

# 4 The relevant markets

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## Introduction

4.1. This chapter examines the relevant markets in this inquiry and the expected effects of the merger situation in those markets. We start by reviewing the various systems of TV broadcasting or transmission used in the UK, focusing in particular on the three main pay-TV platforms (DTH/satellite, cable networks and DTT; see glossary). Following that, we consider the main TV and other markets of relevance in evaluating the merger situation, the main parties involved (Vivendi and BSkyB), and market shares in pay-TV services in the UK. We then provide an account of the markets for sports and film channels and the associated markets for the buying of broadcasting rights. Lastly, we look at the provision of conditional access and access control services used by pay-TV services, and the related software technology.

4.2. The main parties, their financial performance and the reasons for the merger situation are considered in Chapter 3. The views of third parties and the main parties are summarized in Chapters 5 and 6 respectively. A glossary of terms is also included at the end of this report.

## TV transmission systems

4.3. In this section, we briefly review the main TV delivery systems and competing services available in the UK, including the three existing pay-TV delivery platforms and retailers: DTH (satellite), cable networks and DTT (digital terrestrial). These were also considered in the April 1999 report by the Commission on the proposed BSkyB/Manchester United merger (see Appendix 4.1, item 1).

## *Analogue and digital systems*

4.4. Analogue terrestrial TV makes use of land-based transmitters to broadcast signals to viewers within reasonably close proximity of a transmitter. This is the traditional way in which terrestrial channels like the BBC, ITV etc have been broadcast and received in the UK (and elsewhere): an aerial plus a standard TV is the only equipment required to view the channels—though payment of a licence fee (£104 for colour reception, as from April 2000) is also necessary.

4.5. The Government has announced its intention that analogue terrestrial TV transmissions should cease sometime in the period 2006 to 2010 (subject to certain criteria being met), and that they should be replaced entirely by digital TV, which utilizes the radio spectrum allocated to TV broadcasting far more efficiently (thereby allowing a much greater number of channels, ie several dozen—and perhaps as many as 50 to 100, according to ONdigital—rather than the current five). The Government has indicated that the switch-over will not occur until 95 per cent of homes are deemed able to receive digital transmissions (at present, less than 15 per cent are equipped to do so).

4.6. The UK cable TV networks (see paragraphs 4.17 to 4.22) and satellite TV transmissions (DTH) also use analogue transmission at present, though they are in the process of converting to a fully digital service. In both cases, this affords a considerable increase in channel capacity and functionality (for example, the provision of interactive services and near-video-on-demand (NVOD) film channels). As regards DTH, BSkyB introduced its digital system towards the end of 1998, which it currently operates in parallel (albeit using different satellite locations, reception from which requires a different dish aerial) with its existing analogue service: the digital capacity at present is of the order of 200 channels, more than twice that of analogue. The three main cable operators expect their digital systems to have full (or virtually full) service area coverage by the middle of 2001, which would encompass around 50 per cent of UK homes. Operating in parallel with up to 50 analogue channels, each of these cable-based digital systems will offer around 150 channels: when the analogue transmissions cease, digital cable systems in the UK will be capable of delivering more than 500 channels.

4.7. DTT services by contrast are fully digital, and the major DTT platform in the UK (operated by ONdigital; see paragraphs 4.23 and 4.24) accommodates about 30 digital TV channels. Once the terrestrial analogue transmissions cease (see above), it is possible, the ITC told us, that additional DTT multiplexes/platforms could be licensed, thereby expanding the number of digital channels available on DTT. Such developments are subject to Government plans for the sale of released spectrum, and no detailed proposals have yet been formulated.


## *Free-to-air (terrestrial transmission)*

4.8. UK free-to-air broadcast services/providers include the two BBC channels (BBC1 and BBC2) funded by a mandatory TV licence fee; Channel 3 (ITV), comprising several regional franchisees (by far the largest being Granada, Carlton Communications plc (Carlton) and United News & Media plc), each of which is almost wholly advertising funded; and Channels 4 and 5, which are also almost entirely funded from advertising revenues. Each of these channels offers a broad mix of general entertainment programmes, news/documentaries, sports coverage and feature films (as specified in the BBC's Charter and the commercial broadcasting licences issued by the ITC); and taken together, these channels account for around 85 per cent of all TV viewing in the UK (though this proportion has declined in recent years with the advent of pay-TV, and is about 65 per cent in homes with pay-TV; see below). For each channel, programme content may be self-provided; commissioned from independent producers; based on acquired rights (for example, sports or films); or bought-in, ready-made material (for example, US TV shows).

4.9. The BBC also operates several digital channels (for example, BBC Choice, BBC News 24 and BBC Knowledge) which are available on the DTH, cable and DTT platforms. Similarly, Channels 3 and

4 also operate digital channels, whilst two of the Channel 3 franchisees (Carlton and Granada) own and control the major DTT pay-TV operator in the UK (ONdigital). During the course of this inquiry, the proposed mergers between Carlton and United News & Media, Granada and Carlton, and Granada and United News & Media were referred to this Commission for investigation.

### ***DTH (satellite transmission)***

4.10. The major DTH platform in the UK is operated by BSkyB (a main party to this merger inquiry; see paragraph 4.47), and is primarily a subscription-based, multi-channel pay-TV service (see paragraphs 4.48 to 4.59), albeit that some channels are broadcast on a free-to-air, unencrypted basis. Reception requires a dish aerial aligned to the transmitting satellite and a set-top box (an integrated receiver and decoder)/smart card, as well as a standard TV. BSkyB's analogue DTH service has been available in the UK for over ten years, but the digital service was introduced only at the end of 1998. BSkyB told us that it was actively encouraging analogue subscribers to switch over to the digital service (digital subscribers currently account for about half of the total); and that it expected the transition to digital to be largely or wholly completed [  ].

4.11. The digital DTH platform currently accommodates up to 200 separate TV and audio channels, including general entertainment channels (for example, Sky One), themed and special interest channels (for example, The History Channel, children's channels etc), sports channels (for example, Sky Sports—a premium, multi-channel service which includes an interactive channel—and British Eurosport) and dedicated film channels, both subscription-based (for example, Sky MovieMax—a premium, multi-channel service—and Film Four) and PPV-financed (for example, Sky Box Office and u>direct—both multi-channel services). Individual channels are typically characterized as either basic (low cost) or premium (higher cost), and these are made available in the form of a range of multi-channel 'packages'. The BSkyB lowest-cost or 'access' package, for example, offers a number of basic channels together with the option of taking individual premium channels. Higher-cost packages include some premium channels, whilst the most comprehensive package (currently costing £32 a month) includes all the BSkyB basic and premium channels (as well as other channels). Both the cable operators and ONdigital offer similarly structured multi-channel packages.

4.12. Some of the channels available on the DTH platform—notably the premium sports and film channels—are supplied (partly through joint ventures) and retailed by BSkyB itself; though many other channels (about 35 in total) retailed by BSkyB are supplied by other channel providers (for example, Disney Channel, Film Four and others). In addition, a number of channels available on the DTH platform are supplied by companies other than BSkyB and also retailed entirely separately (for example, u>direct, Zee TV, The Racing Channel and several adult channels, among others), reflecting the so-called 'open' nature of the platform (though they all need to use the BSkyB-controlled conditional access system and applications program interface (see paragraph 4.110). Table 4.1 gives 1999 audience share figures for selected pay-TV channels and the UK free-to-air terrestrial channels (ITV channels are broken down by franchise area), all listed in alphabetical order. The same channels are shown in Table 4.2, but in this case, the pay-TV and free-to-air channels (with ITV channels under common ownership being grouped together) are listed separately and also ordered by size of audience share. In both tables the audience shares given relate to the percentage of total TV viewing (across all homes) attributed to each channel.

TABLE 4.1 Audience shares for selected UK TV channels (in alphabetical order) in 1999

<i>Channel</i>	<i>Percentage audience share</i>	<i>Channel</i>	<i>Percentage audience share</i>
Anglia	1.8	MTV*	0.4
Animal Planet*	0.1	Meridian	2.4
BBC1	28.3	Nickelodeon*	0.7
BBC2	10.8	ITV2*	0.1
BBC News 24*	0.1	Paramount	0.1
		Channel*	
Border	0.5	QVC*	0.2
The Box*	0.2	S4C Wales	0.3
Bravo*	0.2	Sci-Fi Channel*	0.2
Carlton	2.8	Scottish	1.9
Cartoon Network*	0.8	Sky Moviemax*	0.5
Central	4.7	Sky Premier*	0.8
Challenge TV*	0.2	Sky Cinema*	0.1
Channel 4	9.9	Sky News*	0.4
Channel 5	5.3	Sky One*	1.6
Channel Television*	0.1	Sky Sports 1*	0.9
CNN*	0.1	Sky Sports 2*	0.6
Discovery*	0.3	Sky Sports 3*	0.2
Discovery Home and Leisure*	0.2	TNT*	0.2
Disney Channel*	0.4	Trouble*	0.2
Eurosport International*	0.3	Tyne Tees	1.5
Fox Kids Network*	0.1	UK Gold*	0.9
GMTV	1.6	UK Horizons*	0.1
Grampian	0.6	UK Style*	0.1
Granada Plus*	0.3	Ulster	1.0
Granada Television	3.9	VH1*	0.3
History Channel*	0.1	Westcountry	0.8
HTV	2.3	Yorkshire	3.2
Living	0.5	Zee TV Europe*	0.3
LWT	2.0	Other channels*	1.4
		<b>Total</b>	<b>100.0</b>

Source: ITC.

\*Pay-TV channels

4.13. Both the DTH platform and some individual channels are funded largely by subscription revenues (the BSKyB/DTH platform has about 3.6 million subscribers at present), though advertising revenues are also important. By way of example, MTV (a music/video channel, owned by MTV Networks Europe) told us that subscription revenues accounted for about 60 to 70 per cent of its total income and advertising for the balance of 30 to 40 per cent. Other channels are either (a) free-to-air and almost wholly advertising-funded (for example, CNN and QVC The Shopping Channel); or (b) PPV channels (for example, u>direct). Many, though not all, of the TV channels available on DTH are also available on both the UK cable networks (which currently have about 3.1 million subscribers in total) and the DTT platform (0.5 million subscribers). Taking all subscription revenues into account, BSKyB itself is funded about 80 per cent by subscriptions and nearly 15 per cent by advertising (the balance of revenues being from other services; see Table 3.3).

4.14. Subscription or pay-TV services on DTH (and other delivery platforms) require the use of conditional access technology (which is considered in detail in paragraphs 4.110 to 4.129), in order to allow the channel or platform operator to enable or disable set-top box receivers in accordance with subscriptions paid.

4.15. Digital transmission also facilitates the provision of interactive services (for example, home shopping, banking, Internet access etc; see paragraph 4.42). Since the end of 1999, such a service, called Open, has been available on BSKyB's DTH platform, which is operated by a joint venture company (Open, a subsidiary of BiB) in which BSKyB and BT each have a one-third equity share (the balance being held equally between the HSBC Bank and Matsushita/Panasonic).

4.16. In various EC markets other than the UK, Canal+ is a major DTH operator. The main shareholder in Canal+ is Vivendi, which is a main party to this merger inquiry (see paragraph 4.46).

TABLE 4.2 Audience shares and rank ordering of selected UK TV channels in 1999

<b>A. Free-to-air terrestrial channels</b>				<b>B. Pay-TV channels</b>			
<i>Owner</i>	<i>Channel</i>	<i>Share</i>	<i>Total</i>	<i>Owner</i>	<i>Channel</i>	<i>Share</i>	<i>Total</i>
BBC	BBC1	28.3		BSkyB	Sky One	1.6	
	BBC2	10.8	39.1	Sports	Sky Sports 1	0.9	
Channel 3 (ITV):					Sky Sports 2	0.6	
Granada	Granada Television	3.9			Sky Sports 3	0.2	
	Yorkshire	3.2		Movies	Sky Premier	0.8	
	LWT	2.0			Sky Moviemax	0.5	
	Tyne Tees	1.5	10.6		Sky Cinema	0.1	
Carlton	Central	4.7		Other	Sky News	0.4	
	Carlton	2.8			Fox Kids Network	0.1	
	Westcountry	0.8	8.3		History Channel	0.1	5.3
United News & Media	Meridian	2.4		BSkyB joint ventures with:			
	HTV	2.3		Viacom	Nickelodeon	0.7	
	Anglia	1.8	6.5	Granada	Granada Plus	0.3	
Other ITV	Scottish	1.9		QVC	QVC	0.2	
	GMTV	1.6		Paramount Pictures	The Paramount Channel	0.1	1.3
	Ulster	1.0		Flextech	UK Gold	0.9	
	Grampian	0.6			Living	0.5	
	Border	0.5	<u>5.6</u>		Bravo	0.2	
Total Channel 3			31.0		Challenge TV	0.2	
Channel 4	Channel 4	9.9			Trouble	0.2	
Channel 5	Channel 5	5.3			UK Horizons	0.1	
S4C	S4C Wales	0.3	15.5		UK Style	0.1	2.2
Other		0.2	<u>0.2</u>	Viacom	MTV	0.4	
<b>Total free-to-air</b>			<b>85.8</b>		VH1	0.3	0.7
				Discovery	Discovery Home and Leisure	0.2	
					Animal Planet	0.1	0.6
				TimeWarner	Cartoon Network	0.8	
				Disney	Disney Channel	0.4	
				Zee TV	Zee TV Europe	0.3	
				Eurosport International	Eurosport	0.3	
				Universal Studios	Sci-Fi Channel	0.2	
				Turner	TNT	0.2	
				The Box	The Box	0.2	
				BBC	BBC News 24	0.1	
				ITV	ITV2	0.1	
				CNN	CNN	0.1	
				Channel Television	Channel Television	0.1	
				Other			<u>1.2</u>
				<b>Total pay-TV</b>			<b>13.0</b>

Source: ITC.

**Notes:**

1. Figures do not sum to 100 because of rounding.
2. Excluded are many small share channels on the pay-TV platforms, eg Tara Television Limited, National Geographic.

## *Cable systems*

4.17. In the UK, cable TV systems originally developed on the basis of relatively small area, exclusive franchises. Since the early 1990s cable operators have been permitted to supply telecommunication services as direct service providers (previously they could provide such services only as agents for BT or Mercury Communications), as well as TV broadcast services. Over the past five years there has been a considerable consolidation (by merger) among operators, with the effect that there are now only three main operators, each of approximately equal size by number of subscribers (Telewest, CWC and NTL). All three are substantial businesses and companies in their own right (each has a market value in excess of £5 billion). The proposed merger between NTL and CWC has been the subject of a parallel inquiry by this Commission. During the course of this inquiry, a proposed merger was announced between Telewest and Flextech Television Ltd, a major pay-TV channel provider (see Table 4.2).

4.18. Cable systems or networks offer broadband transmissions direct to individual homes, using a combination of fibre-optic and coaxial cable; conventional twisted pair copper wire is also used for telecommunication services (the coaxial and copper wire together are known as a 'siamese' cable). In order to view TV programmes, cable subscribers require a cable connection into the home, a set-top box receiver/decoder and a standard TV. As indicated earlier, UK cable operators are in the process of introducing digital systems, and they expect to have full (or virtually full) service area coverage by the middle of 2001. When operated in parallel with up to 50 analogue channels, each of these digital networks can offer around 150 TV channels: when the analogue transmissions cease, digital cable systems in the UK will be capable of delivering more than 500 channels (many of which will in practice be used for PPV and interactive services).

4.19. As with DTH (and DTT; see paragraphs 4.23 and 4.24), cable systems offer multi-channel pay-TV services in the form of multi-channel packages of basic and premium channels (see paragraph 4.31). The range of programmes available is similar (albeit somewhat less extensive) than on the DTH platform, ie general entertainment channels (for example, Sky One), themed and special interest channels (for example, history, travel, children's channels etc), sports channels (for example, Sky Sports and Eurosport), as well as dedicated film channels, both subscription-based (for example, Film Four, Sky MovieMax) and PPV (mainly on the digital services). Many, though not all, of the channels available are the same as on the DTH and DTT platforms, and a number of the premium channels are provided by BSkyB at the wholesale level. As regards the five free-to-air terrestrial channels, the BBC told us that these are transmitted unencrypted to all digital receivers and carriage is guaranteed.

4.20. Cable networks are closed systems as regards pay-TV channels, in so far as each of the cable operators has full control over which channels (and other services, for example interactive services) are or are not broadcast across its distribution infrastructure. During this inquiry (and the parallel inquiry on the proposed NTL/CWC merger) BSkyB made representations to us on the case for 'open access' to cable networks, and this issue is also currently under review by OFTEL and the ITC. We consider that the 'open access' issue, whilst important in itself, is not relevant to this inquiry and we do not therefore evaluate it further in this report.

4.21. About 50 per cent of the UK's 24 million homes are passed by cable systems (mainly in urban areas) and are therefore able to get a cable connection. Currently there are about 3.1 million subscribers to cable TV services, a penetration rate of about 25 per cent within cable areas, though this represents only 13 per cent of all UK homes. This is comparable with France, less than in Germany (where cable penetration is said to be nearly 50 per cent) and the Netherlands/Scandinavia (60 per cent), but far greater than in Spain (under 5 per cent) and Italy (1 per cent).

4.22. As regards funding, neither CWC nor NTL are at present significant channel providers (though NTL in particular is increasing its interests in this area). Reflecting that, their broadcasting services are almost entirely subscription-financed: their advertising revenues are minimal (see paragraph 4.56). Telewest, on the other hand, will no doubt increase its advertising revenues through its merger with Flextech Television Ltd, a provider of channels which are partly advertising-funded. All three cable operators, however, get substantial revenues from the provision of telecommunication services. Indeed, their monthly charges to consumers for pay-TV and telecommunication services are often 'bundled' together, albeit that consumers may be able to purchase the two types of services separately. During this inquiry (and the parallel inquiry on the proposed NTL/CWC merger), BSkyB made representations to us on the potentially anti-competitive effects of such price 'bundling' by the cable operators, and this issue

was the subject of a recent review by OFTEL and the ITC (see Appendix 4.1, item 3). We consider that the ‘bundling’ issue, whilst important in itself, is not relevant to this inquiry and we do not therefore evaluate it further in this report.

### ***Digital terrestrial transmission***

4.23. Multi-channel pay-TV services via the DTT platform were first introduced in the UK towards the end of 1998. The major operator for pay-TV at present is ONdigital, which operates under licence from the ITC (see Appendix 4.2), and which is jointly owned by two of the ITV/Channel 3 companies (Carlton and Granada). Reception requires a normal TV aerial, a set-top box receiver/decoder/smart card and a standard TV. The number of channels available (about 30) is less than that generally available on analogue cable, though ONdigital offers subscribers a programme ‘package’ structure similar to those of the cable and DTH operators. The range of channels available—both basic and premium—is similar (albeit less extensive) than on the cable and DTH platforms, ie general entertainment channels, themed and special interest channels (for example, food, travel, children’s channels etc), sports channels (for example, Sky Sports, Eurosport and ONsports—see paragraph 4.68), as well as dedicated, subscription-based film channels (for example, Film Four and Sky MovieMax). ONdigital has also announced plans to launch a limited PPV service (to be called ONrequest) on the DTT platform, as a joint venture with S4C Digital Networks Limited (SDN) (which is one-third owned by NTL, one of the main cable operators).

4.24. As with cable networks, the DTT platform is a closed system (see paragraph 4.20); and is at present funded almost entirely from subscription revenues. At the end of 1999 there were around 0.5 million DTT subscribers in the UK, though ONdigital forecast that this would double by the end of 2000.

### ***Other TV delivery systems (emerging technologies)***

4.25. The delivery of TV material to homes may also be possible using ADSL technology (one of several DSL technologies). This uses a modem both at the local telephone exchange and at individual homes to transform the standard telephone line (twisted copper wire) into a high-speed digital pathway, which is capable of delivering broadband services such as a video-on-demand (VOD) TV channel or high-speed Internet access. BT is introducing ADSL to its exchanges on an extensive scale this year (2000). Other operators will be able to obtain wholesale versions of retail ADSL services provided by BT. Also, BT is currently in discussions with OFTEL regarding the provision of a local loop product with which other operators could use their own DSL (including ADSL) equipment from July 2001.

4.26. Although ADSL is widely used in the USA (almost entirely for high-speed Internet access), the future impact of ADSL-based systems within the UK—especially for TV broadcasting—appears uncertain at this time. The capacity of ADSL depends crucially on the length of line between local telephone exchanges and the premises using the service, and much of BT’s network is such that—whilst entirely suitable for high-speed Internet access—it could not for the most part provide the necessary capacity for other than a restricted TV service. We note, however, that a limited-area VOD service using ADSL has been introduced recently in London by Video Networks Ltd. Additionally, the network operated by Kingston Communications (a localized telecommunication services provider) is more suitable than that of BT for providing TV services. Reflecting that, Kingston Communications is in the process of introducing a TV/VOD system in its Hull service area using ADSL technology; and has also announced a joint venture with BSkyB. Some (but not all) of the cable operators are also conducting their own technical trials of ADSL.

4.27. Multipoint video distribution services (MVDS) may also offer the prospect in the future of delivering TV material direct to homes, though it may also be used as an adjunct to cable networks. MVDS uses microwave spectrum (radio frequencies) to transmit broadband services, which may include TV channels, VOD, high-speed Internet access and interactive services. Since 1990, cable operators have been permitted to use a given spectrum allocation for MVDS services, in order to extend their networks to sparsely populated areas of the UK where the cost of installing cable would have been prohibitive. In practice, the cable operators have not developed MVDS systems to any significant extent (and we received no evidence that MVDS systems are widely used outside the UK). Nonetheless, the

Government has recently announced proposals to auction additional spectrum for MVDS usage, with a view to encouraging the future development of such services.

4.28. Third generation mobile phones using universal mobile telecommunications standard (UMTS) technology will also be capable of delivering broadband services, including Internet access and some TV/broadcast content. In the UK, the licences to operate UMTS services have yet to be awarded and as a result the necessary infrastructure is not yet in place. Once established, UMTS mobiles seem likely to offer complementary services to those of TV broadcasting rather than constituting a genuine alternative or substitute product.

## **TV markets**

4.29. In order to evaluate the effects of the merger, we need to consider which markets are of relevance, what broadcasting products they include and also their geographic scope (local, national or international). TV broadcasting markets, including the retail level, were considered in some detail in the report by this Commission on the proposed BSkyB/Manchester United merger (see Appendix 4.1, item 1); and also by the European Commission (DGIV) in a number of recent cases involving pay-TV broadcasting (see Appendix 4.1). During the course of the present inquiry (and the parallel investigation into the proposed acquisition of CWC by NTL), the other operators of pay-TV in the UK, and also most other parties in the broadcasting sector from whom we heard, argued that pay-TV services at the retail level should be regarded as a distinct market and therefore separate from that of free-to-air terrestrial TV. This has also been the view of the OFT, the ITC, the BBC, the European Commission and previous reports by this Commission. In contrast to that, both Vivendi and BSkyB (see paragraphs 4.39, and 4.37 and 4.38, respectively) argued that the relevant market was wider than pay-TV alone, and included free-to-air terrestrial channels, most particularly in the market for the acquisition of broadcasting rights for sports events and feature films.

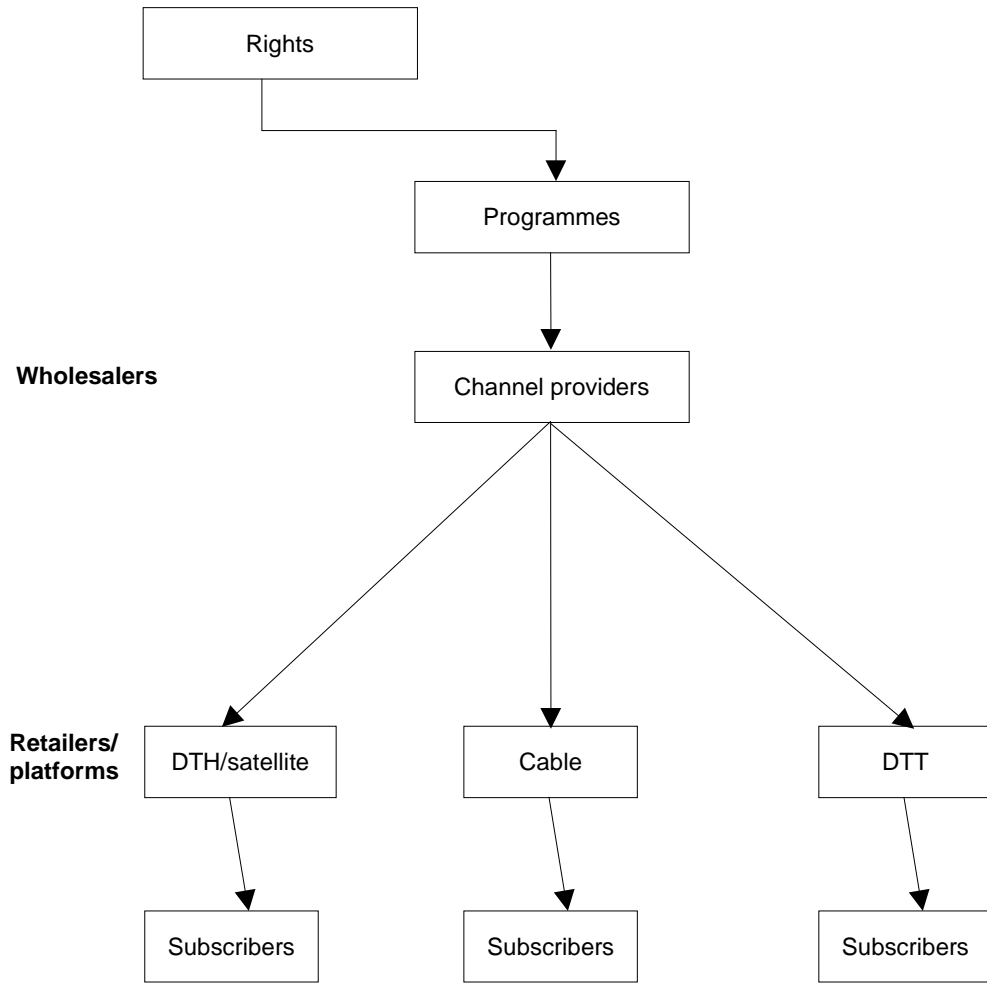
4.30. Television in the UK is comprised of a hierarchy of distinct broadcasting markets, albeit that the boundaries between them are not in some cases well defined. Figure 4.1 sets out the vertical structure and elements of the pay-TV supply chain. As there shown, the main retailers of pay-TV services are essentially the operators of the three delivery platforms: DTH/BSkyB, the individual cable networks/operators and DTT/ONdigital (see paragraphs 4.10 to 4.24). Above that, there is the wholesale level of channel providers, of which BSkyB is the largest by revenue in the UK, particularly for premium channels. At the next highest level is the production of programmes or content; and above that—for some types of programme—is the supply of programme material rights relating to sports events (where the suppliers are primarily event organizers) or films (where the Hollywood film studios play a major role).

4.31. The latter—broadcasting rights to sports and films—are of particular relevance to this inquiry and are considered in detail in paragraphs 4.60 to 4.88 and 4.89 to 4.109 respectively. Both types of rights are characterized by elements of exclusivity. They are, for example, defined on a national, territory or language basis. Moreover, the rights are often purchased on an exclusive (or semi-exclusive) basis in that broadcasters other than the buyers are precluded from showing the content (usually for a given time period and within a given territory). On substitutability, sports programmes and films are not considered to be ready substitutes for each other on either the demand or supply side and may therefore be seen as separate markets. Within both the sports and film rights categories there exists a wide range of programme material, some of which may be regarded as substitutes whilst others are more complementary. Where there are substitutes available (for example, old films/library stock; see paragraph 4.97), rights markets tend to be flexible and generally competitive. Where, however, there are no effective substitutes (for example, the rights to broadcast the English FA Premier League football or first-run feature films) and there is strong demand, sellers have strong bargaining power when selling the rights to broadcasters, and prices may be far higher than for other sports or film rights. As a result, both sports and films rights markets comprise both ‘basic’ and ‘premium’ content and also channels.

4.32. As regards the geographic scope of the rights markets, the territorial nature of rights means that there are no substitutes for UK rights and hence, in an economic sense, the market is national. However, buying and selling takes place in an international market place. Participants include both free-to-air and pay-TV broadcasters, as well as trading intermediaries or ‘brokers’.

FIGURE 4.1

**The pay-TV supply chain**



Source: Commission derived from the ITC.

Notes:

1. No separate rights supplier exists for most TV programmes, the main exception being that of sports rights. Competition for sports rights may also come from free-to-air broadcasters.
2. Broadcasters can retail their channels on the DTH/satellite platform independently of BSkyB.
3. In the context of DTT, pay-TV means ONdigital.

4.33. Turning to the retail level, pay-TV exhibits a number of different characteristics to those of free-to-air broadcasting services. There are many more channels on pay-TV, including some devoted to specialist programmes, exclusive live coverage of many sports events and the showing of films considerably earlier than on free-to-air TV. Pay-TV is also financed largely by subscription revenues, which are additional to the TV licence fee paid by all subscribers. Moreover, the structure of retail prices of cable operators and those of ONdigital are similar to those of BSkyB, the price being related to the number of packages or channels purchased by subscribers. The price structure of these operators is also related to the wholesale prices they pay to BSkyB, which in turn is related to BSkyB's retail prices. Subscription charges for pay-TV increased relative to the RPI during the 1990s and there was also an increase in the demand for pay-TV over the same period.

4.34. We note that there are some sports rights for which competition has occurred between free-to-air and pay-TV broadcasters, but this does not mean that sports programmes on free-to-air TV are ready substitutes for those on pay-TV. The latter involves the purchase of attractive and exclusive rights for which free-to-air TV providers cannot always compete effectively, in particular the rights to FA Premier League football. In the 1996 sale of the FA Premier League live rights, all three bidders were planning to broadcast the matches on pay-TV, and no free-to-air channel was a contender. The FA Premier League

was also reported as having the view that only pay-TV broadcasters would be able to compete; and the BBC and ITV confirmed that they did not expect to submit bids for live rights were the then current selling arrangements to continue.

4.35. In its earlier report, this Commission argued that the normal tests of substitutability used for market definition purposes were not readily applicable in broadcasting markets at the retail level, because consumers were not able to choose pay-TV to the exclusion of free-to-air services. While agreeing that there was a degree of price constraint exerted by free-to-air TV, in that viewers had to be persuaded that pay-TV was worth the added expense, it did not see this as central to the question of market definition. Consumers were likely to choose whether or not to subscribe to pay-TV according to a broad assessment of its benefits, in particular the very different (from free-to-air) choice of TV viewing that was offered, and its cost. A willingness to pay an additional charge (subscription fee) for pay-TV services was therefore a clear indication that customers wanted and valued a service that was different from and additional to free-to-air TV, rather than seeing pay-TV as a simple substitute for free-to-air. It therefore seemed improbable to the Commission, adopting the standard test for the existence of market power, that a hypothetical monopoly supplier of all pay-TV channels (basic and premium) would be prevented from sustaining prices 5 to 10 per cent above competitive levels by the existence of free-to-air services.

4.36. As a result of its analysis of TV retailing, the Commission concluded that pay-TV services represented a separate market from free-to-air services, while recognizing that the existence of free-to-air services places an upper limit on the prices charged by pay-TV broadcasters. The Commission went on to conclude that it was appropriate also to distinguish between premium and non-premium channels, and between premium sports and film channels, and found the relevant broadcasting market for the purposes of that inquiry to be the market for pay-TV premium sports channels. It further concluded that pay-TV was broadly a national market (although the cable sector involves some important local aspects), because BSkyB's service was available throughout the UK, its marketing was national and also its pricing. The European Commission has also taken a similar view on market definition within broadcasting, ie that pay-TV represents a separate market and that such markets are largely national in nature, most particularly at the retail/platform level.

4.37. In its evidence to us, BSkyB argued that there was no clear distinction between basic and premium channels, in terms of either content or price; and that an attempt to draw such a distinction was made more difficult by the fact that channels are generally sold to consumers not on an individual basis but as part of a package. We note, however, that BSkyB's own sales brochures invite subscribers to 'choose your Sky entertainment package, then choose your Premium Channels/Package', the premium channels being clearly identified as Sky Sports channels, Sky MovieMax and Sky Premier. As regards the purchase of sports and film rights, BSkyB argued that films and sports events which have been shown on a premium channel could at some point be shown on either a basic pay-TV or a free-to-air channel; that the buying of premium rights was not necessarily limited to operators who already had premium channels; and that the launch of ONdigital (which has ownership links to ITV/Channel 3 free-to-air services) had increased the possibility that a consortium could profitably buy rights for use on both types of service. The latter two points are dealt with later in this chapter, but with regard to the first point, we note the importance of the time element in determining whether content is premium or not, both for films and for sports events, which are often only 'premium' if broadcast live. For these reasons, BSkyB argued that premium sports and premium film channels should not be viewed as separate from basic channels. Nor did the mere fact that a substantial number of subscribers were willing to pay extra to watch the Sky Sports channels indicate that it formed a separate market. BSkyB also pointed to intense competition for audiences and advertising revenues between free-to-air and pay-TV services, and what it considered to be the constraint that free-to-air services place on the ability of pay-TV service providers to increase prices. As regards differences between the two in price and the types of programming offered, BSkyB argued that differentiation of channel content was an important aspect of competition between TV service providers, which occurred within a single market.

4.38. BSkyB also argued that the Restrictive Practices Court identified free-to-air TV as an important part of the competition faced by pay-TV operators (in its July 1999 judgment on the agreement between the FA Premier League, BSkyB and the BBC). We note that the Restrictive Practices Court did not comment, in that case, on market definition as such. We also note the argument put forward by BSkyB that market definition is influenced by the nature of the competition issues concerned, and indeed that TV as a whole may also compete with other forms of entertainment.

4.39. Vivendi similarly contended that free-to-air and pay-TV services formed part of one and the same market. It proposed first that there was a relationship between pay-TV and free-to-air TV as regards substitutability; and that the distinction between the two became even more blurred when there were pay-TV channels financed by a combination of sources, or as a result of the increase in digital TV programmes and channels. Secondly, pay-TV and commercial/public free-to-air TV services, it said, competed for both viewers and revenues. Thirdly, pay-TV services were reliant on rights to show highly popular programming, with vigorous competition between free-to-air TV and pay-TV for such rights. Nor did Vivendi regard any distinction between premium and basic channels as valid.

4.40. In our view, the focus of pay-TV, with its particular emphasis on film and sport, is significantly different to that of free-to-air TV; it is funded differently, since finance comes primarily from subscriptions; the prices it charges customers for all but some very limited bundles of programmes are significantly higher and have increased over time; and its subscription income puts it in a considerably stronger position than free-to-air TV to bid for the most significant rights. Only a pay-TV channel is in a position to finance the acquisition of the most expensive rights or to broadcast sport and films so extensively. Hence, we believe pay-TV can be regarded as a market separate from that of free-to-air TV. However, we acknowledge there are interactions with free-to-air TV: the demand for pay-TV is to some extent affected by the programmes shown on free-to-air TV; there is some competition between pay-TV operators and free-to-air TV in bidding for some, but not all, programme rights, and also on occasion a degree of collaboration between the two.

4.41. We also believe that the market can be regarded as essentially national—neither Vivendi nor BSKyB suggested otherwise in this inquiry—the bulk of programmes having primarily national appeal. In addition, there appear to be separate markets for different types or categories of TV channels. The main such markets are those for basic channels, for premium sports channels and for premium film channels (with a possible further subdivision between subscription-based and PPV channels). We consider the latter markets—for sports and film channels—in paragraphs 4.60 to 4.109.

4.42. Among the newer media, interactive services (including the provision of e-mail, and limited, or unrestricted, Internet access via TV) may be seen as a potentially separate market. We note, for example, that the European Commission concluded in its decision on the BiB/Open case (see Appendix 4.1, items 10 and 11) that the market for a package of interactive services of the kind offered by Open was separate from those of (a) high street retailing; (b) interactive services available via personal computers; and (c) pay-TV. In reaching these conclusions, the European Commission commented that pay-TV services were entertainment-based, whereas interactive services such as those on Open are largely informational or transactional, and that they are therefore distinct from each other. In effect, they constituted essentially complementary services, albeit that in practice the main interactive TV-based services currently available (or in the process of development) were either owned or part-owned by the operators of the pay-TV platforms over which they are delivered. Hence, Open is on the DTH platform and each of the three cable operators is developing its own package of interactive services. We take the view that these types of interactive services are in an early stage of market development; that new operators may enter the market in the near future (BSkyB told us, for example, that [ § 8 ] others are in the process of developing interactive services); and that it not yet clear in which markets these services will ultimately compete.

4.43. In the context of this merger, and in light of the above and the evidence we have obtained, we consider the broadcasting markets of relevance to be:

- (a) the markets for sports and film rights;
- (b) the overall UK market for pay-TV at both retail and wholesale levels; and
- (c) potentially, the new but developing UK market for interactive services (home shopping, Internet usage etc).

4.44. The other (non-broadcasting) market of relevance is that for conditional access technology and related software/services, which is essential for all pay-TV operators (and also for free-to-air services on the DTH platform, in order to avoid infringing territorial broadcast rights). This is considered to be a

separate market, since it is a particular and specialized application of digital technology for which there are no technical or economic substitutes; and considerable time and resources would be needed to start supplying these services, even for firms with expertise of other digital technologies. We evaluate conditional access in detail in paragraphs 4.110 to 4.129.

## **Vivendi and BSkyB**

4.45. We next provide a brief outline of the main parties, Vivendi and BSkyB (greater detail is given in Chapter 3), before moving on to assess the relevant pay-TV broadcasting and other markets.

4.46. Vivendi is a French company with a wide range of international business interests (in this report we use the term 'Vivendi group' to include Vivendi, Canal+ and associated companies including SECA), including utilities (water, energy etc), transport, telecommunications and media broadcasting. It has a 49 per cent shareholding in Canal+, which is a terrestrial broadcaster, a DTH operator and channel provider in a number of EC countries other than the UK (in this report we use the term the 'Canal+ group' to include Canal+, its associated companies and SECA). It also has cable operations in France. At the end of September 1999, Canal+ had, it told us, around 12 million pay-TV subscriptions to its services across the group. It does not, however, operate any DTH or other broadcasting services in the UK; though on the programming side, Vivendi/Canal+ have a one-third equity interest in the Eurosport International sports channel and also the UK version called British Eurosport (see paragraph 4.77). As regards conditional access technology, Canal+ has a 50 per cent share in Nagra+, which owns an analogue system called Syster (not used in the UK); and also a 50 per cent equity share of SECA, which owns the exploitation rights to the Mediaguard conditional access software used by Canal+ (and others) outside the UK, and by ONdigital within the UK (see paragraph 4.112). Vivendi also has equity interests in two non-UK football clubs, Paris St Germain (French) and Servette of Geneva (Swiss). During the course of our inquiry, a joint venture relating to Internet services was announced between Vivendi and Vodafone Airtouch (a mobile phone company).

4.47. As explained earlier, BSkyB is the sole DTH operator in the UK. Its main shareholder is News International which is itself owned by News Corporation (see Chapter 3). The News Corporation group has a wide range of business interests, including UK newspapers (*The Times* and others); Hollywood film production (Twentieth Century Fox); a one-third stake in Stream, an Italian digital TV terrestrial platform; equity interests in satellite platforms outside the UK, including Star TV (Asia), Sky Latin America and Foxtel (Australia); and in the conditional access technology used by BSkyB, through News Corporation's NDS subsidiary (see paragraphs 4.110 to 4.129). As well as controlling and providing a number of channels directly (Sky One, Sky Sports etc), BSkyB also has a number of subsidiaries, including SSSL (which provides conditional access services) and Sky Ventures Ltd, which manages BSkyB's interests in joint venture channels such as Nickelodeon, National Geographic, The History Channel etc. It also has equity interests (of less than 10 per cent in each case) in several UK football clubs: Manchester United, Leeds United, Chelsea, Sunderland (all FA Premier League clubs) and Manchester City. During the course of our inquiry, BSkyB also entered into an agreement under which it would acquire a 24 per cent equity stake in Kirch, the leading pay-TV operator in Germany.

## **Pay-TV subscribers, revenues and operators' market shares**

4.48. The size of the UK pay-TV market and operators' market shares are conventionally measured both by the number of subscribers and by revenues. As regards subscribers, the number of homes (and other premises) taking pay-TV increased substantially throughout the 1990s. Table 4.3 gives details of the numbers of pay-TV subscribers (analogue and digital combined) in the UK in the years 1997 to 1999, and also the associated market shares for BSkyB/DTH, the cable operators and DTT/ONdigital. As shown in the table, the number of subscribers grew by nearly 22 per cent (1.3 million) over this two-year period, reaching a total of 7.1 million across the three delivery platforms, which represents about 30 per cent of all UK homes. Estimates of future growth vary, but the BBC told us that it was likely that the take-up of pay-TV would exceed 50 per cent of UK households within five years, though some forecasts also suggested, it said, that this would plateau at about 60 per cent.

TABLE 4.3 Pay-TV subscribers in the UK and suppliers' market shares, 1997 to 1999

Platform/suppliers	'000			% market share		
	1997*	1998†	1999‡	1997	1998	1999
DTH/BSkyB	3,532	3,547	3,582	60	56	50
Cable operators:						
Telewest	691	1,000	1,124	12	16	16
NTL	309	812	1,062	5	13	15
CWC	738	822	864	13	13	12
Other cable	<u>571</u>	<u>192</u>	<u>63</u>	<u>10</u>	<u>3</u>	<u>1</u>
Total cable	2,309	2,826	3,113	40	44	44
DTT/ONdigital	<u>0</u>	<u>0</u>	<u>411</u>	<u>0</u>	<u>0</u>	<u>6</u>
Total	5,841	6,373	7,106	100	100	100

Source: Commission, based on data from CWC (supplied in the context of the parallel inquiry on the proposed merger between NTL and CWC).

\*BSkyB as at 30.6.97 and cable operators as at 31.12.97.

†BSkyB as at 30.6.98 and cable companies as at 31.11.98.

‡All companies as at 30.9.99.

4.49. As mentioned earlier (paragraph 4.46), Vivendi/Canal+ have a one-third equity interest in the Eurosport International sports channel and also the UK version called British Eurosport, both of which are currently available on UK pay-TV. These channels are considered further in paragraphs 4.77 and 4.78.

4.50. DTH/BSkyB has long been the largest platform/retail supplier, though its market share (by number of subscribers) has tended to fall throughout the 1990s, mainly reflecting the expansion of cable networks. Indeed, its share declined from some 73 per cent in 1994 to 50 per cent in 1999. In 1998 BSKyB lost 4 per cent of market share directly to the cable networks; and in 1999 it lost a further 6 per cent, which was largely taken up by ONdigital/DTT (launched late in 1998). Its number of subscribers grew only slightly over this period (50,000 or 1.4 per cent compared with 1997). BSKyB told us, however, that its digital service and its free set-top boxes offer had been successful in stimulating its subscriber base, which it expected to grow further over the next few years.

4.51. As with DTH, ONdigital's DTT service offers national (or at least near national) coverage, and it also offers set-top boxes free of charge where subscribers sign up for a 12-month period. By October 1999 ONdigital's subscriber base had grown to 0.4 million, though by the year-end it was about 0.5 million. ONdigital told us that it was hoping to secure a total of around 1.0 million subscribers by the end of 2000 and 1.5 million by 2001.

4.52. As regards the cable platform/operators, the total subscriber base for TV services has trebled since 1994, from under 1.0 million then to 3.1 million in 1999. As shown in Table 4.2, the number of subscribers grew by 35 per cent in the two-year period 1997 to 1999, and the cable platform's national market share rose from 40 to 44 per cent in total. Within that, the number of subscribers and market shares of both NTL and Telewest increased substantially over the period (though the growth of CWC was less marked). In 1999, Telewest's share at the national level was 16 per cent, NTL's was 15 per cent and CWC's was 12 per cent. At the local level (the geographic areas where the cable operators are active) their shares by number of subscribers are far greater. The ITC estimated that Telewest's local area market share was [ 30 ] per cent in 1999, that of NTL was [ 20 ] per cent and CWC's was [ 15 ] per cent.

4.53. In general terms, individual cable operators are able to increase their subscriber base in essentially three ways: merger with other cable operators, network build (ie laying more cable, thereby increasing the catchment or service area), and increased penetration (percentage take-up of services) within existing network service areas. In practice, mergers have been one of the main contributors to growth in subscribers (and market share) over this period for both Telewest and more particularly NTL.

4.54. On network build, Table 4.4 shows the number of homes with access to cable should residents choose to subscribe (homes 'passed') for each of the cable operators in the period 1997 to 1999. Overall,

the number of homes passed by cable increased by 14 per cent between 1997 and 1999 (to a total of 12.2 million). By contrast, the number of subscribers (as mentioned above) increased by 35 per cent. This appears to indicate an increase in penetration rates within existing network areas. In 1999 about 50 per cent of all UK homes had access to cable networks: the 1999 level of 3.1 million cable subscribers is equivalent to an average penetration rate of 25 per cent.

TABLE 4.4 Number of UK homes passed by cable networks, 1997 to 1999

	'000		
Cable operators	1997	1998	1999*
Telewest	3,097	4,227	4,222
NTL	861	2,789	3,540
CWC	3,694	3,908	3,926
Other cable	<u>2,716</u>	<u>981</u>	<u>484</u>
Total	10,368	11,904	12,171

Source: Commission, based on ITC data.

\*As at 1.7.99.

Note: Figures may not sum exactly because of rounding.

4.55. Turning to pay-TV revenues, Table 4.5 provides details of retail subscription and channel advertising revenues combined for 1999, of which retail subscription revenue is by far the major component (close to 90 per cent). Total revenues measured on this basis were £2.0 billion in 1999. Within that total, BSkyB accounted for £1.3 billion or 64 per cent and cable operators accounted for most of the rest at 34 per cent: ONdigital in its first full year of operation achieved revenues of £40 million and a market share of nearly 2 per cent. ONdigital forecast that its revenues in 2000 would expand to over £[ 80 ] million, and reach £[ 80 ] million in 2001.

TABLE 4.5 Revenues (subscription and advertising) and market shares of pay-TV operators, 1999

	1999* £m	1999 %
BSkyB†	1,321	64.0
Cable operators:		
Telewest‡	265	12.8
NTL‡	178	8.6
CWC	244	11.8
Other cable§	<u>16</u>	<u>0.8</u>
Total cable	703	34.1
Ondigital	<u>40</u>	<u>1.9</u>
Total	2,024	100.0

Source: Commission, based on the annual accounts of pay-TV operators.

\*All figures are for the year ended 30 September 1999, except ONdigital for which data relate to the year ended 31 December.

†Excludes payment from the cable operators and ONdigital (£265 million).

‡Adjusted for acquisitions.

§Calculated by CWC (supplied in the context of the parallel inquiry on the proposed merger between NTL and CWC) using data from the ITC, Atlantic and Eurobell.

4.56. These revenue figures tend to overstate BSkyB's share of retail operators' revenues because of the inclusion of advertising revenues, which are more properly attributable to channel providers. BSkyB is the largest such provider by value and has annual advertising revenues of around £215 million, compared with less than £5 million for cable operators, which buy in almost all of their channels.

4.57. Nonetheless, BSkyB does appear to achieve higher retail subscription revenues per subscriber than do the cable operators. In part, this reflects differences in the so-called pay-to-basic ratios (the ratio of the number of subscribers taking premium channels to the number of subscribers taking basic channels) between different operators. NTL, for example, has a pay-to-basic ratio of around 90 per cent, and CWC around 145 per cent, while BSkyB's is around 300 per cent. BSkyB told us that this indicated

that it was better able than others to market and sell its premium sports and film channels, adding that it had recently undertaken joint marketing promotions with CWC and Telewest, in order to encourage the take-up of its premium channels among cable subscribers.

4.58. As mentioned above, BSkyB is also a major channel provider at the wholesale level. As a result, in addition to advertising revenues, it receives subscription revenues from other UK pay-TV operators/platforms taking BSkyB channels: such payments amounted to about £265 million in 1999. The charges levied by BSkyB for its channels are governed by a rate card, the discount structure of which is subject to regulation by the OFT. During the course of our inquiry, the OFT announced that it was undertaking a review of the UK pay-TV market, which would reassess the need for OFT monitoring of the rate card and the undertakings given by BSkyB, taking account of changes in the UK market since the OFT's earlier report in 1996 (see Appendix 4.1, item 7).

4.59. Cable operators also enjoy revenue streams from the provision of telecommunication services which are additional to those from pay-TV. In the future, and once the market develops, interactive services are also expected to provide substantial revenues to cable operators, to DTH and also the DTT platform. For completeness, we also note that the advertising revenues of the ITV free-to-air channels amounted to nearly £1.9 billion in 1999; and that the BBC's licence fee revenue (covering all of its services, but excluding its revenues from commercial activities) in that year was £1.5 billion.

## **Premium sports channels and rights acquisition**

4.60. As mentioned earlier (paragraph 4.31), sports broadcasting rights, and the links with premium sports channels on pay-TV, are of particular relevance to this inquiry. Sports rights/content are essential for TV sports programmes and channels; and, as considered further below, a potential barrier to new entry for sports channels is the cost and difficulty of acquiring a portfolio of attractive TV broadcasting rights—which are usually specified for a fixed time period of several years and therefore only become available for acquisition on a periodic basis.

4.61. In general, such rights are characterized by elements of exclusivity; they are, for example, generally defined and bought and sold (and otherwise traded) on a national, territory or language basis. As regards exclusivity, sports rights are often purchased on an exclusive (or semi-exclusive) basis in that broadcasters other than the buyers are precluded from showing the content in a given time period and within a specified territory. The highest value sports rights tend to be those for live broadcasting in the country of origin where the popular appeal among viewers is at its highest. On substitutability, sports rights/content—and therefore sports programmes/channels—are not considered to be ready substitutes for other types of TV rights/content/programmes on either the demand or supply side. As a result, sports rights constitute a separate economic market, albeit that there are close links with the market(s) for sports programmes and channels.

4.62. Within sports rights taken as a whole, however, there is a wide diversity of alternative programme material, ie both different sports (football, rugby, golf etc) and also different standards of quality or popular appeal (for example, international rugby union as compared with club rugby). Different sports and individual sports events may in some instances be regarded as substitutes on the viewer demand side, whilst others are more complementary in their nature. Where there are effective substitutes available, rights markets tend to be flexible and generally competitive. Where, however, there are no effective substitutes (for example, the rights to broadcast the FA Premier League) and there is strong demand, the original rights holders/sellers may enjoy a degree of market power, and prices for the broadcasting rights may as a result be driven far higher than for other sports rights. As a result, both sports rights and the programmes/channels on which they are shown may be characterized as either 'basic' (low cost, low viewing appeal) or 'premium' (high cost, high viewing appeal); see also paragraph 4.67.

4.63. In addition to being a platform operator and pay-TV retailer in the UK, BSkyB is a major provider of premium sports channels on pay-TV. Canal+ is, it told us, a provider of premium channels which offer programming based on recent films and popular sports events. Both companies have secured broadcasting rights to an extensive range of important sports events, from either rights holders (usually event organizers, but they may be intermediate rights holders) or sports brokers/traders—though at present, as explained below, their respective channels (and delivery platforms) serve different national markets. In the UK (and also other EC countries), demand for pay-TV sports has grown considerably in recent years and seems also to be relatively insensitive to price changes, at least at current price levels.

Indeed, the strength of demand for sports channels (and football coverage in particular) has been one of the main factors leading to an increase in the pay-TV subscriber base in the UK; and also the growth in subscription revenues, which for BSkyB's sports channels doubled between 1995 and 2000.

4.64. BSkyB's sports channels (Sky Sports 1/2/3 and also Sky Sports Extra) are broadcast in the UK, Republic of Ireland (Ireland), the Channel Islands and the Isle of Man. Accordingly, its programme rights apply in almost all instances only to these specified geographic areas (essentially the UK/Ireland), though there are some exceptions, BSkyB told us, where it holds the worldwide (or near worldwide) broadcasting rights. The latter include certain rugby league and rugby union matches/competitions; and also the UEFA Cup home matches of Arsenal, Leeds United, Newcastle United and West Ham United for the current season. A list of the main sports rights (excluding any rights for which BSkyB paid less than £1 million, and including in some instances exchanges of rights with other broadcasters) currently held by BSkyB is included in this report at Appendix 4.3: sports rights which BSkyB expected to become available for purchase over the next three years are listed at Appendix 4.4.

4.65. As regards the UK/Ireland, BSkyB's major sporting rights (for live and exclusive coverage) include some (but not all) of the FA Premier League and FA Cup football matches, English cricket test matches, rugby union, top boxing matches and some of the major professional golf tournaments (see Appendix 4.3). Within these, the rights to the FA Premier League are by far the most valuable, and accounted for more than 50 per cent of BSkyB's total annualized costs for sports broadcasting rights (£318 million in 1999; see Table 3.5): football as a whole accounted for around 75 per cent. Virtually all of BSkyB's sports rights are on an exclusive basis, it told us, though in some cases rights holders have required it to sub-license some elements of the rights (for example, highlights, delayed broadcast rights etc) to free-to-air terrestrial broadcasters. Some of the FA Cup matches, for example, are sub-licensed to ITV (see Appendix 4.3).

4.66. Some of BSkyB's sports rights are sub-licensed from other rights holders/licensees or brokers/traders, including Sport+, a subsidiary of Canal+. BSkyB shows Spanish Premier League football, for example, for which it holds the live and exclusive broadcasting rights in the UK, which BSkyB has sub-licensed from Sport+. Vivendi told us, however, that this was the only example of Canal+/Sport+ having sold UK sports broadcasting rights to BSkyB.

4.67. BSkyB's sports channels are available on all three UK delivery platforms (DTH, cable and DTT) and are the only premium sports channels (apart from MUTV) which currently show live football on the cable and DTH pay-TV platforms in the UK. We believe that, as a result, BSkyB at present enjoys a degree of market power in the premium sports channel market. In the UK, the nearest equivalent—and a potential competitor—to the BSkyB channels is British Eurosport (and Eurosport International on analogue), which is considered at present to be a basic (non-premium) channel and which has ownership links with Vivendi (see also paragraphs 4.77 and 4.78). British Eurosport (and Eurosport International on analogue) currently shows largely different or complementary sports to those of the BSkyB channels, for example Alpine sports, tennis and European cycling events among others, though it also covers boxing and non-UK European football to an extent.

4.68. Important sports events, however, are also shown on both free-to-air channels and the DTT platform; and to that extent, BSkyB competes directly with these other channel operators in the market for sports rights acquisition. The BBC, for example, offers much general sports coverage, including athletics, horse racing, snooker and delayed highlights of FA Premier League games. BSkyB therefore competes with the BBC for these rights; and also occasionally, though not normally, it said, with the European Broadcasting Union (EBU: an EC consortium of state-owned, public service, free-to-air TV broadcasters; see also paragraph 4.88) for certain other sports rights. Similarly, ITV owns the exclusive UK rights—which it sub-licenses to ONdigital—for the UEFA Champions' League (shown on ITV and on ONdigital channels ON28 and ON99—which have recently been renamed as ONsports 1 and 2); ITV has the exclusive UK broadcasting rights for Formula One (Grand Prix) motor racing; and Channel 5 also occasionally shows top international football matches.

4.69. We note that free-to-air channels are actual or potential competitors to BSkyB/pay-TV in relation to a range of sports events (for example, Formula One motor racing and snooker) but not always for others, such as FA Premier League football, certain test cricket and major golf events, and top boxing matches. For the latter, pay-TV is able:

- (a) to offer a higher price for the broadcasting rights than free-to-air services, financed from channel-related subscription revenues (or programme related revenues via PPV); and
- (b) to broadcast such sports events more effectively and comprehensively on its greater channel capacity (which also has interactive and PPV capability).

For many of the higher-value sports broadcasting rights, therefore, the cable networks and DTT (noting that ONdigital represents an alliance between commercial free-to-air channels and a pay-TV retailer/platform) are more likely competitors to BSkyB's sports channels. Although cable operators appear to have shown little interest in the past in developing their own premium sports channels, this is changing, partly as a result of the considerable and recent consolidation within the cable sector (see paragraphs 4.52 and 4.53): NTL in particular is becoming increasingly involved with sports through its interests in both British Eurosport and FA Premier League football clubs (see paragraph 4.72).

4.70. BSkyB told us that it had not been able to identify any worthwhile opportunities for itself and Canal+ to bid jointly for individual events or blocks of sports rights, largely because such rights were almost invariably sold on a country-by-country basis, ie they were for the most part national in nature. For the same reasons, it told us, BSkyB and Vivendi/Canal+ (together with Sport+; see paragraph 4.75) were not in its view direct competitors for broadcast sports rights. It added that for multi-country sports rights (usually for those territories outside the country of origin) there was an active and competitive market, which included many traders/brokers in such rights such as TWI, ISL, ISPR, Prisma, Octagon and the EBU, among others (see also paragraphs 4.81, 4.83 and 4.88).

4.71. We note that although sports rights are often nominally designated (and priced) in terms of individual territories or countries, this applies mainly to the country of origin, where the economic value is generally greatest (for example, FA Premier League football in the UK): the rights for territories outside the country of origin, however, are often sold on a 'block of countries' basis. The broadcasting rights to English FA Premier League football outside the UK, for example, are held by Vivendi/Canal+ in EC countries and elsewhere, except for Asia and the Middle East, where they are controlled by TWI (a rights trading agency: see paragraph 4.81). Moreover, many top-level sporting events are of international appeal, and are becoming increasingly so, we were told—by the ITC (see Chapter 5) and also the BBC (see paragraph 4.84), although BSkyB disputed this. The UEFA Cup and Champions' League competitions, for example, have wide appeal within EC countries; and both Spanish and Italian top league football matches are broadcast in the UK. Similarly, the Six Nations Championship rugby union series (an international competition involving England, Scotland, Wales, Ireland, France and now Italy) has wide appeal within EC countries.

4.72. As regards BSkyB's interests in UK football clubs, it did not consider that these affected the bidding process or that they distorted the market in any other way. It pointed out that NTL (one of the three main cable operators in the UK) had acquired interests of just under 10 per cent in both Newcastle United and Aston Villa, and that Granada (one of the ITV broadcasters) also owned nearly 10 per cent of Liverpool: all of these are FA Premier League clubs.

4.73. Turning to Vivendi, its interests in sports channels, and the buying of sports broadcasting rights, derive from its shareholding in Canal+, which also has interests—within the EC, but outside the UK—in cable networks and DTH platforms. Canal+'s channels are broadcast in 12 national territories, including various EC countries other than the UK. Canal+ in France, and Eurosport France in which Vivendi and Canal+ combined hold a 59 per cent interest and Canal+ assumes management control (see paragraph 4.76) buy broadcasting rights primarily for the French market, and details (based on publicly available information) of their current, main rights for live and exclusive broadcasting of sports in France are at Appendix 4.5 (Table 1): we note that the list is not exhaustive in respect of French rights. As shown in Appendix 4.5, the main sports rights held directly by Canal+ include the French football Premier League equivalent, the French football Cup matches, the UEFA Champions' League (football), rugby union, some of the major professional golf tournaments, major boxing matches and Formula One (Grand Prix) motor racing. Vivendi told us that the only broadcasting rights bought by Canal+ from BSkyB have concerned certain rugby competitions, notably the international matches of the Australian, South African and New Zealand national rugby teams for the years 2000 to 2002.

4.74. As explained above, the list of rights at Appendix 4.5 relates only to Canal+ in France and does not therefore cover rights held by Canal+ Spain, Telepiu in Italy or other Canal+ subsidiaries and associated companies in other countries. Vivendi told us that Canal+ Spain, for example, holds sports rights

for the national football championship, basketball and bullfighting; and the main sports rights held by Telepiu in Italy include the national football championship, professional golf, boxing, athletics and US basketball.

4.75. In addition, Canal+'s Sport+ subsidiary is a broker/trader in sports rights and buys non-French sports broadcasting rights, on a multi-country basis (though excluding the country of origin). Sport+'s current stock of such rights are listed in Appendix 4.5, Table 2. As there shown, these include the rights to the English FA Premier League outside the UK, which it sells (or sub-licenses) to Canal+ for broadcast in France and elsewhere in the EC: among other broadcasting customers, it sells the FA Premier League rights to News Corporation for broadcast in New Zealand and the USA. Vivendi/Canal+/Sport+ has also acquired broadcasting rights to Spanish, Italian and Portuguese Premier League equivalent football. Highlights from these and other EC football leagues outside the UK—though not generally live matches—are often shown on British Eurosport (see paragraphs 4.77 and 4.78). For Spanish football, Sport+ holds the worldwide exclusive live broadcast rights outside Spain and the American continent, it told us; and has sold (or sub-licensed) the UK broadcasting rights to BSkyB. Vivendi/Canal+/Sport+ has acquired the exclusive broadcasting rights to Italian Premier League equivalent football on a fully worldwide basis, excluding the country of origin (Italy). For the present, Sport+ has sold (or sub-licensed) the UK exclusive broadcasting rights for Italian football to one of the ITV franchisees (United News & Media).

4.76. As mentioned above and in Chapter 3, Vivendi (through Havas Image; see Chapter 3) and Canal+ together have a 59 per cent equity interest (the other shareholders being TF1 and ESPN/Disney) in TV Sport which operates Eurosport France, a sports channel available on satellite and cable networks in France, which itself holds sports broadcasting rights relating to the French market, though it mainly draws on the rights held by Eurosport International (see next two paragraphs) for its programming content. TV Sport/Eurosport France's rights are listed as part of the Canal+ group's French sports rights at Appendix 4.5, Table 1.

4.77. Canal+ also has a one-third equity interest in a company called Eurosport Sales Organisation (ESO) which, in partnership with the Eurosport Consortium, owns and controls the Eurosport International channel. TF1, a French terrestrial broadcaster which manages the channel, and ESPN/Disney also have one-third shares in ESO. The Eurosport International channel is broadcast in over 50 countries, including the UK (on analogue transmission). The Eurosport Consortium is a member of Eurovision, the rights exchange arm of the EBU (see paragraph 4.68: Canal+ is a member of the EBU but not of Eurovision), and is also a major holder of sports rights, including winter sports, athletics, motor sport, tennis and football. Around 20 per cent on average of all Eurosport International's sports rights derive from the Consortium's membership of Eurovision (drawing on EBU rights), the rest being obtained mainly from original rights holders. The vast majority of ESO/Eurosport's rights, it told us, are non-exclusive and there is almost no trading of rights between ESO/Eurosport International and other subsidiaries or associate companies within the Canal+ group (which mainly deal in exclusive rights). Since January 1999, there has also been a UK variant of the Eurosport International channel, called British Eurosport (available on analogue cable networks in the UK, DTT and digital satellite transmission), which is operated by ESO. A contractual joint venture between ESO/Eurosport International and NTL has also been set up to provide funding for the enhancement of the presentation of the British Eurosport channel, with a view to increasing its appeal to UK viewers. Vivendi told us that Canal+ is only a minority shareholder in Eurosport International and that neither Vivendi nor Canal+ has any knowledge of the sports broadcasting rights held by either Eurosport International or British Eurosport.

4.78. Eurosport told us that, in practice, the vast majority of the sports broadcasting on both the French and British versions of Eurosport is the same as on the Eurosport International channel and is based on the same sports rights. Eurosport International told us that it saw the British Eurosport channel as complementary to both free-to-air sports programming and the Sky Sports channels. It added that Eurosport International needed to broadcast largely the same sports programmes across its full network (including the UK and French variants) in order to safeguard its advertising and sponsorship revenues. As a result, it did not expect British Eurosport to compete for premium UK sports rights, either now or in the future, in order to differentiate its programming and to compete more directly with Sky Sports.

4.79. On the nature of sports rights, Canal+ told us that the most important and valuable rights to itself and BSkyB were live and exclusive broadcasting of sports events which were also essentially national in nature, the prime example being the French national football championships (equivalent to the English FA Premier League). For Canal+ operating in France, for example, its rights to the French

championship in France accounted for more than half its sports rights acquisition costs (about £135 million in total in 1998) and two-thirds of its prime time sport broadcasting (Canal+ currently pays about £75 million a year for its French championship rights, but this will rise, it told us, to £180 million a year after 2001). We note that these cost figures exclude the costs of other sports rights held by the wider Canal+ group in other countries. Vivendi added that the value of its French broadcasting rights in other countries (for example, the value of French football in the UK) was only perhaps one-tenth of the value in the country of origin. As a result, it said, Canal+ would not be able to enhance BSkyB's competitive position vis-à-vis other potential bidders for UK domestic broadcasting rights. In any event, it said, sports rights holders generally negotiate domestic and non-domestic rights separately; and both BSkyB and Canal+ faced strong competition for sports rights from free-to-air channels (and particularly the EBU) in their respective national markets. We note, however, that a paper put to the Vivendi management board concerning the acquisition of shares in BSkyB referred in the context of possible cooperation with BSkyB to the emergence of new football competitions, but without any explicit reference to joint bidding for rights (see paragraph 3.160 and Appendix 3.3).

4.80. As regards sporting events of international appeal, such as the Olympics and the FIFA World Cup, many such events, it said, were 'listed' (ie protected for broadcasting by free-to-air services in order to avoid viewer exclusion from the limited viewer coverage of pay-TV: see Appendix 4.6 for details of listed events in the UK—other EC countries have established their own set of listed events) and the exclusive rights could not therefore be bought by pay-TV operators. In Vivendi's view, this severely limited the number of events of genuinely international interest for which pay-TV channels could acquire exclusive rights. We note that, as shown in Appendix 4.6, the number of listed events in the UK is somewhat limited and largely confined to the finals of certain events (for example, the FA Cup and the Wimbledon tennis tournament). We note also that pay-TV is not in any way prevented from showing these events, albeit on a non-exclusive basis.

4.81. Vivendi further claimed that sports rights holders were becoming increasingly sophisticated in their approach to selling such rights. Normally, they negotiated the sale of the domestic rights themselves, but non-domestic rights were often sold through rights agencies/traders (including Sport+), in order to maximize the overall, worldwide value of such rights. These rights agencies and traders included TWI (the market leader), ISL (France), ISPR (Germany), Prisma (owned by Kirch), SFX, Octagon and Global Sports. Vivendi told us that BSkyB and Canal+/Sport+ were only minor participants in what it regarded as a highly competitive market. We note that the BBC took a different view; see paragraph 4.83.

4.82. The portfolio of sports rights currently held by Vivendi/Canal+/Sport+ is in our view extensive and includes many of the higher-value events and competitions for which rights are available to pay-TV. The evidence included in Appendix 4.5 also strongly suggests that sports broadcasting rights can be and are in practice purchased on a multi-country or even worldwide basis, albeit generally excluding the country of origin. Clearly, rights holders have every incentive to sell the rights as widely (ie in as many countries) as possible and at the highest overall value/price. There is also some advantage to rights holders in selling 'blocks of rights' (ie on a multi-country basis) to a single buyer in terms of limiting transaction and marketing costs. In turn, this implies that there is likely to be at least some scope (subject to the constraints arising from competition regulations) for coordinated or joint bidding by BSkyB and the Vivendi/Canal+ group for the UK/EC/worldwide rights to many important sporting events, and also greater scope for the trading of rights between themselves.

4.83. In this context, both the ITC and the BBC, among others (see Chapter 5), expressed concern to us to the effect that the merger would offer unfair competitive advantage to BSkyB/Vivendi in the market for sports rights acquisition. The BBC told us that the main integrated rights holders/sports channel broadcasters within the EC were Eurosport, Canal+, BSkyB, Kirch/Prisma and Bertelsmann/CLT-UFA. Reflecting that, it was concerned that the effects of the Vivendi/Canal+/BSkyB merger (both separately and in conjunction with BSkyB's 25 per cent equity stake in Kirch) would give rise to a high level of concentration in the EC market, which might then lead to a foreclosure of access to key sporting events with respect to other broadcasters, especially public service broadcasters such as the BBC. Underlying this concern, it said, was the current market strength of both Vivendi/Canal+ and BSkyB as EC platform operators, channel retailers and incumbent holders of many of the most valuable sports rights available: the latter in particular conferred market power and a great advantage when bidding for the renewal of rights because of critical mass or 'tipping' effects (meaning that the incumbent, large-scale rights holder would be likely to win an even larger proportion of the rights available when negotiating the rights for a further period).

4.84. In the view of the BBC, major sporting events were increasingly marketed and licensed on a pan-European rather than a national basis. As a result, coordinated bidding for such rights by BSkyB/Canal+ would greatly increase the chances of them acquiring the main rights, because (a) they would have greater knowledge than other bidders of the full economic value of the rights in different EC countries; (b) by block-bidding, they could effect a saving on transaction costs for rights holders; and (c) they could offer guaranteed broadcasting coverage on pay-TV across Europe to rights owners, to sponsors and also to advertisers. Specific detriments identified by the BBC concerned possible market distortions in the context of the soon-to-be negotiated rights for the English FA Premier League and FIFA World Cup Finals for 2002; and the possibility of more limited access to (or a greater price for) sporting highlights for broadcasters such as the BBC. A list of sports rights up for renewal in each of the years 1999 to 2002 is given in Appendix 4.7.

4.85. In its earlier report (see Appendix 4.1), this Commission considered both the nature of the auction process and also possible 'toehold' and 'winner's curse' effects (toehold effects arise from the bidder having a financial advantage as it would be a revenue recipient whatever the outcome of the bidding process; the winner's curse refers to the risk of the winning bidder paying in excess of the 'true' economic value). It concluded that it was difficult to apply conventional economic auction theory because of the complex nature of the bidding/selling arrangements adopted for the broadcasting rights to FA Premier League football. More generally, as confirmed by the evidence obtained during this inquiry, the form of the sports rights for a given event/competition—as well as the price—are often themselves part of the complex (and largely non-transparent) negotiations between rights holders and possible buyers. Hence, different bidders may want the rights for different time periods, or want rights to only particular matches/events or the delayed highlights; some will be interested only in the rights in the country of origin, whilst others may be seeking only the broadcasting rights for other countries. In general, bidders that require the widest combination of the rights available and also have access to the largest subscriber base are the most likely to be successful in acquiring the main and most valuable rights. Incumbency may also confer an advantage, not least because there is less uncertainty for the rights holders.

4.86. As well as the benefits (including informational advantages) that BSkyB could be expected to gain in the overall rights-selling process from its financial stake in the revenues received from FA Premier League clubs, it may in our view have an inherent advantage as the incumbent owner of exclusive rights and as the major premium sports channel provider to pay-TV in the UK. Moreover, in our view BSkyB's strengths may possibly be enhanced by cooperation and/or joint bidding with the Vivendi group, because of the latter's own incumbency position and its interest in acquiring complementary sports rights.

4.87. Lastly in this section, we consider certain aspects of regulation. We note that the ITC—the main regulator of commercial TV in the UK—has no regulatory role or powers in relation to the market for sports rights acquisition (see Appendix 4.2). Such powers as do exist derive from the general provisions of the UK and EC legislation on competition matters (especially those concerning restrictive agreements and collusion between separate parties), the main authorities being the OFT in the UK and the European Commission (DGIV) within the EC. These powers bear on the activities of both sellers and buyers of sports rights. With regard to sellers, the OFT recently brought an action in the UK under the Restrictive Trade Practices Act 1976 against the FA Premier League—a rights seller—over the collective selling of the football broadcasting rights, the allegation being that this amounted to a restrictive and anti-competitive agreement. In the event, however, the Restrictive Practices Court found in July 1999 in favour of the FA Premier League (see Appendix 4.1, item 2). Within the EC, the European Commission (DGIV) is currently investigating the potentially anti-competitive effects of certain aspects of the way Formula One motor racing is operated. In particular, the European Commission has suggested that the FIA—the ruling body of Formula One—has used its power to acquire all the TV broadcasting rights to international motor sports events: the case is ongoing and no final ruling has been announced.

4.88. As regards buyers of sports rights, the EBU (see paragraph 4.68) undertakes collective bidding—on behalf of public service, free-to-air services within the EC—for sports rights of a pan-European interest (and currently holds the rights to a wide range of events, especially in relation to athletics, cycling, equestrian events and Alpine skiing). This collective bidding arrangement was considered and subsequently permitted by the European Commission in 1993,<sup>1</sup> but this ruling was later annulled by the European Court of First Instance in 1996.<sup>2</sup> The EBU appeal to the European Court of

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<sup>1</sup>93/403/EEC: Commission decision (IV/32.150—EBU/Eurovision system). OJ No L 179 p23, 1993/07/22.

<sup>2</sup>Judgment of 11 July 1996, ECR 1996 pII—0649.

Justice against this judgment is still pending.<sup>1</sup> In this context, we note that joint bidding for sports rights by Vivendi and BSkyB—when operating as separate corporate entities—could be subject to regulatory scrutiny by the relevant competition authorities.

## **Premium film channels and rights acquisition**

4.89. As mentioned earlier (paragraph 4.31), film broadcasting rights—and the links with premium film channels on pay-TV—are of particular relevance to this inquiry. Film rights/content are essential for TV film programmes and channels; and, as considered further below, a potential barrier to new entry for sports channels is the cost and difficulty of acquiring a portfolio of attractive TV broadcasting rights—which are usually specified for a fixed time period of several years and therefore only become available for acquisition on a periodic basis.

4.90. In general, such rights are characterized by elements of exclusivity. They are, for example, generally defined and bought and sold (and otherwise traded) on a national, territory or language basis. They are also often purchased (other than for PPV; see paragraphs 4.96 and 4.97) on an exclusive or semi-exclusive basis in that broadcasters other than the buyers are precluded from showing the content in a given time period and within a specified territory. The highest value film rights tend to be those for exclusive broadcasting of the most recently released and most popular Hollywood feature films ('blockbusters'). On substitutability between different types of content, film rights—and therefore film programmes/channels—are not considered to be ready substitutes for other types of TV rights/content/programmes on either the demand or supply side. As a result, film rights constitute a separate economic market, albeit that there are close links with the market(s) for film programmes and channels.

4.91. Within film rights taken as a whole, there is a wide diversity of alternative programme material, ie recently released Hollywood feature films (which themselves may differ greatly in terms of their appeal to viewers); old films; special interest films (for example, children's and sci-fi films); and foreign language films. Different films may in some instances be regarded as substitutes on the viewer demand side, whilst others are more complementary in their nature. Where there are effective substitutes available (for example, old films), the market operates in a flexible way and prices are generally lower. Where, however, there are few effective substitutes and there is strong demand (for example, recent Hollywood 'blockbusters'), the original rights holders/sellers are in a strong position, and prices for the broadcasting rights are as a result far higher than for other film rights. As a consequence, the programmes/channels based on these rights may be characterized as either 'basic' (low cost, low viewing appeal) or 'premium' (high cost, high viewing appeal); see also paragraph 4.94.

4.92. As with sports broadcasting (see previous section), both Vivendi and BSkyB are major providers of film programming and channels on pay-TV, and both have secured the broadcasting rights to an extensive range of feature film material. As explained below, however, their respective film programmes/channels serve different national markets. In the UK (and also other EC countries), demand for pay-TV feature films has grown considerably in recent years and seems also to be relatively insensitive to price changes, at least at current prices. Indeed, the strength of demand for film channels has been one of the main factors leading to an increase in the pay-TV subscriber base in the UK.

4.93. BSkyB's premium film channels on its digital service include two subscription-based, multi-channel services (Sky Premier and Sky MovieMax), and also a PPV service (Sky Box Office): PPV charges are typically around £3 per film viewing, which is similar to the charge for video rental. The first two channels are available on all three UK pay-TV delivery platforms (DTH, cable networks and DTT) and represent by far the main premium film channels by value which are accessible by UK viewers: Sky Box Office is available on DTH and CWC's cable network. Rival premium channels on pay-TV include u>direct (a recently-launched, independent PPV service) which is available only on the DTH digital platform; Film Four, a subscription-based channel, launched in November 1998 and owned by Channel 4, which is available on all three platforms; and Front Row, a PPV service launched in 1998 and available only on the NTL and Telewest cable networks, and which is a joint venture between these two cable operators. ONdigital has also announced plans to launch a limited PPV service (to be called ONrequest) on the DTT platform, as a joint venture with SDN (which is one-third owned by NTL).

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<sup>1</sup>Case C 320/96. OJ No C 354 p18, 1996/11/23, Notice 96/C 354/35.

4.94. All BSkyB's premium film channels, as well as Front Row and u>direct, show primarily Hollywood feature films which have been released fairly recently (known as 'output films'). Other, non-premium film channels on pay-TV typically show 'library' films (Film Four, Bravo, UK Gold, Carlton Cinema and Turner Classic Movies) or special interest films (Disney Channel and the Sci-Fi Channel).

4.95. Free-to-air channels are actual or potential competitors to BSkyB/pay-TV in the market for film rights to only a limited extent, in that they show fewer feature films and the films they show are less recent than those shown on pay-TV. Pay-TV operators are able:

- (a) to offer a higher price for broadcasting rights than free-to-air services, financed from channel-related subscription revenues (or programme-related revenues via PPV); and
- (b) to broadcast such films more effectively and comprehensively on its greater channel capacity (which also has NVOD and PPV capability).

For many of the higher-value film broadcasting rights, therefore, the cable networks and DTT are more likely competitors to BSkyB's film channels. Although cable operators appear to have shown little interest in the past in developing their own premium film channels, this is changing, partly as a result of the considerable and recent consolidation within the cable sector: NTL in particular is becoming increasingly involved with films through its interests in both the Front Row and ONrequest film channel ventures.

4.96. There have been several examples of new entry into the pay-TV film channel market over the past year or so. One such entrant has been Film Four, a subscription-based channel drawing on its existing film library. However, the others (Front Row, u>direct and the planned ONrequest channel) are all PPV services based on non-exclusive broadcasting rights. In the wider context of emerging technologies, NVOD/PPV services are also being developed or introduced using ADSL (see paragraph 4.26). This appears to suggest that there are no major or insuperable barriers to market entry based on PPV/non-exclusive film rights.

4.97. On the general market for film broadcasting rights, BSkyB told us that such rights are usually granted/bought on an exclusive basis (other than for PPV) for a period of several years, and in respect of specified national or language-based territories. Rights are also sold by the film studios, it said, by reference to broadcast time 'windows', so as to maximize their revenue for each film, by enabling the studios to charge different prices to different buyers. New films are typically first shown at US and UK cinemas for up to 12 months (the release date often varies between different EC countries), before becoming available on video for rent/purchase for a further period of up to 12 months (the video window). During the second half of the video window, some films may be released for PPV broadcasting (for example, on Sky Box Office and Front Row). Following that, there is the subscription-based pay-TV window (for example, for broadcasting on Sky MovieMax) which lasts for 15 months. After the pay-TV window, films become available for broadcasting (under licence) on free-to-air services for a period of five years. After that, films become regarded as library stock (ie old films).

4.98. Sometimes, BSkyB told us, broadcasters buy exclusive rights for more than a single 'window': ITV bought all the 'window' rights (PPV, pay-TV and free-to-air), for example, to the James Bond film series on an exclusive basis. Details of BSkyB's current film rights, together with those that BSkyB expects to become available over the next three years, are given in Appendix 4.8. As there shown, BSkyB has time-limited contracts covering an extensive range of films with all the major Hollywood film studios, including Twentieth Century Fox, owned by News Corporation. It also has agreements with a few smaller distributors, including Dreamworks, New Line, Polygram and Pathé. Additionally, BSkyB itself has started to produce films, albeit on a small scale and primarily for the UK market (for example, films such as *Tube Tales* and *Milk*). As with sports rights (see paragraph 4.64), BSkyB's film rights relate essentially to the UK/Ireland and are English language rights only: at present, BSkyB itself has no pan-European or worldwide rights. We note, however, that BSkyB's largest shareholders, News International and News Corporation, themselves hold film broadcasting rights outside the UK—within the EC and elsewhere.

4.99. All BSkyB's subscription-based pay-TV film rights are on an exclusive basis (though all the films are available on video for rent). Its PPV film rights are also on an exclusive basis with respect to DTH transmission: u>direct, for example, could not therefore show the same films on DTH/satellite

within the same PPV ‘window’. But otherwise, its PPV rights are non-exclusive, so that they are available for showing in the UK on other pay-TV delivery platforms (cable networks and DTT). As indicated in paragraph 4.96, we believe that there are no major or insuperable barriers to market entry based on PPV/non-exclusive film rights.

4.100. As regards the purchase process for film rights, BSKyB told us that contracts for future rights are negotiated in advance of the time at which they become available. Existing rights owners and other possible buyers are invited to discuss packages of rights in which they are interested, and to offer financial terms. The numbers of subscribers to bidders’ services and the prospects for PPV revenues are important factors in determining the value to individual broadcaster bidders. Ultimately, the terms agreed are an outcome of these negotiations. The form of the fees paid for rights may often be a flat rate charge (for example, £x per film per year) or a mixture of a flat rate fee and a share of revenues, especially for PPV rights: BSKyB’s costs of film programming (including PPV) were around £240 million in 1999. In BSKyB’s view—and ours also—rights holders of popular and recently released films are in an inherently strong negotiating position relative to broadcaster buyers. They also sell the rights, it said, on a country-by-country basis or by language area; and in these circumstances, BSKyB said, it saw few prospects of commercial gain from itself and the Vivendi group bidding jointly for film rights.

4.101. We note, however, that although film rights are often nominally designated (and priced) in terms of individual territories or countries, many US films are popular in a large number of countries which suggests that there is scope for rights to be purchased on a multi-country basis. The popularity of individual films no doubt varies between different countries for cultural or other reasons, but the use of dubbing and subtitles largely overcomes the obvious language problems. We consider further the scope for joint bidding by BSKyB and the Vivendi group in paragraph 4.109.

4.102. On the implications for new entry in this market, CWC (one of the three main cable operators) told us, in the context of the parallel inquiry on the proposed merger between NTL and CWC, that it believed that each of BSKyB’s exclusive film rights contracts with the major Hollywood studios were of a relatively long duration; and that the renewal dates were also spread over time. As a result, particularly of the latter, it was difficult for other broadcasters to get hold of these rights: a rival channel would need, it said, to sign up with at least three studios in order to establish a new, subscription-based film channel of the type operated by BSKyB. We note that there are only six major US studios, of which one (Twentieth Century Fox) is owned by News Corporation and another (Warner Studios) has a joint venture with Canal+ (see next paragraph). Both BSKyB and Vivendi stated that, in their view, entry was possible without signing deals with all the major studios.

4.103. Turning to Vivendi, Canal+’s extensive film interests and channels (including the buying of film broadcasting rights) are operated through the Canal+ group, which, as mentioned earlier (see paragraph 4.46), also has interests—within the EC, but outside the UK—in cable networks, terrestrial broadcasting and a DTH platform. Its channels are broadcast in 12 national territories, including various EC countries other than the UK. Canal+ buys film broadcasting rights for the French market and also other EC markets outside the UK: its annual spend on film rights for broadcasting in France in 1998 was around £170 million. Its Le Studio Canal+ subsidiary also produces French films and has a joint venture in the USA (called Bel Air) with Warner Studios, which aims, it told us, to produce around four to five films a year. Two further Canal+ subsidiaries, called Canal+ Image International (itself comprised of a group of subsidiaries) and Canal+ International Acquisitions (hereafter in this section collectively referred to as simply Canal+), both buy and trade in film rights on an international basis.

4.104. Canal+’s channels—on which films to which it has rights are shown—include Canal+ itself (a subscription-based premium channel comprising sports coverage, feature films and other programme material); Kiosque (a PPV service, which also has output deals with Hollywood studios which are separate from and additional to those of Canal+ itself); and CineCinema and CineClassics, which are both edited by Multithématiques. None of these are available to UK viewers. On pay-TV film rights, Hollywood films are a key driver, it said, for pay-TV in most countries, including France. Accordingly, Canal+ has, it told us, entered into five-year exclusive contracts for ‘output films’ with five Hollywood studios (Twentieth Century Fox, Warner Studios, Universal, Buena Vista and Columbia). Under these contracts, Canal+ has exclusive rights, for pay-TV broadcasting (within the relevant film ‘windows’) of recently released films by these studios in France. We note that the European Commission has estimated that Canal+ had rights in France to 86 per cent of recent Hollywood output: Vivendi told us that since then, the share of film rights for subscription-based pay-TV held by TPS (a rival satellite platform

operator in France) had risen to about 50 per cent. It added that in the French market the broadcasting regulations required that 60 per cent of films shown on pay-TV had to be of EC origin and 40 per cent had to be in the French language; there are also restrictions on the broadcasting of films at certain times of the week. Moreover, Canal+'s purchasing of films shown by the Canal+ channels in countries outside France, it said, varied from country to country, because purchasing was under the control of the local subsidiary or associated company concerned.

4.105. In addition to these purchased rights, the Canal+ group has a catalogue/library of around 5,300 films (including the UGC film stock) of which nearly 30 per cent are US films (for over a quarter of which Canal+ has multi-territory rights); and over 3,000 hours of TV programme material. Exploitation of this catalogue, Canal+ told us, is mainly by sales of broadcasting rights outside the Canal+ group. A significant proportion of the UK film rights which Canal+ owns are not English language films, it told us. It added that in 1998 sales of film rights to BSkyB concerned only 19 films, for a total amount of under £200,000.

4.106. With regard to the market for film rights, Vivendi/Canal+ told us that rights holders (the studios) had the upper hand in the negotiations on financial terms, and almost always held separate negotiations for the rights to each national territory or language area. Canal+ considered that the major film rights holders would not agree to tying in the broadcasting rights for the UK—a major market in its own right—to those of other EC countries. Accordingly, it stated that it saw no gain from Vivendi/Canal+ and BSkyB undertaking joint bidding for film rights. We note, however, that a paper put to the Vivendi management board concerning a possible merger with BSkyB indicated that the acquisition of film rights from the major US studios was an area of possible cooperation between Canal+ and BSkyB (see Appendix 3.3), and specifically it said that 'the purchasing power of the two groups should enable them to strengthen their position vis-à-vis the American suppliers'.

4.107. The views of third parties are summarized in Chapter 5. The ITC told us that it had concerns about the possible market power of the combined group in the market for film rights acquisition. The ITC told us that it was anxious to see the development of greater competition in this market, and was encouraged that the market had recently begun to open up with greater involvement by NTL/Telewest and more recently ONdigital. Its concerns about the Vivendi/BSkyB linkage arose from the scale of their existing film rights and the extent of their vertical integration from film production and rights holding, through channel provision, down to control of delivery platforms.

4.108. It is difficult to apply conventional economic auction theory to the acquisition of film rights because of the complex nature of the bidding/selling arrangements. The form of film rights—as well as the price—are often, for example, themselves part of the complex (and largely non-transparent) negotiations between rights holders and possible buyers. As part of this complexity, different bidders in a given territory may want the exclusive rights for subscription-based pay-TV; or the non-exclusive rights for PPV broadcast; or want rights to only particular films. Moreover, some will be interested in the rights in only a single country or language territory, whilst others may be seeking the broadcasting rights for a 'package' of other countries. In general, bidders that require the widest combination of the rights available and also have access to the largest subscriber base are the most likely to be successful in acquiring the main and most valuable rights. Incumbency may also confer some advantage, not least because there is less uncertainty for the rights holders.

4.109. As in the case of sports rights, the portfolios of film rights currently held by BSkyB and Vivendi/Canal+ are in our view extensive and include many of the higher-value films. As noted in paragraph 4.101, there is scope for film broadcasting rights to be purchased on a multi-country or even worldwide basis. Clearly, rights holders have every incentive to sell the rights as widely (ie in as many countries) as possible and at the highest overall value/price. There is likely to be some advantage to rights holders in selling 'blocks of rights' (ie on a multi-country basis) to a single buyer in terms of limiting transaction and marketing costs. In turn, this implies that there is likely to be at least some scope (subject to any constraints arising from competition regulations) for co-ordinated or joint bidding by BSkyB and the Vivendi/Canal+ group for the UK/EC/worldwide rights to many important feature films, and also greater scope for the trading of rights between themselves. Rights holders, as mentioned earlier, are, however, often in a strong bargaining position. Nonetheless, BSkyB's strengths may possibly be enhanced in our view by cooperation and/or any joint bidding with the Vivendi group, additional factors being the latter's own incumbency position and its interest in acquiring complementary film rights.

## Conditional access/applications program interface/access control services

4.110. Conditional access (encryption) systems allow a pay-TV operator (whether DTH, cable or DTT; and also free-to-air services on the DTH platform, in order to avoid infringing territorial broadcast rights) to authorize or prohibit the unscrambling of programmes in order that only those subscribers with a set-top box/smart card and a valid subscription can watch the programmes transmitted. It is therefore an essential technology for the raising of subscription fees, PPV charges and other pay-TV revenues. Application program interface software, or interactivity software, allows the viewer (via the set-top box's remote control) to access interactive services such as electronic programme guides, home shopping, banking, video games etc. Interactive services are primarily available on digital transmission services, and in this section we consider only digital services. Transactions associated with these services are controlled through access control systems, which typically use the same encryption technology used for the main pay-TV services.

4.111. In the context of market definition, conditional access is therefore a particular and specialized application of digital technology, which has become increasingly sophisticated and for which, on the demand side, there are no technical or economic substitutes. On the supply side, moreover, the development resources and time needed to establish a new system and the associated software also suggest that the supply of conditional access systems is a distinct market, separate from other applications software such as those used for interactive and access control services.

4.112. In the UK there are three different (digital) conditional access systems in use. The digital networks being developed by the three main cable operators use a system called NagraVision (licensed from a Swiss-based company (Kudelski SA), and which does not use smartcards); BSkyB/DTH uses the system developed by NDS (for which News Corporation is the majority shareholder) called VideoGuard; and ONdigital has adopted the SECA system (Canal+ has a 50 per cent equity holding in SECA) called Mediaguard, as well as Canal+'s applications program interface software, called Mediahighway (the two are designed to work together). Vivendi told us that in other EC countries a number of other conditional access systems exist, such as ViaAccess, Irdeto and Betacrypt, each of which performs similar functions. We note, however, that the NDS and SECA systems together account for more than 60 per cent of all pay-TV subscribers within the EC, and also for a far higher proportion of non-cable network subscribers. Vivendi also told us that its Mediaguard software is flexible and can be tailored to the needs of particular operators, such as ONdigital: a customized version of Mediaguard, for example, was developed specially for ONdigital.

4.113. ONdigital told us that the effectiveness of its conditional access technology—and having a committed and reliable supplier—was critical to the success of its business, because of its implications for both the efficient operation of its pay-TV services and also the continuing development of additional, interactive services. In this regard, ONdigital expressed concerns about the merger situation (see also Chapter 5). It told us that BSkyB had originally been part of the ONdigital consortium which had applied for the DTT licence, and that it had at that time actively promoted the use of the NDS system for the DTT platform. Just prior to the awarding of the DTT licence, however, BSkyB had been required on competition grounds to leave the consortium as a condition of the licence being granted to ONdigital.

4.114. At that time, ONdigital started to take a more independent view, it said, and to consider other possible systems: the short-list drawn up included Cryptoworks (Philips) and ViaAccess (France Telecom), as well as the NDS and SECA systems. The Philips and France Telecom systems were quickly eliminated, however, because they appeared to be technically unsuitable and their operators, in ONdigital's view, also lacked experience in system integration. Hence, SECA (Mediaguard) and NDS (VideoGuard) appeared to be the only credible options, in ONdigital's view, which were both appropriate for its planned DTT service and which had the requisite functionality.

4.115. Ultimately, it said, one of the reasons it had chosen Mediaguard was that it was concerned that conflicts of interest might have arisen from choosing VideoGuard, because of the linkage between BSkyB and NDS (both of which have ownership links with News Corporation). It considered that no such conflicts would arise with Mediaguard/SECA, because Canal+ had no direct involvement in UK pay-TV businesses, and it believed therefore that SECA was likely to provide a higher level and quality of support in the critical months following ONdigital's launch (late 1998) and also thereafter. In addition, the SECA system seemed to offer certain technical and cost advantages, in ONdigital's view, over that of NDS. In the event, therefore, ONdigital agreed a renewable, [ ]-year contract with SECA/Canal+. As regards costs, ONdigital told us that fees paid under the contract were £[ ] million in each of the financial years 1998/99 and 1999/2000, and are expected to be £[ ] million in 2000/01.

4.116. ONdigital's central concern about the Vivendi/BSkyB merger situation was that conflicts of interest might re-emerge, to the detriment of ONdigital's UK pay-TV business. Specifically, its concerns were twofold:

- (a) that the quality of SECA's technical service provision might deteriorate (from what ONdigital regarded as its currently high and fully satisfactory standard); and
- (b) that there might be a leakage of commercially sensitive information through SECA/Canal+ to one of its main commercial rivals, BSkyB.

4.117. As regards technical service provision, ONdigital provided an outline schedule of a series of technical projects and system developments over the 1999/2000 period, all of which, it told us, involved substantive technical input from SECA/Canal+. It said that each of these projects was important to the development of its business, and that many had interdependent critical paths, so that a minor delay in one could result in serious disruption to other projects. ONdigital's concern was that were SECA/Canal+ to do perhaps no more than downgrade slightly the priority to be given to the development work on ONdigital's system, this could have a significant adverse effect on the development of ONdigital's pay-TV business.

4.118. With ONdigital's agreement, we put this project schedule to the ITC for its comment. In response, the ITC confirmed that the stages/projects listed in each of the service segments (PPV, electronic programme guide, conditional access software, e-mail etc) appeared to be reasonable. It added that the timetable proposed seemed realistic, though very ambitious and therefore susceptible to any minor delay in the critical path of delivery, which was a matter of some concern to the ITC. We note that many of the projects relate to 1999 and that most others are due for completion by March 2000, though the nature of such systems suggests that there is likely to be a periodic need for future upgrades and further enhancements.

4.119. On the general question of service provision, Vivendi commented that SECA had a [ *Details omitted. See note on page iv.* ] contractual relationship with ONdigital, and was fully committed to ensuring high standards of technical service provision throughout the full period of the contract. It added that whatever the relationship between Vivendi and BSkyB, SECA would have no commercial incentive to downgrade its service provision to ONdigital, which it regarded as an important customer (not least because it was the world's first DTT operator); and poor service by SECA would risk damaging its reputation as a quality supplier of conditional access systems.

4.120. Indeed, it said, were SECA to fail to meet the contract terms (which were supplied to us but which are not included in this report), [

*Details omitted. See note on page iv.*

]. As a result, ONdigital was not, in Vivendi's view, in any way tied to using the SECA software.

4.121. On the question of Simulcrypt, ONdigital stated that the key issue in relation to other conditional access systems is that once established on a platform, it is difficult and extremely costly to change to an alternative supplier. Simulcrypt, it said, could possibly provide a means of introducing another system in parallel with (but probably not instead of) the SECA system. It did not, however, provide for the use of an alternative conditional access system within the existing set-top box population (or installed base); nor did it remove the need to support this set-top box base with applications such as PPV and games written in Mediahighway. As a result, it said, the most feasible means of changing systems was to change the set-top boxes (see also paragraph 4.127) (which both platforms provided to subscribers free of charge). The ITC commented that Simulcrypt could possibly provide a means of allowing another service provider using a different conditional access system to access subscribers using the same set-top box. However, they would have to continue to use the same conditional access system (SECA, for instance) and the service would have to be sold through the existing operator's conditional access system and smart cards.

4.122. As regards ONdigital's second area of concern—that there might be leakage of commercially secret information through to BSkyB—ONdigital gave us some examples of where it considered this might arise and be potentially damaging to its interests. In general terms, it said, conditional access was

so fundamental to its business that almost any new development by ONdigital (for example, on services, marketing or technical developments) required some technical input from SECA. As a result, it was essential that there was trust and openness between ONdigital and its conditional access provider: contract provisions could not adequately deal with these issues. SECA would, for example, need to be notified in advance of any special promotions to be offered by ONdigital (for example, the offering of premium channels free or at reduced cost). Advance notice of that would be of benefit to ONdigital's competitors but highly damaging to ONdigital itself. Similarly, knowledge of likely technical developments in ONdigital's set-top boxes—and the timing of such developments—would give a commercial and competitive advantage to its competitors. Equally, if not more important, was that any advance notice given to its competitors of the launch of new services (for example, enhanced interactive services) by ONdigital would be highly damaging. It added that although OFTEL and the ITC regulated some aspects of conditional access services (see Appendix 4.2), the relationship between itself and Canal+/SECA was not covered by such regulation. The ITC itself also expressed concern about the possible leakage of commercially confidential information through to BSkyB.

4.123. Vivendi told us that the commercial relationship between SECA and ONdigital was necessarily close, but was not such that SECA would be able to obtain confidential information about ONdigital's business. In part, this was because SECA did not provide subscriber management services to ONdigital (or its other conditional access customers). Vivendi added that whilst it would normally have some information on the number of ONdigital's subscribers, this was not confidential and was widely available. Moreover, it said, there are also safeguards in place—based on secure access codes—which prevent SECA from accessing ONdigital's system without its knowledge and agreement.

4.124. More generally, Vivendi/Canal+ told us that it saw the SECA (Mediaguard) and NDS (VideoGuard) systems as competitive rivals in the worldwide market place and that it expected this to continue in the future. Vivendi stated that it did not envisage, as a result of the Vivendi/BSkyB merger situation, that there would be technical cooperation between SECA and NDS, not least because NDS was part of News International rather than BSkyB. It followed that technical convergence between the two rival systems was unlikely. We note, however, that a paper put to the Vivendi management board concerning the acquisition of shares in BSkyB indicated that decoder technology was an area of possible cooperation between Canal+ and BSkyB (see Appendix 3.3). The paper stated that 'The two competing technologies developed by SECA and News Corp (NDS) should converge so as to permit joint developments for the next generation of decoders. The formidable subscriber base of the two groups (20 million) should facilitate the introduction of even more powerful decoders, thus enabling them to bring in still more substantial services which have to be paid for.'

4.125. The BBC expressed concerns to us about the impact of the Vivendi/BSkyB merger situation on the EC-wide market for conditional access services and the potential for damage to ONdigital's service. It said that conditional access providers were in a crucial gatekeeper position in relation to pay-TV services, which is why EC regulation had been introduced. Canal+/SECA and NDS were by far the two largest systems operating in the EC, and between them controlled access for 18 million subscribers (including those currently on analogue systems). Only three other providers existed (ViaAccess, Irdeto and NagraVision), whose subscriber bases were considerably smaller and more locally defined. The BBC was concerned that closer ties between SECA and NDS would greatly strengthen their gatekeeper positions within their respective markets, reducing the potential for competition between them and raising the barriers to potential third party entry by requiring a greater scale of investment for such entry. The vertical integration between platform operators and providers of conditional access further strengthened their gatekeeper position, it told us, and gave scope for monopolistic abuse (notwithstanding the existence of EC regulation).

4.126. As regards ONdigital, the BBC suggested that Vivendi would face possible conflicts of commercial interests. Although these were complex in nature, the BBC felt that Vivendi's strategic interests would be likely to be best served by maximizing the value of its 25 per cent stake in BSkyB. This might well be achieved by undermining the DTT/ONdigital platform by failing to provide an adequate level of technical support and development. Even minor delays on application development could, it said, have a very serious and damaging effect on ONdigital's business.

4.127. At the extreme, should ONdigital be forced to consider switching to a different conditional access system, the costs, in the view of the BBC, would be prohibitive because of the need to change its population of set-top boxes. A similar view was expressed by both the ITC and ONdigital itself. The costs of replacing ONdigital's current stock of set-top boxes (including 0.5 million already with DTT

subscribers and a further 0.25 million committed purchases) could amount to around £150 million, aside from the costs of reconfiguring its systems. Also significant, though less easy to quantify, would be the losses of subscriber revenues arising from the likely damage to its reputation among both its existing and potential customers.

4.128. The BBC added that it regarded these concerns as serious and that the only effective remedy should the merger situation be allowed to stand would be for Vivendi/Canal+ to be required to sell its stake in SECA, since behavioural remedies were not likely to be feasible or effective.

4.129. BSkyB told us that it saw no reason for competition concerns to arise with respect to conditional access services, as a result of Vivendi taking a 25 per cent stake in BSkyB. The provision of such services by Canal+/SECA to ONdigital, it said, was subject to legally enforceable contract terms, thereby ensuring that SECA would provide adequate maintenance and support to ONdigital's system. As regards how BSkyB saw its own interests, it told us that it would not be beneficial to BSkyB for ONdigital to fail in any sense. ONdigital appeared to have tapped a new segment of the potential subscriber base, and because it carried a number of BSkyB channels its continued expansion was leading to further growth in BSkyB's overall channel subscriber base (and revenues) without seeming to damage its platform subscriber base. On the possible leakage of confidential information, BSkyB said that this seemed implausible, since SECA would not, for various reasons, have access to confidential information about ONdigital's business which would be of value to BSkyB; and in any event, conditional access providers were bound by contract terms and other legal obligations which precluded disclosure to third parties.