darcey 3, paras 736-746.

<sup>593</sup> For example, VM's written closing submissions, paras 80-104.

is also likely to inhibit the effectiveness of Virgin Media as a competitor to Sky's satellite service."<sup>594</sup>

565. Ms Burns sought to support Ofcom's conclusions in relation to interactive services in her evidence, stating that "it is unarguable that Virgin and its predecessors have, on a regular basis, sought access to Sky's interactive services and content since their launch on Sky's DTH satellite platform in 1999. Further, Sky has consistently declined to provide such access."<sup>595</sup> She referred to requests for interactive services made as early as 2000,<sup>596</sup> to approaches made by Telewest in 2003 for access to Sky Sports Xtra (now Sky Sports 4) and additional feeds broadcast behind the red button (negotiations in relation to which ceased when the premium channels negotiations with Sky came to a halt), and to discussions during 2004, including a request for the supply of Sky Sports Xtra Interactive and Champions League feeds from Sky, which ultimately "proved fruitless".<sup>597</sup> Ms Burns also commented on the period of negotiation between ntl and Sky about interactive services between 2004 and 2005<sup>598</sup> described above (to which, as we have noted, she was not a party). Her understanding was that, despite ntl doing all that had been required of it in order to enable Sky to address its technical concerns through a feasibility study, Sky ultimately decided not to press ahead with such a study.<sup>599</sup>
566. In cross-examination by leading counsel for VM, Mr Darcey accepted that a fair reading of the documents was that ntl was pressing hard to get things moving, and that Sky was the source of the delay.<sup>600</sup>

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<sup>594</sup> Statement, paras 7.313-7.317.

<sup>595</sup> Burns 3, para 106.

<sup>596</sup> Ms Burns referred in particular to a letter dated 3 November 2000 from Mr Andrew Shaw, Director of Content Acquisition and Business Content at Telewest to Mr Peter Stremes, Head of Cable Distribution at Sky. She states that the letter demonstrates that Telewest requested supply of "interactive components for the Sky channels that we currently receive". However, on closer examination it is clear that Mr Shaw's request was actually for "a clear feed that exclude any interactive components for the Sky channels that we currently receive". This is made clear in a later part of the letter which states that "The clear feed should ensure that all references to Sky's or Open's interactive services are excluded...". It appears that Telewest's primary interest was in the underlying content, rather than the provision of interactive services per se.

<sup>597</sup> Burns 3, paras 108-109.

<sup>598</sup> Burns 3, paras 115-126.

<sup>599</sup> Burns 3, para 124.

<sup>600</sup> Transcript 5/80:8-14.

567. It is clear from the contemporaneous documents, and indeed Mr Darcey acknowledged, that Sky was not enthusiastic about developing interactive versions of its premium sports channels for the cable platforms. He summarised Sky's position as follows:

“...it is true that Sky has historically been reluctant to make its interactive services available on third party platforms. The reason for this, as further detailed below, is that to do so would be a complex exercise, particularly if the ‘look and feel’ and Sky's editorial control over the content is to be maintained (which would be a prerequisite), and Sky is not convinced of the benefits of undertaking such an exercise, particularly where penetration of Sky's premium channels on a platform is low.”<sup>601</sup>

568. However, Mr Darcey vigorously disputed that there was any motive, other than the technical complexity and absence of sufficient commercial value, for Sky's lack of enthusiasm about supplying this service. In particular he rejected the suggestion that Sky's conduct or the absence of supply of interactivity evidenced any strategic incentive on the part of Sky to limit VM's effectiveness as a retailer of Sky's CPSCs. Sky also maintains that interactivity is not as important in regard to the effectiveness of competition as Ofcom and VM argue. We now address these two main issues.

*Was Sky's lack of enthusiasm reasonably justified on technical/commercial grounds? Was Sky's conduct motivated by a strategic incentive to weaken VM's competitive effort?*

569. Mr Darcey explained in his evidence that, whilst normal linear TV channels can quite easily be retransmitted on third party platforms, this was not the case with interactive services.

“614. ...At the most basic level, this is because interactive services are constituted by software applications written to run on the proprietary software which is resident in Sky set top boxes, and would have to be rewritten to run on other platforms. In addition, running the applications involves simultaneously transmitting numerous video and data streams and messages to set top boxes. The real complexity arises, however, in mirroring the processes involved in delivering such services on one platform across others.

615. For example, in the case of Sky Sports, the infrastructure which supports the interactive service consists of two main applications that provide Sky Sports producers (who may be located in outside broadcast units remote from Sky's studios) with considerable flexibility to run a range of interactive services using

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<sup>601</sup> Darcey 1, para 612.

multiple audio and video streams across two satellite transponders. Currently this capacity supports the equivalent of eighteen video streams. The applications are remotely configurable to allow Sky Sports producers to specify which video and audio streams should be included in an interactive application at any particular time, and to specify and change the 'set up' of an interactive service (e.g., how many courts are covered during the US Open Tennis at a particular time), the 'look and feel' of a particular interactive service, and the supporting material included within a particular service (for example the presentation of scoreboards, news and statistics). Individual services are changed in real time to take account of how a particular competition is unfolding, with reconfiguration messages sent to viewers' set top boxes to achieve this during the event. Sufficient flexibility is built into the applications to enable them to cope with schedule over-runs for live sports events by enabling a producer to move an event from a linear channel to the interactive service at short notice. The applications also enable a range of complementary interactive features, such as 'goal alerts' which alert a viewer watching a different channel that a goal has been scored, inviting them to select to watch a video replay of the goal.

616. There is, therefore, a high degree of operational complexity in delivering an interactive service to Sky's own platform, the functionality of which we understand very well. Supplying such services on third party platforms would involve attempting to mirror these complexities across each additional platform on which such services are to be supplied, but with substantial implementation differences. To do so would involve changes not only to the applications themselves but also to the back-end architecture which supports them.

617. Accordingly, developing applications to run on the software resident in Virgin Media set top boxes would involve substantial use of resources which Sky considers would be better directed to other projects. Moreover, supplying on third party platforms may hinder Sky's ability to innovate in relation to its own interactive services, as it would need to ensure that any change it makes to its own interactive services could be implemented on potentially numerous other platforms in a timely fashion. Given the low penetration of Sky's premium sports channels on Virgin Media, the question must be asked as to whether the cost of implementing the services on Virgin Media's platform is worth the effort (both upfront and ongoing) that would be involved."<sup>602</sup>

570. Mr Darcey added<sup>603</sup> that developing interactive services for VM would have hindered Sky's ability to innovate (a point made by the BBC Trust in relation to the provision of bespoke versions of its iPlayer for other platforms) and would involve costs for Sky.

571. In her evidence, Ms Burns disputed this justification by Sky for not supplying its interactive content.<sup>604</sup> In her view, Sky over-stated the nature of the technical challenges involved in the provision of interactive content, having failed to engage proactively and collaboratively to assess how any difficulties could be overcome.

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<sup>602</sup> Darcey 1, paras 614-617.

<sup>603</sup> Darcey 3, para 636-642.

<sup>604</sup> Burns 3, paras 133-150.

She was confident that the cable platform would have been able to overcome any technological difficulties and to address Sky's concerns, based on its experience of providing interactive services to other content providers, including the BBC. In particular, she noted that Sky had not disclosed the costs involved in implementing interactive services on cable, nor had it explored the extent to which these costs might be shared. She also pointed to a "circular effect" in relation to the non-supply of interactive services, insofar as the lack of interactive services was itself a barrier to increased penetration of Sky's premium channels on the cable platform, yet Sky justified its decision not to make these services available on the basis of low penetration. As regards Sky's argument that its own innovation efforts would be inhibited, she stated that innovations and applications that are of value to customers would be expected to grow subscriber numbers on all platforms.

572. In his evidence, Dr Unger refers to Sky's "failure to supply interactive services to Virgin". He, too, states that this failure is not adequately explained by technical complexities, and that if this was the principal reason for Sky's reluctance, one would expect Sky to engage constructively with a potential retailer with a view to exploring whether and how they could be overcome. He stated that the available evidence suggests that Sky did not do this in the case of VM.<sup>605</sup>

573. Dr Unger singled out the following examples in support of this proposition:

(a) Sky rejected ntl's "clean feed" proposal<sup>606</sup> and although it stated that its assessment of the technical feasibility of ntl retransmitting Sky's enhanced services was continuing, there was no evidence to suggest that Sky invited ntl's input in relation to that assessment.

(b) Sky did not seek to correct ntl's interpretation (as set out in its letter of 8 November 2005) that Sky "continues to refuse to supply this content to us for the foreseeable future".<sup>607</sup>

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<sup>605</sup> Unger 1, para 481.

<sup>606</sup> Unger 1, para 482.

<sup>607</sup> Unger 1, paras 481-487.

(c) In his letter of 30 August 2007, Mr Darcey referred back to the 2005 discussions and the fact that ntl “did not pursue” discussions beyond the end of 2005, despite Sky’s own letter of 21 October 2005 suggesting that Sky “would revert to ntl if there was scope for any further discussion and that nothing further was needed from ntl.”<sup>608</sup>

(d) Mr Darcey did not respond to the points set out in ntl’s (Mr Wall’s) letter of 7 November 2007,<sup>609</sup> despite stating that Sky was “happy to re-engage” in discussions on interactive services.

574. As to the last point, we have already referred to Mr Darcey’s explanation for the lack of a response to Mr Wall’s letter.<sup>610</sup> Nor do we find the other points convincing. Although Dr Unger acknowledges that the process is complex, he seems to attribute to Sky an objection that the technical problems were not capable of being overcome. Yet as we understand it that is not the point that Sky was making in its responses to the cable companies at the time of the negotiations or in its evidence to the Tribunal. Sky’s point was and is that the exercise required to make equivalent interactive services available on cable would be both technically complex and costly in time and expense; as such it needed to be counterbalanced by a corresponding commercial benefit. This was the assessment which Sky told the cable companies it needed to make (albeit somewhat belatedly - see for example paragraph 549 above). In cross-examination by leading counsel for VM about Sky’s correspondence with ntl in the summer of 2005, Mr Darcey accepted that Sky had by then formed the view that it was technically possible to recreate a version of the Sky enhanced services on the cable platform, and that the key reason for the lack of progress in discussions was the fact that Sky had difficulty constructing a business case for providing these services. Mr Darcey also stressed Sky’s concern that supplying to a third party platform “rapidly evolving interactive and enhanced services” might affect Sky’s ability to innovate.<sup>611</sup>

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<sup>608</sup> Unger 1, paras 489-490.

<sup>609</sup> Unger 1, para 492.

<sup>610</sup> See para 560 of this judgment.

<sup>611</sup> Transcript 5/100:6-21.

575. The points made by Dr Unger do little more than demonstrate Sky's admitted reluctance to embark upon the development work in question, and do not address the technical complexity of that task nor its cost. As to the former, neither Dr Unger nor Ms Burns appears to take issue with Mr Darcey's description of the processes involved in providing interactive services on a third party's platform. His characterisation of the project as complex and difficult seems to be borne out by the experience of implementing just some (not all) interactive services on VM's platform pursuant to the Kestrel project, to which we referred earlier (see paragraph 562 above). The work to develop and launch on cable even a limited version of Sky's DTH satellite interactivity, which it was projected would require "only approximately seven months",<sup>612</sup> encountered problems and delays when it came to implementing the first of the envisaged series of services. These problems were described as follows by Mr Darcey,<sup>613</sup> in an account which did not appear to be challenged:

"740. The development work, which started on 27 July 2010, is split into two phases: the Liberate Phase and the TiVo Phase. Sky is engaged in the delivery of the first of these phases as at the date of this statement. [21 February 2011] This Liberate Phase is then subdivided further in order to deliver the list of products above. The first of these sub-phases relates to the delivery of the Background Event application and a 'lite' version of the Champions League service for the knock out stages of this competition. The full version (which is needed to show live matches (not featuring Premier League teams) that would otherwise not be able to be viewed) is not required again until the group stages in September/October 2011.

741. The first sub-phase of the Liberate Phase was due to be delivered during the course of February 2011. Unfortunately, the progress of this phase is being held up at Virgin Media's end. Virgin Media has been unable to deliver the live system platform due to network connectivity problems by Virgin Media. In addition, Virgin Media has encountered further significant difficulties that impact on Sky's applications running on certain of its Liberate set top boxes. This is currently not expected to be resolved before the end of March 2011 as Virgin Media needs to develop and implement a software download to these set top boxes. As a result, this means that the 'lite' version of the Champions League application, that Sky has spent six months developing, will now not be deployed.

742. These delays from Virgin Media will then have a knock on effect to the delivery of all the other sub-phases of the Liberate phase..."

576. It is also clear that there is a significant cost involved in making interactivity available on a third party's platform. Mr Darcey's evidence was as follows:

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<sup>612</sup> Burns 3, para 142.

<sup>613</sup> Darcey 3, paras 740-2.

“744. The financial and people costs of the delivery of even this limited set of services are, moreover, significant. Particularly when they are contrasted to the requests made by Virgin Media (and its predecessors) for all of Sky’s interactive applications on all of its sports channels (and sometimes on all of its channels). Sky’s current forecast is that the Liberate Phase alone will cost in excess of £[...][C] million to deliver, requiring nearly [...][C] man days of development work. When this is complete, the team will then be required to develop all of the same applications for the Tivo box and, although Sky has not undertaken the detailed planning for this Tivo-phase, I would expect it to require a similar resource commitment.

745. In terms of the above, I find it difficult to understand how Virgin Media can say that Sky’s concerns regarding costs were “*spurious*” when at the time it was asking for all interactive applications and never offered to bear or even share the costs of the delivery of these applications. Instead, the best offer was “*to share the costs of a feasibility study*”.

746. Further, given the time and cost involved in the delivery of these interactive services and given that the delivery of these services needs to fit within Sky’s fixed pot of total capital expenditure spend during the year, it has the impact of crowding out other projects. These other projects being projects that, in other circumstances, Sky would regard as having a higher priority.”

577. Although Sky referred on several occasions in the course of the negotiations to the need for the cable companies to shoulder the cost of the development work, the contemporaneous documents indicate that the cable companies’ stance at the time was that the content in question was part and parcel of the premium sports channels which Sky was already providing, rather than an additional service, and that Sky was under a regulatory obligation to make Sky’s interactive services available on the cable platforms. It is true that Telewest suggested that a third party developer be used at its cost. However, this offer was linked to Telewest’s proposed “interim solution” (i.e. to provide access to the interactive content via additional linear feeds), which had already been rejected by Sky for editorial and related reasons (see paragraph 556 above). Also, VM expressed itself willing to share the costs of a feasibility study.<sup>614</sup> Nevertheless the general implication was that the cable companies considered they should not have to pay extra for delivery of interactive services, and Mr Darcey stated in evidence that at no time did the cable companies indicate that they would be willing to pay. ntl in particular made clear that it did not believe that it should be required to do so (see paragraph 548 above).

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<sup>614</sup> Darcey 3, para 745.

578. In this connection we note that, although Ofcom has extended the WMO to include the provision by Sky of interactive services, Sky's costs of delivery (including, presumably, developing the services on a third party's platform) are to be covered by the recipient of the services.<sup>615</sup> We also note that Ofcom recognised in the Statement that the technical challenge and costs involved were greater than Ofcom had appreciated earlier in its Pay TV review.<sup>616</sup>
579. We accept the evidence of Mr Darcey on the question of technical complexity, and are unconvinced by the suggestion that he was exaggerating that aspect. We are satisfied that this complexity, together with the fact that the exercise would involve costs to which the cable companies were reluctant to contribute, and scepticism that the provision of these services would lead to a significant increase in the take-up of Sky's premium channels on cable, accounted in large measure for Sky's lack of enthusiasm. We also accept that there was a genuine concern on the part of Sky that the need to maintain, across different platforms, a level of interactivity equivalent to that provided on DTH satellite might affect the speed and quality of Sky's innovation in this area.
580. Our interpretation of the relevant negotiations is not that Sky was closing the door to making these services available, but rather that there was no particular attraction for Sky (and a certain amount of disadvantage) in making the necessary investment and commitment. That position changed when the Kestrel project provided Sky with a commercial incentive to embark on the exercise.<sup>617</sup>
581. Thus far the evidence before us shows Sky's conduct in respect of interactive services as being determined by legitimate commercial and technical considerations. Despite VM's and Ofcom's contentions to the contrary,<sup>618</sup> the evidence does not support Ofcom's central finding that Sky was unwilling to engage with other retailers in the provision of wholesale access to its CPSCs. Nor does the evidence justify a finding that the conduct in question was motivated by a desire to weaken the cable companies' competition.

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<sup>615</sup> Statement, para 9.18 (final bullet), and para 9.296.

<sup>616</sup> Statement, paras 9.295 and 9.297.

<sup>617</sup> Darcey 3, paras 730-731.

<sup>618</sup> For example, VM's written closing submissions, para 80 ff.

*Internal documents said to indicate Sky has an incentive to weaken VM's effectiveness as a competitor*

582. However, as can be seen from paragraph 7.324 of the Statement,<sup>619</sup> Ofcom relies upon certain internal documents of Sky as indicating that it has an incentive to weaken VM's effectiveness as a competitor. These documents are said to have informed each of Ofcom's competition concerns about Sky's existing supply to VM. It is therefore necessary to examine the basis for Ofcom's reliance on them to see whether they affect our assessment of the evidence in relation to the interactive issue or generally.
583. The specific internal documents relied on by Ofcom are described at paragraphs 7.248 to 7.259 of the Statement under the heading "Documentary evidence of Sky's incentives" (itself a sub-heading of a section titled "Sky's incentive to withdraw supply from Virgin Media"). These were disclosed by Sky during the High Court proceedings described earlier in this judgment.<sup>620</sup> They comprise a draft slide pack prepared by Sky in November 2003 titled "What is our relationship with cable – friend or foe?" ("the 2003 draft slides")<sup>621</sup> and an internal Sky email dated 17 August 2006 reporting on a meeting the day before between Alistair Stevens, Mai Fyfield and James Murdoch (all of Sky) in relation to certain basic channels, including Sky One ("the 2006 email").<sup>622</sup>
584. Ofcom states that these documents "provide more information on whether Sky is motivated by strategic incentives", that they "discuss the trade-off between earning wholesale revenues and winning/retaining satellite subscribers" and "also show that Sky has considered other effects".<sup>623</sup> We consider Ofcom's broader conclusions in relation to these documents further below.

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<sup>619</sup> Set out at para 508 of this judgment.

<sup>620</sup> See para 504 of this judgment. Para 7.248 of the Statement refers more broadly to "documents which Sky disclosed during High Court proceedings". However, it is clear from the footnote 994 to the Statement, which refers to paras 6.103 to 6.105 of the Third Pay TV Consultation, that Ofcom is referring only to the two documents described at para 583 of this judgment.

<sup>621</sup> Ofcom 6/2085.

<sup>622</sup> Sky 16/283-285.

<sup>623</sup> Statement, para 7.248.

585. Sky challenged Ofcom’s reliance on the documents, both because Sky did not accept that it has an incentive to limit VM’s effectiveness as a retail competitor, and because Ofcom’s interpretation of them was erroneous. Sky submitted that the documents do not provide any support for Ofcom’s theory of an incentive to harm VM as a retail competitor. Sky stated that the 2003 draft slides intentionally posited extreme theories for the purposes of internal discussion and debate only, and none of these extremes was acted upon by Sky. Sky also argued that the 2006 email, which concerns basic channels, posits a “no supply” of Sky One hypothesis solely for the purposes of providing a counterfactual in order to undertake a vertical arithmetic exercise designed to determine the wholesale price that Sky should seek for wholesale distribution of Sky One. Sky subsequently negotiated a carriage agreement with VM to supply Sky One.<sup>624</sup>

586. Given the reliance placed on these documents by Ofcom in the Statement, we consider each of them in turn below.

(i) *The 2003 draft slides*

587. Ofcom describes the 2003 draft slides in the Statement:

“7.249 A draft slide pack from Sky – which dates back to 2003 – refers to one strategic incentive to continue supplying to cable, namely that “by giving long term security of supply of Sky’s channels on reasonable terms [cable firms are] less likely to go upstream and seek to buy their own content”. Set against that is a clear concern about cable as a retail competitor:

stronger cable industry will make it more difficult for Sky to acquire subscribers and grow the DTH base

giving<sup>625</sup> higher margin will discount and boost their subscriptions at our expense

cable is very weak, have the opportunity to finish them off once and from [sic] all”

588. At paragraph 7.252 of the Statement, Ofcom noted Sky’s explanation that the document was visibly in early draft form, was never circulated or shared with any of Sky’s senior management, and that the document made no link between Sky’s

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<sup>624</sup> Sky written closing submissions, Part A, paras 10.141 to 10.142.

<sup>625</sup> In the original document, at Ofcom 6, page 2101, the passage in question begins: “If giving higher margin....” etc. The extract in the Statement misses out the word “If”.

wholesale strategy and retail competition. Ofcom went on to state that, although the document was “clearly not in final form”, neither was it obviously an early draft as Sky claimed, although Ofcom stated that it could not reliably ascertain which Sky employees saw or contributed to it.

589. Ofcom drew certain conclusions from the content of the 2003 draft slides:

“7.254 As for its content, we consider that the first two quotes above are important evidence that Sky has an incentive to prevent Virgin Media from operating as an effective retail competitor, whether that is primarily due to static or strategic considerations. In particular, the second quote indicates that Sky recognises a relationship between its wholesale prices and Virgin Media’s retail prices. We consider that this contradicts Sky’s assertion that the document does not link wholesale and retail concerns. Indeed, given the apparent wish to eliminate competition from cable, it would be surprising if Sky did not make such a link. The document identifies three points of contact with cable – retail competition, supply of content, and pricing. This is the context in which “finishing off” cable is discussed. The reasons for such a wish are indicated in a further quote from this document:

“Cable has ultimate advantage of added functionality and will cause us problems in the long run, need to kill them now”.

590. In his evidence, Mr Darcey repeated his understanding that the 2003 draft slides were not shared with Sky’s senior management team, and explained that they appeared to be an early draft of a section of a presentation that was ultimately delivered to Mr James Murdoch in January 2004 shortly after he became Sky’s CEO. A copy of that presentation was exhibited to Mr Darcey’s first witness statement<sup>626</sup> (“the 2004 presentation”). In relation to the 2004 presentation Mr Darcey stated:

“The purpose of that presentation was to update the new CEO on the important issues facing Sky at the time. As is clear from the January presentation, two extreme strategies were postulated as bounds to Sky’s relationship with cable – the strategies are marked as “*extreme[s]*” rather than being positioned as credible options. One of these extremes is referred to as an “*Accommodation*” strategy. The other is referred to as a “*Hostile*” strategy. It is on the basis of the existence of this second extreme strategy that Ofcom appears to infer that Sky sought to restrict Virgin Media’s ability to compete by offering unfavourable wholesale terms for its premium channels.

In my experience, this approach of considering extremes is a useful intellectual exercise in considering how to address strategic decisions facing a company. It is, however, very clear that neither of these extremes reflects Sky’s actual behaviour.

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<sup>626</sup> Sky 8/1809.

The final page of the section of the presentation on Sky's relationship with cable asks whether Sky has "*struck [the] right balance*" between these two extremes."<sup>627</sup>

591. As noted by Mr Darcey, the final question posed in the 2004 presentation (which is in significantly different terms from the 2003 draft slides) was whether Sky had struck the appropriate balance between the "extremes" of "accommodation" and "hostility" in relation to cable. The "accommodation" extreme recognised a number of advantages, including the potential to incentivise cable companies to sell more units and boost wholesale revenues by offering them greater margins, which would make them "less likely to go upstream and seek to buy their own content", and also to avoid the "risk of regulatory intervention". By contrast, under the "Hostile strategy" extreme the slides indicated that a stronger cable industry would make it "more difficult for Sky to acquire subscribers and grow DTH base" and that giving cable companies "a bit of" additional margin on premium channels would not necessarily result in a change of behaviour or higher wholesale revenues, but might risk cable companies undercutting Sky's retail prices and targeting satellite customers. (In the 2003 draft slides the postulated "downside" of giving cable additional margin was restricted to the risk of undercutting; the 2003 draft slides did not identify the risk of there being no resultant change in cable behaviour, in other words the risk that cable might simply pocket the extra margin, with no gain to Sky.)
592. In posing the question of whether Sky had "struck the right balance" the 2004 presentation noted at the outset that "Sky has tried to address decline in cable performance with new premium channel incentive deals" offering discounts to wholesale rates for additional premium subscribers; the slide acknowledges the limitations of those deals, such as their short term nature and the lack of a commitment to absolute wholesale prices for longer than 30 days.
593. VM submitted that the 2004 presentation evidenced Sky's ability and willingness to use its terms of supply, in particular by limiting the margin on the premium channels supplied to VM, to limit VM's ability to compete. VM also noted that, notwithstanding the reference to the contemplated commercial deals with Telewest

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<sup>627</sup> Darcey 1, paras 645-646.

and ntl, the presentation highlighted the limitations of those deals, and no deal was ultimately concluded, making the real position worse than that contemplated by the 2004 presentation.<sup>628</sup>

594. Ofcom concluded in relation to the 2004 presentation that it “demonstrated that Sky believed it could manage the level of competition from the cable industry through its wholesale pricing strategy”. It also stated that these slides show that “Sky weighed static and strategic considerations against each other when deciding how best to frame its approach to VM”.<sup>629</sup> Ofcom submitted further that the 2004 presentation demonstrated Sky’s recognition of a credible link between the size of a retailer’s subscriber base and its willingness to bid for sports rights.<sup>630</sup> This submission was based on the following reference in the 2004 presentation:

“Customers turned away from DTH may sign-up to other digital platforms (with lower barriers). Although Sky may still earn wholesale/advertising revenue, contribution likely to be significantly lower (than DTH), plus more difficult to induce switching (due to inertia), and helps competitors build critical mass (in rights buying etc.)”. (Ofcom’s emphasis)

595. In our view neither the 2003 draft slides nor the 2004 presentation constitutes “important evidence that Sky has an incentive to prevent Virgin Media from operating as an effective retail competitor”. Similarly, neither evidences a “wish to eliminate competition from cable” on the part of Sky. (See paragraph 7.254 of the Statement set out above.) We consider that Ofcom was in error in characterising the 2003 draft slides as such. Neither document can be said to encapsulate a final position taken by Sky in relation to its terms of supply to the cable companies (or indeed any other third party). In each case, the document expressly posits possible extremes of behaviour for debate, in the context of discussions within Sky which was examining its relationship with the cable companies upon the arrival of a new CEO and at a time when it was considering revised commercial deals with those companies (see paragraph 513 ff above).

596. The 2003 draft slides are expressed in loose language, with various sections and issues left blank to be completed at a later stage. There is no information as to the

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<sup>628</sup> VM written closing submissions, paras 8-13.

<sup>629</sup> Ofcom written closing submissions, Part 1, paras 266-267.

<sup>630</sup> Ofcom written closing submissions, Part 1, para 282.

identity of their author; nor is it known to whom they were circulated (if at all), although we understand from Mr Darcey's evidence that they were not shown to anyone within Sky's senior management team. Given their inchoate state, and the nature of the language used, it would be surprising if they had been. In our view these slides have no real probative value at all.

597. Elements of the 2003 draft slides were incorporated in the 2004 presentation. The 2004 presentation, which is not referred to in the Statement, was entitled a "Discussion Document" and describes itself as a "starting point for discussion" which "does not seek to provide exhaustive analysis or definitive answers" but "put[s] forward strawmen to stimulate debate."<sup>631</sup> It is clearly a wide-ranging and deliberately provocative document expressly designed to stimulate discussion. However, in our view one of its significant features is the fact that the very first observation in the final relevant slide (entitled "Have we struck right balance?"<sup>632</sup>) is the passage, noted above, namely that "Sky has tried to address decline in cable performance with new premium channel incentive deals." The remainder of the slide is largely concerned with factors possibly indicative of whether the contemplated deals go far enough to achieve the stated aim of incentivising cable. This is the clear tone of the slide, although it recognises that there may be scope, in the form of decisions to be made in the near future, to "shift the balance in one direction or the other." In our view this feature is not consistent with Ofcom's findings in paragraph 7.254 of the Statement that Sky wishes to eliminate or weaken cable. If anything the 2004 presentation supports the contrary view.

598. It is perfectly correct, as VM has pointed out, that these deals did not in the event materialise. However, for the reasons given below<sup>633</sup> we have concluded that Sky was negotiating in good faith and was acting reasonably and rationally from a commercial point of view in preferring to adhere to the existing supply arrangements in the absence of clear regulatory reassurance.

599. Nor do we consider that there is any real substance in Ofcom's submission that the 2004 presentation evidences a belief on the part of Sky that it could manage

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<sup>631</sup> Sky 8/1810.

<sup>632</sup> Sky 8/1834.

<sup>633</sup> Paras 740 to 757 of this judgment.

competition from the cable industry through its wholesale pricing strategy, or that Sky “weighed static and strategic considerations against each other” when deciding how to deal with VM. Whilst it would be absurd to pretend that there is not a relationship between wholesale prices and retail prices, the 2004 presentation is clearly centred on a profit/revenue maximising approach. Sky’s current aim was to incentivise cable, as the presentation shows. Even the slide describing a “hostile” extreme scenario focuses on the relative contributions/ revenues earned by Sky in various circumstances.<sup>634</sup> The same weighing of different “static” incentives is to be seen in the passage cited at paragraph 594 above, where a comparison is made between the size of wholesale revenue gained in the posited situation and the retail revenue lost.<sup>635</sup>

600. The slide relied upon by Ofcom as showing Sky’s recognition of a credible link between the size of a retailer’s subscriber base and its willingness to bid for sports rights must be read alongside another slide in the 2004 presentation which states that “Giving cable long-term security of supply of Sky’s channels on reasonable terms should make them less likely to go upstream and seek to buy content.”<sup>636</sup> Sky does not appear to dispute that there is a potential link between the size of a retailer’s subscriber base and its incentive to bid for content rights: its argument is that this is of a second order compared to the incentive to supply applicable to a large wholeseller.<sup>637</sup>
601. As a general comment, the language used in the 2004 presentation (e.g. “accommodation” and “hostile”) is common in business school type discussions, and the model of the presentation itself reflects contemporary scientific management practice.

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<sup>634</sup> Sky 8/1833.

<sup>635</sup> Sky 8/1821.

<sup>636</sup> Sky 8/1832.

<sup>637</sup> Sky written closing submissions in reply, paras 2.77 and 2.85-6.

(ii) *The 2006 email*

602. Ofcom describes the 2006 email in the Statement:

7.250 An August 2006 memo to Dawn Airey, of a meeting with James Murdoch, indicates that strategic considerations relating to retail competition are still regarded as important, and potentially outweigh revenue-based incentives to supply. In this case the strategic consideration appears to be the value to Sky of being the exclusive supplier of Sky 1. The memo reports Mr. Murdoch as being:

“of the view that exclusivity is worth more to us than we have assumed and that an extension of the current arrangements (even on a better mix of payments) would not be optimal”.”

603. Ofcom acknowledged in the Statement that this evidence relates to a *basic*, not a premium channel. However it stated that the evidence suggests that strategic considerations are predominant in this email, because Sky rules out the possibility of a “better mix of payments” (which would have been considered under a purely static calculation). Further, Ofcom stated that the fact that Sky was willing to forego wholesale revenues to protect the exclusivity of Sky One suggests that Sky would be even more concerned about a loss of exclusivity in the supply of core premium channels which are the key drivers of demand for pay TV subscriptions.<sup>638</sup>

604. In our view there is nothing in this point. The email does not relate in any way to the premium sports channels with which we are concerned in these appeals, but to basic channels (which, as we have seen, were later the subject of entirely separate and very acrimonious legal proceedings and a number of internal presentations and strategy discussions prepared by both Sky and VM). Nor is it clear to us that the email shows the weighing of “strategic” against “static” advantages as Ofcom states: it appears to contemplate “subscriber upsides” i.e. revenue from additional subscribers as a result of exclusivity for Sky One, as against the loss of advertising and other revenue. Both sides of the equation therefore appear to contain revenue-based factors. In any event no concluded view was arrived at, the matter was to be subject to further consideration and, as explained earlier, Sky and VM ultimately concluded a deal for the carriage of the basic channels so that the question of exclusivity was rejected.

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<sup>638</sup> Statement, para 7.256.

605. Ofcom did not refer further to the 2006 email in its submissions in these proceedings, nor was it referred to (or exhibited) by Dr Unger. In our view these omissions were well-judged. This email provides no support for Ofcom’s findings in paragraph 7.324 of the Statement

*The Tribunal’s conclusions – Sky’s internal documents*

606. For these reasons we do not consider that the internal documents in question support Ofcom’s finding of an incentive to weaken or eliminate VM’s effectiveness as a competitor. They do not affect our view of the evidence concerning the supply of interactive services, or otherwise.

607. Ofcom’s reliance on these documents elsewhere in the Statement in support of broader conclusions, is also misplaced. For example, paragraph 7.194 of the Statement contains the following:

“Sky’s approach to supplying Virgin Media, set out in paragraphs 7.248 to 7.259, provides further evidence of Sky’s reluctance to supply as a wholesaler... Sky initially responded to requests by Virgin Media for HD and interactive versions of its Core Premium channels by raising security issues and proposing a retail arrangement (i.e. similarly to its response to request for supply by other providers) even though Sky already has a wholesale arrangement with Virgin Media for its SD Core Premium channels...”.

608. Again, at paragraph 7.183 of the Statement, where Ofcom sets out the position that it took in its Third Pay TV Consultation, Ofcom states:

“We also cited evidence from our review of internal Sky documents relating to Sky’s supply of channels to Virgin Media (described in paragraphs 7.248 to 7.250 below) that Sky weighs short-term revenue considerations against its strategic incentive to weaken or eliminate Virgin Media as a competitor. We would expect Sky to take a similar approach in deciding whether to supply its Core Premium channels to other retailers.”

609. In our view, for the reasons we have given, these internal documents provide no support for such conclusions.

*Importance of interactivity for effective competition*

610. We now turn to the second of the two main issues relating to interactive services, namely whether the non-availability on cable of the interactive services in question has or would have the effect of prejudicing effective retail competition in CPSCs.
611. As noted earlier, Ofcom concluded that “while interactive services are important to a proportion of Sky customers, they are relatively less important than HD services.” Ofcom also found that Sky’s reluctance to allow access to interactive services, particularly to coverage of football matches subject to scheduling clashes, is likely to inhibit VM as an effective competitor to DTH satellite.<sup>639</sup> The basis for these findings appears to consist of submissions made to Ofcom by VM, together with independent research commissioned by Ofcom, namely the TNS report in November 2009.<sup>640</sup> The Tribunal was also shown independent research commissioned by VM’s legal advisers (the Oliver & Ohlbaum (“O&O”) survey of December 2008).
612. Ofcom refers to the TNS survey at paragraph 7.316 of the Statement, and records it as finding that “while 70% of Sky customers did not think red button features were important, 10% would not have chosen Sky if these features had not been available, and 26% would not give them up to save £10 per month”.
613. The specific questions (and results) in the TNS survey apparently relied upon by Ofcom for these conclusions are as follows.<sup>641</sup> First, 326 subscribers to Sky Sports were asked<sup>642</sup> whether they knew they could get extra features using the red button on Sky Sports if watching on DTH satellite. 84% said “Yes”. However, it is unclear what the spread of the sample was as between different platforms. Nor did the question address whether they knew of the red button effects before they chose their particular platform, and if so whether it influenced their choice. Second, 224 Sky Sports subscribers on Sky’s DTH satellite platform who were aware of the red

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<sup>639</sup> Statement, paras 7.316-7.

<sup>640</sup> Statement, paras 7.313-6.

<sup>641</sup> Statement, Annex 6, Appendix 5.

<sup>642</sup> Statement, Annex 6, Appendix 5, Figure 14.

button functionality were asked<sup>643</sup> how important the red button features on Sky Sports were to their choice of platform. 71% said they would have chosen Sky even if those features had not been available. 11% said they wouldn't have chosen Sky in the absence of the features. Third, 265 Sky Sports subscribers who were aware of the red button features on that channel were asked<sup>644</sup> if they would seriously consider changing to a Sky Sports subscription without the red button if it was cheaper than they currently paid. 27% said they would not seriously consider changing if the price was cheaper by £10 per month. However, this question seems to have been asked of subscribers on *all* platforms, and not just subscribers already enjoying the red button features. This raises the possibility that respondents without the red button might have chosen their platform for other reasons. In such cases their reluctance to change, for example, to a notional Sky DTH satellite platform without red button features, to save £10, would have little relevance. In those circumstances we are not sure how much reliance can be placed on the 26% in paragraph 7.316 of the Statement.

614. Sky pointed to a number of features of the TNS survey which, in its submission, demonstrates the negligible importance of interactivity in choice of platform. First, none of the (admittedly small) sample of 53 subscribers to Sky Sports on Sky's DTH satellite platform who *had* considered VM before choosing a platform, identified interactive services on sports when asked why they chose DTH satellite rather than VM for their Pay TV service.<sup>645</sup> 4% (or two people) did identify this as a reason when prompted to give a further reason for not choosing VM. Second, when 242 Sky Sports subscribers on Sky's DTH satellite platform who had *not* considered VM for their Pay TV service were asked why they had not considered VM or cable, none was said to have identified interactive or red button services as a reason.<sup>646</sup> When prompted to give a further reason, again none apparently identified interactive services. These responses do not seem to be referred to by Ofcom in the section of Annex 6 to the Statement dealing with the importance of interactive services.<sup>647</sup>

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<sup>643</sup> Statement, Annex 6, Appendix 5, Figure 15.

<sup>644</sup> Statement, Annex 6, Appendix 5, Figure 17.

<sup>645</sup> Statement, Annex 6, Appendix 5, Figure 5.

<sup>646</sup> Statement, Annex 6, Appendix 5, Figure 6.

<sup>647</sup> Statement, Annex 6, Appendix 5, para 5.43ff.

615. In the light of the above it seems to us that the results of the TNS survey are somewhat equivocal. The suggestion that for one in ten of Sky Sports customers on the satellite platform interactive services are of decisive importance, is qualified by the responses to the question which asked why respondents had chosen to receive Sky Sports on satellite instead of on cable. The latter appear to indicate that interactivity is of importance to considerably fewer than one in ten. We should also say that we do not agree with Ofcom's suggestion<sup>648</sup> that the one in ten of Sky's satellite subscribers questioned who stated that they would not have so subscribed had interactivity not been available, would in that event probably not have subscribed to core premium channels at all. This seems to be reading too much into the responses.
616. The O&O survey in December 2008, commissioned by VM's legal advisers, polled a larger number of people: 1,010 in Survey 1, and 1,002 in Survey 2. The surveys were carried out on-line. Survey 1 is relevant for present purposes. The respondents were asked which of several features they regarded as "essential" when choosing a Pay TV sports package. 8% of the base identified the red button.<sup>649</sup> Two points about the nature of the respondent base may be made. First, it is possible that the fact that the respondents were polled exclusively on-line means they were more amenable to electronic technology than the public at large. Second, although the qualification to be a respondent was that he or she was interested in sport, and those who were not sports fans were rejected,<sup>650</sup> it is not clear from the report that respondents needed to be subscribers to premium channels or even to be Pay TV subscribers at all.
617. On the basis of these two reports we do not consider that one could judge with any confidence how important interactive services are to effective competition in CPSCs. If anything the reports might be said to indicate that the great majority of those questioned do not ascribe much importance to them.
618. Ofcom returned to the importance of interactive services in section 9 of the Statement, when considering a different point, namely whether the content available

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<sup>648</sup> Statement, Annex 6, Appendix 5, para 5.45.

<sup>649</sup> VM 2/6B/547 (internal page 23).

<sup>650</sup> VM 2/6B/528 (internal page 4).

via these services, in particular “primary interactive material such as Champions League matches”, was sufficiently important to justify including the services within the WMO remedy. At paragraph 9.292 of the Statement, Ofcom referred to the following sources:

(a) Viewing data figures (compiled by the Broadcasters’ Audience Research Board (“BARB”)) showing that the average audience across Sky’s “interactive screens” for “several Champions League nights” was 80,000, and that individual matches on interactive screens regularly commanded more viewers than those on Sky Sports 3, and in one instance more than on Sky Sports 1.

(b) Consumer research undertaken by Ofcom in December 2009 showing that the majority of respondents (43%) valued live Champions League matches as the most important feature in Sky’s interactive service.

619. Ofcom’s “main concern” about excluding interactive services from the scope of the WMO was that the effectiveness of the remedy might be compromised if Sky were to *move* premium content from its linear channels and make it available only behind the red button. Ofcom concluded that the risk of “gaming” in that way by Sky, together with the potential for other retailers to have to offer a “sub-standard” version of the channels outweighed the substantial cost to Sky of including interactive in the WMO.

620. However, Ofcom also concluded from this research that Pay TV customers “attach significant value to having an ability to watch live videostreams of sports matches that are broadcast as part of an event shown on Sky Sports 1 or Sky Sports 2”. It referred to the example of a La Liga match between Barcelona and Real Madrid on 29 November 2009, the first half of which was screened exclusively via the red button, leading to a strong reaction from those cable customers who were unable to watch this half of the match. Ofcom stated that this reaction was illustrative of a “broader concern”, that excluding interactive services from a WMO remedy would degrade the services of other retailers offering core premium channels.

621. This additional data and analysis is not referred to in section 7 of the Statement dealing with Ofcom's competition concerns. The material in sub-paragraph 618(b) above may be derived from the TNS report, but its origin is not entirely clear.<sup>651</sup>
622. In response to it, and generally, Sky referred to the evidence before the Tribunal showing red button services to be unimportant as a driver for competition.<sup>652</sup> This included Mr Darcey's evidence that Sky has an incentive to ensure that it schedules events on its linear premium sports channels in such a way as to create the most attractive channels possible, helping to maximise the value that sports customers across all platforms receive from their subscriptions and to attract new sports subscribers.<sup>653</sup> Mr Darcey said that the red button "is not an effective means of optimising viewing and so Sky makes a real effort to avoid putting attractive content behind it."<sup>654</sup> In terms of the need to boost advertising revenue, it was not in Sky's interest to put valuable content there unless Sky had no other choice.<sup>655</sup> He emphasised that for these reasons Sky did not use interactive options as a selling point for the channels.
623. Mr Darcey provided examples of the considerable difference in viewing numbers as between content behind the red button and similar content on a linear sports channel.<sup>656</sup> One such example, involving live Spanish football, was a match between Real Madrid and Valencia in 2010 shown behind the red button. This attracted an average of 66,000 viewers as against an average of 199,000 for Real Madrid matches shown on Sky Sports 3 and 4. Mr Darcey's analysis of viewing figures overall showed that Sky Interactive's share of viewing across Sky Sports 1 to 4 in Sky DTH satellite homes for 2009 was just 0.05%.<sup>657</sup> (See also paragraph 533 above.)
624. As regards Champions League matches specifically, Mr Darcey pointed out that the "concern relates to the least attractive all-foreign pool stage matches", and that the

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<sup>651</sup> See Statement, Annex 6, para 5.22, and figure 16 (referred to as "Figure 20").

<sup>652</sup> Sky's written closing submissions in reply, para 4.34-4.35, referring in particular to the material set out at paras 10.82 to 10.125 of its written closing submissions (Part A).

<sup>653</sup> Darcey 3, paras 630-634.

<sup>654</sup> Darcey 3, para 635.

<sup>655</sup> Darcey 3, para 634

<sup>656</sup> Darcey 3, para 635.

<sup>657</sup> Darcey 3, footnote 445.

matches in the knock-out stage of the tournament are not behind the red button but shown on the main channels. Further, the interactive application for Sky's Champions League coverage relates not to the CPSCs but only to matches shown on Sky Sports 4, which is not the subject of the WMO remedy in any event.<sup>658</sup> He also said that demand for red button matches in that contest is modest given that a viewer watching the red button match must prefer to watch non-Premier League teams, to watching either of the Premier League matches simultaneously available on the main channels. Finally, he pointed out that VM could itself have acquired the rights for a modest sum but apparently chose not to bid.<sup>659</sup>

625. When considering whether lack of access to interactive services is likely to inhibit the effectiveness of VM as a competitor to Sky's DTH satellite service, the further data described at paragraph 618 above do not provide us with much more assistance than the material which was referred to in section 7 of the Statement. The sources to which Ofcom refers are primarily concerned with access to certain Champions League pool stage matches shown prior to the knock out "round of sixteen" stages. As mentioned above, the knock-out stage matches of the Champions League are shown only on the linear channels. (The particular example of a complaint from cable customers relates to the separate La Liga tournament.) The consumer research showing that 43% of respondents considered live Champions League matches to be the most important feature of Sky's interactive services, seems to represent a relative ranking of features *within* the group of interactive services, and tells us little about the importance of interactivity as a competitive tool. VM's customers may attach a relatively higher value to other service features offered by VM (and which may not be available to Sky DTH satellite customers). Divorced from context, it is difficult to draw any firm conclusions from this data. In relation to viewing figures, the interactive share of viewing across channels Sky Sports 1 to 4 in DTH satellite homes (0.05% in 2009) seems to provide a better picture of the relative importance overall of this enhanced service than the specific examples given by the parties.
626. More generally there appears to be no evidence to support Ms Burns' claim that the inability to offer interactivity available on the DTH satellite platform has adversely

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<sup>658</sup> Darcey 3, para 720.

<sup>659</sup> Darcey 3, para 719-726.

affected the penetration of Sky's premium channels on cable, or which shows that the non-availability of interactive services has had a significant impact on the reasons why a subscriber chose Sky over VM (or on a decision to upgrade or to churn away from VM to Sky).

627. It is also important to bear in mind the nature and cost of the content used for the Football First service. As already mentioned, not all Premier League games are licensed for live broadcast.<sup>660</sup> Only 138 out of 380 games are so licensed. The remainder, the less attractive matches, are licensed to be broadcast on a delayed basis or in extended highlights form. The amounts paid for rights to this "near-live" content at the three auctions since 2003 has been [...] [C] modest compared to the cost of the live rights. In the 2009 auction the amount paid by Sky in respect of the three following seasons was £[...] [C], compared with £1,623 million for the live rights. (Further, the price paid for the near-live rights had [...] [C].) Although, as Mr Darcey pointed out, VM could have bid for and purchased this near-live content for a relatively modest cost, it had not done so. Moreover, Mr Darcey states that neither BT nor TUTV has ever expressed an interest in acquiring the Football First content, and that in 2009 Sky could not persuade BT to contribute even £[...] [C] to buy some of the rights then being sold, although at previous auctions BT and Sky had jointly purchased some. Sky therefore bought the rights.

628. In summary, our findings on the basis of all the material before us are as follows. The research evidence is equivocal as to the importance of the services in the eyes of subscribers. Although it is clear that the cable companies were keen to have access to the services (or to the underlying content), they did not value them sufficiently to indicate to Sky that they were prepared to pay anything extra. Nor, apparently, did they regard the services as important enough for them to make a concerted effort to purchase the relatively inexpensive near-live rights which would have reduced their dependence on Sky in this respect. Moreover, Mr Darcey's description of the content shown behind the red button, which was not challenged, indicates why the rights have been so much less expensive to acquire than the live rights - the material is correspondingly less appealing to subscribers. Interactive's

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<sup>660</sup> See para 533 of this judgment.

overall share of viewing in homes served by Sky's DTH satellite service tends to confirm this picture.

629. We remind ourselves that in considering whether the non-availability on cable of the interactive services in question prejudices effective retail competition in CPSCs Ofcom was exercising its judgment as it was required to do under the relevant legislation. Accordingly the Tribunal when reviewing on appeal the exercise of that judgment should apply the principles discussed in section IV of this judgment, and which we have sought to distil at paragraph 84.
630. Attaching due weight to Ofcom's reasoning and its decision, and mindful that the Tribunal should not interfere unless satisfied that the decision is wrong, we have nevertheless concluded in the light of our findings above that the non-availability of interactive services on cable is not liable to prejudice fair and effective competition in the retailing of those channels, or to make any significant contribution to such an effect in combination with other factors, and we are satisfied that Ofcom was wrong to find otherwise.

*The Tribunal's overall conclusion: interactive services*

631. The evidence concerning enhanced or interactive services, including that related to Sky's conduct in the relevant negotiations with the cable companies, provides no support for Ofcom's central finding that Sky has withheld wholesale supply of its premium sports channels to other retailers. Nor does the evidence justify a finding that the conduct in question was motivated by a desire to weaken competition from the cable companies. Rather, Sky's attitude to the supply of these services appears to have been based on legitimate commercial considerations. Sky's conduct reveals no "practice" on the part of Sky which would itself be liable to prejudice effective retail competition in the supply of CPSCs, or which would make a significant contribution to such an effect in combination with other factors.

### *Negotiations with VM in relation to HD services*

632. We have already referred at paragraph 528 above to 7.235 of the Statement, where Ofcom identifies the specific question that it is considering in relation to both HD<sup>661</sup> and interactive services, namely whether Sky has sought to avoid supplying this content to VM and if so whether this is prejudicial to fair and effective competition.

633. At 7.312 of the Statement, Ofcom sets out its overall conclusion specifically in relation to HD:

“Our view is that, given the increasing importance of HD as a means of viewing premium content, the non-supply of the HD versions of Sky’s Core Premium channels to Virgin Media is and will prevent Virgin Media from competing effectively.”

634. In the Statement, Ofcom states that VM had highlighted the “non-supply of Sky HD services” as a concern in response to Ofcom’s Second Pay TV Consultation, and noted VM’s claim that it had repeatedly asked Sky to supply VM with HD versions of its channels, but that VM had not succeeded in progressing any form of discussions, with Sky using “a number of stalling techniques to justify its refusal to supply HD.”<sup>662</sup> Ofcom went on to consider evidence of the importance of HD content, before turning to the evidence of Sky’s behaviour during negotiations for supply of HD versions of the channels. A summary of that evidence is set out at paragraph 7.61 of the Statement:

“Virgin Media’s predecessors (ntl and Telewest) initially inquired about the wholesale supply of high definition versions of Sky’s premium channels in 2005. However, there was no correspondence on this point between the parties until mid-2007 when Virgin Media approached Sky to request the supply of Sky’s premium channels on Virgin Media’s off-net platform, and the supply of Sky’s HD premium channels, along with other changes in their agreement. As was the case with the ITPV potential operator [Orange] and BT, Sky’s preference was to enter into a retail (Sky By Wire) deal with Virgin Media, while Virgin Media’s preference was for a wholesale deal. The correspondence continued for several months, to November 2007, but no agreement was reached. In March 2009, Virgin Media issued a request for proposals from channel providers wishing to distribute HD content over its cable platform. Sky approached Virgin Media with a proposal to

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<sup>661</sup> High definition (or “HD”) television provides viewers with a higher picture resolution than standard definition (“SD”) digital television. In order to view TV signals broadcast in HD, consumers require a TV capable of displaying HD pictures and an HD-compatible STB.

<sup>662</sup> Statement, para 7.291.

supply a number of its HD channels on a wholesale basis. Sky indicated that due to Virgin Media's 5/6 channel limit, its proposal focused on the basics and sport HD channel offerings, but Sky also offered to develop "an attractive Sky Movies HD proposal for Virgin Media". At the same time, Sky expressed interest in acquiring Virgin's content business. Negotiations have continued over both of these issues in tandem, but no agreement has been concluded to date..."

635. At 7.299 to 7.304 of the Statement, Ofcom referred to the documentary evidence about negotiations for the supply by Sky of HD services, to which we will return in detail below. From this evidence Ofcom disputed Sky's claim that it had offered its HD sports channels to VM "at the first genuine opportunity", namely in response to a "request for proposal" issued by VM in 2009 (see paragraph 684 below). Rather, Ofcom concluded that an earlier request by VM in 2007 for wholesale supply of Sky's HD channels was a genuine opportunity for Sky to make its HD premium channels available to VM. Ofcom stated that, instead of engaging with this opportunity, Sky raised a series of obstacles to a wholesale agreement, and put the onus firmly on VM to overcome them, without setting out any proposals or suggestions as to how VM could address Sky's concerns or demonstrate to Sky's satisfaction that sufficient extra revenue would be generated by the proposal or that it would be better off under a wholesale deal.<sup>663</sup> Ofcom's conclusion about the relevant 2007 correspondence was that, although it left open the possibility of further discussion, it also signalled that Sky would be unlikely to take a constructive approach in any such discussions.<sup>664</sup>
636. Ofcom stated that negotiations between VM and Sky since early 2009 had "developed considerably" from the position in 2007. However, it noted that these had not yet led to agreement, and that it was unclear whether Sky would have an incentive to reach an agreement following the conclusion of Ofcom's market review. It pointed to VM's evidence that Sky's security concerns had not yet been resolved.<sup>665</sup>
637. Sky disputed Ofcom's conclusions in relation to HD, stating that it had never spurned a genuine opportunity to supply VM with the HD versions of its CPSCs (still less that it had done so in pursuit of the alleged strategic incentives), and that a

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<sup>663</sup> Statement, paras 7.305-7.309.

<sup>664</sup> Statement, para 7.310.

<sup>665</sup> Statement, para 7.311.

deal with VM on HD supply would certainly have been concluded without Ofcom's intervention.<sup>666</sup>

638. As with interactive services, in order to assess Ofcom's conclusion in the light of Sky's challenge, we will need to refer to the relevant negotiations with VM and its predecessors as revealed in the contemporaneous documents.

#### The documentary evidence relating to the HD negotiations

639. In the section of the Statement that sets out Ofcom's conclusions about HD,<sup>667</sup> Ofcom focussed on two examples of Sky's behaviour, namely the failure to respond to a genuine commercial opportunity in 2007, and the fact that, by the time of publication of the Statement, a deal had not yet been concluded as a result of Sky's response to VM's 2009 "request for proposal".
640. Although Ofcom does not refer in any detail in the Statement to earlier discussions of HD between Sky and the cable companies in 2005 and 2006, Dr Unger draws certain conclusions about these discussions in his evidence. In particular, his view was that they demonstrated that the cable companies had expressed a clear interest in obtaining HD channels and content when such services were launched,<sup>668</sup> and that Sky could have supplied its HD channels to these companies if it had wanted to, as the merged ntl/Telewest would clearly have HD capability.<sup>669</sup> We therefore first consider the pre-2007 documentary evidence before turning to the later discussions in 2007 and 2009.

#### Discussions about HD in 2005-2006

641. On 9 and 10 August 2005, meetings took place between Sky and each of ntl and Telewest, at which there was some initial discussion of HD services. The Sky/ntl meeting on 9 August 2005 was attended by Mr Katz and Ms Stanton of ntl and by Mr Rey and Mr Middleton of Sky. We were shown ntl's note of that meeting,

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<sup>666</sup> Sky written closing submissions, Part A, paras 10.19-10.20.

<sup>667</sup> Statement, paras 7.305-7.312.

<sup>668</sup> Unger 1, para 432.

<sup>669</sup> Unger 1, para 435.

prepared by Ms Stanton.<sup>670</sup> In relation to HD, Mr Rey is said to have confirmed that Sky would “do something in 2006”, but that its focus was to launch its own services, with no immediate plans to involve other platforms. Mr Katz was said to have asked for some visibility of Sky’s intentions in order to prioritise its development, and that cable movie subscribers might be disadvantaged if Sky did not make broadband content available to them. He confirmed this in a subsequent letter to Mr Rey on 14 September 2005,<sup>671</sup> which recorded Mr Katz’ understanding that Sky had no immediate plans to involve any other platform in the distribution of HD and broadband content and that ntl “should not prioritise its own plans in these areas expectant [on] the receipt of Sky content.”

642. Although we were not shown a note of the Sky/Telewest meeting on 10 August 2005 (to which we have already referred at paragraph 555 above), we were shown a letter from Ms Burns to Mr Rey on 19 September 2005,<sup>672</sup> referencing that meeting. She noted in that letter that the Telewest PVR included the functionality to broadcast content in HD. In this regard, she stated: “We are interested in carrying Sky HDTV content, particularly the Premier League football matches that will be filmed beginning in the 2005/06 season.”
643. Mr Rey responded separately to the letters from Mr Katz (for ntl) on 21 October 2005<sup>673</sup> and Ms Burns (for Telewest) on 28 October 2005.<sup>674</sup> In relation to HD, his response to each company was identical, referring to the fact that Sky’s ability to launch innovative services at the earliest opportunity was considerably greater for DTH satellite customers than for closed platforms such as those of the cable operators, as Sky had no direct access to or influence on the architecture of such platforms or related systems such as client relationship management systems. He stated that Sky had not considered in any great detail whether, or how, HD services might be offered to distributors on other platforms, but that “this is something we can begin assessing fully once these services are through their launch phase.”

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<sup>670</sup> Ofcom 6/2719-2720.

<sup>671</sup> Ofcom 6/2737-2738.

<sup>672</sup> VM 5/2/K/203.

<sup>673</sup> Ofcom 6/2741-2742; Sky 8/1619-1620.

<sup>674</sup> VM 5/2/L/207.

644. We were not shown any specific response from Telewest to this letter (or indeed any further HD-related correspondence concerning Telewest prior to its merger with ntl), although Mr Burns stated in her evidence that, subsequent to her letter of 19 September 2005, “despite Telewest’s efforts, Sky did not engage constructively with Telewest as regards the supply of HD channels and no progress towards a HD carriage agreement was made.”<sup>675</sup> However, Ms Burns accepted in cross-examination that it was “ludicrous” to suggest that Sky would have given away HD content in response to her request of 19 September 2005, as Sky did not itself propose to use this content (relating to the 2005/6 FAPL season) on its own platform, Sky cameramen were still learning how to use their cameras, and the company was continuing to iron out glitches with HD.<sup>676</sup>
645. ntl did respond to Mr Rey’s letter of 21 October 2005. Mr Katz was blunt in his response of 8 November 2005.<sup>677</sup> Under the heading “Broadband and High Definition Content”, Mr Katz stated: “again we would urge Sky to consider how withholding this content will discriminate against its customers on the cable platform versus its DTH customers.” Mr Katz’ approach corresponded with the view taken in an internal ntl strategy document, dated August 2005.<sup>678</sup> The document noted that there was a need to source HD content, and that Sky had “already refused” supply.
646. A further meeting took place between ntl and Sky at Sky’s Isleworth office on 30 November 2005, and we were again shown a meeting note prepared by Ms Stanton,<sup>679</sup> together with a largely redacted version of Sky’s own meeting note.<sup>680</sup> Although much of this meeting related to the supply of non-sports content, there was some discussion of Sky’s proposed launch of sports (and other) content via broadband and in HD format, although Sky again confirmed that its focus was on its own launch to DTH satellite customers. In that meeting, ntl confirmed that it was working on its own launch of an HD offering, together with the BBC and other broadcasters.

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<sup>675</sup> Burns 3, paras 80-83.

<sup>676</sup> Transcript 10/52:3-14.

<sup>677</sup> Ofcom 6/2743-2744.

<sup>678</sup> Ofcom 6/2721-2735.

<sup>679</sup> Ofcom 6/2749-2751.

<sup>680</sup> Ofcom 6/2753-2755; Sky 8/1621-1624.

647. Further meetings took place between Sky and the merged ntl/Telewest on 11 May 2006 and 16 June 2006, attended on each occasion by Mr Rey, Mr Jacquet and Mr Middleton of Sky, and Mr Katz, Ms Twiss and Ms Stanton of ntl. We were shown Ms Stanton's notes of each meeting,<sup>681</sup> together with Mr Jacquet's note (dated 21 June 2006) of the meeting on 16 June 2006.<sup>682</sup> Both meetings covered a wide range of topics, including the agreements between the parties concerning the supply of basic channels, piracy issues, and other technical matters. In relation to HD, Mr Rey once again reported that Sky was focussed on its own launch of HD channels and had no plans to make these available to cable. According to Ms Stanton's note, at the meeting on 16 June 2006, Mr Katz is said to have "again requested that Sky offer ntl:Telewest their HD channels" and that "ntl:Telewest would clearly favour launch [of] an HD channel over an SD channel so if HD is not available from Sky bandwidth would go to other HD channels." Mr Rey's position was said not to have changed from the earlier meeting. In an internal ntl email sent on 21 June 2006,<sup>683</sup> Mr Katz summarised the meeting on 16 June 2006, stating in relation to "Premium HD/BB/VOD" that "Sky maintained their position that they would refuse to supply this content", and that the "current impasse... continues".
648. However, Sky's own note of the meeting on 16 June 2006 made no reference to the request by Mr Katz for HD channels. The relevant part of the note states as follows in relation to HD:

"They referred to existing bandwidth constraints on [ntl's] network which would continue until at least the middle of next year together with the focus on HD as meaning that any addition of a new SD channel to the ntl network as having to undergo a rigorous business case (but note would not stop existing Sky Channels on ntl being put onto Telewest).

VOD / HD / Broadband – Cable UK explained that availability of basic channels' content across these platforms / services was key as it is seen as a point of differentiation with competing platforms. The availability of that content in these formats for distribution by Cable UK was stated to be critical to the ongoing value of a channel to them. On HD, Sky stuck to the position as per last meeting."

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<sup>681</sup> Ofcom 7/2885-2886; Ofcom 7/2895-2896.

<sup>682</sup> Note that this document was provided after Mr Darcey referred (in cross-examination) to Sky's own note of the meeting, and that this gave a different impression from ntl's note. See PL17/15.

<sup>683</sup> Ofcom 7/2897.

*The Tribunal's discussion and conclusions – discussions about HD in 2005-2006*

649. It is appropriate to pause here (as we were not taken to any further discussions about HD between Sky and the cable operators until those in 2007) and consider the conclusions drawn by Ofcom and Dr Unger from this evidence of discussions in 2005 and 2006. Dr Unger states that, notwithstanding the fact that Sky did not itself launch any HD channels until June 2006,<sup>684</sup> the early discussions with ntl in 2005 and 2006 demonstrate that ntl had expressed a clear interest in obtaining HD channels and content when such services were launched, and that Sky was “at best undecided as to whether to agree to such supply”.<sup>685</sup>
650. He stated that this was borne out by an internal Sky memo dated 24 March 2006,<sup>686</sup> which in his view showed that Sky was considering the possibility of delaying the supply of this content to cable.<sup>687</sup> The Tribunal has considered that memo, which appeared to have been prepared in anticipation of the renegotiation of various deals involving Sky, Flextech and UKTV channels at the end of 2006, and which presented various commercial strategies for consideration. In relation to “Premium HD content”, the memo stated<sup>688</sup> that “Sky faces options whether to offer HD content in the short term, only in the medium term or not at all.” It is also clear from the memo that Sky contemplated the possibility of the cable operators winning three or more packs of FAPL rights, and that Sky’s position regarding the supply of premium sports HD and VOD rights would change as a consequence.
651. Dr Unger stated that it was clear from the discussions in 2006 between Sky and ntl/Telewest that:

“...Sky could have supplied its HD channels to cable if it had wanted to, and that following the merger of ntl and Telewest, the merged company would clearly have HD capability. ntl was clearly requesting Sky’s HD channels. Sky’s reason for not supplying them was simply that it was “focussed on the DTH launch”. I note in

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<sup>684</sup> Mr Darcey confirms in his evidence that the HD channels launched in June 2006 (Darcey 1, para 593). However, he refers to the launch of Sky’s HD service in May 2006 (Darcey 1, para 85). We take June 2006 as the launch date of HD channels in the rest of this section.

<sup>685</sup> Unger 1, para 432.

<sup>686</sup> Ofcom 6/2825-2836.

<sup>687</sup> Unger 1, para 433.

<sup>688</sup> Ofcom 6/2834.

particular that Telewest launched its HD services in December, 6 months before Sky launched its service on DSat.”<sup>689</sup>

652. Mr Darcey disputed the suggestion that the discussions between Sky and the cable operators in 2005 and 2006 could evidence any refusal to supply channels in HD, pointing to the fact that Sky did not launch its own HD channels until June 2006. In particular, he stated that Sky would not have been in a position to determine a sensible wholesale price for its HD channels before it had launched its own DTH satellite service and had had a chance to establish the level of demand.<sup>690</sup> He added that, in his view, it was perfectly legitimate for Sky to have a period of exclusivity in respect of “entirely new, innovative products such as HD”, during which Sky would seek to build demand.<sup>691</sup> In its closing submissions Sky describes the discussions between Sky and the cable operators in 2005 and 2006 as “merely expressions of general interest in HD and attempts to understand how HD was progressing within Sky, in case VM subsequently decided to launch a HD service of its own”.<sup>692</sup>
653. There was some dispute between the parties as to whether or not the cable operators were requesting linear HD channels in 2005 and 2006, as distinct from HD content (Dr Unger’s conclusion at paragraph 651 above was that “ntl was clearly requesting Sky’s HD channels”). Ms Burns’ evidence on this issue was somewhat less categorical: she appeared to agree in cross-examination that a request from Telewest in September 2005 related to HD content rather than linear channels,<sup>693</sup> and that the request for such content at a time when Sky were still learning how to use it themselves was not realistic.<sup>694</sup> A little later she expressed the view that in the period 2005/6 the context would not have indicated on-demand content and would have been referring to linear channels,<sup>695</sup> although she frankly accepted that in relation to Telewest’s September 2005 communication she did not know which it was.<sup>696</sup> She referred to the contacts about HD between ntl and Sky in 2005 as

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<sup>689</sup> Unger 1, para 435.

<sup>690</sup> Darcey 1, para 593.

<sup>691</sup> Darcey 1, para 600.

<sup>692</sup> Sky written closing submissions, Part A, para 10.37.

<sup>693</sup> Transcript 10/51-52.

<sup>694</sup> Transcript 10/52.

<sup>695</sup> Transcript 10/53 and 10/60.

<sup>696</sup> Transcript 10/53.

amounting to “interest, but not an offer”,<sup>697</sup> and she stated that the absence of any specific action points relating to HD in discussions between Sky and ntl in November 2005 was not “surprising given that the channel hadn’t launched yet.”<sup>698</sup> In relation to 2006, Ms Burns said that she was not directly involved with the content acquisition group and could not comment on any requests. However, she initially appeared to state that she did not believe there were any requests in the period between 16 June 2006 and 8 June 2007.<sup>699</sup> A little later in her evidence she stated that she believed there had been requests in 2006.<sup>700</sup>

654. Although ntl/Telewest’s note of the meeting on 16 June 2006 refers to “HD channels”, and does so in a separate paragraph from a reference to “wider rights – eg VOD, HD, multiscreen, broadband – beyond the pure linear content”, Mr Darcey’s evidence was that the relevant context for that meeting was the renewal of the carriage agreements for Sky’s basic channels, and that there was some interest in obtaining HD VOD *content* in relation to those channels. He explained that this was borne out by the negotiations in relation to basic channels at the beginning of 2007, when the cable companies again expressed interest in HD VOD content, rather than HD linear channels.<sup>701</sup>
655. Having reviewed the relevant documentary evidence and considered the explanations provided by the witnesses in relation to that evidence, we are satisfied that Sky was not presented with a firm proposal by the cable operators for supply of the linear HD premium sports channels in 2005 and 2006. VM expressly disavowed any such suggestion in its closing submissions.<sup>702</sup> Rather, the evidence demonstrates an understandable interest by the cable operators in Sky’s plans for HD, probably including HD channels generally.
656. Even if the cable operators had requested HD versions of Sky’s linear sports channels in 2005 and 2006 (as opposed to expressing “some general, unspecified,

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<sup>697</sup> Transcript 10/46-47.

<sup>698</sup> Transcript 10/50.

<sup>699</sup> Transcript 10/61.

<sup>700</sup> Transcript 10/64-65.

<sup>701</sup> Transcript 5/17:8-23:19.

<sup>702</sup> See the submissions of leading counsel for VM at Transcript 32/42-43.

interest in HD services”<sup>703</sup>), there are question marks over the validity of Dr Unger’s conclusions (see paragraph 651 above) that (1) Sky could, at that time, have supplied these channels if it had wanted to and (2) that the cable operators would “clearly have HD capability”.

657. First, as Dr Unger acknowledged, Sky was not itself providing these services to its own customers before June 2006. Sky’s position prior to that date was consistently and clearly expressed to the cable operators, namely that Sky was focussed on its own launch of HD channels on the DTH satellite platform. As Ms Burns accepted, Sky would be learning how to use their HD equipment and ironing out glitches in order to enable the service to be provided on the satellite platform. In those circumstances any concrete request (as opposed to an expression of interest) from the cable platform would appear to be premature and unrealistic. Mr Darcey’s evidence (paragraph 652 above) that Sky was not in a position sensibly to determine the terms on which HD channels would be offered to other platforms until it had a clear view of customer demand is, in our view, reasonable.

658. Second, in light of the Tribunal’s conclusions at paragraphs 676 to 681 below, it is important to distinguish “HD capability” from the question of whether the cable operators’ had sufficient capacity to offer HD versions of the CPSCs, in light of existing constraints (in particular the capacity taken up by existing analogue customers). Whilst the cable operators clearly were capable of launching HD services generally, as evidenced by Telewest’s launch of an HD STB at the end of 2005, and carriage of the BBC HD channel from May 2006, we are not persuaded that the cable companies had the necessary capacity to launch a suite of HD channels until VM’s 2009 “request for proposal” (described at paragraph 684 below). Indeed, the cable companies continued to operate just one HD channel (BBC HD) until 2009.

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<sup>703</sup> Sky written closing submissions, Part A, para 10.44.

## Discussions about HD in 2007

659. The next substantive period of engagement between the cable operators and Sky regarding HD came in 2007, by which point ntl/Telewest had rebranded under the name “Virgin Media”. However, the discussions that took place in 2007 were set against the backdrop of the serious commercial dispute between Sky and VM regarding the supply of basic channels, which we have summarised at paragraph 504 above.
660. A further element of the backdrop in 2007 was that, on 16 January 2007, the cable companies had participated in the joint complaint to Ofcom (see paragraph 189 above). Annexed to that complaint was an “outline of problems encountered by ntl”, which included a section titled “Sky’s refusal to supply HD channels to ntl”. The cable companies alleged: “Despite NTL’s technical ability and commercial desire to carry Sky’s HD channels, which it has communicated to Sky on a number of occasions, Sky has declined to supply these channels to NTL.”<sup>704</sup>
661. Against this background the meeting of 9 May 2007 took place between Mr Darcey and Mr Wall, VM’s Chief Executive Officer for Content. As already noted<sup>705</sup> there is some dispute about what was discussed. But following the meeting Mr Wall wrote to Mr Darcey on 8 June 2007.<sup>706</sup> In his letter which, as we have seen,<sup>707</sup> more broadly concerned the possibility of securing a new long-term agreement between Sky and VM in respect of the premium channels, Mr Wall expressed the view that the product made available by Sky to VM was a “poor relation” of the content available on DTH satellite, in so far as interactive and HD content was not made available, “despite repeated requests”, making it more difficult for VM to market and sell the channels. He suggested that Sky and VM should accept a series of general principles for negotiations, including an obligation on Sky to license distribution of premium content that would match Sky’s DTH satellite offering, and

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<sup>704</sup> Ofcom 7/3271.

<sup>705</sup> Para 558 of this judgment.

<sup>706</sup> Ofcom 7/3329-3330; Sky 8/1625-1626.

<sup>707</sup> Para 559 of this judgment.

would include channels in both SD and HD format, together with all relevant interactive content, VOD and subscription VOD (“SVOD”) content.

662. In his reply on 30 August 2007,<sup>708</sup> Mr Darcey expressed surprise at Mr Wall’s suggestion that VM had been pressing for the supply of HD services, observing that this conflicted with statements made by VM’s then CEO, Mr Steve Burch, at a recent conference, in which he had apparently been dismissive of the attractiveness of HD sport. Mr Darcey’s letter went on to state that there were technical and security issues that would first need to be considered before the services could be provided on cable, in particular “long-standing concerns” as to the integrity of the cable network. He added that Sky would wish to consider whether a self-retail arrangement for HD channels would be preferable, and that Sky would need to consider whether the extra revenue from HD services “makes the endeavour worthwhile”.

663. The letter concluded:

“We would, as always, prefer to address your points through negotiation and, if your apparent willingness to negotiate is genuine, we would welcome further discussion. You will understand that we have reservations on this score, given that many of the points made in your letter are directly relevant to your complaint to Ofcom (the review of which, given its late disclosure to us, has delayed this reply). Please let us know whether you intend to proceed by negotiation, or whether you prefer instead to await the outcome of your complaint to Ofcom.”

664. It appears that Mr Darcey was referring here to the supplemental submissions to Ofcom made by VM and the other parties to the joint complaint on 3 July 2007. We referred earlier to his evidence that Mr Wall’s letter appeared to have been written mainly to bolster the joint complaint to Ofcom.<sup>709</sup> We return to this aspect below.<sup>710</sup>

665. Mr Wall responded to Mr Darcey’s letter on 7 November 2007.<sup>711</sup> In relation to premium HD services, Mr Wall stated that VM “have regularly over the last couple of years requested from you Sky’s HD content”, but had been told that Sky was focussed on its own launch and would not be offering its HD services to third

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<sup>708</sup> Ofcom 7/3403-3405; Sky 8/1627-1629.

<sup>709</sup> Para 559 of this judgment.

<sup>710</sup> Para 670 of this judgment.

<sup>711</sup> Ofcom 7/3465-3467; Sky 8/1630-1632.

parties until that launch was completed. Mr Wall pointed to the fact that Sky's launch was now over a year ago, and the content was still not available to third party platforms. In relation to security issues, Mr Wall agreed that this was an issue for both company's networks and pointed to the joint initiatives taking place between them to combat piracy and fraud, as well as other measures being adopted by VM in this area. He added that VM was willing to discuss these strategies with Sky in the context of commercial negotiations, and to reach an appropriate anti-piracy agreement with Sky.

666. We have already noted Mr Darcey's evidence explaining why he did not reply to this letter.<sup>712</sup>

*The Tribunal's discussion and conclusions – HD discussions in 2007*

667. Ofcom described the 2007 exchange between Mr Darcey and Mr Wall in the following terms in the Statement:

“7.306 In our view, Virgin Media's 2007 request for wholesale supply of Sky's HD channels was a genuine opportunity for Sky to make its HD premium channels available to Virgin Media. Sky's response raised security issues and questioned whether such a deal (either with a wholesale or with a self-retail model) would be worth the endeavour given Virgin Media's public statements ascribing very little value to HD. However, nothing in the response indicates that it would not have been possible for Sky to take advantage of this opportunity had it wished to do so.

7.307 Instead of engaging with this opportunity, Sky's response raised a series of obstacles to a wholesale agreement taking place, and put the onus firmly on Virgin Media to overcome them.

7.308 Moreover, in its written response Sky did not make any concrete proposals, or even suggestions, as to how Virgin Media could address its concerns.

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7.310 While Sky's response left open the possibility of further discussion of these issues, we consider that it also signalled that Sky would be unlikely to take a constructive approach in any such discussions. Sky's repeated emphasis on a remark made by a Virgin Media executive at a trade conference further indicates its negative view of the proposal.”<sup>713</sup>

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<sup>712</sup> Para 560 of this judgment; see also para 671.

<sup>713</sup> See also Unger 1, paras 424 and 439.

668. In his evidence, Dr Unger criticised Sky in particular for failing to make any suggestions as to how VM might address Sky's concerns, and for questioning VM's commitment to HD on a "rather flimsy" basis, primarily by reference to comments made by VM's CEO in August 2007 (see paragraph 662 above). As regards security concerns, Dr Unger noted that VM's own letter of 7 November 2007 stressed that this was an issue that VM treated as serious, and noted that Sky, when it later responded to VM's "request for proposal" in March 2009, had specified the minimum security and piracy requirements that it would require VM to meet. He said that it therefore appeared that security concerns were not an insurmountable obstacle to Sky engaging constructively with VM's 2007 request.<sup>714</sup>

669. A great deal of witness evidence and submissions were targeted at the brief 2007 exchange between Mr Wall and Mr Darcey (both in relation to HD and other matters). Ofcom and Dr Unger concluded that this correspondence demonstrated a genuine opportunity for Sky to make its HD premium channels available to VM,<sup>715</sup> that Sky failed to engage with this opportunity,<sup>716</sup> and that Sky signalled it would be unlikely to take a constructive approach in commercial discussions.<sup>717</sup> We now consider whether these conclusions are correct.

(i) *A genuine opportunity for Sky to make its HD premium channels available to VM?*

670. Although on the face of it Mr Wall's letter in June 2007 was simply exploring with Mr Darcey the possibility of concluding a revised agreement for the wholesale carriage of the premium channels on the cable platform, and potentially revisiting other aspects of the commercial relationship between the two firms, in its closing submissions Sky suggests<sup>718</sup> that VM's only reason for writing the letter was in order to "provide the material to strengthen" the supplementary complaint to Ofcom filed on 3 July 2007.

671. It is a fact that the letter was sent when the parties were in the midst of a bitter commercial dispute in relation to basic channels, which was likely to be their

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<sup>714</sup> Unger 1, paras 452-463.

<sup>715</sup> Statement, para 7.306.

<sup>716</sup> Statement, para 7.307.

<sup>717</sup> Statement, para 7.310.

<sup>718</sup> Paras 10.66-10.67 of Sky closing submissions (Part A). See also para 664 of this judgment.

primary pre-occupation at that time (see Mr Darcey's evidence at paragraph 661 above). When he was asked during cross-examination about his reasons for not responding to Mr Wall's letter of 7 November 2007, Mr Darcey said:

“So what happened in January, before we had responded to this letter, which took Malcolm [Wall] nine weeks to write his one-line proposal, we made contact in December, I believe, and we met on 8 January, and that was the first time we had actually had a commercial meeting, and at that meeting we got back to the genuine commercial issue that was behind us at the time, which was the restoration of the basic channels to the Virgin network, and Malcolm and – it was either Brian Hall or Scott Dresser, whichever lawyer was there, were pretty clear that that's what they wanted to focus on, and don't worry about those other things.”<sup>719</sup>

672. It is also true that, as well as the correspondence being exchanged in the midst of ongoing litigation, there was a direct overlap between the issues raised in Mr Wall's 2007 letters and the issues outlined in the joint complaint to Ofcom. In evidence Mr Darcey said that “Sky was never in any doubt that Virgin Media's correspondence during 2007 relating to HD and IPTV was being carefully tailored to achieve Virgin Media's twin objectives of strengthening its complaint to Ofcom and strengthening its hand in the litigation it had brought against Sky.”<sup>720</sup>
673. Although Dr Unger stated that Ofcom recognised that the regulatory process had the potential to influence negotiations, he said that it did not follow that any request by VM could simply be dismissed as an attempt “to lay a paper trail”, in particular as the litigation concerned basic channels, whereas VM's request concerned premium channels (which Sky continued to supply during the relevant period). Further, to pursue a regulatory strategy to the exclusion of a commercial one would have been “extremely risky”, as Ofcom's market investigation was still in its infancy.<sup>721</sup>
674. Ms Burns denied that VM's approaches were tainted by regulatory gaming: “Virgin and [its] predecessors made these repeated approaches to Sky over this very lengthy period because they had a genuine commercial desire to obtain Sky's premium channels (and related HD and interactive content) on terms that would provide them with an incentive actively to market that content to subscribers (and future

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<sup>719</sup> Transcript 5/57:11-22.

<sup>720</sup> Darcey 3, para 582. See also Darcey 1, para 602, Darcey 3, para 587 and Transcript 5/40:21-41:3.

<sup>721</sup> Unger 1, paras 445-448.

subscribers). That remains the case.”<sup>722</sup> She added, “our approach to Ofcom did not mean that we had, from that point, given up on securing a commercial deal with Sky in favour of lobbying Ofcom... Our primary strategy was still to secure a commercial deal with Sky.”<sup>723</sup> She did accept, however, that VM hoped that the commencement of regulatory scrutiny “might make Sky more amenable to entering into a commercial deal.”<sup>724</sup>

675. Whatever effect, if any, Mr Wall’s letter may have had on the litigation between the companies, as regards the Ofcom complaint it is clear that VM was making submissions to Ofcom in relation to the supply of the premium channels at the same time as the correspondence between Mr Wall and Mr Darcey was taking place.<sup>725</sup> It is also clear that VM drew on the 2007 correspondence, which it had initiated, in support of its complaint,<sup>726</sup> and that the letters from both VM and Sky were drafted extremely carefully in view of likely regulatory scrutiny. Mr Darcey made explicit reference to VM’s participation in the joint complaint in the conclusion of his letter of 30 August 2007.<sup>727</sup>
676. Irrespective of any regulatory gaming, the extent of the “opportunity” available to Sky in 2007 appears to the Tribunal to be questionable. The supply of HD services was only one element of a broad-ranging set of principles put forward for discussion by Mr Wall and it is apparent, both from Mr Darcey’s evidence quoted above,<sup>728</sup> and from the absence of any correspondence in relation to HD in 2008, that VM did not make any further attempt to discuss HD services with Sky after Mr Wall’s letter of November 2007 until the issue of VM’s 2009 “request for proposal”. There is thus a notable contrast in this regard between the volume of correspondence between Sky and the cable companies in relation to the interactive

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<sup>722</sup> Burns 3, para 195.

<sup>723</sup> Burns 3, para 200.

<sup>724</sup> Burns 3, para 202.

<sup>725</sup> Before Mr Darcey had responded to Mr Wall’s letter of 8 June 2007, VM, together with the parties to the joint complaint to Ofcom, made a further submission to Ofcom on 3 July 2007 (Ofcom 7/3363). In an annex titled “Outline of problems encountered by Virgin Media”, VM made submissions in relation to HD that were essentially identical to those made on behalf of ntl/Telewest (see para 660 above, and also para 715 below).

<sup>726</sup> See for example para 715 below in relation to IPTV supply.

<sup>727</sup> See para 663 above.

<sup>728</sup> At para 671.

aspects of Football First,<sup>729</sup> and the more sparse high level correspondence between Mr Wall and Mr Darcey in relation to HD. This is consistent with Sky's view that due to capacity constraints VM was not in a position in 2007 to launch HD versions of the premium CPSCs on the cable platform.

677. In her evidence, Ms Burns suggested<sup>730</sup> that Sky had exaggerated the extent to which VM had been capacity constrained:

“As a matter of good business practice, Virgin Media does not set aside valuable capacity (used for VOD, linear channels and broadband) in the hope that at some undefined point in the future, an attractive service could be made available to Virgin. Rather, if attractive services such as HD versions of Sky Sports channels do become available, Virgin Media manages its capacity in order to ensure there is sufficient capacity for that service.”

678. In cross-examination, Ms Burns insisted that, had VM acquired Sky Sports 1 and Sky Sports 2 in HD in 2007, VM would have made the capacity available to launch them.<sup>731</sup> She accepted, however, that despite approaches from various content providers to launch HD channels on cable's platform at this time (including channels owned by VM), these channels were not at that stage launched.<sup>732</sup>

679. In his evidence, Mr Darcey stated<sup>733</sup> that, in 2007, VM did not appear to have the network capacity to launch a suite of linear HD channels, and the financial position of the company was apparently parlous, making it unlikely that VM would have “turned off” its remaining analogue subscribers in order to free up the network capacity needed to carry HD channels, or committed to a capital expenditure project such as the development of an IPTV network. Ms Burns accepted in cross-examination that switching off VM's analogue signal would have had an impact on VM's cash flows unless the relevant individual ended up switching to the digital service.<sup>734</sup> At paragraph 4.48 of the Statement, Ofcom confirmed that VM did not begin shutting down its analogue networks until 2008.<sup>735</sup> Sky submitted in its closing submissions that documents referred to by VM's CEO during an earnings

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<sup>729</sup> See paras 534 to 562 above.

<sup>730</sup> Burns 3, paras 95-102.

<sup>731</sup> Transcript 10/66:19-25. See also Transcript 10/26:15-22.

<sup>732</sup> Transcript 10/69:1-71:25.

<sup>733</sup> Darcey 3, paras 593-621.

<sup>734</sup> Transcript 10/36:12-20.

<sup>735</sup> Mr Guest of VM told the Tribunal that the switch to digital had not yet been completed at the time of the hearing in mid 2011. See para 795 below.

call in 2008 showed that in the first instance VM intended to use such capacity as was liberated by switching off the analogue signal to improve broadband speeds.<sup>736</sup>

680. Mr Darcey accepted during cross-examination that Sky did not believe that VM had absolutely *no* capacity, and that there might have been a possibility that VM could have launched “a few” channels. However, he stated that his understanding was that VM’s preference was to use what capacity they had for other purposes, such as expanding their VOD service or for further broadband take-up.<sup>737</sup> This appeared to reflect Sky’s view as expressed in internal documents at the relevant time. Mr Darcey referred to an internal Sky presentation about the VM business from November 2007,<sup>738</sup> which highlighted that a small fraction of VM’s capacity remained spare, and that a very large portion of its capacity was required for analogue TV customers. The Sky presentation also included an illustrative timeline showing VM’s spare capacity. This predicted an increase in VM’s capacity from the second half of 2008 onwards following reduction in the number of analogue channels, and anticipated a “launch of linear HD channel line up (using MPEG2)” between the second half of 2009 and the first half of 2010, as a result of the increased capacity. This timeline proved to be particularly prescient, as it was only in Spring 2009 that VM issued its “request for proposal” in respect of HD services. In its closing submissions, Sky pointed to the fact that VM’s CEO, in a July 2010 earnings call had insisted that VM had not been “late to market” with HD channels, and that it had “waited for Sky to stimulate demand ... They’re doing very well, and we’re carrying off the back of them.”<sup>739</sup> This strategy was confirmed by Mr Guest in his evidence.<sup>740</sup>
681. In the light of the above we have concluded that Sky was justified in being sceptical about whether there was a genuine commercial opportunity in relation to HD services which Sky could have exploited in 2007. This is supported, in particular, by the scant correspondence concerning HD services in 2007 and the capacity constraints which appeared to make the launch of a suite of HD channels by VM a

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<sup>736</sup> See Transcript 10/23:21-24:10 and the documents at PL17/24.

<sup>737</sup> Transcript 5/46:14-23.

<sup>738</sup> Sky 17/C/450-467. See also the internal Sky email at Ofcom 7/3314, where Sky refers to capacity issues as one of the reasons why “cable has not yet sought to secure a range of linear HD channels.”

<sup>739</sup> Sky written closing submissions, Part A, para 10.62.

<sup>740</sup> See para 795 below.

remote commercial possibility at that time. In our view, Ofcom's conclusions attach undue significance to a relatively limited exchange of letters between senior executives, sent at a time of high tension between the companies, and against the backdrop of VM's active participation in the joint complaint, which we feel may well have influenced that correspondence.

- (ii) *Sky's alleged failure to engage with this opportunity / signalling that it would be unlikely to take a constructive approach in commercial discussions*

682. Having concluded that Sky was justified in believing there was no real commercial opportunity for Sky to exploit at that time, nothing more needs to be said about Sky's alleged failure to engage with that "opportunity". As to any signals sent by Sky, in his evidence, Dr Unger describes Sky's response to VM's approach in 2007 as follows:

"Sky's responses (a) raised various obstacles to the supply of HD and interactive services; and (b) stated a "firm preference" for a SBW (i.e. self-retail) proposition for any IPTV offering. Virgin addressed the issues raised by Sky in a letter of November 2007. Sky did not reply. There appears to have been no further discussion of these matters until March 2009."<sup>741</sup>

683. This is, in our view, a somewhat terse summary of the 2007 correspondence. The characterisation of the apparently not unreasonable points raised by Sky in its August 2007 response as "obstacles" implies that Sky had no right to raise such matters as security, mode of delivery and commercial viability. The summary also gives the impression that, by the time of Mr Wall's November 2007 letter, VM had done everything that was necessary to satisfy Sky's concerns, and that a deal for the wholesale supply of the linear HD channels could now be concluded. In fact, as we have seen, Sky genuinely believed that VM's capacity constraints at that time would not indicate an HD linear channel launch until 2009/10. In addition Mr Darcey's evidence was that Sky continued to hold security concerns, and was unconvinced that VM would put its "full weight" behind ensuring the success of the launch of the HD premium channels.<sup>742</sup> Sky's August 2007 letter stated that Sky was willing to negotiate on these issues, and in all the circumstances we do not agree with Dr Unger's assessment that the August letter signalled that in any further

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<sup>741</sup> Unger 1, paras 416-417.

<sup>742</sup> Darcey 1, para 598.

discussions about HD Sky would be unlikely to take a constructive approach. There is no reason to doubt Mr Darcey's account<sup>743</sup> of why he did not respond to Mr Wall's November 2007 letter. It is clear that HD supply of the premium channels was not pursued by VM once the parties agreed to re-engage in attempting to resolve the dispute about the basic channels in early 2008.

#### HD discussions in 2009

684. The next discussions regarding the supply of HD channels were in early 2009. An email<sup>744</sup> dated 5 March 2009 from Mr Peter Chapman, Head of Content Acquisition at VM to Sky's Mr Rey referred to a meeting that had taken place between Mr Darcey and Mr Wall in February 2009, at which the pair had discussed VM's HD strategy. Mr Chapman sent a further email later that day,<sup>745</sup> in which he informed Mr Rey that VM intended to launch a "slate" of 5 to 6 HD channels in the third quarter of 2009. He attached a formal "request for proposal", and invited Sky to respond by 20 March 2009. That document outlined the nature of VM's proposed launch, which included a requirement for linear channels, together with certain additional services (including VOD and the ability to view TV content from VM's website), and detailed VM's proposed technical delivery of the channels. The request was not specific to Pay TV channels in HD, but sought "linear channels which enable Virgin Media to deliver a well-rounded and appealing consumer HD proposition."

685. On 24 March 2009 (having received an extension of time in which to respond), Mr Rey responded by letter to Mr Chapman and enclosed a formal 19 page response to the "request for proposal".<sup>746</sup> Mr Rey's letter began:

"We are delighted that Virgin Media is now in a position to allocate sufficient network capacity to enable, for the first time, development of an HD channel proposition in Q3 2009, and we hope that Virgin Media will agree to discuss the terms for supply of Sky's HD channels, following this initial [request for proposal] process."

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<sup>743</sup> At paras 560 and 671 above.

<sup>744</sup> Ofcom 7/3823.

<sup>745</sup> Ofcom 7/3827-3840; Sky 8/1635-1645.

<sup>746</sup> Ofcom 7/3841-3861; Sky 8/1646-1666.

686. Mr Rey went on to state that Sky wished to offer VM the right to distribute certain of its basic channels in HD, together with Sky Sports 1-3 in HD, “subject to satisfaction of Sky’s security and bandwidth requirements”. Mr Rey noted that, due to the initial limit of 5-6 channels, Sky had focused on basic channels and premium sports channels, but added that Sky would be keen to offer Sky’s nine Sky Movies HD channels to VM subscribers.

687. Sky’s formal response to VM’s “request for proposal” was detailed, and included a requirement that VM provide greater levels of contractual protection regarding security. As no mention had been made in the “request for proposal” of “channel enhancements”, these were excluded from the proposal. The key commercial proposal was that VM would pay Sky an incremental monthly fee per subscriber of £[...] [C] for the right to distribute the channels in HD; VM would be required to pay Sky an up-front payment for the right to these services; and VM would also be required to provide an annual MRG. In regard to this last issue, Sky stated there would need to be:

“...further discussions regarding the level of that MRG between [Sky] and Virgin Media as it would necessarily seem to be linked to Term, the underlying basis upon which the corresponding SD Sky Sports channels are provided, and commitments that Virgin Media are willing to make to market and promote the Sky Sports channels.”

688. A meeting took place on 8 April 2009 between VM and Sky to discuss Sky’s HD proposal. We were shown VM’s note of that meeting.<sup>747</sup> Much of it was devoted to discussion of the basic channels in HD, although the premium sports channels were also discussed, including the length of the agreement and the possibility of making certain on-demand content available. The note concluded with the following summary:

“The tone of the meeting overall was constructive and positive. Sky were at pains to point out that they would like to launch on the platform and there were no traps underlying any element of their response. However, it was VM’s feeling that there are numerous stumbling blocks that at face value appear reasonable but are able to be conflated to present practical barriers to launch.”

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<sup>747</sup> Ofcom 7/3878-3880.

689. Mr Chapman sent an email to Mr Rey on 15 April 2009<sup>748</sup> outlining some of the agreed action points from the meeting; these included that Sky should provide viewing data, consider the provision of certain on-demand content, and provide a detailed breakdown of technical requirements related to security for consideration by VM (ahead of a meeting to discuss both security and also technical delivery of the channels). Mr Chapman referred to the “aim to meet w/c 20 April when appropriate team are in place”.
690. On 22 April 2009, Mr Marek Rubasinski, Business Development Manager at Sky emailed Mr Chapman<sup>749</sup> with a “summary note” of Sky’s technical security requirements, and proposing a meeting to discuss security functionality, the picture and sound quality of VM’s platform and other issues. A meeting then took place between the parties on 30 April 2009. In a further email sent on 1 May 2009,<sup>750</sup> Mr Rubasinski confirmed that Sky proposed to offer certain HD VOD content to VM, which would include “all HD programmes from the Sky HD channels distributed by Virgin Media as Sky makes available to its HD customers as part of its DTH Sky Anytime TV service”. Mr Rubasinski sent a further email on 20 May 2009<sup>751</sup> in which he responded on certain action points relating to Sky’s security requirements, and asked VM to revert on its own action points. He also attached a “second section” of Sky’s security and anti-piracy requirements.
691. In a further email dated 20 May 2009, Mr Rey of Sky emailed Mr Chapman of VM<sup>752</sup> with details of both the launch fee and MRG that Sky was seeking in consideration for the supply of the Sky Sport HD channels. On 16 July 2009, Ms Burns responded with a counteroffer.<sup>753</sup>
692. Mr Chapman sent an email to Mr Rey on 29 May 2009,<sup>754</sup> in which he thanked Mr Rey “for the time you and your team have invested re our HD launch to date”. He

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<sup>748</sup> Ofcom 7/3899

<sup>749</sup> Ofcom 7/3901-3905

<sup>750</sup> Ofcom 7/3909-3910.

<sup>751</sup> Ofcom 7/3915-3917.

<sup>752</sup> Ofcom 7/3923-3924.

<sup>753</sup> Ofcom 8/3979-3981.

<sup>754</sup> Ofcom 7/3939-3942.

responded on certain commercial points, asking clarification of Sky's rationale for a launch fee for these channels, and attached a brief commercial proposal.

693. In his evidence, Mr Darcey described what happened next:

“Although a series of meetings between Sky and Virgin Media followed, ultimately no agreement was reached with Virgin Media in respect of the supply of Sky's HD channels as part of the HD [request for proposal] process. However, Virgin Media did launch five HD channels on its platform in the latter part of 2009, all of which were basic HD channels.”<sup>755</sup>

694. Although Sky's linear HD channels did not appear on VM's platform as a consequence of VM's “request for proposal”, negotiations about HD continued in parallel to negotiations in connection with the proposed “Project Kestrel”.<sup>756</sup> An email sent by Mr Stephen Nuttall of Sky to the relevant individuals at VM in connection with Project Kestrel on 6 June 2009<sup>757</sup> noted that separate discussions in relation to the supply of HD services were ongoing, and that it was understood that these would evolve separately.

695. According to Ms Burns, VM identified the discussions about Project Kestrel as an opportunity to apply negotiating leverage to address the terms on which it was supplied with, *inter alia*, Sky premium channels, in particular by making VM's continued participation in the Project Kestrel sale process conditional on Sky entering into negotiations about the terms of supply of Sky's premium channels, together with interactive services.<sup>758</sup>

696. As Dr Unger notes in his evidence, no agreement for HD supply had been reached by the time Ofcom's Statement was published on 31 March 2010.<sup>759</sup> Except for a reference to a note of a meeting on 8 April 2009, Dr Unger did not in his evidence examine the exchanges between Sky and VM beyond Sky's response to VM's request for proposal on 24 March 2009. His evidence about HD concluded as follows:

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<sup>755</sup> Darcey 1, paras 606-607.

<sup>756</sup> The project for Sky to acquire VM's branded television channels and to enter into an agreement for the long term supply by Sky to VM of Sky's basic channels and the former VM channels. See para 561 of this judgment.

<sup>757</sup> Ofcom 7/3943-3946

<sup>758</sup> Burns 3, para 67.

<sup>759</sup> Unger 1, para 476.

“It appears that, at some point during 2009, the HD discussions became bound up with wider discussions relating to the possible sale to Sky of Virgin’s television content business.”

*The Tribunal’s discussion and conclusions – discussions about HD in 2009*

697. In the Statement, Ofcom stated its conclusion on the 2009 HD negotiations between Sky and VM as follows:

“Negotiations between Sky and Virgin Media since early 2009 appear to have developed considerably from Sky’s position in 2007. However, these have not yet led to agreement, and, as Virgin Media notes, Sky’s security concerns have not yet been resolved. It is unclear whether Sky would have an incentive to reach an agreement following the conclusion of Ofcom’s market review.”<sup>760</sup>

698. Thus, notwithstanding the development in the negotiations between the parties,<sup>761</sup> Ofcom appeared to doubt that any deal would ultimately be concluded on HD. This is expressed more definitively at 9.219-220 of the Statement (in connection with remedies):

“9.219 Although discussions are ongoing between Sky and Virgin Media, it is now almost five years since Virgin Media first made a request to obtain supply of HD channels and supply has still not been agreed, although we are aware that discussions over HD supply have progressed further as part of the discussions over possible sale of Virgin Media’s VMTV channels to Sky.

9.220 Even though discussions are taking place between Sky and Virgin Media, we have limited confidence that an agreement will be successfully concluded through commercial negotiation, in light of experiences of other operators in negotiating for SD channels. Given the importance that HD capability increasingly holds for effective competition, we believe this concern is sufficiently material for it to be appropriate for a wholesale must-offer obligation on HD channels to include cable operators.”

699. For the reasons set out at paragraphs 655 to 658 above in relation to the 2005 and 2006 discussions, we do not agree with Ofcom’s intimation that VM’s request for supply of the HD channels had been made “almost five years” prior to the publication of the Statement. Nor do we consider that the evidence supports Ofcom’s “limited confidence” that an agreement on HD would be successfully concluded. Further, for the reasons set out in detail earlier in the judgment, Ofcom’s findings in relation to the “experiences of other operators in negotiating for SD

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<sup>760</sup> Statement, para 7.311.

<sup>761</sup> Dr Unger similarly noted that Sky’s response to VM’s 2009 request for proposal “appeared to adopt a more constructive tone than its responses in 2005, 2006 and 2007” (Unger 1, para 475).

channels” do not provide support for Ofcom’s conclusion about the HD negotiations that were ongoing at the time of the Statement.

700. In our view, VM’s 2009 “request for proposal” had a different tone from the 2007 correspondence. Ms Burns accepted (in cross-examination) that VM had not before prepared for Sky a document such as that.<sup>762</sup> It represented a genuine commercial opportunity to supply Sky’s premium HD channels, and it is clear that Sky understood it as such.

701. Ofcom has acknowledged<sup>763</sup> that Sky’s response to the “request for proposal” was positive, and constituted an apparently genuine offer to wholesale the CPSCs in HD. It is interesting to note in particular that although VM’s “request for proposal” did not specifically request that Sky put forward a proposal in respect of the premium sports channels in HD,<sup>764</sup> Sky’s response *did* offer these channels. Although discussions about supply of the premium HD channels between Sky and VM continued, VM ultimately did not proceed on the basis of Sky’s response to the “request for proposal”, opting instead for a suite of basic HD channels.

702. Ms Burns stated that VM didn’t “turn down” Sky’s offer in response to the “request for proposal”, rather that discussions about HD were rolled forward into the parallel talks that the parties were having concerning Project Kestrel, and the sale of the VMtv channels.<sup>765</sup> Mr Darcey’s view was that VM had to accept the consequences of that decision, namely that the supply of HD versions of premium channels would be likely to be delayed as it became part of a larger agenda:

“Virgin Media clearly prioritised the supply of basic HD channels by not accepting Sky’s offer in response to the [request for proposal] and deciding that it would try to address the supply of Sky’s HD channels as part of a broader discussion regarding the sale of the VMtv channels. Virgin Media had to know that in doing this there was inevitably going to be a delay.”<sup>766</sup>

703. The regulatory backdrop also continued to loom large in the negotiations between Sky and VM in 2009 and 2010. In its response of 1 December 2009 to an Ofcom

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<sup>762</sup> Transcript 10/86:17-21.

<sup>763</sup> Ofcom written closing submissions, Part 1, Annex 3, para 357.

<sup>764</sup> See para 684 above.

<sup>765</sup> Transcript 10/89:24-91:18.

<sup>766</sup> Darcey 3, para 699.

information request,<sup>767</sup> VM referred to all of the correspondence that had passed between Sky and VM on the subjects of premium HD and IPTV content between July 2009 and November 2009 (providing copies) in the context of the ongoing Project Kestrel negotiations, citing this as evidence of the “intransigence on the part of Sky”.

704. In the light of the evidence it seems to us likely that, absent the Statement and WMO, Sky and VM would have concluded a deal in relation to HD versions of the CPSCs. Neither Ofcom in the Statement nor Dr Unger in his evidence examines the correspondence between Sky and VM in 2009 and 2010 subsequent to Sky’s response to the “request for proposal”, with a view to commenting on the prospects of a deal.<sup>768</sup> Nevertheless, Ofcom still expressed the view that it had “limited confidence” in a successful outcome, such that the inclusion of HD versions of the CPSCs within the WMO could be justified (albeit not at a regulated price). However we do not consider that the evidence supports that conclusion.
705. In view of our conclusions we do not need to consider the evidence<sup>769</sup> concerning the importance to customers of CPSCs in HD format.

#### The Tribunal’s overall conclusions on HD

706. For the reasons explained above we do not consider that the evidence before us, including that which relates to Sky’s conduct in the HD negotiations, and the internal Sky documents discussed earlier in the judgment,<sup>770</sup> justifies Ofcom’s conclusion that Sky had sought to avoid supplying this content to VM, or that its conduct in relation to HD represented a “practice” which was prejudicial to fair and effective competition. Sky’s attitude and conduct in this regard was not in our view motivated by a desire to weaken competition from the cable companies, but was

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<sup>767</sup> Ofcom 8/4585-4628.

<sup>768</sup> Dr Unger refers at para 476 of his witness statement to a note of a meeting between VM and Sky on 8 April 2009, in which VM expressed concern that some of the security issues raised by Sky might have been “artificial concerns designed to make potential launch unfeasible”, and to a submission by VM to Ofcom that the security and anti-piracy requirements provided by Sky in April and May 2009 were unreasonable. He noted in relation to the latter that these “did reflect concerns also communicated by Sky to Ofcom, which we took seriously”. There is no analysis of negotiations between VM and Sky later in 2009 and 2010, however.

<sup>769</sup> The evidence in question includes that which is referred to at paras 7.296 to 7.298 of the Statement.

<sup>770</sup> See paras 582 to 609 above.

based on normal and reasonable technical and commercial considerations, as in the case of interactive services. Nor do we consider that the evidence of Sky's conduct in relation to HD provides any material support for Ofcom's central finding of Sky's alleged unwillingness to wholesale its premium sports channels to other retailers.

***Negotiations with VM for supply to a proposed off-net IPTV platform***

707. The Tribunal heard evidence and submissions about a further strand of negotiations between Sky and VM. This involved a possible supply of the CPSCs to a proposed "off-net IPTV service". In this section of the judgment we shall refer to this simply as "IPTV supply".

708. At 7.61 of the Statement, Ofcom summarised these negotiations:

"...[in] mid-2007...Virgin Media approached Sky to request the supply of Sky's premium channels on Virgin Media's off-net platform... As was the case with ... [Orange] and BT, Sky's preference was to enter into a retail (Sky by Wire) deal with Virgin Media, while Virgin Media's preference was for a wholesale deal. The correspondence continued for several months, to November 2007, but no agreement was reached".

709. In the Statement Ofcom does not consider this issue of IPTV supply in the same way as the supply of interactive and HD services. It does not reach specific conclusions in the Statement about the impact of any alleged failure by Sky to supply to this proposed platform, nor do its key conclusions in relation to VM at paragraph 7.324 of the Statement make any reference to IPTV supply. However, at paragraph 7.49 of the Statement, Ofcom notes that "Virgin Media said that Sky had refused wholesale supply of Sky Sports and Sky Movies for Virgin Media's off-net IPTV service" and later in the Statement Ofcom seems to find that Sky has refused supply, albeit in a footnote.<sup>771</sup> Further, the discussions on IPTV supply appear at Figure 108 of the Statement (which purports to provide extracts from Sky's negotiations with each of BT, TUV, Orange and VM). It is also clear from paragraphs 7.146, 7.170 and 7.236 of the Statement that Ofcom considered Sky's response to VM's approach in relation to IPTV supply in Ofcom's broader analysis

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<sup>771</sup> See footnote 1145 of the Statement: "In section 7 we also note that Sky has refused [to] supply Virgin Media's IPTV service."

of the reasons for the failure of negotiations for wholesale supply of the core premium channels.

710. Sky contests Ofcom's conclusions on IPTV on the basis that VM, having no such IPTV service or platform, and having shelved its plans to launch one, is in a position analogous to that of France Télécom / Orange. Further, Sky submitted that Ofcom has relied on a single request by VM that Sky amend its distribution contract with VM within 30 days to allow such supply; that despite Sky seeking details of what the new platform entailed, VM failed to provide any, and the matter was not pursued further. Sky also submitted that VM's approach to IPTV supply was tainted by regulatory gaming, in that VM's request allowed it to add a new section to the joint complaint to Ofcom.
711. In order to assess Ofcom's conclusion in the light of Sky's challenge, we will need to refer to the contemporaneous documents.

#### The documentary evidence concerning IPTV supply

712. On 3 May 2007, Ms Burns of VM wrote to Mr Rey of Sky<sup>772</sup> about the launch by VM of certain "off-cable" services, and in particular the anticipated provision by VM of IPTV services via DSL. Ms Burns stated that VM proposed to offer Sky's premium channels to VM's off-cable customers by this means but that it was currently precluded from doing so under the general terms and conditions applying to Sky's distribution of Sky's premium channels. She therefore proposed that these terms be amended (providing some suggested drafting) and asked that Mr Rey confirm within 30 days that the rate card would be extended to cover distribution of these channels via VM's IPTV service.
713. In his already-much-discussed letter to Mr Darcey of 8 June 2007,<sup>773</sup> Mr Wall noted that VM had not yet received a response to Ms Burns' letter of 3 May 2007. The detail of the proposals that were put to Mr Darcey for discussion in that letter

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<sup>772</sup> Ofcom 7/3326-3327; Sky 8/1787-1788.

<sup>773</sup> See paras 559 and 661 above.

included an obligation on Sky to licence distribution of premium content “across any television service operated by VM (i.e. on both cable and via DSL/IPTV).”

714. Mr Rey replied to Ms Burns’ letter on 21 June 2007.<sup>774</sup> He expressed Sky’s interest in achieving distribution of Sky’s premium channels by way of VM’s IPTV platform, subject to Sky satisfying itself that the platform met Sky’s technical requirements and to the agreement of terms commercially acceptable to Sky. Mr Rey stated that Sky’s preference was to self-retail its channels on new platforms (including DSL-connected homes), on the basis that Sky was best placed to maximise its revenues by ensuring the channels were appropriately promoted and marketed. Mr Rey expressed hope that VM and Sky could embark on constructive discussions about a self-retail proposition, but rejected the notion that this could be achieved simply by way of the amendments to the terms and conditions proposed by Ms Burns. Rather, he said that the proposal required substantially more consideration on Sky’s part, given that it related to a “completely new arrangement”, and noted that VM had not yet provided any details of the IPTV service and the system by which it would be conveyed.
715. On 3 July 2007, VM and the other parties to the joint complaint to Ofcom made a further written submission to Ofcom. In an annex titled “Outline of problems encountered by Virgin Media”, VM made certain submissions under the heading “Sky’s refusal to supply its premium channels for distribution on IPTV.” These submissions referenced Ms Burns’ letter of 3 May 2007 and Mr Rey’s response, and stated that Sky’s refusal to supply its premium channels to VM “will remove entirely the prospect of retail competition in relation to Sky’s premium channels in all areas in which there is no cable coverage”.<sup>775</sup> We return to this submission at paragraph 725 below.
716. As we have noted,<sup>776</sup> there was ongoing correspondence at this time at a higher level than the exchange between Ms Burns and Mr Rey. In that context, Mr Darcey

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<sup>774</sup> Ofcom 7/3333-3334; Sky 8/1789-1790.

<sup>775</sup> Ofcom 7/3363.

<sup>776</sup> At paras 559 and 661 above.

replied to Mr Wall's letter on 30 August 2007,<sup>777</sup> stating so far as IPTV is concerned:

“As David Rey explained in his letter to Katharine Burns Rivington of 21 June, responding to your request for a premium channel wholesale arrangement to cover your new IPTV network, even if all the technical issues (including security issues) can be resolved, which is as yet unclear, we consider that we could better realise the value of our channels via your new IPTV network by retailing those channels directly to customers. The sentiments you express in your letter about not being incentivised to sell Sky's premium channels actively do little to persuade us that wholesaling to you for IPTV distribution would be the optimal model. I note that you have not yet responded to our invitation to brief us on your new service and IPTV system”.

717. In his response of 7 November 2007<sup>778</sup> Mr Wall picked up on Mr Darcey's comments about security and Sky's proposal for a self-retail deal for IPTV. As regards security issues, Mr Wall stated that Sky's concerns were unfounded, pointed to the fact that the VM IPTV platform provided for encrypted closed access using point to point technology. He rejected the notion of a self-retail deal on IPTV, stating that VM had no incentive to provide Sky with direct access to its customer base, and that he saw no reason – subject to Sky's reasonable satisfaction with the technical elements of the IPTV system – why Sky should not be willing to extend wholesale terms to encompass distribution via IPTV.
718. We have already recorded<sup>779</sup> (in connection with supply of interactive and HD services) Sky's reasons for not responding to Mr Wall's November 2007 letter. In his evidence, Mr Darcey stated that, as far as he was aware, beyond the exchange with Mr Wall in 2007, “there were no further discussions with Virgin Media about IPTV until 2009” when discussions about Project Kestrel and possible sale of VM's basic channel business commenced. In cross-examination he noted that Sky had, in that context, granted VM limited rights to distribute Sky's premium channels via IPTV, but that, as at the date of the hearing before the Tribunal, there existed no platform on which they could be supplied.<sup>780</sup>

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<sup>777</sup> Ofcom 7/3403-3405; Sky 8/1627-1629.

<sup>778</sup> Ofcom 7/3465-3467; Sky 8/1630-1632.

<sup>779</sup> At paras 560 and 671 above.

<sup>780</sup> Transcript 5/112:7-17. See also Burns 3, para 169.

## The Tribunal's discussion and conclusions – IPTV supply

719. As we have said, Ofcom does not appear to draw any specific conclusions in the Statement about Sky's response to VM's request for IPTV supply (other than perhaps at footnote 1145<sup>781</sup>). However, Ofcom seeks to rely on these negotiations in support of its conclusions about Sky's approach to requests for wholesale supply more generally. Similarly, Dr Unger in his evidence considered the issue of IPTV supply in the same context as other new requests for the wholesale supply of Sky's channels:

“...as part of its consideration of new requests for the wholesale supply of Sky's channels, Ofcom examined the negotiations for the supply of Sky's HD channels and the supply of channels for Virgin's proposed off-net IPTV service. It noted that no agreement was reached as a result of these negotiations, and concluded that the restricted supply of Sky's core premium channels (of which the failure of these negotiations was an example) was prejudicial to fair and effective competition”.<sup>782</sup>

720. In her evidence, Ms Burns insisted that VM's IPTV plans were “rooted in reality”, pointing to attempts by VM and its corporate predecessors to develop IPTV capability from 2004 onwards.<sup>783</sup> In relation to the specific request made in 2007, Ms Burns said that this was “a genuine approach to Sky to obtain content for an off-net [service] that was, at that time, very much in contemplation.”<sup>784</sup> She described Mr Wall's letter of 7 November 2007 as a response to Sky's preference for self-retail and its concerns about security and technical issues. Ms Burns stated that “Virgin also described the secure design of the IPTV offering and therefore why Sky's concerns as to “security issues” were unfounded”.<sup>785</sup>

721. In his evidence Mr Darcey rejected the suggestion that VM's approach to the question of IPTV supply was genuine, describing the proposal as “not real at all”<sup>786</sup> and “written for a quite different purpose”,<sup>787</sup> noting that the parties' discussions

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<sup>781</sup> See footnote 771 above.

<sup>782</sup> Unger 1, para 410. See also para 498: “Sky's response was consistent with its responses to other requests by rival retailers for wholesale access.”

<sup>783</sup> Burns 3, paras 154-159.

<sup>784</sup> Burns 3, para 164; see also Burns 3, para 158.

<sup>785</sup> Burns 3, para 168.

<sup>786</sup> Transcript 5/107:8-12.

<sup>787</sup> Darcey 3, para 748.

about IPTV had been “scant”. He also observed that VM had not provided Sky with any detail of its proposed new platform:

“...Sky could barely begin to consider the terms on which it might provide its channels to Virgin Media for an IPTV network until it had received a full briefing of Virgin Media’s plans and considered the security and technical issues associated with the new platform.”<sup>788</sup>

Mr Darcey suggested that it was not surprising that scant detail was provided of VM’s proposed IPTV system “as it transpired that Neil Berkett, who became acting CEO of Virgin Media the same month, had halted Virgin Media’s IPTV plans when he assumed that role”.<sup>789</sup>

722. It is true that Ms Burns’ letter of May 2007 provided Sky with no details of VM’s proposed IPTV platform. Nor were such details furnished by Mr Wall in his November 2007 letter, other than a very high level description of the technology that would be used to operate the service. Having considered the evidence, we consider it very unlikely that on the basis of these letters VM could realistically have expected Sky simply to agree to amend its terms and conditions without further discussion enabling Sky to ascertain the technical and commercial feasibility of the proposed supply.
723. A chronology dealing with the IPTV discussions provided by VM to Ofcom during the Pay TV review<sup>790</sup> describes Mr Wall’s November 2007 letter in the following terms: “Virgin Media responds to Sky’s concerns as to technical and security issues and explains lack of incentive to offer Sky direct access to Virgin Media customer base.” This chronology gives the impression that VM had done all that was reasonably necessary to persuade Sky that it was capable of carrying Sky’s channels securely via its IPTV network. However, as we have said, VM was yet to provide any details of its proposed IPTV platform, and there had been no substantive engagement between the parties as regards the technical issues involved in

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<sup>788</sup> Darcey 1, para 632.

<sup>789</sup> Darcey 1, paras 627 and 635. See also Burns 3, para 158: “shortly after the appointment of Neil Berkett in March 2008, Virgin decided not to focus to the same degree on its proposed IPTV off-net service.”

<sup>790</sup> Ofcom 7/3479.

transmitting Sky's channels on it. Indeed, VM's response to Ofcom (at paragraph 3.2) confirmed that at that stage VM had "no off-net IPTV offering".

724. As regards Sky's response to the approach by VM, we accept that the tone of Mr Darcey's letter was rather more negative than that of Mr Rey. (By the time of Mr Darcey's letter Sky was aware that VM had complained to Ofcom about IPTV supply.) However, we do not consider that either letter can fairly be read as amounting to a refusal of VM's request. Sky responded by inviting further discussion of certain issues that were important to it, including security and technical matters, and the commercial terms, in particular the possibility of concluding a self-retail deal. As we have already seen, Ofcom acknowledges that Sky was entitled to seek to negotiate self-retail deals, and that it could not be expected to surrender as soon as any resistance was encountered.<sup>791</sup>
725. Yet again, the regulatory backdrop to these discussions is evident. That aspect of the exchange between Mr Wall and Mr Darcey in 2007, discussed at paragraphs 672 to 675 above, is also pertinent to VM's request for IPTV supply. Within just a few days of receiving Mr Rey's response to Ms Burns' request, VM made a submission to Ofcom in which it stated that Sky had refused supply.<sup>792</sup>
726. In cross-examination,<sup>793</sup> Ms Burns was asked whether it was fair for VM to complain to Ofcom about Sky withholding distribution via IPTV, given that Mr Rey had replied on 21 June 2007 expressing an interest in distributing via the proposed IPTV platform. Ms Burns confirmed that she had not responded to Mr Rey's letter, nor had any negotiations taken place in relation to IPTV supply before VM made its submissions to Ofcom. She nevertheless maintained that it was fair to suggest that Sky was withholding distribution "based on [her] experience with the other content providers at that time". She expressed the view that VM had "always preferred to try to resolve this commercially", referring to Mr Wall's reply to Mr Rey's letter. However, it is to be noted that that reply came in November 2007, a long time after Mr Rey's letter. We do not consider that VM's conduct in relation to

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<sup>791</sup> See para 339 above.

<sup>792</sup> See paras 703 and 709 above.

<sup>793</sup> See Transcript 10/103:12-112:11.

IPTV supply at this time evidences the “commercial” approach contended for by Ms Burns.

727. In our view, there was no basis on which VM could justifiably have made the assertion contained in its submission to Ofcom in July 2007. Mr Rey had not refused but had expressed Sky’s interest in distribution of its channels on this future platform, subject to certain issues being discussed, and certain information about the proposed new platform being provided. At the time of its submission to Ofcom VM had neither provided Sky with the requested information, nor responded to Mr Rey’s suggestion of a meeting to discuss the proposal.
728. Ofcom concludes at paragraph 7.146 of the Statement that the documents relating to the negotiations between Sky and VM for IPTV supply “do not support the notion that the failure to reach agreement was ultimately due to regulatory gaming”. Whilst regulatory gaming does not appear to have been the ultimate cause of the failure to reach agreement on IPTV supply, we consider that it clearly played an important role in the discussions between Sky and VM on this issue.

*The Tribunal’s overall conclusions on IPTV*

729. In our view Sky’s reaction to VM’s request for IPTV supply does not provide evidence to support either Ofcom’s core concern about Sky’s attitude to wholesale supply to other retailers. Nor does it evidence any concern of Ofcom about the terms of supply to VM in particular. It certainly does not provide backing for the suggestion that Sky had (or was acting upon) an incentive to render VM ineffective as a retail competitor in respect of CPSCs.
730. Leaving aside VM’s ultimate intentions with regard to the development of an IPTV platform, it is clear that its initial approach (in the May 2007 letter from Ms Burns) provided Sky with no detail of the proposed platform, and was less than realistic in requesting Sky simply to transpose the existing terms of supply to an entirely different proposed platform virtually without discussion and within a timescale of about three weeks. The timing and nature of VM’s approach to Sky appear to be tailored to the impending submission which VM was making to Ofcom, and which

contained an entirely unfounded allegation against Sky. We consider Sky's initial response to VM's request to have been reasonably constructive, and it was certainly not a refusal, as it was portrayed in that submission. In our view the questions which Sky raised were reasonable. In particular it was not unreasonable for Sky to try to persuade VM to agree to a supply via a self-retail arrangement. Mr Wall's subsequent letter of November 2007 provided little in the way of details of the architecture of the proposed platform, and in the absence of these his assurances as to the security of the proposed platform could not have held much weight. We accept Mr Darcey's explanation of why the correspondence was not pursued further at that time.<sup>794</sup> The absence of any further correspondence on this subject from VM until 2009 appears to indicate that IPTV supply was not a high priority for VM.

F. COMPETITION CONCERNS RELATING TO VM AND ITS CORPORATE PREDECESSORS: TERMS OF WHOLESALE SUPPLY – RATE CARD PRICES

*Preliminary observations*

731. Among the features of the existing wholesale supply to VM about which Ofcom expressed its concern are the cable rate card prices charged by Sky. The relevant conclusions are summarised in paragraphs 1.28-1.30 and 7.324-7.327 of the Statement. We have already set out these paragraphs,<sup>795</sup> but it is convenient to repeat part of paragraph 7.324 here:

“7.324 ...we are concerned about the effect on competition of a number of features of Sky's existing supply to Virgin Media. This view is based on:

- Internal documents from Sky indicating that it has an incentive to weaken Virgin Media's effectiveness as a competitor.
- Sky's wholesale prices are, in our assessment, close to the highest Sky could charge while passing a margin squeeze test based on Sky's scale. Virgin Media's scale is much smaller than Sky's, so it is unsurprising that prices set on such a basis do not allow Virgin Media to compete effectively with Sky.
- One specific consequence of this approach to pricing is that Virgin Media's incremental margin on the SD versions of Sky's Core Premium channels is negative. Virgin Media therefore has little

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<sup>794</sup> See paras 560 and 671 above.

<sup>795</sup> At para 160 and para 508 respectively of this judgment

incentive to sell premium channels to an existing basic subscriber. This is reflected in the relatively weak incentives offered to Virgin Media sales staff for selling Sky Core Premium channels.

- ...”

732. Thus, Ofcom stated that Sky’s approach to pricing was to set prices close to the maximum whilst still passing (the Ofcom version of) the margin squeeze test. Ofcom acknowledged that Sky believed the prices were compliant with an *ex post* competition law margin squeeze test (presumably a reference to the OFT version of that test), and appeared to accept that such belief is justified, and therefore that retailing on the basis of those wholesale prices should be profitable at Sky’s scale.<sup>796</sup> However, Ofcom concluded that the rate card prices do not allow VM, or any other retailer who does not have Sky’s scale, to compete effectively with Sky. Although the “challenges [VM] faces as a result of these prices are not a competition concern of the same magnitude as those created by the absence of supply to other retailers....they nonetheless create a situation in which consumer choice is likely to be distorted.”<sup>797</sup> Ofcom considered that in combination with the other factors mentioned at paragraphs 7.324-7.327 of the Statement, the rate card prices contributed to lower penetration of the premium channels on cable than on DTH satellite.<sup>798</sup>

733. The relative contributions of Ofcom’s several competition concerns to its overall decision to impose the WMO, and to include VM within its scope, are not clear. Given the acknowledgement by Ofcom in the Statement that the concern about the rate card prices is “not of the same magnitude” as Ofcom’s core concern about the absence of wholesale supply to other retailers, it seems at least open to question whether the pricing factor alone would or could reasonably have led to the WMO.

734. In any event, in its appeal Sky challenges these findings of Ofcom.<sup>799</sup> In particular Sky disputes that it has an incentive to weaken VM as an effective competitor, and that it sets the rate card prices for the premium sports channels just below the limits of the margin squeeze test rather than setting a profit-maximising price in

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<sup>796</sup> Statement, para 1.29 read with para 7.324, second bullet.

<sup>797</sup> Statement, para 7.327.

<sup>798</sup> Statement, para 7.325.

<sup>799</sup> Sky amended notice of appeal, para 4.130 ff.

accordance with normal commercial conduct. It is Sky's case that the rate card prices are set so as to maximise profits, and although the prices are checked against the margin squeeze test to ensure that they are compliant, they are not set by reference to it. Sky also disputes that its prices had the effect of limiting VM's incentive and rendering VM unable to compete effectively with Sky in retailing those channels. Sky argues that VM has a strong financial incentive to compete with Sky in the retail of the CPSCs, and does so effectively.

***The main issues arising from the parties' evidence and arguments***

735. We now consider the main issues arising from the parties' evidence and arguments, in particular:

- (a) The relevance of certain Sky internal documents to the wholesale prices charged to VM (paragraphs 736 to 739 below); (NB these documents have already been mentioned in connection with the interactive services issue<sup>800</sup>);
- (b) The discussion of discounting arrangements with counterparties, and Sky's retention of the rate card price (paragraphs 740 to 747 below);
- (c) The possibility of Sky making a simple reduction in rate card price as an alternative to penetration discounts (paragraphs 748 to 757 below);
- (d) Ofcom's conclusions about margin squeeze (paragraphs 758 to 767 below);
- (e) VM's negative incremental margin (paragraphs 768 to 783 below);
- (f) Comparison of retail prices (paragraphs 784 to 789 below);
- (g) VM's performance as a retailer of the CPSCs and generally (paragraphs 790 to 806 below);
- (h) Sky's advantage of scale (paragraphs 807 to 808 below).

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<sup>800</sup> Para 582 ff.

Then, at paragraphs 809 to 815, we set out our general conclusions on VM's incentives and ability to compete effectively at rate card prices, before referring briefly to certain other pricing issues.

The relevance of certain Sky internal documents to the wholesale prices charged by Sky

736. With reference to the Sky internal documents described in the first bullet of paragraph 7.324 of the Statement (see paragraph 731 above), we have already considered these documents in detail when dealing with the parties' contentions in relation to interactive services.<sup>801</sup> We concluded that the documents did not support Ofcom's finding that Sky had an incentive to weaken or eliminate VM's effectiveness as a retail competitor. That conclusion applies equally to any suggestion that the documents evidenced such incentive on the part of Sky when it came to setting the wholesale prices paid by VM. Indeed, the documents evidence a desire on Sky's part to incentivise the cable companies by means of price discounts.<sup>802</sup> We do not, therefore, need to revisit the documents here.

737. However, there is one curious aspect of Ofcom's evidence which calls for comment. Referring to paragraph 7.324 of the Statement, Mr Mark Caines, Director of Economic Analysis in Ofcom's Competition Group, explained in his first witness statement:

"A153. To be clear, Ofcom's concern was about the *effect on competition* of the terms of Sky's supply to Virgin Media. This was based on

- a. Internal documents indicating that Sky had an incentive to weaken Virgin Media's effectiveness...;
- b. Sky's wholesale prices being close to the margin squeeze limit;
- c. The effect of these prices on Virgin Media's retail margins and incentives;
- d. The failure of negotiations for the supply of Sky's HD CPCs, and interactive services, on Virgin Media's platform.

A154. While Sky's incentives were an aspect of Ofcom's concerns, Ofcom did not reach a view on whether Sky had set its prices with the specific intention of weakening Virgin Media as a competitor."<sup>803</sup>

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<sup>801</sup> See paras 582 to 609 above.

<sup>802</sup> See para 597 above.

<sup>803</sup> Caines 1, paras A153-4 of Annex.

738. There is a tension between Mr Caines's suggestion that Ofcom did not reach a view about Sky setting its prices with a view to weakening VM, and the Statement's assertion that its conclusions were based on (in combination with other factors) the existence of documents said to evidence an incentive to do so. This factor is the first one mentioned by Ofcom in paragraph 7.324 of the Statement. If Ofcom did not conclude that Sky was acting or at least likely to act on the incentive in setting prices, it is difficult to see the relevance of the factor. The corresponding paragraph of the Statement itself does not contain Mr Caines's qualification, which appears to be a gloss.
739. As to whether there is evidence from any other source which throws light on this issue, the existence of an incentive of the kind identified by Ofcom (and any suggestion that Sky had acted upon it) would appear at odds with Ofcom's finding that Sky is deterred from withdrawing supply of those channels from VM by fear of losing the wholesale revenues generated by that supply (as well as by the regulatory risk involved in withdrawal).<sup>804</sup> If Sky values its wholesale revenue from VM, as Ofcom apparently believes that it does, one asks rhetorically why Sky should seek to stifle the competitive effort which produces that income stream. In this connection it may also be relevant to consider Sky's apparent attempts to incentivise the cable companies by means of new long-term price and discount arrangements. We discuss this in the following section.

#### The discussion of discounting arrangements and Sky's retention of the rate card price

740. In the Statement Ofcom refers to Sky's explanation for its approach to wholesale pricing (in Sky's response to an information request in July 2008):

“Since the OFT's 2002 decision, and in the absence of any long term agreement with cable operators in respect of the carriage of its sports and movie channels, Sky has continued to wholesale its sports and movie channels to cable operators on a rate-card basis. The terms of the rate-card are designed to ensure that Sky's wholesale pricing structure satisfies the conditions of the margin squeeze test set down by the OFT in the 2002 decision.”<sup>805</sup>

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<sup>804</sup> Statement, para 7.9.

<sup>805</sup> Statement, para 7.262.

741. Ofcom then went on to record that in its Third Pay TV Consultation it had concluded that Sky had used the margin squeeze test to set the rate card “rather than entering into negotiations to establish a mutually beneficial price”.<sup>806</sup>
742. We have already described<sup>807</sup> how in the past Sky had sought to agree with the cable companies contractual provisions for penetration discounts off the rate card, with the ostensible purpose of creating a stronger incentive for the cable companies to distribute Sky’s premium channels. These initiatives came to nothing in the end. We have taken account of the evidence of, in particular, Dr Unger,<sup>808</sup> Ms Burns<sup>809</sup> and Mr Darcey.<sup>810</sup> We note, for example, Ms Burns’ evidence that Sky had never initiated a discussion with VM or its predecessors about the prices of its premium channels, that Sky appeared to be “looking for reasons for ... negotiations to fail” and sought unnecessary and inappropriate levels of regulatory comfort in respect of the proposed agreements.<sup>811</sup>
743. Nevertheless, having considered the contemporaneous documents, as well as the witness evidence, we are of the view that Sky’s desire to encourage the cable companies to market the channels in question was genuine. We conclude that Sky was not engaged in what would have been an elaborate and extended charade of seeking regulatory approval which it knew would be unlikely to be forthcoming, in order to camouflage its real aim of hobbling the competitive effort of the cable companies. We are satisfied that Sky entertained genuine and not unreasonable anxiety about entering into new discounting arrangements with the cable companies in the absence of clear regulatory reassurance.
744. Sky’s anxiety existed in the context of regulatory investigation and oversight of the wholesale prices and discounts applicable to Sky’s channels, including its premium channels, extending more or less continuously from about 1995 until the OFT decisions of 2002 and 2003;<sup>812</sup> these latter followed the OFT’s investigation of an

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<sup>806</sup> Statement, para 7.263.

<sup>807</sup> See paras 511 to 527 above.

<sup>808</sup> Unger 1, paras 507-518.

<sup>809</sup> Burns 3, in particular paras 74 and 198.

<sup>810</sup> Darcey 1, para 643-4; Darcey 3, paras 822-840.

<sup>811</sup> Burns 3, para 74.

<sup>812</sup> See para 511 above.

alleged abuse of a dominant position by Sky in relation to its wholesale pricing and discount structure. We note the explanation of Dr Unger<sup>813</sup> for Ofcom's unwillingness to go further than it did in providing regulatory reassurance to Sky on the proposed long term contract with ntl. He said that the main caveats concerned the relative levels of wholesale and retail prices, and discrimination through discounting, "which was not a concern which prevented Sky from offering discounts". He added that there was no legal requirement on Sky to obtain regulatory approval in advance of entering into any such agreement, given that the "whole thrust" of the current competition regime is that the onus is on undertakings to self-assess their agreements and/or conduct for compliance with UK and EU competition law.

745. We do not criticise Ofcom for its stance. Nevertheless, given the regulatory history to which we have adverted, in our view it is not at all surprising that in the light of the very qualified comfort which Ofcom provided in respect of the proposed agreement for pricing and discounts,<sup>814</sup> Sky felt safer sticking to the pricing arrangements which had existed for several years and had survived extensive regulatory scrutiny.<sup>815</sup>
746. In his evidence, Mr Caines referred to the now familiar exchange between Mr Wall (of VM) and Mr Darcey (of Sky) in 2007,<sup>816</sup> which we have already described at length in dealing with the interactive, HD and IPTV issues.<sup>817</sup> Mr Caines said that, contrary to Mr Darcey's view that VM had never made a proposal which offered Sky comfort that its wholesale revenues would rise as a result of a wholesale price reduction, Mr Wall had attempted to do so in this 2007 exchange. Mr Caines noted that Sky had sought assurances from VM that a reduction in wholesale prices would give rise to an overall increase in revenues, in response to which VM had proposed "a sliding price mechanism which would provide for a decrease in price upon an

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<sup>813</sup> Unger 1, paras 508ff.

<sup>814</sup> Summarised at para 524 above.

<sup>815</sup> See in this regard Darcey 1, paras 643-4, and Darcey 3, paras 822-840. See also Caines 1, para A209.

<sup>816</sup> Caines 1, para A211-212, referring to the exchange at Ofcom 7/3329-3330, 3403-3405 and 3465-3467.

<sup>817</sup> See, for example, paras 559 and 560 (interactive); 661 to 667, 671 to 676, and 683 (HD) and 713 to 718 (IPTV).

increase in subscribers.” Mr Caines noted that Sky had not responded to that proposal.

747. We have already discussed Mr Darcey’s explanation of the reasons why this chain of correspondence came to an end.<sup>818</sup>

#### Simple reduction in rate card price as an alternative to penetration discounts

748. Ofcom has argued that as an alternative to penetration discounts with their regulatory complications, Sky could simply have effected an unconditional reduction in the rate card price, with a view to recouping the immediate loss of wholesale revenue through attraction of additional subscribers to cable and any other platform to which the reduced price was given.<sup>819</sup> A similar suggestion was made by Dr Unger in his evidence. We have referred to this when considering the negotiations between Sky and BT.<sup>820</sup>

749. The assumption in this argument is that Sky was not already charging what it considered a profit-maximising price. As noted at paragraph 734 above, Sky maintains that the rate card is regarded as such a price. Mr Darcey stated that both Sky and he were of the view that Sky would not in fact be better off if it gave a unilateral price cut to VM. He said the most likely outcome would be that VM would pocket the additional margin, rather than using it to reduce retail prices or to increase its marketing activity. Moreover, in the unlikely event that VM did reduce retail prices, Mr Darcey said it was unclear what the effect on the number of subscribers to Sky’s premium channels would be, and in particular whether it would be sufficient to make up for the immediate loss of revenue which the reduction would cause to Sky. He referred to two examples<sup>821</sup> where an increase in VM’s margin, or a reduction in VM’s retail price relative to that of Sky, had not produced sufficient (or, in the second example, any) increase in premium subscribers on cable.<sup>822</sup> Mr Darcey said that such examples confirmed Sky’s commercial judgment that a straight rate card price reduction (whether for VM or BT) would make Sky

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<sup>818</sup> For example, at para 560 above. See also para 730.

<sup>819</sup> Defence, paras 360b and 368b; Ofcom skeleton, para 171.8; Caines 1, paras A197-A212.

<sup>820</sup> See paras 320 to 321 above.

<sup>821</sup> One of these examples is the VAT change referred to in para 750.

<sup>822</sup> Darcey 3, paras 841-849.

worse rather than better off, and that the best way to create incentives through lower prices was via a penetration discount, which did not jeopardise existing revenue.<sup>823</sup>

750. In cross-examination by counsel for Sky, Mr Guest (VM's Director of commercial and customer strategy) confirmed that in the event of a price reduction VM might use some of it to improve its margin, rather than passing it on to subscribers.<sup>824</sup> Mr Guest also acknowledged that when VM moved its retailing business from the UK to Luxembourg in 2009 a lower rate of VAT brought about the equivalent of a cut in the rate card of £[...] [C] per subscriber per month.<sup>825</sup> He accepted that the wholesale revenue which would be lost by Sky if it made a reduction of that order across the board (and did not link it to penetration performance in some way) would not be recovered by additional subscribers obtained by VM.<sup>826</sup> Asked about the effect of a still deeper cut in price (£6), Mr Guest confirmed his written evidence that he believed there was unmet demand for CPSCs on cable; although it could not be calculated with accuracy whether wholesale revenue from additional premium subscribers on cable would be sufficient to compensate Sky for its lost wholesale and retail revenue, he believed there was a "strong prospect" that recovery would occur within a reasonable period; whether the loss was recoverable would depend on a number of variable factors, including the price elasticity of the customer base, as to which he said that research would be necessary.<sup>827</sup> It was also accepted by Mr Guest that each £1 reduction in the wholesale price charged to VM per subscriber per month would cost Sky in the order of £[...] [C] million per annum in lost revenue.

751. In our view the fact that Sky did not unilaterally grant an unconditional wholesale price cut for VM provides no support for Ofcom's contention that Sky was not profit-maximising and not acting in accordance with normal commercial considerations and therefore, by implication, was forgoing profit by acting on an incentive to weaken VM rather than genuinely seeking to incentivise it. On the material before us we consider that Sky was clearly entitled to conclude that VM

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<sup>823</sup> Darcey 3, paras 423-429.

<sup>824</sup> Transcript 11/58.

<sup>825</sup> According to Mr Darcey the saving could be as much as £[...] [C] depending upon the particular basic plus Sky Sports channel package taken: Darcey 1, para 662.

<sup>826</sup> Transcript 11/60.

<sup>827</sup> Guest 3, para 73; Transcript 11/65-67.

might well pocket all or part of any reduction in price rather than employing it to increase premium subscribers. Sky's apprehension in this regard is to some extent confirmed by Mr Guest's evidence. We also accept that Sky was justified in treating as wholly uncertain the extent of any uplift in the number of premium subscribers on cable which might result from a reduction in VM's retail price and/or extra marketing by VM (assuming VM opted to take these steps rather than taking the amount of the reduction as additional margin). When all this uncertainty is weighed against the certain and immediate loss of established wholesale revenue consequent upon an unconditional reduction in its rate card price, we find it wholly unsurprising that Sky did not opt for this approach. To opt for it would, in our view, have been commercially naïve.

752. The controversy between Mr Caines and Mr Darcey, as to the validity of Mr Darcey's two examples of the effects on subscriber numbers of increased margin or changes in relative retail prices (above), demonstrates how difficult it is to establish cause and effect when several factors are in play.<sup>828</sup> Having disputed Mr Darcey's reliance on those two examples by pointing to other factors which may have given rise to the effects relied upon,<sup>829</sup> Mr Caines himself then seeks to attribute a [...]C] % increase in VM's CPSC subscribers in the year from September 2009 together with an increase in Sky's wholesale revenues from VM, to the decrease in some wholesale prices which took place<sup>830</sup> as a result of the WMO and the better terms negotiated by VM in the context of Project Kestrel.<sup>831</sup> It was now Mr Darcey's turn to counter this attribution of cause and effect by pointing to other factors which, in his view, were likely to be responsible for VM's increase in premium subscribers.<sup>832</sup>

753. Prominent among these other factors were the steps taken by VM to address piracy on its network which, according to Mr Darcey's evidence, began to be rolled out on a regional basis in March 2010 and were completed in December 2010. Mr Darcey stated that many pirates subscribed to basic services on VM's network in order to

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<sup>828</sup> See Caines, 1, paras A199-A203, and Darcey 3, paras 842-849.

<sup>829</sup> Caines 1, para 203.

<sup>830</sup> Subject to the terms of the Tribunal's interim order, requiring payment of the difference into escrow (see para 6 above).

<sup>831</sup> Caines 1, para A204.

<sup>832</sup> Darcey 3, paras 850-855 and Annex 1.

obtain or retain the necessary STB, and then obtained premium channels via the STB without payment. When improvements in the CA system prevented this ploy, some of these subscribers would begin to pay for premium channels as “upgrades”. Mr Darcey also said that [another cable operator][C (substituted text)] had taken similar steps against piracy in 2009 and had also seen a subsequent increase of over 16% in its premium subscriber numbers, which was continuing.<sup>833</sup>

754. Mr Darcey said that VM’s subscriber numbers were also likely to be affected by the normal seasonal uplift seen at the start of each football season (plus, a little later in the year, the usual movie “season” effect), by the improvement in the Sky Sports offering as a result of additional live Premier League matches becoming available, and by knock-on benefits from particularly intensive marketing by Sky and BT in the summer of 2010. He said that in the same period Sky’s DTH satellite subscriber numbers, too, had increased considerably as a result of these factors, despite an increase in the retail price of Sky Sports products in September 2010.<sup>834</sup>

755. Mr Darcey stated that it was more relevant to see what happened from mid 2010 when the lower wholesale prices for some products were introduced. He analysed the relationship between the growth (or otherwise) in subscriber numbers for VM’s Pay TV packages and the movements (or otherwise) in VM’s retail prices and wholesale prices of the various packages. For example, Mr Darcey stated that VM’s retail price for the XL basic package had not changed in the period June to October 2010. This was the basic package whose subscribers were most likely also to take Sky’s Dual Sports. He inferred that the growth in premium subscribers taking this package must be the result of factors other than price. The same applied to certain other packages which saw significant subscriber growth. Conversely, he pointed to cases where VM retail prices had changed but there had been no corresponding reduction in the relevant wholesale price. In relation to the products where a reduction in wholesale price was accompanied by a reduction in retail prices of the relevant packages (in particular the M+ and L basic packages), Mr Darcey was of the opinion that the scale of the retail reductions indicated that they had been implemented by VM for reasons unconnected with the reduction in wholesale price

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<sup>833</sup> Darcey 3, Annex 1, paras 959-962.

<sup>834</sup> Darcey 3, Annex 1, paras 952-954.

of the premium part of the package. In his view they were probably prompted by the prospect of entry by BT which was seen by VM as likely to present a direct challenge for customers interested in the M+ and L tiers. Mr Guest confirmed this in his evidence. It was pointed out by Sky in submissions that VM's retail price reduction for these packages applied equally to packages which included Sky Movies channels, which are not the subject of the WMO, and also that there is no evidence that the growth in VM's CPSC subscribers is in these packages.<sup>835</sup>

756. Mr Guest's evidence was that the WMO would improve VM's position relative to the rate card price in respect of only [...]C% of its premium customer base, and would not offer improved wholesale prices for packages in which the overwhelming majority of new premium subscribers would be interested.<sup>836</sup> He also acknowledged in cross-examination that VM's improved performance in subscriber numbers in 2010 was attributable in part to it having taken steps to combat piracy on the cable platform, and that it had lowered its retail prices on the M+ and L packages largely in anticipation of BT bringing in cheaper packages to compete with those products. He told us that there was a lot of marketing on the part of Sky and BT in 2010 which was producing additional subscribers for VM too. He said that for the first time Sky's marketing was referring to the fact that Sky's premium channels could also be obtained on VM's and BT's networks. Mr Guest attributed this particular change of approach to the WMO.<sup>837</sup>

757. In our view the suggestion that the increase in premium subscriber numbers on VM's network in the course of 2010 is attributable to the reduction in wholesale price of certain premium products from about the middle of that year is wholly speculative. In the light of the evidence we prefer Mr Darcey's doubts to Mr Caines's confidence that the changes in wholesale price caused the increase. However, either way it would not affect our conclusion that in the years preceding the WMO Sky was acting commercially and reasonably in considering that a unilateral rate card price cut was by no means obviously going to make Sky better off and would certainly cause an immediate loss in revenue. The reasonableness

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<sup>835</sup> Sky written closing submissions, Part A, para 10.189.

<sup>836</sup> Guest 1, paras 14, 20 and 24.

<sup>837</sup> Transcript 11/102-106.

and genuineness of Sky's commercial judgment in, say, 2007-9 is not affected by something which has happened since the WMO came into operation (partly) in 2010.

### Margin squeeze

758. As we have seen, Ofcom found, contrary to Sky's contentions, that Sky's approach to pricing was to set prices close to the maximum whilst still passing the margin squeeze test. Ofcom acknowledged that Sky believed the prices did satisfy that test, and appeared to accept that Sky's belief was justified, and therefore that retailing on the basis of those wholesale prices should be profitable at Sky's scale.<sup>838</sup> However, the issue is clouded by the manner in which Ofcom applied the margin squeeze test. Some explanation is required.

759. Paragraphs 7.263-266 of the Statement provide:

"7.263...In our Third Pay TV Consultation, we noted that the threshold at which a margin squeeze abuse occurred was necessarily high. In other words, rather than entering into negotiations to establish a mutually beneficial price, our understanding was that Sky has, for the past seven years, been setting its price level by calculating the price just below an abusive price, as determined by the OFT in 2002. We said that Sky appeared to present the margin squeeze price as a floor beneath which it would not negotiate, either with cable retailers or others.

7.264 In its response to our Third Pay TV Consultation, Sky said that it did not suggest that its prices were just sufficient to pass the range of prices in the OFT's test. It described this claim as objectionable. Sky said that its wholesale prices comfortably passed the range of prices in the OFT test, and estimated that its retailing business had earned at least £[...][C] above the OFT threshold over the last eight years.

7.265 In November 2008, Ofcom asked Sky [to provide the document that set out its analysis of the margin squeeze test. Sky replied that the document was legally professionally privileged, and it was not therefore compelled to provide it.] Following its response to the Third Pay TV Consultation, and in the context of the arguments from Sky in the paragraph above, Ofcom asked Sky to provide supporting evidence for its assertion that its rate-card comfortably passed the range of prices in the OFT test, [including the model used to calculate these figures]. We anticipated that this model might have common material with Sky's margin squeeze model. We noted that the fact that the argument above appeared to be based on similar analysis makes it even more necessary that Ofcom is able to see this analysis, in order fully to be able to understand Sky's views.

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<sup>838</sup> Statement, para 7.324, second bullet, and para 1.29.

7.266 In response, Sky reiterated that its model was subject to legal professional privilege. It provided summary data of the costs and revenues of its retail residential business. However, without knowledge of the assumptions used, it is impossible for Ofcom to verify Sky's claim that its model comfortably passes the margin squeeze test (see paragraph 7.264). Our own calculations indicate that Sky's rate-card price is close to the maximum it could charge while meeting the test."

760. As we have seen, Ofcom concluded in paragraph 7.324 that:

"Sky's wholesale prices are, in our assessment, close to the highest Sky could charge while passing a margin squeeze test based on Sky's scale. Virgin Media's scale is much smaller than Sky's, so it is unsurprising that prices set on such a basis do not allow Virgin Media to compete effectively with Sky."

761. The conclusion was expressed slightly differently in paragraph 2.31:

"Our own analysis suggests that Sky sets wholesale prices to cable which are close to the maximum allowable under the OFT's 2002 margin squeeze test."<sup>839</sup>

762. One could be forgiven for understanding these passages to mean that in assessing the rate card prices Ofcom applied the same margin squeeze test as the OFT had applied in 2002 and as Sky had applied since then.<sup>840</sup> In fact it becomes clear later in the Statement that the test applied by Ofcom was different in certain significant respects. The OFT had adopted a period-by-period analysis of profitability based on a return on turnover of 1.5%, and had conducted the test across different bundles of basic and premium channels, including basic-only packages. Ofcom, on the other hand, used a return on capital basis, valuing Sky's subscriber base using current replacement cost and calculating the prices that would result from discounting future cashflows at the rate required. Also, Ofcom did not apply the test across bundles of basic and premium channels, but sought to isolate the costs and revenues associated with retailing particular packages of premium channels and to exclude the revenue earned from the related activity of supplying basic-only packages.<sup>841</sup>

763. Sky disputes that it is Sky's practice to set rate card prices in the way suggested by Ofcom i.e. close to the maximum level that will pass the margin squeeze test. In his evidence Mr Darcey said that Sky sets wholesale prices broadly with a view to

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<sup>839</sup> See also Statement, para 7.277: "...a vertically-separate wholesaler...would not set satellite retail prices and then use those prices to calculate wholesale cable prices according to a margin squeeze test".

<sup>840</sup> See para 740 above.

<sup>841</sup> Teh 1, para 30(d); Transcript 27/165-172; Statement, 10.157-8 and 10.210-211; Darcey 1, para 649.

maximising profits, and only then checks that the prices as set are compliant with the test applied by the OFT.<sup>842</sup> He reiterated the point made in response to the Ofcom's Third Pay TV Consultation,<sup>843</sup> namely that there had been substantial scope over the previous several years for Sky to increase its rate card prices and still comply with that test, but Sky had chosen not to increase prices to that extent. As a result, he said, Sky's wholesale prices have been well below the level they might have attained had they been set at the maximum allowed under the test, and that over the previous eight years Sky's retail business had earned at least £[...]C] more than it would have earned if the wholesale prices had been set at that maximum.<sup>844</sup>

764. In the Statement Ofcom says that without knowledge of the assumptions used by Sky in its compliance model it was impossible to verify Sky's claim that its rate card "comfortably passed"<sup>845</sup> the margin squeeze test. Ofcom noted that it had twice asked for the document that set out Sky's analysis of the margin squeeze test, including the model used by Sky to calculate its prices, and on each occasion Sky stated that the model and analysis were subject to legal professional privilege.<sup>846</sup> Sky had, however, provided Ofcom with summary data of the costs and revenues of its retail residential business. In cross-examination Dr Yih-Choung Teh, a Director in Ofcom's Competition Group and chair of its Broadcasting Competition Steering Group, stated that Ofcom had not applied the OFT's test because it was an impossible task without Sky's calculations. Asked why Ofcom could not have constructed its own model based on the OFT's approach together with the data provided by Sky, Dr Teh said that this would have been a very difficult exercise given the level of description in the OFT's decision, which left some questions unresolved.<sup>847</sup>
765. It is clearly unsatisfactory that, as part of its assessment of whether the long-standing rate card price prevented VM competing effectively, Ofcom should have

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<sup>842</sup> Darcey 3, para 779.

<sup>843</sup> See quote at para 759 of this judgment.

<sup>844</sup> Darcey 1, para 649; Darcey 3, paras 855-6.

<sup>845</sup> Statement, para 7.264.

<sup>846</sup> Sky is said to have informed Ofcom that its model contained judgments that were based on legal advice about how certain aspects of the OFT decision were to be interpreted: Transcript 27/170.

<sup>847</sup> Transcript 27/169-170.

applied a significantly different margin squeeze test from the one which was used by the OFT and had been relied upon by Sky for a number of years. Even if Ofcom preferred its own methodology (as it appears to have done) we find it surprising that it did not attempt to replicate the OFT test using the data available, if only as a cross-check. Sky could hardly have complained if, in order to do so, Ofcom had used its own assumptions in the absence of access to Sky's compliance model.<sup>848</sup>

766. The position is particularly unsatisfactory given Ofcom's reliance on the results of its own margin squeeze analysis as evidence of Sky's allegedly uncommercial and strategic approach to the setting of wholesale prices.<sup>849</sup> In this regard the results of Ofcom's version of the test can hardly provide evidence of an *intention* on the part of Sky to price as close as possible to the margin squeeze limit, as Sky was using the OFT methodology rather than Ofcom's significantly different approach. The current somewhat ambiguous position is also unsatisfactory because in the context of an investigation under section 316, compliance with the margin squeeze test, and the ease (i.e. margin) with which that compliance was achieved, are likely to be considered relevant to whether the criteria for regulatory action under that provision are satisfied, albeit not determinative.
767. As it stands *both* Sky and Ofcom may be right: the rate card prices may pass the margin squeeze test "comfortably" under the OFT/Sky version, and may pass it only by the skin of their teeth under the Ofcom version. We are not in a position to determine. Therefore, when considering the issue of VM's ability to compete effectively while paying the rate card price, we do so on the basis that under both versions the rate card apparently satisfies the margin squeeze test – whether it does so comfortably or not is an open question.

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<sup>848</sup> We have not thought it necessary to delve into the questions whether the claim for privilege was justified, or whether there were other ways in which the parties might have sought to overcome the problem.

<sup>849</sup> See para 761 of this judgment.

### VM's negative incremental margin

768. Ofcom has found that the rate card prices “do not allow Virgin Media to compete effectively with Sky.”<sup>850</sup> Ofcom goes on to state that:

“One specific consequence of this approach to pricing is that Virgin Media’s incremental margin on the SD versions of Sky’s Core Premium channels is negative. Virgin Media therefore has little incentive to sell premium channels to an existing basic subscriber. This is reflected in the relatively weak incentives offered to Virgin Media sales staff for selling Sky Core Premium channels.”<sup>851</sup>

769. In contesting these findings Sky argues that VM has strong financial incentives to compete with Sky in the retail of CPSCs and that it is able to do so effectively.

770. One of the main arguments put against Sky is the one identified specifically in the conclusionary paragraph of the Statement, cited above, namely that VM earns a lower or “negative incremental” margin on the sale of packages containing the CPSCs when compared with basic-only packages, which do not. Ofcom and VM submit that this reduces VM’s incentives to compete with Sky for CPSC subscriptions to the extent that VM is only willing to market the CPSCs as a means of retaining an existing customer.<sup>852</sup>

771. Ofcom examined the evidence of the incremental prices charged by VM in relation to Sky’s premium channels and the margins earned, at paragraphs 7.270 to 7.290 of the Statement. Ofcom concluded that VM achieved a negative incremental margin for Sky Sports, a small positive incremental margin for Sky Movies, and a negative incremental margin for a combined package.<sup>853</sup> Further, although there was some variation in incremental prices between VM’s packages, VM’s incremental prices for Sky’s premium channels were higher than Sky’s.<sup>854</sup>

772. The “incremental price” referred to is the difference between the retail price of a *package* which includes CPSCs and of a *package* which does not, for example a

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<sup>850</sup> Statement, para 7.324.

<sup>851</sup> Statement, para 7.324.

<sup>852</sup> See also VM skeleton argument at para 133.

<sup>853</sup> Statement, para 7.270.

<sup>854</sup> Statement, paras 7.271, 7.274, 7.283-7.284.

basic-only package. It is common ground that subscribers are not able to purchase CPSCs at their incremental price; this is because CPSCs are retailed by both VM and Sky as part of a package of products/services consisting of one or more of Pay TV, broadband, and fixed/mobile telephony. In these circumstances Mr Guest accepted in cross-examination that when deciding whether to subscribe to the CPSCs from VM or from Sky, a customer would consider the *package* price and content.<sup>855</sup> On this basis Sky submits, and it does not seem to be disputed by Ofcom or VM, that when Sky and VM are competing for subscribers to CPSCs it is the overall prices (and contents) of their respective packages containing the CPSCs that will form the battleground, and not the incremental prices of the CPSCs.

773. It is also not in dispute that VM earns a higher retail margin on packages which do *not* contain CPSCs than on packages which do. This difference in margin is described by Mr Caines as “the key point” affecting VM’s incentives.<sup>856</sup> It follows from the difference in margin that VM is worse off when an *existing* customer upgrades from a basic-only package to a package containing CPSCs. VM is worse off in comparison with what its position would be if, instead of upgrading, the customer had remained on a basic-only package. VM is not worse off than if the customer had ceased to subscribe at all. This is because, although the retail margin on packages containing CPSCs is lower than on basic-only packages, it is still a *positive* margin – VM still makes a profit on Pay TV packages containing CPSCs, and so it is worth retaining an existing customer who wishes to upgrade. The amount of this margin may vary depending on the particular package.

774. Mr Guest told us that [most][C (**substituted text**)] subscribers to CPSCs on cable take the XL basic package, which is VM’s “top of the range” basic pack. He said that the XL package is priced more or less at parity with Sky’s 6 Mix basic package<sup>857</sup> - usually the retail prices are within 50p or a £1 of each other. He agreed

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<sup>855</sup> Transcript 11/94.

<sup>856</sup> Caines 1, para A182.

<sup>857</sup> Mr Darcey and Ms Burns describe in their evidence the respective packages available from each of Sky and VM at the relevant time:

- According to Mr Darcey, “Sky offers consumers the ability to combine six packages of basic pay TV channels (denoted ‘Mixes’) and 15 different packages of Sky Sports and Sky Movies (denoted ‘premium’) pay TV channels. The ability to choose any combination of these packages means that Sky alone offers over 1,000 different combinations of pay TV channels from which consumers may select, of which 768 contain one or both of Sky’s sports channels

that the weighted average retail margin on the basic component of VM's XL package was in the region of £[...] [C], or [...] [C]% of the basic retail price of £24.50 per month. Mr Guest said that when a subscriber to that package upgraded by adding CPSCs, the incremental price did not cover the incremental cost (of which the main component was the rate card), and so the retail margin dropped by about [...] [C]% or [...] [C]p, reducing the weighted average retail margin from about £[...] [C] to about £[...] [C].<sup>858</sup>

775. Mr Guest confirmed that VM's bundled packaging and pricing were designed to encourage customers to purchase multiple services and that discounts were offered to those who subscribed to two or more of VM's products. He said that Pay TV, broadband and fixed telephony all shared the same cable infrastructure, and so there were economies of scope as they shared common costs. The infrastructure used for the mobile telephony services was not quite the same, but there were some common costs there too.<sup>859</sup>

776. Mr Guest accepted that what ultimately matters is VM's "bottom line" and the profitability of its customers in absolute terms.<sup>860</sup> According to Mr Guest [most] [C] (**substituted text**) of VM's Pay TV customers (including its premium subscribers) are "triple play" or "quad play" customers who take broadband and telephony from VM as well as Pay TV. He agreed that these other services generated additional revenue and that VM's retail margin on broadband was higher than on Pay TV. He said that from a commercial point of view it was in VM's interests to compete to win new Pay TV subscribers whatever package they took, as VM stood to make a [significant] [C] (**substituted text**) margin on them. He also said that, although VM's marketing material referred to the fact that Sky's CPSCs were available on

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(including options comprising only Sky Sports 1 or Sky Sports 2 and no other pay TV channels)." (Darcey 1, para 161).

- According to Ms Burns, "[VM] supplies its retail customers with different tiers of basic channels which are aggregated into various packages and retailed at different rates (i.e. an M package with up to 52 channels, an M+ package with up to 70 channels, an L package with up to 113 channels and an XL package with up to 173 channels). Subscribers also have the ability to add premium sports or movie channels (including Sky's premium channels) and other niche channel offerings (such as Asian interest and adult channels) to a basic pack of TV channels. The vast majority of subscribers to premium channels subscribe to Sky premium content." (Burns 1, para 17).

<sup>858</sup> Guest 3, para 21; Transcript 11/29-35. See also the VM internal presentation at Ofcom 7/3469-3477.

<sup>859</sup> Transcript 11/8-9.

<sup>860</sup> Transcript 11/36.

cable, when a potential customer rang to inquire VM would not mention Sky premium channels unless the customer did. He did not regard VM's positioning on the CPSCs as competitive.<sup>861</sup>

777. Asked about incentives to “upsell” the CPSCs to existing basic-only customers, Mr Guest said that VM had no means of identifying in advance (i.e. before a subscriber rang up to say they wanted to disconnect) which of its existing customers were potentially switchers away from VM and which were “Virgin loyalists” i.e. basic-only customers who were not inclined to leave VM but might be persuaded to buy CPSCs. He said that VM therefore regarded all existing customers as potential switchers, and had an incentive to sell the CPSCs to them if that was necessary to retain their custom.<sup>862</sup>
778. In the light of all the evidence it is clear that VM stands to make a [significant][C (substituted text)] margin by winning a *new* Pay TV customer even where that customer wishes to take the CPSCs in addition to a basic package. [Most][C (substituted text)] of such customers will also take broadband or telephony from VM, adding further [significant][C (substituted text)] profits. In the face of those rewards VM's incentive to win such customers against competition from Sky or other retailers cannot in our view be affected significantly by the slightly lower margin applicable to a Pay TV package when it includes CPSCs, and Mr Guest did not really suggest otherwise in his oral evidence.
779. We cannot therefore agree with Mr Caines that VM “does not have a strong incentive to compete against Sky for new Sky Sports subscribers or to induce existing Sky Sports subscribers to switch away from Sky.”<sup>863</sup> VM's incentive to compete for such new customers could only be affected by the negative incremental margin on upgrades in the following circumstances: if it was likely that any new premium customers won by VM's marketing effort would be outnumbered by “upgraders” resulting from that marketing who are VM loyalists (i.e. their upgrading to premium channels was not necessary in order to retain them as customers), to such an extent that the additional profits earned from gaining the new

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<sup>861</sup> Transcript 11/35-39.

<sup>862</sup> Transcript 11/39-43.

<sup>863</sup> Caines 1, para A149.

customers would be wholly offset by the negative incremental margins incurred on the latter. There is no evidence or reason to suggest that this would be likely to occur.<sup>864</sup> If anything the evidence suggests that this is unlikely to be the case.<sup>865</sup>

780. As for *existing* basic customers, it is not disputed that for the same reasons VM has a strong incentive to retain them all, and to upgrade them to CPSCs if that is what is required to keep them. That incentive means that it is in VM's interest to ensure that they are all fully aware that they can upgrade to a package which includes CPSCs without having to switch to Sky's satellite service, and it is not in dispute that VM makes them aware of this. Mr Caines referred to an advertisement by VM in 2007 headlined "The cheapest place to get Sky Sports isn't Sky".<sup>866</sup> However, it may well be open to question whether many of these particular customers are likely to be motivated to add CPSCs to their existing basic package, as VM has already been able to acquire them, in the face of competition from Sky and others, by providing them with just a basic Pay TV package. Mr Darcey told us that the vast majority of Sky Sports subscribers take CPSCs at the point of initial subscription rather than by upgrading at a later stage.<sup>867</sup>
781. Even if VM were to have no incentive to sell an upgrade to existing basic-only customers, we struggle to see how there could be any significant distortion of competition as a result. These customers are made aware of the availability of CPSCs on cable, have been won by VM in competition with Sky and others, and if they show any sign of switching away VM's incentives to retain them will unquestionably be triggered, so that VM will actively seek to sell CPSCs to them if that is what is required to retain their custom.
782. Sky has also argued that VM has some control over the incremental margin which it obtains for CPSCs, as this margin depends on the retail prices that VM sets for basic-only packages and for packages including CPSCs. Thus, for example, a reduction of £[...][C] in the retail price of its basic-only packages would automatically increase the incremental margin earned on packages with CPSCs, and

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<sup>864</sup> See also in this regard Biro 4, paras 137-140.

<sup>865</sup> See para 780, last sentence.

<sup>866</sup> Caines 1, para A174.

<sup>867</sup> Darcey 3, para 789.

would transform the margin from negative to positive. Mr Guest's response was that VM would not want to do this because VM has many more customers on basic-only packages.<sup>868</sup> There is no reason to doubt the commercial good sense of Mr Guest's approach. However, Sky's point was not that VM should reduce the retail price of the basic-only package; its point was that in examining VM's incentives it was wrong to place so much emphasis on the fact that the incremental margin of the CPSC package was negative, as this was a factor of VM's decision to set the basic-only retail price at the level VM presumably judged to be profit-maximising. Ofcom argued that because VM faces competition in relation to basic channels its basic-only prices are as low as they could be if VM is to earn a profit.<sup>869</sup> However, as has been seen, Mr Guest confirmed in his evidence to us that VM made [significant][C (**substituted text**)] margins on its basic-only packages,<sup>870</sup> and acknowledged that VM enjoyed some flexibility in relation to the overall prices of its packages.<sup>871</sup> Therefore there is merit in Sky's argument that VM has some control.

783. As to Sky's contention that VM similarly has a certain amount of flexibility in regard to the retail prices of packages which include CPSCs, and that if VM were to increase those prices that too would increase the incremental margin, VM argues that it is constrained by Sky's prices. This question elides with another issue to which we now turn, namely the comparability of Sky and VM's retail prices.

#### Comparison of retail prices

784. We have already referred to the fact that the most popular VM Pay TV packages containing CPSCs are its "top of the range" XL packs (taken by [most][C (**substituted text**)] of Sky Sports subscribers on VM's platform). Mr Guest indicated that this was where "the competitive action" was.<sup>872</sup> While Ofcom accepts that VM's retail prices for its "bottom of the range" CPSC bundles (i.e. basic plus Single Sports and basic plus Dual Sports) were respectively £2 and £9 cheaper than

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<sup>868</sup> Transcript 11/29.

<sup>869</sup> Ofcom skeleton argument, para 171.2.

<sup>870</sup> Transcript 11/32-33.

<sup>871</sup> Transcript 11/28-29.

<sup>872</sup> Transcript 11/96.

the equivalent Sky packages, it states that the retail prices of VM's corresponding XL packs were higher than Sky's equivalent, by £7.50 and £2.50 respectively. Mr Guest, too, observes that VM's retail prices are "less aligned" for larger packages than smaller ones, and that for the larger packages VM is more expensive than Sky. Both Ofcom and Mr Guest suggest that this is an indication that VM cannot compete effectively with Sky for CPSCs.<sup>873</sup>

785. Sky takes issue with the validity of the comparisons relied upon by Ofcom and VM, arguing that on a like-for-like basis Sky's retail prices are higher than VM's or at least more closely comparable than Ofcom has suggested. Mr Darcey acknowledged that on the face of it the retail price of VM's XL bundle together with the Sky Sports Collection (when taken with a phone line, but excluding the cost of the line<sup>874</sup>) was £2 more than the best matching Sky DTH satellite bundle (£46 per month as against £44). However he asserted that this was only the starting point, and that two adjustments were needed if a like-for-like comparison were to be made.
786. First, VM provided all its XL subscribers with ESPN at no additional charge, whereas Sky charged its subscribers an extra £9 per month for ESPN. Sky argue that in order to ensure that the comparison is fair Sky's charge for ESPN should be added to the Sky subscription of £44, making the figure £53. Mr Guest accepted<sup>875</sup> that this adjustment means that instead of being £2 more expensive, VM's XL plus CPSCs package is £7 cheaper than Sky's equivalent bundle for someone who is interested in ESPN.
787. Second, Sky points to the fact, acknowledged by Mr Guest,<sup>876</sup> that a VM subscriber to the XL plus CPSCs package can obtain in HD all the channels in the pack that are available in that format (about 20) for an additional charge of £7; Sky subscribers, on the other hand, were charged at least £10.25 per month extra for

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<sup>873</sup> Caines 1, paras A183-190; Guest 3, paras 37-41; Defence para 366; VM skeleton argument para 131.

<sup>874</sup> Mr Guest stated that the number of subscribers who took TV services without also taking broadband and/or telephony was very small. See, for example, Transcript 11/99. It also appears to be common ground that VM's and Sky's prices for a phone line are very similar. See Darcey 3, para 819, and Transcript 11/100.

<sup>875</sup> Transcript 11/96.

<sup>876</sup> Transcript 11/98.

access to channels in HD (other than FTA channels in HD). In Sky's submission this difference of £3.25 should also be taken into account in the comparison.

788. Mr Guest accepted that the effect of the two adjustments was to make the Sky package over £10 more expensive for someone who was interested in both ESPN and HD.<sup>877</sup> He pointed out, however, that if one looked beyond the Pay TV aspects of the packages, and took into account telephony, the position changed; Sky allowed free evening and weekend telephone calls whereas VM charged £4. Similarly with broadband, Mr Guest said that VM charged on average about £16 and Sky gave it away for nothing.<sup>878</sup>

789. What we glean from the evidence is that the comparison between VM's and Sky's retail prices is considerably more complex than the headline package prices would suggest. It is not established that VM's most relevant Pay TV packages for comparison purposes are more expensive on a like-for-like basis than Sky's equivalent packages. This comparative aspect does not in our view advance Ofcom's case that the rate card price so reduces VM's incentives that it is disabled from competing effectively with Sky. No cogent evidence that consumers regard VM's prices as uncompetitive with those of Sky was put before us. However, Ofcom argues that it can be deduced from VM's relatively low premium penetration compared to Sky that customers consider VM's prices less attractive.<sup>879</sup> We now consider the parties' main arguments and evidence on this point.

### VM's performance

790. As mentioned earlier, Ofcom concluded that in combination the factors referred to in paragraph 7.324 of the Statement, including the rate card price and VM's negative incremental margins, contributed to the "substantially lower penetration" of the CPSCs on cable as compared with Sky's DTH satellite platform.<sup>880</sup> Ofcom and VM submit that the level of penetration shows that VM's incentives and ability

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<sup>877</sup> Transcript 11/99.

<sup>878</sup> Transcript 11/99-101.

<sup>879</sup> Ofcom skeleton argument, para 171.3.

<sup>880</sup> Statement, para 7.325.

to compete effectively with Sky are impaired by these factors.<sup>881</sup> They point in particular to: VM's lower and relatively declining share of the total UK Pay TV subscriber base, as compared with Sky's share;<sup>882</sup> VM's inferior share of premium subscribers as compared with Sky;<sup>883</sup> VM's lower and declining penetration of CPSCs<sup>884</sup> as compared with Sky's penetration.<sup>885</sup>

791. Sky submits that these aspects of VM's performance are not attributable to the rate card, and are due to a number of other factors which neither Ofcom nor VM has properly addressed.

(i) *Overall UK Pay TV customer base*

792. In their evidence both Mr Guest and Mr Darcey produced graphs indicating the total UK Pay TV subscribers on cable and on satellite.<sup>886</sup> Mr Guest's graph started in 2000. This showed (and it is common ground) that since about 2000 total Pay TV subscribers on the cable platform in the UK have grown relatively more slowly, and to a lesser extent, than on Sky's satellite platform. Mr Darcey's graph, which started in 1994, showed that until about 2000/2001 cable subscriptions grew at a somewhat higher rate than those on satellite. At that point the position changed, with numbers on cable beginning to flatline and those on satellite continuing to grow - and at an even higher rate than before. Mr Darcey's evidence was to the effect that there were a number of reasons for this, and that none of them was the rate card price.

793. First, Mr Darcey pointed to the limited cable footprint.<sup>887</sup> It is common ground that only 50% of UK households have access to the cable network whereas satellite can reach virtually all households. Mr Guest accepted in cross-examination that this meant that VM could only compete with Sky in half of the UK market.<sup>888</sup> In this connection he was shown another graph produced by Mr Darcey in his written

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<sup>881</sup> Defence, paras 364-5; Ofcom skeleton argument, para 171.3; Caines 1, para A235; Guest 3, paras 8-19; VM skeleton argument, para 129.

<sup>882</sup> Guest 3, para 11; Transcript 11/73.

<sup>883</sup> Guest 3, para 15; Defence, para 364.

<sup>884</sup> i.e. the number of Sky Sports subscribers as a percentage of VM's total subscriber base.

<sup>885</sup> Guest 3, paras 16-17; Defence para 364.

<sup>886</sup> Guest 3, para 11; Darcey 3, para 800.

<sup>887</sup> Darcey 3, para 799.

<sup>888</sup> Transcript 11/68.

evidence,<sup>889</sup> containing Sky's estimate of Pay TV subscriber numbers in areas where *both* cable and satellite are available. The graph, which covered the period from the beginning of 2007 until October 2010, showed that in these areas cable had more subscribers than Sky, and that both platforms had consistently grown their numbers at approximately the same rate, with cable retaining its superiority in subscriber numbers. Mr Guest did not suggest that the graph was wrong in these respects but he did not accept that this meant that VM was an effective competitor to Sky in these areas. He said that the number of subscribers was one thing, the revenue produced by them was another, and Sky was obtaining more revenue from basic channels than was VM.<sup>890</sup>

794. The second factor relied upon by Sky was the prolonged financial difficulty experienced by the cable industry, which was an obstacle to its investment. In this connection Mr Darcey referred to the considerable debt burden of cable due in particular to the need to lay network under the roads. In addition the industry had rationalised itself from about 130 separate franchisees in the 1980s to just two major players by 2000. Both inherited considerable indebtedness as a result of *inter alia* the infrastructure costs and the expenses of multiple mergers and system integration exercises. As a consequence ntl with about \$18 billion of debt had entered into Chapter 11 bankruptcy in 2002, and it had been necessary for Telewest to re-structure its debt in 2004. Mr Darcey said that during this period and for a significant time thereafter both companies were limited in the level of capital expenditure and marketing they could deploy, at a time when Sky was enjoying a period of strong subscriber growth at modest cost. These financial constraints meant that ntl was not in a position to fund all necessary network improvements or effect the transition from analogue to digital. Sky had completed this transition by 2001, and its customers were benefiting from improved channel choice and picture quality. In view of the upfront costs of Pay TV subscriber acquisition, ntl had limited its ambitions in relation to Pay TV and had focused more on its high margin/lower cost broadband and telephony businesses. The position was similar for Telewest. In the meantime Sky was not only providing its customers with the benefits of the move to digital, but had also introduced PVRs (2001) and HD

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<sup>889</sup> Darcey 3, para 811.

<sup>890</sup> Transcript 11/70-72.

(2006). Also in 2001 Sky began to offer telephony and (in 2006) broadband, enabling it to compete with VM in triple play, where Sky had previously been at a disadvantage.<sup>891</sup>

795. This evidence was not disputed. Mr Guest accepted that VM's predecessors had been subject to severe financial difficulties in 2000/2001 which constrained their ability to invest generally. He stated that VM had still not completed the switch from analogue to digital, unlike Sky who had completed it about ten years earlier in 2001. Mr Guest also confirmed that the PVR, launched by Sky in 2001, was a very significant factor in driving up Sky's subscriber numbers. He accepted that Sky had created the market in HD by investing in HD content and subsidising HD STBs, and that VM had been able to make use of the market thus created by Sky.<sup>892</sup> Mr Guest agreed that Sky's success in relation to HD was a factor of its investment and not connected with the rate card price. He also acknowledged that VM had recently been rolling out an upgrade to its CA system in order to combat piracy which existed on VM's network, and that loss of cable subscribers through piracy had nothing to do with the rate card price.<sup>893</sup>

796. A third factor to which Sky pointed was Sky's investment in *basic* content. Mr Darcey's evidence was that between about 1999 and 2010 Sky's basic-only subscriber base grew from [...] [C] to [...] [C] – an increase of about [...] [C]% whereas its premium subscribers grew by [...] [C]% (from [...] [C] to [...] [C]). He ascribed the proportionately much greater increase in basic-only customers to Sky's adoption of a more inclusive sales strategy targeting overall volume and not just the most expensive packages; more choice and quality were added to basic-only packages. He said that over the same period cable had not grown its customer base in the way Sky had done. The failure to do this could not be attributed to the rate card price, which had no application to basic-only packages.<sup>894</sup> When this evidence was put to him Mr Guest did not dispute the figures but did dispute that the rate card was innocent of all effect. He said that the fact that there had been no effective

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<sup>891</sup> Darcey 1, paras 759-762; Darcey 3, paras 799-808.

<sup>892</sup> Transcript 11/73-76.

<sup>893</sup> As to the possible effect on subscriber numbers of reducing piracy, see para 753 of this judgment.

<sup>894</sup> Darcey 3, paras 809-811.

competitor of Sky in relation to premium channels had an effect on relative growth.<sup>895</sup>

797. Mr Guest's written evidence appeared inconsistent as to the relevance of the relative performance of VM (and its predecessors) and Sky in building their respective *total* UK Pay TV subscriber base: at one point he prayed in aid the different levels of performance in this respect,<sup>896</sup> whereas in a later passage he suggested that total subscribers numbers was not the relevant measure of VM's effectiveness as a competitor, and that it was necessary to look at VM's base of premium subscribers.<sup>897</sup> Be that as it may, the evidence touching on the relative performance of VM (and predecessors) and Sky in building their respective overall UK Pay TV subscriber numbers does not in our view implicate the rate card prices. Mr Darcey's evidence, accepted in large measure by Mr Guest, shows that other factors unrelated to the rate card were in play. These factors or some of them were just as likely to have been responsible for any relative shortfall in cable's overall performance. The fact that cable is prevented from competing against Sky in relation to half of all UK households must be a powerful inhibiting factor, quite apart from the other matters relied upon by Sky. Moreover, it is significant that in those geographical areas where VM can compete with Sky the company holds its own in terms of overall subscriber numbers.

(ii) *Penetration of premium channels generally and CPSCs in particular*

798. It appears non-controversial that from about mid 1997 to mid 2010 both Sky and cable experienced a similar rate of decline in CPSCs penetration (about [...] [C]% decline on each platform), so that the gap between them remained more or less constant over that period, with Sky's penetration declining roughly from [...] [C]% to [...] [C]%, and cable's roughly from [...] [C]% to [...] [C]%. During the four years or so at the end of the period Sky's rate of decline actually appears to have been rather steeper than VM's ( [...] [C]% as compared with [...] [C]%).<sup>898</sup>

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<sup>895</sup> Transcript 11/77-80.

<sup>896</sup> Guest 3, para 11.

<sup>897</sup> Guest 3, para 14.

<sup>898</sup> Darcey 3, para 813 (and table 5) and 815; Transcript 11/82 (Mr Guest).

According to another graph produced by Mr Darcey,<sup>899</sup> the proportion of the ex-VAT retail price of Sky's 6 mix package represented by the rate card price has remained reasonably constant from 1997 until mid 2010, flat lining at or just under the 60% mark. As already mentioned, it is common ground that Sky's 6 mix package is directly comparable with VM's XL package - the product taken by [most][C (substituted text)] of VM's premium customers.<sup>900</sup> In the light of this, Sky submits that the decline in penetration cannot be attributed to the rate card price, and that the decline is a result of the growing importance of basic-only packages to new Pay TV subscribers, who are increasingly likely to take such packages.<sup>901</sup>

799. As noted in the previous paragraph, the difference between VM's penetration rate for premium subscribers including subscribers to CPSCs, and Sky's penetration rate, has remained fairly constant since about 1997, albeit perhaps narrowing slightly in the last few years. Sky submits that this gap is likely to be caused by a number of factors unrelated to the rate card price. These factors include cable's poor record in combating piracy until the recent upgrade of its CA system, and certain economic advantages available to Sky, which have been referred to as the "double marginalisation" and "principal and agent" issues.

800. In relation to piracy, we have already referred to the evidence of Mr Darcey and Mr Guest when we were considering possible causes of the increase in premium subscribers observed on the cable platform after mid 2010.<sup>902</sup> It appears to be generally accepted that the greater attraction and value of premium channels renders them more likely to be targeted by pirates. It is therefore likely that premium penetration will suffer as a consequence of poor security on a platform, and that penetration rates will improve when security is enhanced.

801. Turning to Sky's economic advantages, Sky incurs a much lower marginal cost for each new premium subscriber added to its Pay TV customer base than does VM. This is because, as the channel producer, Sky's wholesale costs are mainly fixed, in

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<sup>899</sup> Darcey 3, para 815 (and table 6).

<sup>900</sup> Transcript 11/87-92 (Mr Guest).

<sup>901</sup> Darcey 3, paras 810 and 815. See also para 796 above.

<sup>902</sup> See paras 753 and 756 above.

the form of the prices paid by Sky for the content rights which form the basis of its premium channels. When Sky acquires a new premium subscriber the marginal cost of adding that subscriber is virtually zero. Sky therefore has a stronger incentive to market, as each new subscriber makes a contribution to those fixed costs. By contrast, the marginal cost of a new premium subscriber to the platform of a retailer such as VM is much higher, as it includes the per-subscriber rate card price (or the WMO) paid to Sky. Such a retailer therefore has a lower profit incentive than Sky to market the premium channels, and will consequently be under a relative disadvantage which may well lead to lower penetration. The situation could only be made symmetric if Sky supplied the premium channels at a wholesale price close to zero, which no one has suggested is realistic. So much appears to be common ground.<sup>903</sup> This problem is one of the reasons put forward by Sky to explain its strong preference for self-retail.

802. It is also common ground that the effects of the problem may be mitigated, and the incentives better aligned, by, for example, contractual arrangements which produce lower (“non-linear”) tariffs or discounts linked to the achievement of penetration targets. Ofcom argues that Sky could have taken such steps.<sup>904</sup> We have already discussed the attempts by Sky to obtain what it regarded as an acceptable degree of regulatory comfort in respect of such arrangements when seeking to reach long-term wholesale supply contracts with the cable operators.<sup>905</sup> We concluded that Sky’s reluctance to enter into discounting arrangements of that kind without clearer regulatory approval was understandable in all the circumstances.
803. Whilst accepting that the economic factors to which we have referred have an effect on VM’s incentives, Ofcom argues that the effect is exacerbated by Sky’s setting the rate card price close to the maximum permitted under its margin squeeze test.<sup>906</sup> However, for the reasons set out earlier in this judgment<sup>907</sup> that finding is not established on the basis of the specific application of the margin squeeze test used by the OFT in 2002 or by Sky. As already noted, Sky maintains that by reference to

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<sup>903</sup> Statement, para 7.277; Darcey 1, paras 200-201; Transcript 11/48-49 (Mr Guest); Van Reenen 1, paras 168-175, 192-197; Caines 1, paras A156-7, A217-8.

<sup>904</sup> For example, Caines 1, para A157.

<sup>905</sup> See paras 524-526 and 742-744 of this judgment.

<sup>906</sup> Caines 1, para A157.

<sup>907</sup> Paras 765-767 above.

the latter methodology it has allowed considerable leeway to VM and its predecessors, and Ofcom has not attempted to replicate that methodology in order to verify Sky's claim.

804. In his expert economic evidence on behalf of FAPL Mr Zoltan Biro, a director of Frontier Economics Limited, identified a number of other additional potential causes of the difference in premium subscriber penetration between cable and satellite. These included: the possibility that content has been decisive in choice of platform at the outset; in other words, customers with a low demand for premium content have chosen cable in order to enjoy their telephony and broadband services, and customers with a strong demand for premium content have chosen satellite. In addition, there may be an effect resulting from an association in customers' minds between Sky channels and the satellite platform, due to Sky's brand name. In this regard Mr Biro referred to the TNS omnibus customer survey commissioned by Ofcom<sup>908</sup> in which 22% of Sky Sports customers on DTH satellite who did not consider VM for their TV services said after prompting that Sky was the obvious choice for Sky channels. Mr Biro also referred to: the differences in retail prices, and the availability of HD and interactive services, both of which we have discussed earlier. Finally, referring again to the TNS survey, he suggested that the lower penetration rate in CPSCs may be wholly or partly due to a greater tendency of VM customers to take advantage of the availability of other sports programming, in particular on other channels e.g. ESPN, and by watching sports events in public houses. Mr Biro commented that in the Statement<sup>909</sup> Ofcom had acknowledged these as potential causes but had insufficiently evaluated them before concluding that the lower take-up of the CPSCs on cable was not attributable to them but to the level of the rate card.<sup>910</sup>
805. In his evidence Mr Caines responded to Mr Biro's comments.<sup>911</sup> Whilst agreeing that there were a range of factors driving premium penetration, Mr Caines's view was that most of these were related, at least in part, to the rate card's effect on VM's incentives and ability to compete. For example, whilst it might be true that

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<sup>908</sup> Statement, Annex 6, Appendix 5, Figure 5.

<sup>909</sup> Statement, para 7.321.

<sup>910</sup> Biro 1, paras 70-71.

<sup>911</sup> Caines 1, paras A227-A235.

customers with a demand for sports would choose satellite, this was because of the unattractive terms on cable. The same applied to the association of the Sky brand name with the satellite platform, and the greater tendency of VM customers to use alternative means of viewing sports.

806. In our view Ofcom's (and Mr Caines's) attribution of the reason for lower cable penetration of premium channels, and in particular CPSCs, to the level of the rate card prices (albeit in combination with the other factors referred to in paragraph 7.324 of the Statement), amounts in essence to little more than speculation. There are other factors in play which seem likely to have had an effect on premium penetration, such as the need to upgrade security to combat piracy, and the economic factors which work to Sky's advantage by enhancing its incentives to market. We have already explained why Sky acted rationally and commercially in taking the view that there was considerable uncertainty as to whether a simple reduction in the rate card prices would translate into improved retail terms for VM's customers and, if so, would produce a sufficient number of additional premium subscribers to compensate Sky for the loss of wholesale revenue.<sup>912</sup> The specific evidence about declining premium penetration rates on both platforms, and about the potential causes of the persistent gap between those rates, serves rather to confirm the rationality of Sky's reluctance to lower the rate card other than in the context of a performance-based pricing arrangement.

#### Sky's advantage of scale

807. Finally, some further light may be thrown on the question of VM's ability to compete effectively against Sky at the rate card prices by evidence given in the context of a separate issue: this was whether Ofcom was justified in extending the benefit of the WMO remedy to VM. The question concerned Sky's advantage over rivals who were assumed to be equally efficient but of smaller scale in terms of subscriber numbers. Ofcom's WMO remedy was based on an adjustment to Sky's costs to reflect what Ofcom considered to be Sky's unmatched scale. In cross-examination Dr Teh was asked about an analysis which was contained in his written evidence on behalf of Ofcom. He agreed that on the basis of that analysis an equally

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<sup>912</sup> See paras 748 to 757 of this judgment.

efficient rival of approximately VM's scale (c. 4 million Pay TV subscribers), and with a subscriber base with the same composition as Sky, would incur about 3% more costs. This translated into a cost advantage for Sky of £5.40 per annum, or 45p per month, per subscriber.<sup>913</sup> Dr Teh pointed out that VM does not have Sky's composition of subscribers, having significantly lower premium penetration. However, it is by no means clear that a higher proportion of premium subscribers would reduce overall costs. It appears quite possible that it would in fact increase them.<sup>914</sup> Dr Teh accepted that Ofcom had not investigated VM's costs to see if they were as efficient as Sky.<sup>915</sup>

808. As we noted earlier, Ofcom concluded that the rate card price only just passed Ofcom's specific application of the margin squeeze test at Sky's scale, and that given VM's much smaller scale it was not surprising that the rate card price prevented VM from competing effectively with Sky.<sup>916</sup> The figures discussed in the previous paragraph relating to Sky's advantages of scale are merely estimates, and it would be wrong to place too much reliance on them. However, in our view a scale cost advantage of 45p per subscriber per month in the context of two business models and platforms (Sky and VM) which are distinct from each other in so many other ways (some of which operate to VM's advantage<sup>917</sup>), does not seem to be substantial enough to have a material impact on VM's ability to provide effective competition.

The Tribunal's general conclusion on VM's incentives and ability to compete effectively at rate card prices

809. The evidence before the Tribunal shows how Sky and the cable companies have developed their respective businesses in very different ways over many years. Sky has focused on its Pay TV operation, coming much later to telephony and broadband in order to be in a position to compete with cable in triple play and related packages. VM's history is more that of a telecommunications operator

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<sup>913</sup> Transcript 27/62-89; Teh 1, figure 1, page 57, and worksheet 1.

<sup>914</sup> Transcript 27/78-80.

<sup>915</sup> Transcript 27/74.

<sup>916</sup> Statement, para 7.324, second bullet point.

<sup>917</sup> See para 809.

which has come to Pay TV via its primary telephony business. In the light of their different infrastructure, history and development, each has certain natural advantages and disadvantages. We have already referred to the economic issues which provide Sky with stronger incentives than VM in relation to marketing of the CPSCs. VM, too, has a number of advantages compared with Sky. For example Ms Burns agreed that VM considered its broadband offering, based on its unique cable network, as second to none in terms of speed and quality, providing it with a competitive advantage. Similarly, she said that VM's VOD service was regarded as having led the way in widening the scope of the market for this kind of TV product. VM also has the advantage over Sky of being able to offer mobile telephony and therefore "quad play" packages.<sup>918</sup> Further, as noted earlier, [most of][C (substituted text)] VM's Pay TV subscribers also take broadband and telephony. Given the fixed costs represented by VM's cable infrastructure over which its broadband and telephony are provided, VM has enhanced incentives to provide those services (in areas covered by its network), analogous to Sky's advantages in respect of the fixed costs of the CPSCs. Conversely, Sky has no equivalent broadband/telephony network and is obliged to purchase the necessary wholesale service from BT on a per-subscriber basis, giving Sky a weaker incentive to supply those services than VM. Despite this disadvantage it is common ground that Sky provides some broadband services free of charge in order to obtain or retain customers who will provide revenue by taking a package of services.<sup>919</sup> The negative incremental margin this implies is no doubt worthwhile for Sky because Sky makes a positive margin on the package supplied to the customer.

810. Competition between operators with these inherent differences is never going to be symmetrical, and each is obliged to play to its own particular advantages. Effective competition does not require such symmetry. The question is not whether VM is *as effective* a competitor as Sky in the marketing of packages containing CPSCs, but whether the rate card price has been shown to obstruct (or to contribute to the obstruction of) fair and effective competition by VM. We are clear that the answer is negative.

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<sup>918</sup> Transcript 10/169-171.

<sup>919</sup> Transcript 11/50-54 (Mr Guest).

811. Although a lower wholesale price and a higher margin on such packages would no doubt be welcomed by VM, in the light of the evidence we consider that the relatively small negative incremental margin which upgrading VM's basic-only customer to a package including CPSCs involves, cannot affect to any significant extent VM's incentives to market the channels. The evidence makes clear that VM has a strong commercial and financial incentive to win and retain all customers who are interested in the CPSCs, in competition with Sky and others.
812. It is also relevant to note that Ofcom found there is no margin squeeze, and that on Dr Teh's analysis any Pay TV cost advantage over VM by reason of the two platforms' difference in scale, is relatively small. Nor does the evidence justify a finding that the level of the rate card is a significant cause of the persistently lower CPSC penetration on cable. As we have said,<sup>920</sup> other factors, unrelated to rate card levels, are at least as likely to be at the root of this phenomenon.
813. In our view the evidence overall demonstrates that VM is rightly regarded by Sky as a serious, well-established rival capable of constraining Sky's actions in the market, and that it does in fact compete effectively with Sky in relation to the supply of packages which include CPSCs. We therefore conclude that Ofcom's finding as to the effect of the rate card on VM's incentives and competitive effort is not justified. Nor indeed is customer choice likely to be adversely affected to any real extent. Existing customers of VM who wish to take CPSCs can do so without switching, and at prices which are comparable with those on satellite.
814. In so deciding we have taken account of the evidence and submissions of the other retailers, both in their interventions and in their own appeals, in so far as these have a bearing, directly or indirectly, on the ability of VM to compete effectively at the rate card price.<sup>921</sup>

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<sup>920</sup> See para 806 above.

<sup>921</sup> See for example BT written closing submissions paras 253-261; Watson 3, paras 138-151; Transcript 9/125 (Mr Watson); Guest 1, paras 13, 57 and 69; Guest 3, para 113; Guest 4, para 51. 1. Much of the material in question related to the alleged inadequacy of the WMO to provide an effective remedy. For example, the primary focus of BT's appeal concerned the particular methodology used by Ofcom to calculate the WMO prices, as to which BT alleged errors primarily of a technical and accountancy nature (e.g. errors in Ofcom's chosen reference retail prices, assumptions used in Ofcom's discounted cashflow model, levels of fixed costs, churn rate, and assumptions in relation to discounting by Sky). VM similarly challenged the methodology used to calculate the WMO prices, and specifically

815. We have well in mind that in reaching our overall conclusion about the effect of the rate card on VM's ability to compete effectively we are again differing from Ofcom on a matter on which it has exercised an element of judgment under section 316. Nevertheless, having due regard to the principles summarised at paragraph 84 above, on the evidence put before us we are satisfied that Ofcom's assessment is wrong in that respect.

#### Miscellaneous points relating to prices

##### *Prices above competitive level*

816. In the Statement Ofcom concluded it was likely that the rate card prices and retail prices of packages including the CPSCs were appreciably above competitive levels.<sup>922</sup> These findings, based on material which included two reports by the economic consultancy Oxera and a pricing model of Ofcom, were mainly used by Ofcom to support its conclusion that Sky has market power in the wholesale supply of the CPSCs.<sup>923</sup> Whilst Sky did not challenge Ofcom's definition of the relevant market or its finding of market power, it did strongly dispute the finding that the wholesale and retail prices in question were appreciably above competitive levels, and filed detailed evidence and submissions comprehensively opposing the findings, including evidence from two economic experts.<sup>924</sup> Thereafter, although in its Defence (paragraph 124) and skeleton argument (paragraph 79) Ofcom referred to Sky's "high prices", it did not respond to Sky's points or adduce any evidence in response. Neither did Ofcom seek to cross-examine Sky's experts. Mr Darcey, who was cross-examined for several days, was not asked about this issue. The Tribunal did not have the benefit of any detailed oral submissions on the issue.

817. In the light of the absence of any response in the Defence, Sky had thrown down the gauntlet in its Reply, stating:

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the lack of any provision for a price adjustment mechanism, and Ofcom's alleged failure to control the prices charged by Sky for Sky Sports 1 and 2 when these form part of a bundle including Sky Sports 3 and 4 and/or any of the Sky Movies channels.

<sup>922</sup> See for example Statement, para 5.54. See also, paras 1.45-47, 5.513ff, 7.354-366, 8.267-270, 9.14-16, and Annex 3.

<sup>923</sup> Statement, para 5.590.

<sup>924</sup> See Sky amended notice of appeal, para 1.29 and Annex 1; Darcey 1, paras 729-822; and the expert evidence of Professor Grout and Mr Hulbert.

“Sky notes that Ofcom ... does not take issue with Sky’s challenge to Ofcom’s findings on price and profitability set out in Annex 1 of the NoA and the evidence of Professor Grout, Mr Hulbert or Mr Darcey on those issues. Accordingly the Tribunal will not be called upon to consider the evidence on this issue and should proceed on the basis that Ofcom is not entitled to rely on any claims ... that the wholesale or retail prices for the CPSCs are appreciably above competitive levels in defence of its Decision.”<sup>925</sup>

818. Ofcom’s written closing submissions contained the following passage:

“Ofcom concluded that Sky was earning returns above its cost of capital and that this implied that consumers were paying high prices. It decided, however, that it should not seek to address this finding, as to do so carried risks that were not justified by the level of harm to consumers that had been identified. Those risks included the risk that the remedy might artificially reduce the value of sports rights.”<sup>926</sup>

819. This statement appears to be directed at the level of Sky’s retail prices. As far as wholesale prices are concerned, the procedural history outlined above, and the absence of any substantive response to the gauntlet thrown down by Sky in its Reply, appears to signal an acknowledgement by Ofcom that the issue will not fall to be determined by us. The fact that we do not have the benefit of counter submissions to those in Annex 1 of the amended notice of appeal or any reply to Sky’s evidence in support of them, would make an attempt at such determination wholly unsatisfactory, and probably otiose in the light of our conclusion that the rate card price is not an obstacle to effective competition on the part of VM.

#### *Other retailers*

820. Ofcom’s leading counsel, in her closing submissions, argued that as Sky was offering to supply the likes of BT only at the rate card price, this amounted in substance to a finding of constructive refusal to supply.<sup>927</sup> These submissions were made in the context of addressing one of Sky’s and FAPL’s jurisdiction arguments, dealt with at paragraph 119 ff of this judgment, namely that the criteria for action by Ofcom under section 316 are closely aligned with the *ex post* competition prohibitions.

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<sup>925</sup> Sky’s Reply, para 1.4. See also Transcript 29/8-9 and 30/28:1-3.

<sup>926</sup> Ofcom written closing submissions, Part 1, para 309.

<sup>927</sup> Transcript 4/23-35 and 37/71-72.

821. We recognise that other retailers, and in particular BT, claim that they would not be able to compete effectively on the basis of Sky's rate card price.<sup>928</sup> We have not found it necessary or appropriate to reach any specific conclusion about this. Although in negotiations between Sky and BT, Sky was insistent that wholesale prices of CPSCs should be based on the rate card prices, we have found that Sky was open to agreeing discounts from those prices, referable to penetration rates achieved by the retailer. We also found that the negotiations with BT were very significantly affected by the ongoing Pay TV review, and by the prospect of Ofcom imposing a regulatory price lower than the rate card. In these circumstances, when a favourable outcome of the Pay TV review appeared imminent, BT indicated that it was prepared to agree to wholesale supply at the rate card price provided that the agreed price would be changed in due course to reflect the regulatory price. In the event the regulatory outcome preceded the finalisation of the agreement with BT. There was therefore no negotiation on price between Sky and BT which was unclouded by likely regulatory action, and there is no way of knowing what the result of a genuinely commercial negotiation would have been. The same applies to negotiations with other retailers, actual or potential. The negotiations with TUTV and Orange did not founder because of the rate card price, but for other reasons, as discussed at length earlier in this judgment.

#### *Picnic profitability*

822. In the Statement Ofcom reviewed Sky's business plan for its proposed Picnic service, the plans for which were abandoned by Sky in 2008 before any launch of the service. Ofcom found that, making a number of adjustments to Sky's cost model, and taking the provisional retail price used by Sky for modelling, the rate card prices were higher than the level at which a rival retailer would have been able to compete effectively.<sup>929</sup> Sky disputed the adjustments made to the cost model and challenged Ofcom's conclusion.

823. This aspect of the debate between the parties did not provide us with any real assistance, and we have not found it necessary to consider it in any detail. The

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<sup>928</sup> See, for example, paras 48-50 of BT's Statement of Intervention in Sky's appeal.

<sup>929</sup> See Statement, paras 7.121-133; see also Caines 1, paras A236-A282.

business model related to a service which was never launched. The retail price used in the model was merely provisional. Sky's evidence was that there was scope to increase the retail price, as it was significantly cheaper than the nearest equivalent package on DTH satellite; therefore it might well have been at a different level on or after launch.<sup>930</sup> In response Mr Caines pointed out<sup>931</sup> that this evidence did not identify what effect a price rise would have on demand, nor what the "equivalent" DTH satellite package was. This is true but we question whether it is really appropriate to seek to resolve hypothetical questions about a service that was never introduced. In any event we do not propose to do so.

#### G. THE TRIBUNAL'S CONCLUSIONS ON SKY'S CHALLENGE TO OFCOM'S COMPETITION CONCERNS

824. We have now examined in considerable detail the evidence relating to the competition concerns which led Ofcom to impose the WMO remedy, pursuant to section 316 of the 2003 Act. In particular we have looked at the negotiations between Sky and TUTV, BT, Orange and the cable companies, upon which Ofcom places considerable reliance.<sup>932</sup> The evidence relating to Sky's discussions and relations with the cable companies do not change the conclusions we reached after considering the negotiations with TUTV, BT and Orange.<sup>933</sup> Indeed, we have found significant errors of assessment also in Ofcom's findings in the context of Sky's dealings with the cable companies.
825. In the light of our findings we have concluded that Ofcom's core competition concern is unfounded. That concern is that Sky has deliberately withheld from other retailers wholesale supply of its premium channels, preferring to be entirely absent

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<sup>930</sup> Darcey 1, para 410.

<sup>931</sup> Caines 1, paras A272-A277.

<sup>932</sup> We have also considered such evidence as was put forward in relation to Sky's negotiations with Video Networks Limited ("VNL"), provider of the "HomeChoice" IPTV service, which later became Tiscali TV, and subsequently TalkTalk TV. As we note at para 187 of the judgment, the CPSCs were made available on this platform through a self-retail arrangement with Sky. Ofcom relies on this evidence in various contexts, including as evidence of a perception by VNL of Sky's unwillingness to enter into a wholesale arrangement (Ofcom written closing submissions, Part 1, Annex 3, para 479), the poor penetration levels achieved on this platform (and Sky's alleged reluctance to refer to penetration on this platform in negotiations with other counterparties), and more generally the unsatisfactory nature of a self-retail arrangement. The evidence relating to Sky's arrangements with VNL does not alter our conclusions in the judgment.

<sup>933</sup> See para 496 of this judgment.

from those retailers' platforms than to give them wholesale access,<sup>934</sup> and that in doing so Sky has been acting on strategic incentives unrelated to normal commercial considerations of revenue/profit-maximisation. We have reached this conclusion having found a significant number of Ofcom's pivotal findings of fact in the Statement to be inconsistent with the evidence, including the contemporaneous documents. We do not repeat here all the respects in which we have found Ofcom's factual assessment to be erroneous. For this, reference should be made to the earlier parts of the judgment in which our conclusions on the individual negotiations are set out. Some of the most important issues on which we have differed from Ofcom relate to the respective conduct and motivation of Sky and its counterparties in the various negotiations.

826. For example, while acknowledging the existence of some regulatory gaming on the part of other retailers, Ofcom has attributed responsibility for the failure to reach agreement largely to Sky's failure to engage constructively with its counterparties. However the evidence shows that Sky did on the whole engage constructively. On the other hand its counterparties by no means always did so: in our view regulatory gaming on the part of some of Sky's counterparties played a much more important role in the negotiations and their progress (or lack of it) than Ofcom has recognised. Although regulatory gaming was not so evident in the case of Orange, Ofcom's findings as to the reasons for ultimate abandonment of those negotiations, and its apparent attribution of significant responsibility to Sky, are again inconsistent with the evidence.
827. Another example is Ofcom's finding that, because it was unlikely that a competitor would be willing to allow it to self-retail, it was also unlikely that Sky itself would have had an expectation that a competitor might do so. As we explained earlier,<sup>935</sup> this finding is inconsistent with the evidence and wrong in both respects, and has important implications for Ofcom's conclusions about Sky's motivations and in particular the disputed strategic incentives.

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<sup>934</sup> A finding which Ofcom's leading counsel described as "the crucial finding of fact" in the Statement: Transcript 15/20.

<sup>935</sup> Paras 227 to 232 and 493 to 495 above.

828. Although Sky admittedly has a strong preference for self-retail of its premium channels, and acts upon that preference in conducting negotiations for access to them, this is not in itself a subject of criticism by Ofcom. Further, the evidence put before us shows that Sky has no theological objection to wholesale supply of its premium channels. Leaving aside its very long-standing wholesale supply to the cable companies, the evidence demonstrates that where it becomes evident that a counterparty will not agree to Sky self-retailing on its platform, Sky is willing to wholesale. This feature – which is directly contrary to Ofcom’s finding - emerged clearly in the negotiations with BT. In our view the evidence of the Orange negotiations is also consistent with such willingness. However in that case, at the time the plug was pulled by Orange, Sky believed (with good reason) that it was making headway in persuading Orange to agree to a self-retail arrangement. As Mr Darcey put it in his evidence, it depended on who blinked first. Whereas in the BT negotiations Sky blinked first, with Orange the point at which one side or other would have to blink had not yet been reached. Furthermore, the absence of any rooted objection on the part of Sky to wholesale access to its premium channels is also, in our view, supported by Sky’s willingness to give commitments to that effect to Ofcom in 2007 after the Pay TV review had begun,<sup>936</sup> and by its agreement to wholesale to other parties in the context of the Interim Relief Order in the present proceedings.<sup>937</sup>

829. Given these conclusions, there is no need for the Tribunal to resolve the issues debated before us at some length as to the plausibility or otherwise as a matter of economic theory of the alleged strategic incentives on which Sky was said by Ofcom to be acting in its conduct of the various negotiations. As we have said, Ofcom’s position at the hearing was that its findings relating to the strategic incentives were not essential to the existence of its core competition concern. Ofcom submitted that the fact of Sky’s acting upon these incentives would be revealed when we looked at the empirical evidence of Sky’s conduct in the individual negotiations.<sup>938</sup> Having examined that evidence we have formed a clear view that Sky was acting for ordinary profit/revenue-maximising commercial

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<sup>936</sup> Paras 190 to 192 of this judgment.

<sup>937</sup> Para 6 of this judgment.

<sup>938</sup> Paras 166 and 167 above.

motives, and it cannot in our view be inferred from the material put before us that the alleged incentives were conditioning Sky's conduct.

830. For the reasons set out in this judgment, we have found that Ofcom's other competition concerns, relating specifically to the terms of existing wholesale supply of the premium channels to VM and the supply to that company of certain new services, are also unfounded. In that connection we have found no evidence to justify Ofcom's finding that Sky has (or has acted upon) an incentive to weaken VM or its corporate predecessors as competitors.
831. The nature and extent of our disagreement with Ofcom's assessment of the facts are such that in general it has not been necessary for us to consider whether, on the basis of *Ofcom's* findings, Sky's alleged conduct in regard to each competition concern would have been such as to prejudice fair and effective competition in the retail supply of the CPSCs. For example, we have not looked at whether, if Sky had *not* engaged constructively with other retailers in negotiations for access to premium channels, and *had* been acting on a preference to be entirely absent from a platform rather than agree to wholesale to a competitor, that behaviour would have prejudiced fair and effective competition. On our assessment of the evidence that situation simply did not arise. Similarly we have not found it necessary to look at that issue when dealing with Ofcom's competition concerns about supply of HD services to the cable companies, or about the supply of premium channels to a possible IPTV platform.
832. However, in two specific areas (supply of interactive services and rate card prices paid by VM) the facts were such that we have felt it appropriate to consider that question. In each of those cases Ofcom's decision on the issue of prejudice to fair and effective competition was, in our view, wrong. In reaching that conclusion we were mindful that the issue was one on which Ofcom, as the specialist regulator, had exercised a degree of judgment, and therefore that when reviewing a decision of that kind on appeal we should have regard to the principles set out earlier in this

judgment.<sup>939</sup> In particular we should not interfere with Ofcom's decision unless satisfied that it was wrong.

## **VII. CONSEQUENCES OF THE TRIBUNAL'S CONCLUSIONS IN SECTIONS V AND VI**

### *Other appeals and grounds of appeal*

833. The Tribunal's conclusions on Sky's grounds of appeal relating to Ofcom's competition concerns are sufficient to dispose of all these appeals, and it is not necessary for the Tribunal to determine Sky's and the other Appellants' grounds of appeal in relation to the validity, effectiveness and proportionality of the WMO itself, nor for the Tribunal to determine the STB and CAM appeals. Nor do we consider that it would be appropriate for us to do so.

834. It is sometimes sensible for a court to express its views on issues even though they have become academic in the light of its findings on other matters. This can be the case where, as here, the court has heard evidence and submissions on the now academic matter. The court's views on that matter might become relevant or helpful in the event of an appeal, and the matter might itself be appealed contingently, against the possibility of the determinative ruling being overturned. However these considerations did not persuade us in the present case. It would be difficult to justify the delay in handing down the Tribunal's decision which this exercise would have entailed, as well as the additional expenditure of judicial and other resources on issues which, in the light of our primary conclusions, are academic.

835. The decision not to embark on that exercise was to some extent vindicated by Ofcom's request to the Tribunal on 14 June 2012 not to give judgment yet but first to reopen the hearing in order to admit further evidence and allow further submissions. This request related to issues which are now academic in that they concern grounds of challenge to the WMO remedy itself. Ofcom's request<sup>940</sup> arose out of the latest FAPL auction of live audio-visual rights, the results of which were

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<sup>939</sup> See, in particular, para 84 of the judgment.

<sup>940</sup> This was not the first request to the Tribunal to delay its judgment. In May 2012 FAPL asked the Tribunal not to deliver judgment while its 2012 live rights auction was in progress.

made public at that time, and which in its view had a bearing on the arguments put before us. Had we acceded to the request other parties would inevitably have wished to introduce new evidence and submissions themselves. We declined to reopen the hearing, indicating that our reasons would be contained in this judgment. Those reasons should now be clear.

*Directions and other relief*

836. In the light of the Tribunal's conclusions, which are unanimous, Sky's appeal must be allowed, but the Tribunal will hear the parties in due course on the appropriate ruling, in particular as regards (1) any action that Ofcom should be directed by the Tribunal to take for the purposes of section 195(3) of the 2003 Act<sup>941</sup> (as applied by section 317(7)); (2) any other order(s) that should be made in respect of the appeals themselves; and (3) the effect of this judgment on the Interim Relief Order, and generally.

The Honourable Mr.  
Justice Barling

Professor John Beath

Michael Blair QC

Charles Dhanowa  
Registrar

Date: 8 August 2012

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<sup>941</sup> See para 67 above.

## GLOSSARY OF DEFINED TERMS

1990 Act	<b>Broadcasting Act 1990</b>
1996 Act	<b>Broadcasting Act 1996</b>
1998 Act	<b>Competition Act 1998</b>
2002 Act	<b>Enterprise Act 2002</b>
2003 Act	<b>Communications Act 2003</b>
Arqiva	<b>Telecommunications company which provides infrastructure and broadcast transmission facilities in the United Kingdom and Republic of Ireland</b>
BARB	<b>Broadcasters' Audience Research Board</b>
BT	<b>British Telecommunications plc</b>
CA	<b>Conditional access</b>
CAK	<b>Conditional access kernel</b>
CAM	<b>Conditional access module</b>
CAM appeal	<b>Sky's appeal in Case 1179/8/3/11</b>
Complainants	<b>BT, Setanta, TUTV and VM</b>
Conditions	<b>The conditions imposed on Sky in the Statement concerning the supply by Sky of the programme content of the CPSCs to other undertakings</b>
CPSCs	<b>The core premium sports channels, namely Sky Sports 1, Sky Sports 2, Sky Sports 1 HD and Sky Sports 2 HD</b>
Directive	<b>Television Without Frontiers Directive (Directive 2007/65/EC of the European Parliament and of the Council of 11 December 2007)</b>
DSat	<b>Digital satellite</b>

DSL	<b>Digital subscriber line</b>
DTH satellite	<b>Direct-to-home satellite</b>
DTT	<b>Digital terrestrial television</b>
EPG	<b>Electronic programme guide</b>
FAPL	<b>Football Association Premier League Ltd</b>
FRND	<b>Fair, reasonable and non-discriminatory</b>
FTA	<b>Free to air</b>
HD	<b>High definition</b>
Interim Relief Order	<b>Order of the President dated 29 April 2010 (as amended on 9 November 2010), and with the agreement of the parties then appearing, varying the Conditions on an interim basis, suspending the operation of the Statement generally, and modifying Sky's obligations in respect of specified platform operators</b>
IPTV	<b>Internet protocol television</b>
ITC	<b>Independent Television Commission</b>
MSR	<b>Minimum security requirement</b>
MRG	<b>Minimum revenue guarantee</b>
O&O	<b>Oliver &amp; Ohlbaum Associates Ltd</b>
Ofcom	<b>Office of Communications</b>
OFT	<b>Office of Fair Trading</b>
Orange	<b>Orange Home UK plc</b>
Pay TV	<b>Pay television</b>
Pay TV review	<b>Ofcom's investigation into the Pay TV sector</b>
Picnic	<b>A proposal by Sky to launch certain Pay TV channels on DTT</b>

Picnic Statement	<b>Ofcom’s “Statement on Sky’s Picnic proposal”, dated 31 March 2010.</b>
PVR	<b>Personal video recorder</b>
SD	<b>Standard definition</b>
Setanta	<b>Setanta Sports Holdings Ltd</b>
Sky	<b>British Sky Broadcasting Ltd</b>
Sports Body Interveners	<b>RFL (Governing Body) Ltd, The Football Association Ltd, Rugby Football Union, The Football League Ltd, PGA European Tour and the England and Wales Cricket Board</b>
Statement	<b>Ofcom’s “Pay TV Statement” published on 31 March 2010</b>
STB	<b>Set-top box</b>
STB appeal	<b>Sky’s appeal in Case 1170/8/3/10</b>
SVOD	<b>Subscription video on demand</b>
TLCS	<b>Television licensable content services</b>
Tribunal Rules	<b>Competition Appeal Tribunal Rules 2003 (S.I. No. 1372 of 2003)</b>
TUTV	<b>Top Up TV Europe Ltd</b>
VM	<b>Virgin Media, Inc.</b>
VNL	<b>Video Networks Ltd</b>
VOD	<b>Video on demand</b>
WMO	<b>Wholesale must-offer obligation</b>

## ANNEX A: OVERVIEW OF THE PAY TV SECTOR

1. What follows is necessarily a very abbreviated account of the Pay TV sector in the UK. It is intended to be a non-contentious background to these appeals and draws from sections 3 and 4 of the Statement, the first witness statement of Mr Michael Darcey dated 29 May 2010, and the first witness statement of Dr Stephen Unger dated 29 November 2010. The Annex first outlines the evolution of the Pay TV sector in the UK. It then provides a short description of each of the different levels of the UK broadcasting industry. Finally, there is a brief description of some of the recent technological developments in the sector.

### *Evolution of the Pay TV sector in the UK*

2. Television services are either distributed free-to-air (“FTA”) or they are paid for, either via a subscription or on a pay-per-view (“PPV”) basis. Until the 1980s TV services in the UK were almost exclusively broadcast FTA via analogue signals to rooftop aerials. Analogue broadcasting is radio-based, un-encoded and operated within a fixed and somewhat limited amount of spectrum. Pay TV emerged in the 1980s with the development of cable and satellite platforms as means of distributing TV services. A significant development, in 1990, was the merger of the satellite platforms of British Satellite Broadcasting and Sky Television to create British Sky Broadcasting plc. Since then the Pay TV sector in the UK has grown dramatically, both on satellite and on cable, as a result of consumer demand for access to a wider choice of TV content than has traditionally been available on a FTA basis.
3. A process of “switching off” analogue terrestrial TV services is underway in the UK (commonly known as the “digital switchover”) and is due to be completed in 2012. It is UK and European Union policy to promote digital technology as it provides a more efficient method than analogue for transmitting data, including radio and television programmes, since it allows more for more TV channels to be broadcast on a single frequency than do analogue technologies. At the point of digital switchover, consumers will have to choose both a form of digital distribution technology and a platform utilising that technology if there is more than one. There

are currently four digital distribution technologies through which Pay TV (and FTA) services can be delivered to consumers:<sup>942</sup>

- (a) Digital terrestrial television (“DTT”): DTT is transmitted on radio frequencies in a similar way to standard analogue television, with an important difference: the use of multiplex transmitters to allow reception of multiple channels on a single frequency range. In order to view TV services broadcast via DTT consumers require a DTT tuner, which is typically contained either in a set-top box (“STB”) or integrated into the TV set, which decodes the digital signal. DTT has hitherto been predominantly used to broadcast FTA TV services. Freeview<sup>943</sup> was launched in 2002 and, as its name implies, provides FTA TV services via DTT. By the end of 2009 approximately 18.6 million households had equipment to receive Freeview. Pay TV services have also been offered via DTT: this was first done by ONdigital (later ITV Digital) from 1998 to 2002 and more recently by TUTV, which uses the STBs distributed originally by ITV Digital and leases spectrum from Channel Five.
- (b) Digital Satellite (“DSat”): the distribution of digital content via satellite. As with DTT, digital satellite requires a STB to receive digital TV services. Sky was the first, in 1998, to launch a digital direct-to-home (“DTH”) satellite platform in the UK. Ten years later a second digital satellite platform, branded as Freesat, was launched by the BBC and ITV. Digital satellite is the most widely used Pay TV platform in the UK, reaching 9.5 million homes by the end of 2009.
- (c) Digital Cable: the distribution of digital content via cable networks. Receiving digital cable TV services requires consumers to have a digital STB. These are provided by VM, the main cable TV provider in the UK, on

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<sup>942</sup> In addition, there are ‘hybrid’ services which employ two technologies together: for example, BT Vision is a hybrid DTT/IPTV service, with broadcast services being received via DTT through a TV aerial while VOD and interactive services are delivered via a broadband internet connection.

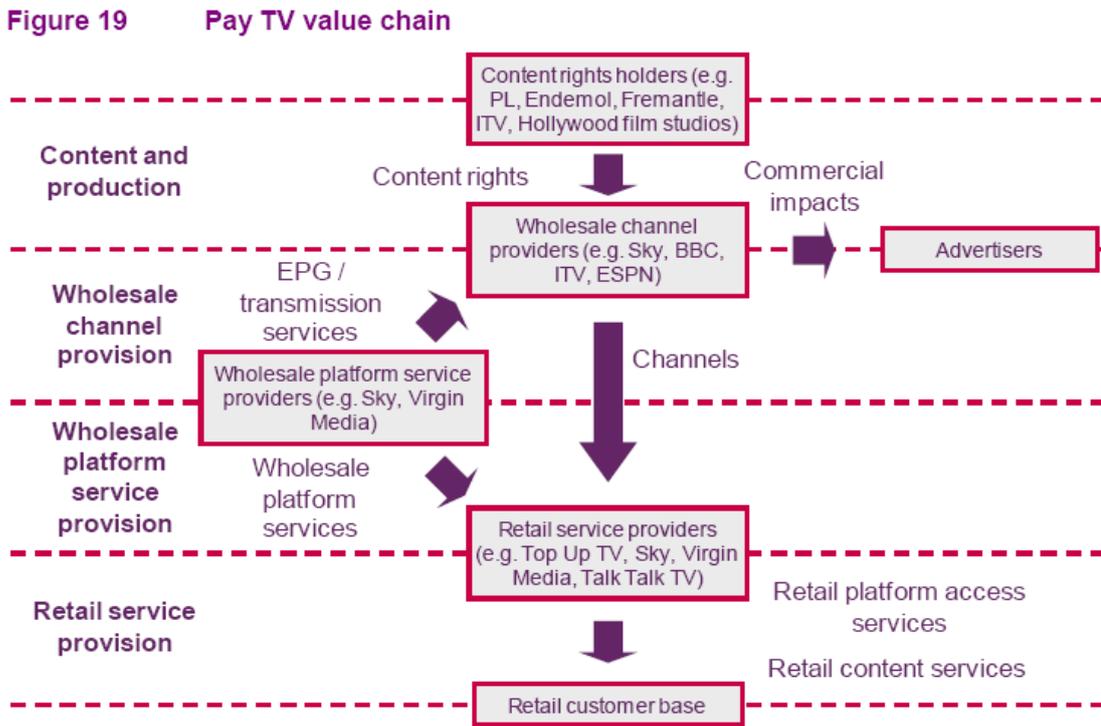
<sup>943</sup> Freeview is a non-subscription platform which requires consumers to purchase a STB or a TV with an integrated Freeview tuner in order to access a wider range of content than is available through analogue TV. Freeview launched in 2002 (using the spectrum relinquished by the failure of ITV Digital) and is owned by the BBC, Sky, Arqiva and, since 2005, ITV and Channel 4.

a rental basis. As with other modes of digital broadcasting, digital cable is able to provide a greater number of channels and/or better quality of picture and sound.

- (d) Internet Protocol Television (“IPTV”): streamed linear and on-demand TV content can be delivered to subscribers or viewers using internet protocol, the technology that is also used to access the internet.

*Structure of the TV broadcasting industry*

- 4. The broadcasting sector in the UK may be divided into four separate, but related, stages of production:



Source: Ofcom

- 5. Ofcom noted that these levels of the industry do not represent a linear value chain, but do provide a conceptual framework in which to consider the various types of transactions which take place between firms at different levels of the industry.<sup>944</sup> Each of the levels is briefly described below.

<sup>944</sup> Second Pay TV Consultation, para 4.14.

## **Content and production**

6. Putting the matter very broadly, TV broadcasters, such as the BBC and Sky, obtain TV content in one of three ways: they either make their own programmes, commission external production companies to create programmes or acquire pre-made programmes from production companies. Each form of programming (in-house, commissioned and acquired) involves dealing with programming rights. There is a wide variety of programming content available on Pay TV, often referred to collectively as ‘basic’ content, to distinguish it from ‘premium’ content which refers to sports and movies. So far as sports content is concerned, a broadcaster must acquire the rights to enter a sports ground to film the event. In the case of the FAPL, this process has taken the form of an auction, whereby the football clubs in the FAPL collectively sell their various media rights to a certain number of live Premier League football matches for a given period of time. The amounts paid by broadcasters, such as Sky and ESPN, for exclusive rights to sports content are substantial.

## **Wholesale channel provision**

7. Wholesale channel providers (such as Sky) purchase content from content providers (such as FAPL) typically for a fixed fee on an exclusive basis for a given period. Wholesale channel providers perform two primary functions. First, they aggregate content into “linear” TV channels or a package of channels<sup>945</sup> or create non-linear content for use in “on-demand” services. Sky, for example, uses premium sports content acquired from rights holders to create its sports channels: Sky Sports 1, Sky Sports 2, Sky Sports 3 and Sky Sports 4. This process of aggregation reflects the observed fact that consumers have widely differing preferences for content. The second function of wholesale channel providers is to license their channels or non-linear content to retailers on various distribution technologies.

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<sup>945</sup> TV channels include FTA channels, which are free at the point of access for viewers; basic-tier channels for which wholesale channel providers are paid carriage fees based on a per-subscriber rate by the platforms that retail them; premium channels which are generally sold as a more expensive option on top of a basic tier of channels; standalone à la carte channels and pay-per-view services

8. So far as the distribution of Sky's CPSCs to retailers on other platforms is concerned, a retailer must either seek an agreement with Sky for the wholesale supply of those channels or agree to Sky "self-retailing" those channels on its platform.

### **Wholesale platform service provision**

9. In order to provide a secure encrypted Pay TV service retailers require technical platform services. Conditional access ("CA") is an example of a technical platform service which restricts access to content that has been made available on a digital platform only to those consumers that have been authorised to access it.

### **Retail service provision**

10. Consumers obtain access to Pay TV channels (and video on demand ("VOD") services) from Pay TV retailers. Each Pay TV retailer provides its services to customers via a "platform". A Pay TV platform is the specific combination of distribution and reception technology, and CA system, that enables consumers to receive encrypted broadcasts. How much of the distribution and reception technology the Pay TV retailer needs to provide to the customer will depend on the provider's chosen platform. Most of the large Pay TV retailers operate their own Pay TV platform and provide consumers with the connection equipment needed to view encrypted pay channels. Some Pay TV retailers do no more than provide a website and a password for CA to their customers. The customers then use their own broadband internet connection to access content and, in such cases, the internet can be regarded as the platform. Other Pay TV retailers, such as Sky, VM and BT Vision, provide their customers with dedicated devices (typically a STB and, in the case of Sky, a satellite dish) and dedicated connections (for example, Sky's DTH satellite connection, VM's cable network, TUTV on DTT and TalkTalk TV on IPTV). BT Vision's platform uses a combination of DTT and IPTV technology.
11. The three largest Pay TV retailers in the UK are Sky, VM and BT Vision; they respectively provide their TV services through DTH satellite, cable and DTT/IPTV technology. Each of them sells subscriptions to Pay TV channels to consumers, and

bundles Pay TV channels together in a variety of packages, often for logistical and commercial reasons. Alongside the distribution of such channels, Pay TV retailers are typically responsible for various aspects of customer service, such as billing. Some Pay TV retailers also bundle non-TV services with Pay TV packages, in particular mobile and fixed line telecommunications, as well as broadband access.

12. Retailers tend to differentiate their Pay TV offering by quality and range of content. Providing premium content, such as popular, recent movies and live sport, allows retailers to create a more appealing TV proposition which consumers wish to buy. Ofcom identified sports and movies as the content which stood out as being among the most valued by consumers and which also had a high degree of exclusivity to Pay TV providers.<sup>946</sup>

#### *Recent technological developments in Pay TV*

13. Paragraphs 4.53 to 4.70 of the Statement describe a number of technological advances in Pay TV including personal video recorders (“PVRs”), VOD, and high definition (“HD”) television.
14. A PVR is an item of consumer electronics equipment that includes a hard disk which enables users easily to record TV programmes for viewing at a later date. They also allow viewers to pause and rewind live TV. In September 2001 Sky launched its PVR, Sky+, which integrated a hard disk into a Sky DTH satellite STB. PVRs are now provided to end-users by VM, TUTV, TalkTalk TV and BT (and also separately for digital FTA services).
15. HD television provides viewers with a higher picture resolution than standard definition digital TV. In order to view TV signals broadcast in HD, consumers require a TV capable of displaying HD pictures and an HD STB. HD television was launched in the UK at the end of 2005 on the cable network of Telewest (which merged with ntl to become VM in November 2006). In May / June 2006 Sky launched its HD television service.

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<sup>946</sup> Statement, paras 4.104, 4.111, 4.182.

**ANNEX B: RELEVANT STATUTORY MATERIAL (REFERRED TO IN  
SECTION V OF THE JUDGMENT)**

1. The relevant sections of the 2003 Act provide as follows:

**“3 General duties of OFCOM**

(1) It shall be the principal duty of OFCOM, in carrying out their functions—

(a) to further the interests of citizens in relation to communications matters;  
and

(b) to further the interests of consumers in relevant markets, where appropriate  
by promoting competition.

(2) The things which, by virtue of subsection (1), OFCOM are required to secure  
in the carrying out of their functions include, in particular, each of the following—

...

(c) the availability throughout the United Kingdom of a wide range of  
television and radio services which (taken as a whole) are both of high  
quality and calculated to appeal to a variety of tastes and interests;

(d) the maintenance of a sufficient plurality of providers of different  
television and radio services;

(e) the application, in the case of all television and radio services, of  
standards that provide adequate protection to members of the public from the  
inclusion of offensive and harmful material in such services;

(f) the application, in the case of all television and radio services, of standards  
that provide adequate protection to members of the public and all other  
persons from both—

(i) unfair treatment in programmes included in such services; and

(ii) unwarranted infringements of privacy resulting from activities  
carried on for the purposes of such services.

(3) In performing their duties under subsection (1), OFCOM must have regard, in  
all cases, to—

(a) the principles under which regulatory activities should be transparent,  
accountable, proportionate, consistent and targeted only at cases in which  
action is needed; and

(b) any other principles appearing to OFCOM to represent the best regulatory  
practice.

(4) OFCOM must also have regard, in performing those duties, to such of the  
following as appear to them to be relevant in the circumstances—

- (a) the desirability of promoting the fulfilment of the purposes of public service television broadcasting in the United Kingdom;
- (b) the desirability of promoting competition in relevant markets;
- (c) the desirability of promoting and facilitating the development and use of effective forms of self-regulation;
- (d) the desirability of encouraging investment and innovation in relevant markets;

...

(5) In performing their duty under this section of furthering the interest of consumers, OFCOM must have regard, in particular to the interests of those consumers in respect of choice, price, quality of service and value for money.

...

### **211 Regulation of independent television services**

(1) It shall be a function of OFCOM to regulate the following services in accordance with this Act, the 1990 Act and the 1996 Act—

- (a) services falling within subsection (2) that are provided otherwise than by the BBC or the Welsh Authority; and
- (b) services falling within subsection (3) that are provided otherwise than by the BBC.

(2) The services referred to in subsection (1)(a) are—

- (a) television broadcasting services that are provided from places in the United Kingdom with a view to their being broadcast otherwise than only from a satellite;
- (b) television licensable content services that are provided by persons under the jurisdiction of the United Kingdom for the purposes of the Television without Frontiers Directive;
- (c) digital television programme services that are provided by persons under the jurisdiction of the United Kingdom for the purposes of that Directive;
- (d) restricted television services that are provided from places in the United Kingdom; and
- (e) additional television services that are provided from places in the United Kingdom.

(3) The services referred to in subsection (1)(b) are—

- (a) television multiplex services that are provided from places in the United Kingdom; and

(b) digital additional television services that are provided by persons under the jurisdiction of the United Kingdom for the purposes of the Television without Frontiers Directive.

...

### **232 Meaning of “television licensable content service”**

(1) In this Part “television licensable content service” means (subject to section 233) any service falling within subsection (2) in so far as it is provided with a view to its availability for reception by members of the public being secured by one or both of the following means—

(a) the broadcasting of the service (whether by the person providing it or by another) from a satellite; or

(b) the distribution of the service (whether by that person or by another) by any means involving the use of an electronic communications network.

(2) A service falls within this subsection if it—

(a) is provided (whether in digital or in analogue form) as a service that is to be made available for reception by members of the public; and

(b) consists of television programmes or electronic programme guides, or both.

(3) Where—

(a) a service consisting of television programmes, an electronic programme guide or both (“the main service”) is provided by a person as a service to be made available for reception by members of the public, and

(b) that person provides the main service with other services or facilities that are ancillary to, or otherwise relate to, the main service and are also provided so as to be so available or in order to make a service so available,

subsection (1) has effect as if the main service and such of the other services or facilities as are relevant ancillary services and are not two-way services constituted a single service falling within subsection (2).

(4) Where a person providing the main service provides it with a facility giving access to another service, the other service shall also be taken for the purposes of this section as provided by that person with the main service only if what is comprised in the other service is something over which that person has general control.

(5) A service is a two-way service for the purposes of this section if it is provided by means of an electronic communications network and an essential feature of the service is that the purposes for which it is provided involve the use of that network, or a part of it, both—

(a) for the transmission of visual images or sounds (or both) by the person providing the service to users of the service; and

(b) for the transmission of visual images or sounds (or both) by those users for reception by the person providing the service or by other users of the service.

(6) In this section—

“electronic programme guide” means a service which consists of—

(a) the listing or promotion, or both the listing and the promotion, of some or all of the programmes included in any one or more programme services the providers of which are or include persons other than the provider of the guide; and

(b) a facility for obtaining access, in whole or in part, to the programme service or services listed or promoted in the guide;

“relevant ancillary service”, in relation to the main service, means a service or facility provided or made available by the provider of the main service that consists of or gives access to—

(a) assistance for disabled people in relation to some or all of the programmes included in the main service;

(b) a service (apart from advertising) which is not an electronic programme guide but relates to the promotion or listing of programmes so included; or

(c) any other service (apart from advertising) which is ancillary to one or more programmes so included and relates directly to their contents.

...

### **235 Licensing of television licensable content services**

(1) The licence that is required for the purposes of section 13 of the 1990 Act in respect of a television licensable content service is a licence granted under Part 1 of that Act on an application complying with this section.

(2) An application for a licence to provide a television licensable content service—

(a) must be made in such manner,

(b) must contain such information about the applicant, his business and the service he proposes to provide, and

(c) must be accompanied by such fee (if any),

as OFCOM may determine.

(3) Where an application is made to OFCOM in accordance with subsection (2) for a licence to provide a television licensable content service, OFCOM are entitled to refuse the application only if—

(a) they are required to do so by section 3(3) of the 1990 Act (licences to be held only by fit and proper persons);

(b) they are required to do so by section 5 of the 1990 Act (restrictions on the holding of licences); or

(c) they are satisfied that, if the application were to be granted, the provision of the service would be likely to involve contraventions of—

(i) standards set under section 319 of this Act; or

(ii) the provisions of a code of practice in force under Part 5 of the 1996 Act (fairness).

(4) The provision of more than one television licensable content service shall require a separate licence under Part 1 of the 1990 Act to be granted and held in respect of each service.

(5) A single licence to provide a television licensable content service may authorise the provision of a service which consists (to any extent) of different programmes to be broadcast simultaneously, or virtually so.

(6) A licence to provide a television licensable content service shall continue in force until such time as it is surrendered or is revoked in accordance with any of the provisions of this Chapter or of the 1990 Act.

...

### **316 Conditions relating to competition matters**

(1) The regulatory regime for every licensed service includes the conditions (if any) that OFCOM consider appropriate for ensuring fair and effective competition in the provision of licensed services or of connected services.

(2) Those conditions must include the conditions (if any) that OFCOM consider appropriate for securing that the provider of the service does not—

(a) enter into or maintain any arrangements, or

(b) engage in any practice,

which OFCOM consider, or would consider, to be prejudicial to fair and effective competition in the provision of licensed services or of connected services.

(3) A condition imposed under this section may require a licence holder to comply with one or both of the following—

(a) a code for the time being approved by OFCOM for the purposes of the conditions; and

(b) directions given to him by OFCOM for those purposes.

(4) In this section—

“connected services”, in relation to licensed services, means the provision of programmes for inclusion in licensed services and any other services provided for purposes connected with, or with the provision of, licensed services; and

“licensed service” means a service licensed by a Broadcasting Act licence.

...

### **317 Exercise of Broadcasting Act powers for a competition purpose**

(1) This section applies to the following powers of OFCOM (their “Broadcasting Act powers”)—

(a) their powers under this Part of this Act and under the 1990 Act and the 1996 Act to impose or vary the conditions of a Broadcasting Act licence;

(b) every power of theirs to give an approval for the purposes of provision contained in the conditions of such a licence;

(c) every power of theirs to give a direction to a person who is required to comply with it by the conditions of such a licence; and

(d) every power of theirs that is exercisable for the purpose of enforcing an obligation imposed by the conditions of such a licence.

(2) Before exercising any of their Broadcasting Act powers for a competition purpose, OFCOM must consider whether a more appropriate way of proceeding in relation to some or all of the matters in question would be under the Competition Act 1998 (c. 41).

(3) If OFCOM decide that a more appropriate way of proceeding in relation to a matter would be under the Competition Act 1998, they are not, to the extent of that decision, to exercise their Broadcasting Act powers in relation to that matter.

(4) If OFCOM have decided to exercise any of their Broadcasting Act powers for a competition purpose, they must, on or before doing so, give a notification of their decision.

(5) A notification under subsection (4) must—

(a) be given to such persons, or published in such manner, as appears to OFCOM to be appropriate for bringing it to the attention of the persons who, in OFCOM’s opinion, are likely to be affected by their decision; and

(b) must describe the rights conferred by subsection (6) on the persons affected by that decision.

(6) A person affected by a decision by OFCOM to exercise any of their Broadcasting Act powers for a competition purpose may appeal to the Competition Appeal Tribunal against so much of that decision as relates to the exercise of that power for that purpose.

(7) Sections 192(3) to (8), 195 and 196 apply in the case of an appeal under subsection (6) as they apply in the case of an appeal under section 192(2).

(8) The jurisdiction of the Competition Appeal Tribunal on an appeal under subsection (6) excludes—

(a) whether OFCOM have complied with subsection (2); and

(b) whether any of OFCOM’s Broadcasting Act powers have been exercised in contravention of subsection (3);

and, accordingly, those decisions by OFCOM on those matters fall to be questioned only in proceedings for judicial review.

(9) For the purposes of this section a power is exercised by OFCOM for a competition purpose if the only or main reason for exercising it is to secure that the holder of a Broadcasting Act licence does not—

(a) enter into or maintain arrangements, or

(b) engage in a practice,

which OFCOM consider, or would consider, to be prejudicial to fair and effective competition in the provision of licensed services or of connected services.

(10) Nothing in this section applies to—

(a) the exercise by OFCOM of any of their powers under sections 290 to 294 or Schedule 11;

(b) the exercise by them of any power for the purposes of any provision of a condition included in a licence in accordance with any of those sections;

(c) the exercise by them of any power for the purpose of enforcing such a condition.

(11) In subsection (9) “connected services” and “licensed service” each has the same meaning as in section 316.

(12) References in this section to the exercise of a power include references to an exercise of a power in pursuance of a duty imposed on OFCOM by or under an enactment.

...

### **361 Meaning of “available for reception by members of the public”**

(1) The services that are to be taken for the purposes of this Part to be available for reception by members of the public include (subject to subsection (2)) any service which—

(a) is made available for reception, or is made available for reception in an intelligible form, only to persons who subscribe to the service (whether for a period or in relation to a particular occasion) or who otherwise request its provision; but

(b) is a service the facility of subscribing to which, or of otherwise requesting its provision, is offered or made available to members of the public.

(2) A service is not to be treated as available for reception by members of the public if each of the three conditions set out in subsections (3) to (5) is satisfied.

(3) The first condition is that the service is confined to the provision of a facility—

(a) for the making by users of the service of individual selections of the material to be received; and

(b) for receiving whatever is selected.

(4) The second condition is that it is only in response to a selection made by a user of the service that anything (whether encrypted or not)—

(a) is broadcast from a satellite or by means of a multiplex service; or

(b) is otherwise transmitted by means of an electronic communications network.

(5) The third condition is that the individual selections that may be made do not include any that are limited to electing to be one of the recipients of material that is or has been offered for reception on the basis—

(a) that it is material selected by the provider of the service for the purpose of being made available for broadcasting or distribution simultaneously, or virtually so, to an audience consisting of users of the service; and

(b) that it will be broadcast or distributed simultaneously, or virtually so, to every member of the audience (if any) that consists of the users of the service who have elected to receive it.

(6) References in this section to members of the public are references to members of the public in, or in any area of, any one or more countries or territories (which may or may not include the United Kingdom).

(7) The Secretary of State may by order modify any of the provisions of this section if it appears to him appropriate to do so having regard to any one or more of the following—

(a) the protection which, taking account of the means by which the programmes and services are received or may be accessed, is expected by members of the public as respects the contents of television programmes or sound programmes;

(b) the extent to which members of the public are able, before television programmes are watched or accessed, to make use of facilities for exercising control, by reference to the contents of the programmes, over what is watched or accessed;

(c) the practicability of applying different levels of regulation in relation to different services;

(d) the financial impact for providers of particular services of any modification of the provisions of that section; and

(e) technological developments that have occurred or are likely to occur.

(8) No order is to be made containing provision authorised by subsection (7) unless a draft of the order has been laid before Parliament and approved by a resolution of each House.

(9) In this section “multiplex service” means a television multiplex service, a radio multiplex service or a general multiplex service.

...

### **362 Interpretation of Part 3**

(1) In this Part—

...

“provision”, in relation to a service, is to be construed (subject to subsection (3)) in accordance with subsection (2), and cognate expressions are to be construed accordingly;

...

(2) In the case of any of the following services—

- (a) a television broadcasting service or sound broadcasting service,
- (b) the public teletext service;
- (c) a television licensable content service or radio licensable content service,
- (d) a digital television programme service or digital sound programme service,
- (e) a restricted television service,
- (f) an additional television service or additional radio service,
- (g) a digital additional television service or a digital additional sound service,

the person, and the only person, who is to be treated for the purposes of this Part as providing the service is the person with general control over which programmes and other services and facilities are comprised in the service (whether or not he has control of the content of individual programmes or of the broadcasting or distribution of the service).

### **405 General interpretation**

(1) In this Act, except in so far as the context otherwise requires—

...

“Broadcasting Act licence” means a licence under Part 1 or 3 of the 1990 Act or under Part 1 or 2 of the 1996 Act;

...

2. Section 2 of the Broadcasting Act 1990 (now repealed by the 2003 Act) provides as follows:

**“2 Regulation by Commission of provision of television services.**

(1) It shall be the function of the Commission to regulate, in accordance with this Part, the provision of the following services, namely—

(a) television programme services which are provided from places in the United Kingdom by persons other than the BBC and the Welsh Authority, and

(b) additional services which are provided from places in the United Kingdom,

and to regulate, in accordance with Part II, the provision of local delivery services (within the meaning of that Part) which are so provided.

(2) It shall be the duty of the Commission—

(a) to discharge their functions under this Part and Part II as respects the licensing of the services referred to in subsection (1) in the manner which they consider is best calculated—

(i) to ensure that a wide range of such services is available throughout the United Kingdom, and

(ii) to ensure fair and effective competition in the provision of such services and services connected with them; and

(b) to discharge their functions under this Part as respects the licensing of television programme services in the manner which they consider is best calculated to ensure the provision of such services which (taken as a whole) are of high quality and offer a wide range of programmes calculated to appeal to a variety of tastes and interests.

(3) Subsection (2)(a)(ii) shall not be construed as affecting the discharge by the Director General of Fair Trading, the Secretary of State or the Monopolies and Mergers Commission of any of his or their functions in connection with competition.

(4) In this Part—

“additional service” has the meaning given by section 48(1); and

“television programme service” means—

(a) a television broadcasting service (as defined by subsection (5));

(b) a non-domestic satellite service (as defined by section 43(2)); or

(c) a licensable programme service (as defined by section 46(1)).

(5) In this Part “television broadcasting service” means (subject to subsection (6)) a service consisting in the broadcasting of television programmes for general reception in, or in any area in, the United Kingdom, including a domestic satellite service (as defined by section 43(1)).

(6) Subsection (5) does not apply to any teletext service or any other service in the case of which the visual images broadcast in the service consist wholly or mainly of non-representational images, that is to say visual images which are neither still pictures nor comprised within sequences of visual images capable of being seen as moving pictures.”

3. Section 13 of the Broadcasting Act 1990 provides as follows:

**“13 Prohibition on providing television services without a licence.**

(1) Subject to subsection (2), any person who provides any relevant service without being authorised to do so by or under a licence under this Part or Part I of the Broadcasting Act 1996 shall be guilty of an offence.

(1A) In subsection (1) “relevant regulated television service” means a service falling, in pursuance of section 211(1) of the Communications Act 2003, to be regulated by OFCOM, other than a multiplex service.

(2) The Secretary of State may, after consultation with OFCOM, by order provide that subsection (1) shall not apply to such services or descriptions of services as are specified in the order.

(3) A person guilty of an offence under this section shall be liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to a fine.

(4) No proceedings in respect of an offence under this section shall be instituted—

(a) in England and Wales, except by or with the consent of the Director of Public Prosecutions;

(b) in Northern Ireland, except by or with the consent of the Director of Public Prosecutions for Northern Ireland.

(5) Without prejudice to subsection (3), compliance with this section shall be enforceable by civil proceedings by the Crown for an injunction or interdict or for any other appropriate relief.

(6) Any order under this section shall be subject to annulment in pursuance of a resolution of either House of Parliament.”

4. The relevant provisions of Television Without Frontiers Directive<sup>947</sup> are as follows:

**“Article 2**

1. Each Member State shall ensure that all audiovisual media services transmitted by media service providers under its jurisdiction comply with the rules of the system of law applicable to audiovisual media services intended for the public in that Member State.

2. For the purposes of this Directive, the media service providers under the jurisdiction of a Member State are those:

(a) established in that Member State in accordance with paragraph 3; or

(b) to whom paragraph 4 applies.

3. For the purposes of this Directive, a media service provider shall be deemed to be established in a Member State in the following cases:

(a) the media service provider has its head office in that Member State and the editorial decisions about the audiovisual media service are taken in that Member State;

(b) if a media service provider has its head office in one Member State but editorial decisions on the audiovisual media service are taken in another Member State, it shall be deemed to be established in the Member State where a significant part of the workforce involved in the pursuit of the audiovisual media service activity operates. If a significant part of the workforce involved in the pursuit of the audiovisual media service activity operates in each of those Member States, the media service provider shall be deemed to be established in the Member State where it has its head office. If a significant part of the workforce involved in the pursuit of the audiovisual media service activity operates in neither of those Member States, the media service provider shall be deemed to be established in the Member State where it first began its activity in accordance with the law of that Member State, provided that it maintains a stable and effective link with the economy of that Member State;

(c) if a media service provider has its head office in a Member State but decisions on the audiovisual media service are taken in a third country, or vice-versa, it shall be deemed to be established in the Member State concerned, provided that a significant part of the workforce involved in the pursuit of the audiovisual media service activity operates in that Member State.

4. Media service providers to whom the provisions of paragraph 3 are not applicable shall be deemed to be under the jurisdiction of a Member State in the following cases:

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<sup>947</sup> Directive 2007/65/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directive 89/552/EEC on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities.

(a) they use a satellite up-link situated in that Member State;

(b) although they do not use a satellite up-link situated in that Member State, they use satellite capacity appertaining to that Member State.

5. If the question as to which Member State has jurisdiction cannot be determined in accordance with paragraphs 3 and 4, the competent Member State shall be that in which the media service provider is established within the meaning of Articles 43 to 48 of the Treaty.

6. This Directive does not apply to audiovisual media services intended exclusively for reception in third countries and which are not received with standard consumer equipment directly or indirectly by the public in one or more Member States.

...

## **Article 22**

Member States shall take appropriate measures to ensure that television broadcasts by broadcasters under their jurisdiction do not include programmes which might seriously impair the physical, mental or moral development of minors, in particular those that involve pornography or gratuitous violence. This provision shall extend to other programmes which are likely to impair the physical, mental or moral development of minors, except where it is ensured, by selecting the time of the broadcast or by any technical measure, that minors in the area of transmission will not normally hear or see such broadcasts.

Member States shall also ensure that broadcasts do not contain any incitement to hatred on grounds of race, sex, religion or nationality.”

**ANNEX C: DRAMATIS PERSONAE<sup>948</sup>**

<b>Name</b>	<b>Organisation</b>	<b>Position held (where known)</b>
Abensur, Eric	Orange	Vice-President
Ahuja, Sanjiv	Orange	Chief Executive Officer
Alner, Chris	BT	Head of Business Development
Bouverot, Anne	Orange	Executive Vice-President of International Business Development
Burch, Steve	VM	Chief Executive Officer
Burns, Katharine <i>(Ms Burns produced four witness statements and was cross-examined during day 10 of the hearing)</i>	VM	Executive Director of Multi-screen Content Acquisition at VM, and formerly Managing Director of Content Acquisition and Strategy (from January 2007). Ms Burns joined Telewest in November 1999, prior to its merger with ntl in 2006 and the later rebranding to VM.
Caines, Mark <i>(Mr Caines produced two expert reports and was cross-examined during days 19-20 of the hearing)</i>	Ofcom	Director of Economic Analysis in Ofcom's Competition Group
Chance, David <i>(Mr Chance produced one witness statement and was cross-examined during day 12 of the hearing)</i>	TUTV	Co founder and Chairman
Chapman, Peter	VM	Head of Content Acquisition
Colley, Liam <i>(Mr Colley produced four expert reports and was cross-examined during days 22-23 of the hearing)</i>	Sky	Managing Director at AlixPartners Limited
Copeland, Matthew	VM (Telewest)	Regulatory Manager
Darcey, Michael <i>(Mr Darcey produced three witness statements and was cross-examined during days 5-7 of the hearing)</i>	Sky	Chief Operating Officer
Darroch, Jeremy	Sky	Chief Executive Officer
De Roover, Bart	Orange	Vice President, International Business Development
Duarte, Bruno	Orange	Head of Orange's fixed broadband operation
Freudenstein, Richard	Sky	Former Chief Operating Officer
Fyfield, Mai	Sky	Head of the Strategy Planning Group

<sup>948</sup> This *dramatis personae*, which lists only those individuals referred to in section VI of the judgment, has been compiled so far as is possible from the available documents and evidence, but may contain some inaccuracies. In particular, the Tribunal notes that the job titles of the relevant individuals may have changed over time. It is intended as an *aide memoire* for the reader only. References to witness statements are to those filed in the four main appeals only.

Goswami, Martin	Sky	Commercial Director
Guest, Richard <i>(Mr Guest produced four witness statements and was cross-examined during day 11 of the hearing)</i>	VM	Director of Commercial and Customer Segment Strategy
Horsman, Matthew	TUTV (Intermediary acting on behalf of TUTV)	Joint Managing Director Mediatique Limited
Hughes, Jeff	Sky	Formerly Director of IT
Jacquet, Olivier	Sky	
Katz, Gidon	VM (ntl)	Director, Content Acquisition
Livingston, Ian	BT	Chief Executive Former Chief Executive Officer, BT Retail
Markham, Nicholas <i>(Mr Markham produced one witness statement but was not cross-examined)</i>	TUTV	Chief Executive of TUTV (Europe) Limited
Marks, Dan	BT	Former Chief Executive Officer
Mee, Angie	Orange	Head of Content Acquisition
Middleton, Andrew	Sky	Deputy General Counsel
Mitsch, Isabelle	Orange	
Murdoch, James	Sky	Chairman and Chief Executive News Corporation Europe and Asia Former Chief Executive Officer
Nuttall, Stephen	Sky	Former Director, Commercial Group Former Business Development Director
Overton, Marc	Orange	Group Strategy Director
Parry, Griffin	Sky	Corporate Development Director
Patterson, Gavin	BT	Managing Director, BT Retail
Payan, Herve	Orange	Senior Vice President of Content
Persoff, Simon	Orange	Director of Regulatory Affairs Former General Counsel
Petter, John	BT	Managing Director, BT Retail
Rey, David	Sky	Commercial Director Former Business Development Director
Rhodes, Michael	Sky	Formerly Head of Regulatory Affairs and later formed a consultancy which provided advice to TUTV amongst others
Roxburgh, Beatrice	BT	Regulatory and competition lawyer
Rubasinski, Marek	Sky	Business Development Manager
Sandry, Vicky	Sky	Head of Legal (Regulatory & Competition)
Shah, Anand	Orange	
Stanton, Kate	VM (ntl)	Former Associate General Counsel,

		VM Former Legal Director, ntl
Stevens, Alistair	Sky	Director, Commercial Finance
Teh, Yih-Choung <i>(Dr Teh produced two witness statements and was cross-examined during days 25-27 of the hearing)</i>	Ofcom	Director in Ofcom's Competition Group and chair of its Broadcasting Competition Steering Group
Thatcher, David <i>(Mr Thatcher produced one witness statement but was not cross-examined)</i>	TUTV	Managing Director
Tveter, Eric	VM (Telewest)	President and Chief Operating Officer
Twiss, Georgina	VM (ntl)	
Unger, Stephen <i>(Dr Unger produced one witness statement and was cross-examined during day 13 of the hearing)</i>	Ofcom	Chief Technology Officer. Former Competition Policy Director
Wall, Malcolm	VM	Chief Executive Officer for Content
Watson, Marc <i>(Mr Watson produced four witness statements and was cross-examined during day 9 of the hearing)</i>	BT	Chief Executive Officer, BT Vision Former Commercial Director
Weiss, Shai	VM (ntl)	Director of Operations/Managing Director, Consumer Products
Young, Richard	BT	Business Development Director