Completed acquisition by British Sky Broadcasting Group plc of TV channel business of Virgin Media Television

ME/4568/10

The OFT's decision on reference under section 22(1) given on 14 September 2010. Full text of decision published 5 October 2010.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. British Sky Broadcasting Group plc ('Sky') is a diversified media and communications company, with subsidiaries mainly active in the creation, wholesale supply, and broadcast of linear television (TV) channels;[1] the retail distribution of its and third parties' linear pay TV channels via direct to home (DTH) satellite, the internet, and mobile technologies; the retail distribution of video on demand (VOD) content; retail telephony and broadband services; the provision of conditional access, access control and electronic programme guide (EPG) services to broadcasters and interactive service providers on Sky's DTH platform and the sale of advertising and sponsorship on Sky's and third parties' channels and websites, through Sky Media.

2. Virgin Media Television ('VMTV') was a subsidiary television channel business of Virgin Media Inc ('Virgin Media'). The VMTV channels (together with certain high definition (HD) and time-shifted versions) are mainly pay TV (subscription) channels, namely LIVING, LIVINGit, Bravo, Bravo 2, Challenge, Challenge Jackpot and Virgin 1 (a free-to-air ('FTA') channel).

[1] A 'linear' television service is that where TV programmes are broadcasted at scheduled times on specific channels.

Virgin Media also owns Interactive Digital Sales Limited ('IDS'), an advertising sales house, which currently sells airtime and programme sponsorship on the VMTV channels, and also on the UKTV channels in which Virgin Media has a 50 per cent stake. Virgin Media is also active in providing television, broadband and fixed line telephony services over its large UK cable network, and in mobile telephony services.

TRANSACTION

3. Sky has purchased the assets and share capital of various entities comprising most of the business of VMTV, excluding certain rights and assets (the 'target business'). The transaction does not include Virgin Media's interest in the UKTV joint venture, nor the IDS sales house business. In parallel with the transaction, Sky and Virgin Media have also agreed carriage terms for the future supply by Sky of its basic TV channels, including the acquired channels, to Virgin Media cable TV service.

4. The acquisition agreement was announced publicly on 4 June 2010, and the transaction completed on 13 July 2010. The OFT received a satisfactory submission from Sky on 20 July 2010 and the administrative deadline for the OFT's decision is 14 September 2010.

JURISDICTION

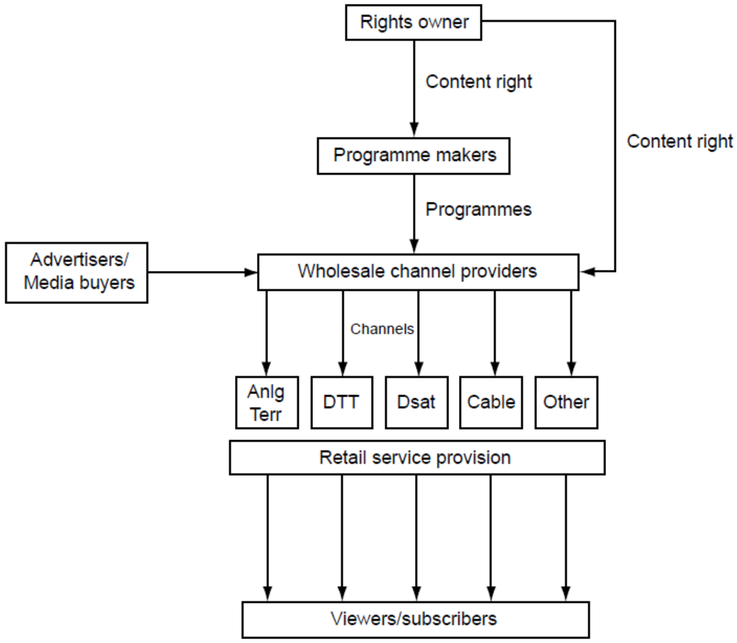
5. As a result of this transaction Sky and the VMTV target business have ceased to be distinct. The UK turnover of the VMTV target business exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied.

MARKET DEFINITION

Background

6. The structure of the television supply chain is shown in Diagram 1 below:

The television supply chain



Source: CC based on Ofcom diagram.

Diagram 1

7. The target business is a wholesale channel provider, whereas Sky is vertically integrated and active in rights acquisition, programme commissioning, wholesale channel provision and retail service provision.

Product scope

Background

8. As a preliminary remark, the OFT notes that market definition provides a useful tool for conducting a competitive assessment but is not an end in itself. Market definition may provide a framework for analysing the direct competitive pressures faced by the merged firm by considering its market share relative to the shares of other suppliers active in the market. However, in television channels, market shares may not be a good indicator of the likelihood of unilateral effects for two reasons: firstly, because television channels are differentiated, (given branding and/or differing actual or perceived quality); and secondly, because television channels are provided in bundles (at the retail and wholesale levels), which can differ in scope from one supplier to another. So bundles of channels differ between suppliers and the channels themselves differ.

9. When looking at product market definition in this instance, it is important to recognise that any market for television channels is likely to be 'two-sided', meaning that television channels cater for two sets of customers, audiences and advertisers. The different sides of the market are inherently inter-related, since the amount that advertisers are prepared to pay is linked to the size and demographics of the viewing audience and because audiences view television channels for their content, not for the advertisements that they carry.

10. In addition, in terms of background and market dynamics, it is important to note that FTA broadcasters rely exclusively on advertising for revenues (with the exception of the BBC that is a publicly-funded broadcaster) whereas subscription television channels generate revenue from subscriptions, via carriage fees paid by retail operators, and advertising.

Overlaps

11. The transaction gives rise to a horizontal overlap between Sky and the target business in the wholesale supply of television channels and in the sale of television advertising.

12. There is also an overlap in relation to FTA channels between Virgin 1 and Sky's FTA channels (that is, Sky 3, Sky News) and in the acquisition of content rights, but as the segment shares and increment are extremely small these are not discussed further.

Wholesale supply of television channels

13. In respect of the wholesale supply of television channels, the main overlap between Sky and the target business relates to the supply of 'basic pay' channels. Pay TV channels are only accessible by viewers who have a subscription to a relevant channel package on a retail pay TV service. Basic pay channels are broadly those which do not offer 'premium' sports or movies content, or other specialised content for which additional subscription fees are required.

14. Sky submits that the relevant frame of reference is 'at least, the production and supply of general entertainment television channels, whether pay or FTA.' Under such an approach it identifies BBC1, ITV1 and Channel 4 as

providing the greatest direct competition to the merged entity in terms of audiences and programme content acquisition. Sky argues that although the VMTV channels are predominantly basic pay TV channels, they are dependent on advertising revenues for their commercial viability and hence on their success in attracting viewers in competition both with other pay and with FTA channels.

15. The OFT notes, in this respect, that FTA channels differ in one significant respect from channels for which a subscription is required in that they do not attract carriage fees. In addition, the OFT notes that it is examining the wholesale supply of television channels as an input to pay TV retailing so that any substitutability from the viewers' or advertisers' perspective between FTA channels and pay TV channels is of less direct relevance than are patterns of substitution by pay TV retailers. However, the OFT notes that there could, nevertheless be indirect constraints from FTA channels on pay TV channels. This is discussed further below.

16. A number of previous competition assessments (by both Ofcom and the Competition Commission (CC)) have examined the issue of market definition in this context and, in particular, whether pay TV and FTA form distinct product markets.

17. In its *December 2007 Pay TV review consultation* documents, Ofcom came to a preliminary view that premium sports and movies channels were in distinct wholesale and retail product markets, which it confirmed in its pay TV statement of 31 March 2010. In respect of the retail of stand-alone basic tier pay TV channels, Ofcom, while noting the constraints from FTA, also pointed, in its December 2007 document, to some significant differentiating aspects between basic pay TV and FTA channels in relation to valuable content.[2] Ofcom noted that this differentiation was reflected in basic tier TV packages commanding a premium of £11 to £21 per month over FTA TV. While Ofcom did not definitively conclude that the retailing of basic pay TV was in a separate market, it did note that this was likely to be the case.

18. In *BSkyB/ITV,*[3] the CC also focussed on the parties' retail offering (albeit noting that ITV does not have a direct relationship with a set of viewing

[2] Ofcom identified Sky 1, UKTV Gold and Discovery as specific examples
[3] *BSkyB/ITV*, Report sent to Secretary of State (BERR) 14 December 2007

customers). It considered it likely that the FTA offer is a closer substitute to packages which contain only basic channels than to those which contain basic and premium channels. The CC's conclusion was that at current prices FTA and pay services compete with one another within a highly differentiated market for 'all TV', including VOD. The CC considered that the 'relatively broad' market for 'all-TV' was the appropriate framework for analysing any loss of competition arising from the BSkyB/ITV merger, but noted that this did not imply that the same market definition should necessarily be used to analyse other mergers in the industry.

19. The OFT's market investigation in this case concerned wholesale supply, not retail supply. In this respect, its results were mixed, with some third party respondents indicating that wholesale supply of basic pay TV channels is the relevant market in which to assess the transaction. This is because for pay TV retailers, FTA channels are not a good substitute for basic pay channels, which they need in order to differentiate their offer from free multichannel (digital) platforms and so to attract subscribers. The OFT notes, however, that even if there is a relevant market for wholesale basic pay TV, account must be taken of the constraints existing from FTA channels (and/or indirectly from FTA platforms at the downstream retail level) and from VOD (non-linear) content, on both pay and free retail platforms. Constraints from VOD content are likely to be strongest for channels offering content which is attractive to viewers but not particularly time-sensitive (for example, series of popular US drama/comedy shows) – a category which arguably includes Sky 1 and LIVING.

20. Taking a conservative approach, nevertheless, the OFT has analysed the merger on the basis of a 'wholesale market for the supply of basic pay TV'. However, given that no competition concerns arise even on the basis of this conservative approach, the OFT has not found it necessary to definitively conclude on whether basic pay TV and FTA form distinct product markets.

Television advertising

21. Sky submits that there is some evidence that internet advertising is becoming an increasingly important substitute for TV advertising. However, the OFT has received no evidence to corroborate this claim, neither from Sky nor from its market investigation.

22. Previous merger reviews have consistently produced findings that the relevant product market is that for television advertising.[4] In *BSkyB/ITV*, the CC noted third party evidence that expenditure with other sales houses was constrained by the possibility of switching to ITV in reaching its conclusion that the relevant advertising market in that case was at least as wide as television advertising.

23. The CC has recently reaffirmed this view in the context of its *CRR review.*[5] The CC concluded that for its purposes the relevant product market remained no wider, and no narrower, than television advertising. The CC did not consider it appropriate to segment the market for television advertising by platform, or by demographic group.

24. The view that the market is no wider than television advertising was also re-confirmed in Ofcom's *Airtime Sales Rules Review*. Ofcom noted that 'internet display advertising does not currently act as a competitive constraint on the price of TV advertising, though it may do so in the future.'

25. The OFT's market investigation generally supported the existing precedent in this respect albeit it did point to some product differentiation for 'direct response airtime' – that is, relatively inexpensive airtime within low rating programming and/or dayparts. This is discussed further in the competitive assessment section.

26. Given the above, the OFT has therefore considered television advertising to be the relevant frame of reference for the competitive assessment in this case.

Geographic scope

27. In past cases, television broadcasting (as currently structured) and related television advertising markets were considered to be national in their geographic scope.[6] As the OFT's market investigation has supported this view, the OFT has considered that the scope of the geographic markets in question are national.

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[4] *BSkyB/ITV* (see footnote 3, above), *Carlton Communications Plc and Granada plc: a report on the proposed merger*, TSO, Cm 5952, October 2003

[5] Competition Commission, *ITV Contract Rights Renewal,* Final Report published 12.05.10

[6] See footnote 5, above *ITV Contract Rights Renewal*

HORIZONTAL ISSUES

UNILATERAL EFFECTS

Wholesale supply of pay TV channels

Market shares

28. Despite the fact that Sky does not agree that there is a distinct market for the wholesale supply of pay TV channels, it has provided the following estimates of the shares of basic pay TV viewing:

Channel	% share by viewing
Sky	12.1
VMTV	12.2
Combined	**24.3**
UKTV	15.7
Viacom	18.0
Discovery	9.4
Disney	9.3
NBC	6.6
Turner	5.9
Other	10.8

Table 1

29. The OFT notes that on the basis of this conservative approach, a combined share of 24.3 per cent would not appear to give rise to competition concerns given the existence of a significant number of other competitors with sizeable shares of viewing.

30. The OFT notes, however, that Sky has a number of equity stakes in joint venture (JV) basic pay TV channels. Sky has argued that these JV stakes should not be attributed to Sky in the OFT's analysis since each JV has its own management team responsible for day-to-day operation and editorial control. However, the OFT notes that Sky's equity stakes are between 25 to 50 per cent, and that it is also represented by directors on the various boards. Given that this level of shareholding (combined with board representation) would typically be sufficient for the OFT to consider that Sky could have 'material influence' on the JVs, the OFT has taken a cautious approach and has also included the JV stakes in its calculations of

Sky's market shares. Shares of revenue taking Sky's equity stakes into account lead to the following shares:[7]

Channel	% share by revenue
Sky (incl. JV channels)	[ ][8]
VMTV	[ ]
Combined	**[40-50]**
UKTV (Virgin JV)	[10-20]
Discovery	[10-20]
Disney ABC	[0-10]
Viacom	[0-10]
Turner	[0-10]
NBC	[0-10]
Other	[0-10]

Table 2

31. On one permutation, concentration levels could be as high as almost [40-50] per cent and this could raise some initial concerns. However, the OFT notes that in differentiated product markets such as these, market shares cannot be determinative of the competitive assessment and particular attention should be given to the actual competitive process. This is discussed in further detail below.

Closeness of competition between Sky and VMTV channels

Demographics

32. In terms of closeness of competition between Sky 1 and LIVING, Sky's internal analysis of the transaction highlights differing demographics of the core audiences for the two channels, implying they don't necessarily compete closely for the same audiences. The documents indicate that LIVING's viewing audience is about [60 – 70] per cent female, compared

[7] If **all** of Sky's JV viewings are attributed to it, then the combined market share could be approximately [30-40] per cent of the total **viewing share**. The revenue attribution, however, accurately reflects Sky's shareholding in each JV. In addition, the OFT also notes that the figure for 'others' in Table 2 includes revenues for the FX channel, a basic pay channel owned by News Corporation. News Corporation owns 39 per cent of shares in Sky. Even to the extent that News Corporation were to have material influence over Sky (so that it would be appropriate to consider the FX channel as being under the same control as the Sky and VMTV channels) there will be no impact on the OFT's analysis given the small share of revenue and viewing of FX.

[8] This includes attribution of revenues from Sky JV channels to each JV partner (including Sky) in proportion with their stakes.

to about [40-50] per cent female audiences for Sky 1 and Sky 2. Sky's submission stated that in attracting a larger proportion of female and older audiences than Sky's existing general entertainment channels, the VMTV channels complement Sky's existing channels and provide Sky with an opportunity to broaden its appeal to audiences.

Sky 1 and LIVING are 'key content' channels

33. Some respondents to the OFT's market investigation submit that the transaction increases the basic pay TV channels that have 'key content' controlled by Sky, that is, that the transaction gives rise to a substantial lessening of competition for the wholesale supply of pay TV channels because either of Sky 1 and LIVING need to be part of a pay TV retailer's portfolio of channels (as they both have key content that viewers are willing to pay for).

34. In assessing this claim, the OFT notes that Sky 1 and LIVING are the two most popular basic pay TV channels by viewer numbers. However, the OFT also notes the following:

- Ofcom consumer research identified significant consumer valuation for other basic pay channels such as UKTV Gold and Discovery, implying that Sky 1 and LIVING are not an exclusive set of 'key content' basic pay TV channels

- Ofcom's 2007 initial views on market definition for wholesale basic TV channels imply that control of individual highly valued basic channels was not considered sufficient to potentially confer significant market power. In addition, Ofcom's 2007 consultation document[9] stated that 'Aggregation of basic content [ ] is less likely to lead to the creation of market power [than aggregation of premium content]. Wholesale markets for basic content are relatively broad, making it considerably more difficult for one wholesale channel provider to aggregate all the basic content which might be regarded as substitutable.'

- table 3 below shows the ranking by viewer share of the top ten basic pay TV channels: the merger increases Sky's (wholly-owned) number of channels in the top ten from two to three. The OFT notes that UKTV

[9] Paragraph 6.16

owns three channels in this 'top 10' category, more than either Sky or VMTV had. This suggests that UKTV[10] will remain a significant competitor to Sky's basic pay channels in terms of both its portfolio of ten differentiated channels, and its ability to obtain broadcast rights to attractive BBC content (BBC Worldwide benefits from certain 'first-look' provisions in relation to BBC-produced content).

Top 10 UK basic pay TV channels by viewers, 2009
(source: Sky analysis of BARB viewing data)

1	**Sky 1**
2	**Living**
3	Disney Channel
4	G.O.L.D. (UKTV)
5	Comedy Central[11]
6	Hallmark
7	Watch (UKTV)
8	Playhouse Disney
9	**Sky 2**
10	Alibi (UKTV)

Table 3

- In addition, the OFT notes the fact that a significant number of additional competitors remain present in the supply of pay TV channels.

Constraint from FTA channels

35. The OFT notes that the previous Ofcom and CC reports referred to above indicate that there are increasing 'out of market' constraints on basic channels from the FTA offer and from VOD that are significant and growing. When comparing audiences for the Sky and VMTV channels with FTA general entertainment channels in multichannel TV homes, the OFT

[10] It has recently been reported in the press that Virgin Media is actively planning to sell its stake in UKTV.
[11] Sky (25 per cent stake) JV with Viacom.

notes that Sky 1 is the most watched basic pay TV general entertainment channel, and in multichannel households ranks slightly lower than ITV2 in terms of audience share. VMTV's strongest channel is LIVING, which attracts a viewing share in pay TV households which is less than ITV2 and comparable with E4, ITV3 and BBC3 (all FTA).

36. The comparability of viewing shares and the offering of pay TV and FTA channels suggest that the channels do compete strongly for viewers. The OFT is mindful that where concerns regard the wholesale supply of pay TV channels as an input for pay TV retailers, that FTA channels cannot be considered directly substitutable in this respect. The OFT considers that some weight should be given, however, to the constraint from FTA. This is because a wholesale pay TV channel's carriage price will be in large part determined by its ability to attract viewers and subscribers. To the extent that there is significant competition for viewers, therefore, wholesale pay TV channels are constrained in their ability to attract a significant share of viewers and increase their value to pay TV retailers.

Conclusion

37. The OFT's view is that the addition of the VMTV channels to Sky's existing basic pay portfolio is not sufficient to generate a horizontal concern. The Sky basic TV channels and the VMTV channels are not necessarily particularly close competitors, there are remaining constraints from other basic pay channel providers, significant wider constraints from FTA channels and VOD (paid for and free) content in terms of competition for audiences (and associated advertising revenue) as well as (indirect) constraints on wholesale pay TV channel pricing.

Television advertising

Market shares

38. Sky submits that the impact of the transaction on television advertising results in a very small increment to Sky's share and therefore does not give rise to competition concerns. In addition, Sky submits that the key effect of the transaction in relation to television airtime sales will be to make Sky Media a marginally more effective competitor to the two leading sales houses (ITV Sales and Channel 4 Sales).

39. Sky has provided the OFT with the following estimates of market shares by sales house:

2009 shares by sales house

SALES HOUSE	NET ADVERTISING REVENUE (%)	COMMERCIAL IMPACTS (%)
ITV Sales	[40-50]	40
Channel 4 Sales	[20-30]	18
Sky Media[12]	**[10-20]**	**17**
IDS (total) *of which:* **VMTV** UKTV	[0-10] **[0-5]** [0-5]	11 **4** 7
Five Sales	[0-10]	8
Others	[0-10]	6

Table 4

40. The OFT notes that IDS will effectively exit from the start of 2011. Under the terms of this transaction Sky will assume responsibility for selling advertising for the acquired VMTV channels from January 2011, giving the merged entity a combined share of [10-25] per cent by revenue and 21 per cent by volume. In addition, on 5 July 2010, UKTV and Channel 4 announced that they had reached agreement for Channel 4 Sales to become the exclusive advertising representative for the UKTV portfolio, effective from 1 January 2011. On a forward-looking basis, therefore, the effect of this would be to attribute to Channel 4 Sales [20-35] per cent by revenue and 25 per cent by volume.

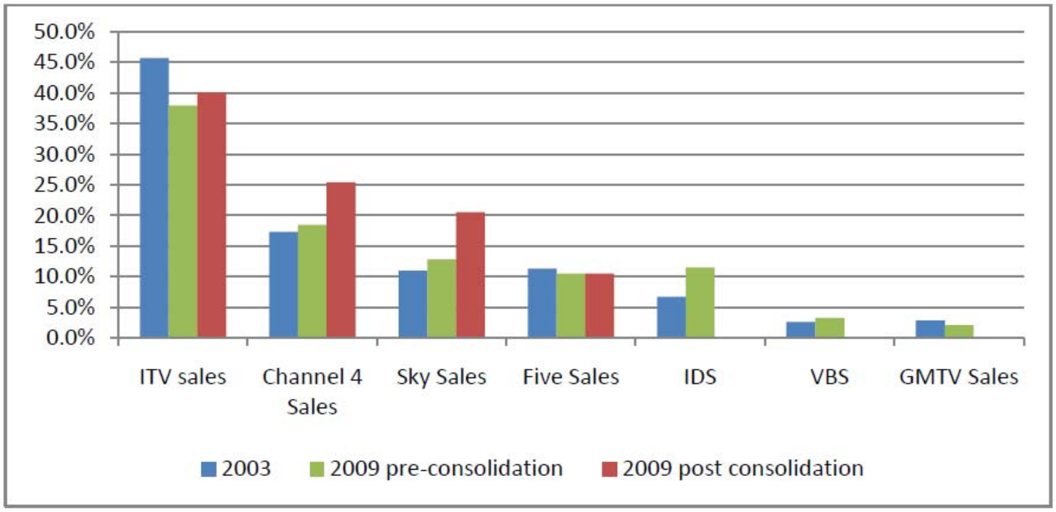
Ofcom Airtimes Sales Rules Review (ASR)[13]

41. In its recent Statement on the ASR, Ofcom directly considered recent consolidation in the television advertising sales house sector, including that arising from the Sky/VMTV transaction. Ofcom took the view that although there has been consolidation between sales houses, to which this transaction contributes further, the consequence may be that Channel 4 and Sky Media are better placed to offer competitive alternatives to ITV. The chart below is from Ofcom's ASR report, showing the impact of recent ownership and contractual consolidation on the main sales houses'

[12] Includes allocation of share from Viacom channels, which Sky Media began representing in January 2010.
[13] http://stakeholders.ofcom.org.uk/binaries/consultations/asr/statement/statement.pdf

aggregate share of commercial impact ('SOCI').[14]

Figure 1: Adult SOCI by sales house 2003 and 2009



Source: Ofcom, BARB

42. In its ASR statement Ofcom stated that '...it is not clear that recent consolidation between sales houses will necessarily lead to less competition. While this is possible, it may also be the case that a smaller number of more evenly-sized sellers – in terms of more similar market shares, with strong brands and with a wider portfolio of channels and a broader range of audience demographics - could bring a more competitive environment than one characterised by one large sales house and a series of much smaller sales houses.'[15] Ofcom noted specifically that the consolidation has brought Sky Media closer to Channel 4, not just in terms of more similar market share, but also in terms of strong brands and the range of particular audience demographics provided, and may mean that Sky has a greater ability to compete with Channel 4 (and ITV). Ofcom's conclusions from its review, taking into account a number of factors, resulted in its decision in July 2010 to remove the ex ante ASR regulations despite the identified recent consolidation (including that arising from the anticipated exit of IDS).

[14] The chart incorporates the recent developments by which ITV now sells the GMTV channels, Sky Media sells the VBS/Viacom channels and will sell the VMTV channels, and the Channel 4 Sales house will sell the UKTV channels. The merger-specific consolidation arising from this transaction is only one part of the wider consolidation which has occurred (and which Ofcom was considering during its review).

[15] Ofcom ASR statement (July 2010), para 2.32.

Closeness of competition between Sky Media and IDS

43. While the OFT's market investigation on the impact of the transaction on television advertising received mixed views, it raised the following particular concerns about the loss of IDS as an alternative to Sky Media:

- IDS had been a constraint on Sky Media's pricing due to their similar audiences and the relative ease of switching advertising spend between Sky and IDS (compared with switching from ITV or Channel 4)

- both IDS and Sky Media were particularly close competitors in 'direct response' advertising for customers requiring (relatively cheap) airtime in low rating programming and 'non-premium dayparts'.[16] It was suggested that Sky may be able to increase prices at the 'cheap end' of the market

- the pattern of recent consolidation among sales houses, with this transaction as a component, would encourage Sky Media to bundle valuable airtime on key channels (such as Sky Sports) with obligations to purchase airtime on the long tail of weaker digital channels.

44. Market participants that were not concerned about the transaction, submit that the fierce competition between sales points in the TV market and the strength of ITV means that the transaction would not give rise to any competition concerns in relation to the sale of television advertising.

45. In relation to the concerns that were identified, the OFT notes the following:

- Sky submitted data to the OFT showing that for all the demographic categories sold by IDS and Sky Media there are at least two other important suppliers of impacts to such audiences. Sky commented that IDS's lower average 'cost per thousand' (£[ ] in 2009) relative to that of Sky Media (£[ ]) is principally a reflection of the relative attractiveness of the audiences delivered to advertisers by IDS and Sky Media; and

[16] Dayparts categorise the particular times of day in which airtime can be delivered. Different dayparts have different audience characteristics whose attractiveness will vary between media buyers.

- Sky data on 2009 cost per thousand (CPT) by broadcaster suggest that the average CPT for the digital channel portfolios[17] of ITV, Channel 4 and Channel 5 were £[ ], £[ ] and £[ ] respectively, each closer to IDS's CPT than is Sky Media's average CPT.

Buyer power

46. The OFT also notes that there has been considerable consolidation among media buyers in recent years, as mentioned in Ofcom's ASR consultation document and report. In 2009 the top five media agency customers of Sky Media accounted for over [ ] per cent of its total revenues. Sky (and IDS) argued that media buyers are able to exercise a significant degree of countervailing buyer power, particularly against airtime sales houses other than ITV.

47. Ofcom's analysis in its ASR report did indeed note a process of long-term consolidation on the media buyer side of the television advertising market, and a possible increase in buyer power.

48. In its CRR report the CC recognised that there had been consolidation of media agencies, but noted that increased concentration of media agencies does not necessarily imply countervailing buyer power. For the purposes of the CC's specific analysis, this depended on whether media agencies can credibly threaten to switch expenditure away from ITV1. It would seem consistent with the CC's assessment that the scope of any buyer power possessed by media buyers is likely to be greater in relation to negotiations with Sky Media than with ITV.

Conclusion

49. The OFT notes that the transaction results in a minimal increment in Sky's market share for the sale of television advertising. It also notes Ofcom's recent ASR that did take into account the absorption of IDS by Sky and Channel 4 Sales and again did not consider that significant competition concerns would arise out of this. In addition, Sky has provided evidence that counters concerns raised by the OFT's market investigation that IDS and Sky were particularly close competitors post-merger for a subcategory of advertisers. Moreover, while the OFT did not find it necessary to

[17] that is, excluding their main analogue terrestrial channels – ITV1, C4 and Five.

conclude in this respect, it does note that media agencies have also experienced considerable consolidation and that they could be in a strong position to resist any attempted price increases by Sky.

VERTICAL ISSUES

50. Although the merger is principally horizontal in character (at the television channel supply level), it also has vertical aspects due to Sky's vertically-integrated business structure - in particular its position as the leading retail pay TV distributor.

Ability to foreclose

51. The first issue to consider is whether the merger may result in Sky having the ability and/or incentive to foreclose wholesale access to downstream rivals, with detrimental impact on downstream competition and associated consumer harm. The OFT may be concerned if downstream rivals lack a reasonable alternative to the vertically integrated firm. Hence the discussion above of the scope for the merger to generate horizontal effects for television channels is also highly relevant to the consideration of ability to foreclose.

52. The OFT had received concerns that Sky may withhold wholesale channel supply to pay TV retailers ('total input foreclosure'). In this respect, the OFT received submissions that a pay TV retailer would need access to Sky's enhanced portfolio of 'key content' pay TV channels in order to be able to provide a credible retail offer.

53. As discussed above, the OFT has not received compelling evidence to conclude that the VMTV channels are 'key content' channels so that the transaction would lead to Sky having the ability to foreclose competitors in the retail pay TV market. As noted, although Sky owns certain popular channels, pay TV retailers are able to access a variety of channels to form their retail offer to customers. The OFT also notes the ability to provide VOD content as is currently the practice by some pay TV retailers such as

Talk Talk and BT.[18] This suggests that pay TV offerings are not entirely reliant on (specific) linear channels.

54. In addition, the OFT did not receive any evidence that Sky could commit not to ever supply its popular channels to pay TV retailers, as it would need to for such a strategy of total foreclosure to be credible.

Conclusion

55. The incremental merger-specific impact on channel ownership arising from the transaction is unlikely to result in Sky having the ability to foreclose downstream competitors in relation to the supply of basic pay TV channels. Given the lack of such ability, the OFT has not further considered whether Sky would have the incentive to do so or whether such a foreclosure would result in an impact on competition in pay TV retail.

BARRIERS TO ENTRY AND EXPANSION

56. Sky submitted that barriers to entry and expansion are low, as evidenced by a significant number of channel launches over recent years, facilitated by technical developments (new means of distribution and expanded capacity on existing platforms). Sky noted that the number of television channels available in the UK increased from around 250 in 2000 to around 500 currently (including time-shift channels[19]).

57. The OFT's market investigation did not consistently support this view with high start-up costs (for example, distribution costs and platform fees), securing capacity and the need to establish a brand identified as the main potential entry barriers.

58. In *Sky/ITV*, the CC found that whilst it might be relatively straightforward to set up a new television channel, acquiring or producing quality content that would be sufficiently attractive to capture a significant share of viewing would require high levels of investment. It considered, therefore

[18] TalkTalk offers a number of branded on-demand channels, including HBO on Demand and WarnerTV. BT Vision recently announced that it will be offering 'ABC TV On Demand' – a VOD service offering a range of shows made by ABC Studios.
[19] A time-shift channel is a television channel carrying a time-delayed rebroadcast of its 'parent' channel's output.

that barriers to niche entry as a channel provider may be relatively low but barriers to expansion would be high.

59. Given its conclusions above, however, the OFT has not needed to conclude on the scope for new entry and expansion.

THIRD PARTY VIEWS

60. Third party views were discussed above where relevant.

61. On an initial view, Ofcom did not identify significant competition concerns arising from the transaction. It considered that sufficient constraints exist from other basic pay channels, VOD content, FTA channels and scope for entry/expansion.

62. The results of the OFT's market investigation were mixed. There were some concerns in relation to Sky's position regarding wholesale supply of television channels. In addition, there were some concerns about the transaction's impact on concentration in the supply of advertising sales. Other market participants were not concerned.

ASSESSMENT

63. Sky and the target business overlap in the supply of basic pay TV channels and television advertising. The OFT therefore considered whether the transaction would have any horizontal effects resulting from these overlaps. In addition, it considered whether there would be any vertical foreclosure concerns in the pay TV retail market resulting out of Sky's vertically integrated position in the wholesale and retail pay TV markets.

64. In respect of supply of basic pay TV channels, the OFT notes that the transaction results in a market share of between 24 and [40-50] per cent (depending on the basis on which this is calculated). The OFT notes that market shares may not necessarily be determinative in markets for differentiated products such as these. In this case, the OFT did not consider that the Sky channels and VMTV were markedly each others' closest competitors neither in terms of demographics nor in terms of having 'key content' channels. In addition, a number of pay TV channels remain active in the market post-merger. Moreover, the OFT recognised the

indirect constraint by FTA channels on pay TV channels, given that there is necessarily competition for viewers (and advertising revenue) between the two types of channels and that the carriage fees that pay TV channels will be able to command depend on the audience levels and valuation that they can attract.

65. In television advertising, the transaction contributes further to a wider recent consolidation process. The relatively limited increment to Sky's market share resulting from the acquisition could serve to strengthen Sky's competitive position relative to the larger ITV and Channel 4 Sales operations. In addition, the OFT has not found that Sky and the VMTV channels were particularly 'close' competitors, as distinct from the digital channel portfolios of other broadcasters.

66. In respect of any vertical foreclosure concerns resulting out of Sky's vertically integrated position in the wholesale and retail pay TV markets, the OFT does not consider (given its conclusions on the scope for the merger to generate horizontal effects in the supply of basic TV channels) that the transaction results in Sky having the ability to foreclose wholesale access to downstream rivals. It does not, therefore, further consider whether Sky would have the incentive to do so or whether such a foreclosure would result in an impact on competition in pay TV retail.

67. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

68. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.