



Neutral citation [2008] CAT 6

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

Case Number: 1082/3/3/07

Victoria House  
Bloomsbury Place  
London WC1A 2EB

31 March 2008

Before:

MARION SIMMONS QC  
(Chairman)  
PROFESSOR PAUL STONEMAN  
DAVID SUMMERS

Sitting as a Tribunal in England and Wales

BETWEEN:

**RAPTURE TELEVISION PLC**

Appellant

-v-

**OFFICE OF COMMUNICATIONS**

Respondent

supported by

**BRITISH SKY BROADCASTING LIMITED**

Intervener

Mr. Michael Bowsher QC, Miss Elisa Holmes and Miss Fiona Banks (instructed by Orrick, Herrington & Sutcliffe LLP) appeared for the Appellant.

Mr. Christopher Vajda QC and Mr. Philip Woolfe (instructed by the Office of Communications) appeared for the Respondent.

Mr. Peter Roth QC (instructed by Herbert Smith LLP) and Stephen Wisking (Partner, Herbert Smith LLP) appeared for the Intervener.

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**MAIN JUDGMENT**

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## INTRODUCTION

1. There is before us an appeal by Rapture Television plc (“Rapture”) filed on 9 May 2007, against a determination by the Office of Communications (“Ofcom”) of a dispute between Rapture and British Sky Broadcasting Limited (“Sky”). Ofcom published its determination (“the Determination”) on 9 March 2007.
2. The dispute which Ofcom accepted, decided it was appropriate for it to handle and which is the subject of its Determination is:

“whether Sky’s charges to Rapture for the provision of EPG services between November 2005 and November 2006 are fair, reasonable and non-discriminatory”.

EPG services are Electronic Programme Guide services.

3. The background to this appeal is set out in our earlier judgment on permission (1) to amend the Notice of Appeal and (2) to adduce further evidence, dated 23 November 2007: see [2007] CAT 34 (the “Permission Judgment”). We refer to paragraphs [1] – [16] and [19] – [21] of that judgment as to the background to this appeal and as to the relevant statutory materials.
4. Sky operates a digital satellite TV platform over which both Sky channels and third party channels are available to viewers. Approximately 8.5 million households view channels via the ‘Sky platform’. In order to view channels on the Sky platform consumers require a satellite dish and a Sky set-top box (“STB”). Sky offers an electronic programme guide (“EPG”) listing to broadcasters who want their channel to be available on the Sky platform. The EPG listing enables viewers to navigate between channels, access channels and browse through programming schedules and related data. The Sky STB contains software which allows access to the Sky EPG listing.
5. The Sky STB also contains software supporting Conditional Access (“CA”) services and Access Control (“AC”) services. Sky separately offers CA services and AC services to broadcasters who have a Sky EPG listing. CA services make use of encryption to restrict access to a channel: for example to viewers who have paid for the

channel. AC services enable the viewer to use the interactive functions of the Sky platform: for example by using the red button on the STB remote control.

6. Rapture only requires Sky to provide it with EPG services. It does not require CA services or AC services.
7. Sky subsidises, or has subsidised, the cost of the STBs in whole or in part.

## **THE REGULATORY FRAMEWORK**

8. On 7 January 1997, Oftel issued a Class Licence for Conditional Access Services (the “1997 CA Class Licence”) under section 7 of the Telecommunications Act 1984.
9. In May 1999 Oftel published Guidelines on ‘The Pricing of Conditional Access and Access Control Services’ (the “1999 Guidelines”). At paragraph 1.12 of the 1999 Guidelines Oftel stated that:

“As general guidance, Oftel would take the view that conditional access services included ...

- listing in electronic programme guides in so far as the EPG is linked to the conditional access system or is itself a mechanism for controlling the viewer’s access to television services”.

10. EPG was defined in the 1999 Guidelines as follows:

### **“Electronic Programme Guide (EPG)**

Software in the receiver which takes data on programmes and displays these in the form of an on-screen guide. The guide displays information about what is on now and next on each channel as well as future programmes. Viewers may also be able to use the on-screen menus to order pay-per-view services or to access interactive services.”

11. On 1 August 2001, the Secretary of State for Trade and Industry replaced the 1997 CA Class Licence with a new ‘class licence to run telecommunication systems for the provision of conditional access services’ (the “2001 CA Class Licence”). This included EPGs. The conditions set out in the 2001 CA Class Licence included:

**“SERVICE OBLIGATION FOR OPERATORS OF ELECTRONIC PROGRAMME GUIDE SERVICES**

1.1 Where a Third Party requires the provision of an Electronic Programme Guide Service in respect of decoders administered by the Licensee, the Licensee shall offer that Service to that person on a fair reasonable and non-discriminatory basis.

1.2 Where the Licensee provides any Electronic Programme Guide Service pursuant to the offer referred to in paragraph 1.1 above, the Licensee shall co-operate with the Third Party and do whatever is necessary and reasonable to ensure the interconnection or interoperability of the Applicable Systems and associated apparatus to enable the Electronic Programme Guide Services to be provided and maintained.”

12. The 1999 Guidelines were replaced in October 2002 by new guidelines entitled ‘The terms of supply of conditional access: Oftel guidelines’ (the “2002 Guidelines”).
13. A new regulatory framework for electronic communications networks and services entered into force on 25 July 2003. The basis for the new regulatory framework was five new EU Communications Directives. One of the principal changes in the United Kingdom was the ending of the licensing regime under the Telecommunications Act 1984. However certain transitional provisions applied, including those set out in paragraph 9 of Schedule 18 to the Communications Act 2003 (the “2003 Act”).
14. In accordance with paragraph 9 of Schedule 18 to the 2003 Act the Director General of Telecommunications (the “Director”) gave notice (in a “Continuation Notice”) that the conditions set out in the Class Licence and Schedule 1 to the Continuation Notice would continue to have effect from 25 July 2003 as modified and to the extent set out in Schedule 1 until the Director gave a further notice that the Continuation Notice should cease to have effect. No such notice has been given. The conditions set out in the Continuation Notice related only to the provision of EPGs (the “EPG Conditions”), the Director having issued new conditions in relation to CA (excluding EPGs) under the Communications Act 2003.
15. The roles of the Director and of Oftel were abolished by the 2003 Act, and their functions were transferred to OFCOM. References in this judgment to OFCOM are to include, where relevant, the Director and Oftel.

16. OFCOM applied the 2002 Guidelines in determining the dispute between Rapture and Sky. It is not disputed that the 2002 Guidelines continued to apply to the provision of EPG services for the period relevant to the dispute in question.

17. Paragraph S.3 of the Summary of the 2002 Guidelines states:

“S.3 Key points amplified within these guidelines include:

- the obligation on providers of conditional access and access control services is to offer such services on a fair, reasonable and non-discriminatory basis to third parties wishing to purchase services regulated under that licence;
- in assessing fairness and reasonableness, Oftel will consider whether the terms offered are consistent with those which would be expected in a competitive market;
- prices should fall between the ‘floor’ of the incremental cost of providing the service, and the ‘ceiling’ of the stand-alone cost of the service, whilst not allowing for over-recovery by providers. The prices for services to all categories of user would be expected to cover their costs;
- a range of factors should be taken into account in assessing prices including the service required, the benefits to the platform for carrying the service, the benefits for the broadcaster or service provider of inclusion on the platform, the revenues accruing to the broadcaster from carriage on the platform, and the willingness to pay of the broadcaster for the service required; and
- in assessing non-discrimination, Oftel regards it as acceptable for differential prices to be offered where there is no material adverse effect on competition; but the basic approach should be that comparable prices should be offered to comparable users, for comparable services, at comparable times.”

18. Accordingly, EPG services are to be offered to the broadcaster on a “fair, reasonable and non-discriminatory” (“FRND”) basis.

19. The relevant sections of the 2002 Guidelines are reproduced below. The 2002 Guidelines are a public document, available on OFCOM’s website.

20. The 2002 Guidelines have since been replaced by new OFCOM guidelines on the provision of technical platform services, published in September 2006. These new guidelines were stated to apply as from 1 January 2007, which is after the period under consideration by OFCOM in connection with this dispute.

*OFCOM's dispute resolution powers and the Tribunal's jurisdiction*

21. OFCOM determined the dispute under sections 188 and 190 of the 2003 Act, having accepted the dispute as one which falls within the scope of section 185(1) of the 2003 Act. These provisions, in so far as material, are set out in paragraphs [12] – [14] of the Permission Judgment, and we do not repeat them here.
22. In its notice of intervention dated 30 May 2007, Sky submitted that rather than considering Rapture's allegations under its dispute resolution powers in the 2003 Act, OFCOM should instead have dealt with the matter as a complaint for breach of Sky's *ex ante* regulatory obligations relating to the provision of EPG services. Sky submitted that a mechanism for enforcing the EPG Conditions existed under sections 16 – 18 and 53 of the Telecommunications Act 1984 in conjunction with paragraph 13 of Schedule 18 of the 2003 Act. Sky submitted that in its view, that mechanism would have been the appropriate means of addressing Rapture's allegations, not the dispute resolution powers in sections 185 – 191 of the 2003 Act. Sky went on to say, however, that if OFCOM had considered Rapture's allegations using the correct legal basis, Sky did not consider that this would have changed the substantive outcome of OFCOM's investigation. Sky explained:

“whilst it might not affect the substantive outcome of this appeal, Sky is concerned that as an intervener if it does not raise the scope of Ofcom's dispute resolution powers in these proceedings, it will be more difficult for Sky to raise the issue in any subsequent investigation by Ofcom, as not doing so now will be taken as acceptance that Ofcom's arguments as to the scope of its jurisdiction in its Decision were correct.”

23. At the case management conference on 1 June 2007 it was accepted by Sky that, subject to it being open to Sky (if so advised) to take the jurisdictional point on the proper interpretation of section 185(1) of the 2003 Act in a future case, this point would not be relied upon in the present appeal before the Tribunal or in any subsequent appeal in these proceedings.

**THE ISSUES**

24. The Notice of Appeal (as amended) generally lacked clarity, precision and particularisation. At the main hearing of this appeal which took place on 18 and 19

December 2007 Rapture produced a document headed “*Summary of Rapture’s case regarding determination: with indicative cross-references to Rapture’s Written Argument*”. In this document, Rapture sets out five grounds on which its appeal is founded. We use this document as our starting point, and annex it to this judgment.

25. We address the issues raised by Rapture under the following headings:
1. Should the STB subsidy be treated as a common cost of the EPG service?
    - (a) What is the EPG service?
    - (b) If the STB is part of the EPG service, should the STB subsidy be treated as a common cost?
    - (c) Should the STB subsidy be treated as an externality?
  2. Is the price fair and reasonable?
    - (a) Is the price such as would be expected in a competitive market?
    - (b) Has the requirement for input costs to be reasonably and necessarily incurred been properly considered?
    - (c) Do the costs of CA and AC services need to be unbundled?
    - (d) Was the return on Sky’s investment in the platform excessive?
  3. What is the relevance of commercial negotiations?
  4. Have Rapture’s ‘willingness to pay’ and other relevant factors (including non-discrimination) been properly taken into account?
    - (a) Willingness to pay.
    - (b) Other relevant factors – including non-discrimination.

## **THE ISSUES**

### ***1. Should the STB subsidy be treated as a common cost of the EPG service?***

#### ***(a) What is the EPG service?***

#### *The Parties’ Submissions*

26. Rapture submits that an EPG is an on-screen guide to the channels available through Sky; that the EPG allows viewers to browse programme schedules by genre, channel,

time and title, amongst other things. Rapture submits that the STBs are provided as part of the installation of the equipment required to receive access to satellite television and are part of the services provided by Sky to subscribers, rather than part of the EPG.

27. OFCOM submits that Rapture wants access to the EPG, which is a ready way of directing the viewer to the channel. Access to the EPG gives Rapture access to 8.5 million households. A STB is required for a viewer to use the EPG. So in terms of EPG, the broadcaster is paying effectively for ready access to the viewer. The cost of access to the 8.5m households is a common cost.
28. Sky submits that Rapture, by launching onto the Sky platform, wants to be listed in the EPG so as to have access to the audience that comprises the 8.5 million households who have Sky STBs and satellite dishes so that they can easily view Rapture's programmes.
29. Sky submits that Rapture's whole approach involves the fallacy that there are two separate services, one to channel providers, broadcasters, and the other to subscribers, but in fact those elements – access to the EPG via the STB – are essential to the service which the broadcaster needs and which Sky provides for the benefit of the broadcaster and of course for the benefit of the viewers too.

*The Tribunal's Analysis*

30. The Continuation Notice provides the following definition of EPG service:

“Electronic Programme Guide Service” means a service which consists of—

(a) the listing or promotion, or both the listing and the promotion, of some or all of the programmes included in any one or more programme services the providers of which are or include persons other than the provider of the guide; and

(b) a facility for obtaining access, in whole or in part, to the programme service or services listed or promoted in the guide”.

31. Accordingly the charge to be made by Sky to Rapture is for the EPG service which consists of both (i) the listing and/or promotion of some or all of the programmes included in any one or more programme services provided by Rapture and (ii) a facility

for obtaining access, in whole or in part, to the programme service or services listed or promoted in the guide (including programmes provided by Rapture).

32. It is accepted by all parties that a STB is the means through which the viewer obtains access to programme services listed or promoted in a guide.
33. The STB is the facility for obtaining access, in whole or in part, to the programme service or services listed or promoted in the guide. Accordingly we consider that the STB is part of the service encompassed by the term “EPG service”. It cannot be divorced from the EPG service and be attributed only to Sky’s provision of satellite services to its subscribers. Therefore in our judgment the rationale behind Rapture’s submission that the STB was not part of the EPG service is misconceived.

*(b) If the STB is part of the EPG service, should the STB subsidy be treated as a common cost?*

34. Insofar as material, chapter 3 of the 2002 Guidelines provides as follows:

**“Allowable costs**

3.1 The general principle that Oftel would follow in assessing the costs to be recovered from conditional access or access control charges, is that those costs should be reasonably and necessarily incurred in the provision of those services. Notwithstanding that principle, there are a range of cost categories for which there is an issue about the extent to which they should be recoverable via such charges.

...

**Fixed and common costs**

3.4 With a conditional access or access control system, most of the actual costs involved in the set up and running of the system do not vary significantly with the number of channels provided. The presence of economies of scale and scope means that the incremental cost of supplying the service to one additional broadcaster or channel is likely to be low. As the fixed and common costs of running the system must be recovered through the charge, it is not possible for the provider to charge a price equal to the incremental cost to every purchaser. Such a price would not cover all the costs associated with the infrastructure that makes the operation of the service possible.

3.5 Oftel considers that it is appropriate that all users of the service should pay a charge that is equivalent to incremental costs together with a reasonable contribution to common costs (ie a price that falls between the floor of incremental costs and a ceiling of the ‘stand alone’ cost of providing the system). This is the outcome that would be expected in a market where there was competitive supply

of conditional access or access control services, although the relative contributions might well vary between different users. ...

3.6 Oftel would expect that the result of negotiations between providers and the broadcaster is that common costs are likely to be distributed amongst different bundles or single channels at differential levels depending on the overall balance of benefits which could accrue to the provider and the broadcaster. Oftel recognises that there are economies of scale and scope which are available to both parties.

...

### **Treatment of subsidy of consumer equipment**

3.9 A vertically integrated supplier may wish to subsidise consumer equipment to promote take-up of its retail services. The question arises whether this subsidy may be treated as a cost to be recovered via conditional access or access control charges, or whether this should be borne entirely by the vertically integrated company.

3.10 In principle, Oftel considers that other broadcasters typically benefit from such a subsidy (in terms of increased viewer base), so it is therefore reasonable to expect them to contribute to the costs. Different broadcasters may benefit to different extents, in which case their relative charges should reflect this.

3.11 However, in certain cases, recovery of subsidy via conditional access or access control charges may have anti-competitive effects. In such cases, recovery would not be permitted. Each case would be examined on its merits. However, one example where Oftel would have serious concerns is where the granting of subsidy was tied to a requirement to subscribe to a retail service of a vertically integrated supplier.”

35. In the Determination, OFCOM treated the STB subsidy as part of the common costs: see paragraphs 5.49 to 5.69. At paragraph 5.67, OFCOM concluded:

“... based on the facts of this case, Ofcom considers it is a reasonable requirement that free-to-air channels with an EPG listing on the Sky Platform, such as Rapture, make a contribution towards the common costs of operating the Sky Platform. In particular, there is no basis for a finding on the evidence before Ofcom in this investigation that it would be unreasonable for Rapture to contribute to the largest single common cost, that of providing STB subsidies, during the period covered by this dispute. Such subsidies increase the number of viewers on the Sky Platform and free-to-air channels (particularly in the case of a channel such as Rapture that is not available on other distribution platforms) will benefit to some extent from an increased pool of potential viewers.”

### *The Parties' Submissions*

36. Paragraph 42 of Rapture's skeleton argument, dated 5 December 2007, states:

“Rapture's central complaint is that Ofcom failed to analyse properly or at all the common costs to which free-to-air broadcasters should contribute in pricing the

EPG services provided by Sky. In particular, in relation to set top boxes, Rapture's primary case is that set top boxes should not be treated as a common cost of the EPG service because, in fact, it is a common cost of the provision of television satellite services provided to Sky subscribers. ..."

37. Rapture further submits that:

- (a) common costs are those costs that would continue to be incurred by a firm producing all the other relevant products and services in the event that they cease to produce that product under investigation;
- (b) even if the STB subsidy is a common cost, it is not necessary and so should not be included as a cost when assessing the price of EPG payable by Rapture; and
- (c) the STB subsidy should be categorised as part of the incremental cost of providing satellite TV access to subscribers.

38. OFCOM submits that:

- (a) the common costs are those which do not vary with the number of channels;
- (b) common costs are costs common across the board for all broadcasters;
- (c) although from a strict analysis of cost drivers the costs of STB subsidies are driven by the number of subscribers, and hence the cost of the STB subsidy might be said to be incremental with respect to the number of subscribers, OFCOM considered that all broadcasters, including both Sky channels and non-Sky channels, *benefited* from the STB subsidy, therefore it is reasonable, in principle, for all broadcasters to contribute to the cost of that subsidy; and
- (d) the largest element of common cost to the broadcasters is the cost of the STB subsidy.

39. Sky submits that, as the EPG service has to include the STB and since the provision by Sky of free STBs has been a very significant factor in Sky STBs now being in up to 8.5 million households, it is economic logic and principle that a broadcaster such as Rapture should pay a contribution to the cost of the STB subsidy.

*Tribunal's Analysis*

40. Rapture's submissions are again founded on Rapture's misconception that the STB is not part of the EPG service but is part of a separate and distinct service which Sky provides to its subscribers. For the reasons set out above we consider Rapture's submissions in this regard to be clearly ill-founded and we accordingly reject them.
41. We do not accept that Rapture's submission as to the meaning of common costs is appropriate in the circumstances now under consideration. We understand the meaning of "common costs" in the present context to be those costs which do not vary with the number of providers of programme services and which benefit all providers of programme services which are listed or promoted in the guide. From this perspective on the facts of the present case these costs are the costs which Sky incurs or incurred in developing and operating the EPG and also include a reasonable contribution to the common costs of developing and operating the digital satellite platform. This accords with the 2002 Guidelines equating common costs with "the 'stand-alone' costs of providing the system" (see paragraph 3.5 of the 2002 Guidelines).
42. The STB is the facility for obtaining access to the programme service or services listed or promoted in the guide and the EPG includes this facility. Accordingly in our judgment the STB subsidy is a common cost to all providers of programmes which are listed or promoted in the guide and OFCOM was correct in treating it as a common cost.
43. Paragraph 3.1 of the 2002 Guidelines states that there is a range of cost categories for which there is an issue about the extent to which they should be recoverable via charges for EPG services. The 2002 Guidelines identify one of these categories to be the treatment of the subsidy of consumer equipment. In paragraphs 3.9 and 3.10 it is stated that, in principle, a subsidy given by a provider to consumers, benefits broadcasters and it is therefore reasonable to expect them to contribute to that subsidy except where the subsidy has an anti-competitive effect. The inclusion of the STB subsidy as part of the common costs is therefore contemplated by the 2002 Guidelines.

44. It follows that Rapture's reasons for submitting that the STB subsidy should not be treated as a common cost of the EPG service are misconceived.

*(c) Should the STB subsidy be treated as an externality?*

*The Parties' Submissions*

45. Rapture submits that the STB subsidy should be treated as an externality arising from the subsidy relationship between Sky and its subscribers (from which Rapture derives a benefit) rather than as a common cost. Rapture relies in this regard on the treatment of externalities by authoritative regulatory bodies in, for example, the Competition Commission's 2003 "Reports on references under section 13 of the Telecommunications Act 1984 on the Charges made by Vodafone, O2, Orange and T-Mobile for terminating calls from fixed and mobile networks".
46. OFCOM submits that to treat the STB subsidy as an externality when it is a common cost would be to depart from rather than to apply the 2002 Guidelines. Rapture agrees that the 2002 Guidelines apply to the dispute.
47. Sky submits that Rapture's submission that the STB cost should be treated as an externality is at odds with the 2002 Guidelines which contain no reference to "externalities".
48. Sky further submits that the STB subsidy is not an externality since it is one of the costs of establishing the platform and therefore an input cost of the platform services (in which context platform services would include EPG services). Sky submits that an externality exists when the production or consumption of a good directly affects business or consumers not involved in buying or selling it and when these spill over effects are not fully reflected in market prices. Sky submits that an externality would arise where a non-platform related subsidy (such as free installation) enhances the STB population (i.e. the number of people who have STBs) which in fact, benefits channels such as Rapture.

*The Tribunal's Analysis*

49. We accept the submissions of Sky that in the context of this dispute the STB subsidy is not an externality but is part of the common costs and should be treated as such. We have explained above our reasons for concluding that the STB subsidy is part of the common costs. Accordingly we reject Rapture's submission that the STB subsidy should be treated as an externality.

**2. *Is the price fair and reasonable?***

50. The 2002 Guidelines provide:

**“Fair and reasonable**

2.1 The obligation providers [*sic*] is to offer services regulated under the respective class licence (...) on a fair, reasonable and non-discriminatory basis to third parties wishing to purchase them. In assessing fairness and reasonableness, Oftel will consider whether the terms offered are consistent with those which would be expected in a competitive market. ...

2.2 In any assessment as to whether charges are fair and reasonable, Oftel will usually need to consider whether input costs are reasonably and necessarily incurred in supplying the services in question. In particular, where the provider purchases inputs, such as smart cards, from an associated company, the provider would need to demonstrate that the input costs are not excessive and that it has appropriate arrangements for the independent scrutiny of charges for services from related companies.

2.3 Oftel takes 'reasonableness' to mean, amongst other things, that terms and conditions under which products are offered are fair between the parties; sensible, practical, and proportionate. Timeliness in the provision of information, and of the products themselves is also critical to ensuring that access is effective. The following offers some guidance as to what Oftel would consider to be 'reasonable':

- the provider should be able to recover its efficiently incurred costs over a reasonable period; and
- the services offered must, if technically feasible, be sufficiently 'unbundled', so that the broadcaster only pays for what it needs.”

51. We also refer in this regard to paragraphs S.3 and 3.5 of the 2002 Guidelines, set out at paragraphs 17 and 34 above respectively.

*(a) Is the price such as would be expected in a competitive market?*

*The Parties' Submissions*

52. Rapture submits that although OFCOM correctly identified that the price charged by Sky to Rapture for EPG services was between the floor of the incremental cost and the ceiling of the stand alone cost, OFCOM erred in failing to assess whether the price arrived at between the floor and the ceiling was one which would be expected in a competitive market.
53. Rapture submits that it was not enough for OFCOM to identify that the charges fell in this range. Rapture submits that OFCOM had to consider whether the charges fell at the appropriate level within this range.
54. OFCOM submits that the price charged by Sky should fall between the floor of incremental cost and the ceiling of stand alone cost and that a price which falls outside these bounds cannot be FRND. It further submits that a price which falls between these bounds is not necessarily or per se FRND: that it is also necessary to check that Sky does not earn an excessive return on the Sky platform. OFCOM submits that if Sky charged every channel a price close to the ceiling of stand-alone cost it would earn an excessive return and the price would not be FRND. OFCOM submits that Rapture, in making its submissions, is committing a serious error in that it is ignoring the multi-layered approach of the 2002 Guidelines.

*Tribunal's Analysis*

55. Rapture's submissions appear to us to misconstrue paragraphs 2.1 and 3.5 of the 2002 Guidelines. Paragraph 2.1 of the 2002 Guidelines provides that in assessing fairness and reasonableness OFCOM will consider whether the terms offered are consistent with those which would be expected in a competitive market. Paragraph 3.5 states that users of the service should pay a charge that is equivalent to incremental cost together with a reasonable contribution to common costs (i.e. a price that falls between the floor of incremental cost and a ceiling of the "stand alone" cost of providing the service).

56. The 2002 Guidelines require consideration as to whether the price falls between the floor of incremental cost and a ceiling of the stand alone cost of providing the service. If so, then the 2002 Guidelines state that this is the outcome that would be expected in a market where there was competitive supply. The 2002 Guidelines do not require a separate assessment as to what would be expected in a competitive market. Accordingly OFCOM did not err by not considering what would be expected in a competitive market.
57. There is no dispute between the parties that the price does fall between the floor of incremental cost and a ceiling of the “stand alone” cost of providing the service. OFCOM did not confuse the question of whether the price charged fell between the floor of the incremental cost and the ceiling of the stand alone cost with the subsequent question of whether the rate of return on Sky’s investment was excessive (which is addressed in paragraphs 71 - 91 below).

***(b) Has the requirement for input costs to be reasonably and necessarily incurred been properly considered?***

58. OFCOM’s consideration of this factor is set out at paragraphs 5.15 – 5.69 of the Determination. The STB subsidy is the largest single common cost of operating the Sky platform. OFCOM concluded that it is a reasonable requirement that free-to-air channels with an EPG listing on the Sky platform, such as Rapture, make a contribution towards the common costs of operating the Sky platform.

*The Parties’ Submissions*

59. Rapture submits that OFCOM erred in its application of the requirement that input costs should be reasonably and necessarily incurred in providing the service. Rapture submits that no visible analysis of costs efficiency (i.e. an assessment of whether costs were efficiently incurred) was conducted by OFCOM under this component but instead OFCOM wrongly concentrated on how costs for EPG services can be allocated (i.e. how the different costs are allocated between the different users).
60. OFCOM submits that it was not necessary to undertake an extensive analysis of whether common costs were correctly allocated or reasonably incurred. The common

costs of the Sky platform are extremely large, running into hundreds of millions of pounds, in comparison to the rate card price for the EPG service of £76,800. Accordingly, the gap between the floor of incremental cost and the ceiling of stand alone cost is extremely wide and there is a very broad range within which Sky may set the price, subject to the prohibition on earning an excessive rate of return. OFCOM submits that even if a large proportion of the input costs to the Sky platform had been disallowed as being inefficiently incurred, it would still have been reasonable to conclude that the indicative rate card price would fall between the floor and ceiling and would therefore be considered potentially fair and reasonable, subject to the prohibition on earning an excessive rate of return, non-discrimination and the requirements for negotiation. OFCOM submits that it was not required to undertake further extensive analysis of whether particular input costs were efficiently incurred in providing the EPG service.

61. Sky submits that there is simply no basis to suggest that the platform costs were unnecessary, unreasonable or inefficient or that OFCOM has failed properly to investigate them.

*The Tribunal's analysis*

62. Rapture did not provide any response to the submissions made by OFCOM which we summarise in paragraph 60 above. On the material before us we do not consider that it would have been proportionate for OFCOM to have conducted the exercise which Rapture submits OFCOM should have conducted. Accordingly we accept OFCOM's answer as summarised in paragraph 60 above.

**(c) Do the costs of CA and AC services need to be unbundled?**

63. OFCOM's assessment of the common costs to which EPG customers should be expected to contribute is set out at paragraphs 5.26 to 5.69 of the Determination. Paragraph 5.56 of the Determination states:

“Ofcom accepts that EPG customers should not be expected to contribute to the direct cost of components of the Sky Platform from which they derive no benefit. Whilst there are components of the Sky Platform that are not used by free-to-air channels (such as access control technology and encryption), the direct costs associated with conditional access and access control services comprise only a

relatively small proportion of total platform costs (less than [0-20] %) and are not included in Ofcom's calculation of relevant common costs. Given that the majority of platform costs relate to the common cost of building up a base of viewers and the contribution of EPG listing customers to common costs is small (less than [0-5]%) it is reasonable to conclude that EPG customers are not contributing towards the direct costs of other technical platform services from which they do not derive a benefit.”

*The Parties' Submissions*

64. Rapture submits that OFCOM should have unbundled the costs of the STB in the calculation of common costs so as to remove such CA and AC costs as are attributable to the incorporation of the functionality to provide CA and AC (which is included in all STBs).
65. Rapture submits that, should it have to make a contribution to Sky for its subsidy of the STB, only the costs associated with basic STBs should be taken into account. Rapture does not use all of the facilities in the STB, as most are for the benefit of those broadcasters taking CA or AC services. Rapture submits that it should only have to contribute towards the costs corresponding to the parts of the STB that it actually uses for the EPG services. In his witness evidence, Mr. Henry of Rapture stated:
- “As regards the appropriate level of charges to be made for Sky’s EPG listing service for a free-to-air channel, I have the following observations. I believe that the costs associated with the STB should not be reclaimed from the free-to-air digital channels as most of the technology they contain, and certainly all of the expensive technology, relates to only pay-tv channels. I find it unfair, therefore, that Sky offers a lower price for the EPG segment of the agreement to pay-tv channels compared to free-to-air channels. Free-to-air channels were charged £76,800 per year in 2005 while pay-tv channels were charged £36,000 (as they must also purchase conditional access services).”
66. Rapture submits that the 2002 Guidelines require OFCOM to consider whether the services offered are, if technically feasible, sufficiently unbundled, so that the broadcaster only pays for what it needs, and that OFCOM erred in including all the cost of STBs in the category of common costs relevant to the service provided by Rapture rather than ensuring that Rapture only contributed to the common costs from which it benefited.
67. OFCOM submits that whilst there are components of the Sky platform that are not used by free-to-air channels (such as AC technology and encryption), the direct costs

associated with CA and AC services comprise only a relatively small proportion of total platform costs and are not included in OFCOM's calculation of relevant common costs. Revenues from EPG charges only went to cover the direct costs of EPG services together with a small contribution to common costs, revenues from EPG services being less than 5% of total common costs. Further, only a small proportion of the Sky platform's total revenue was derived from EPG listing charges, either from itself and/or from third parties. OFCOM submits that since EPG listing customers such as Rapture only provided revenue sufficient to cover direct costs plus a small contribution to common costs, it follows that it was reasonable for OFCOM to conclude that EPG customers, including Rapture, were not contributing towards the direct costs of other platform services from which they did not derive a benefit. OFCOM submits that Rapture had not provided sufficient evidence to support a finding that it would be unreasonable for it to make any contribution to the common costs of the Sky platform.

68. Sky submits that OFCOM's approach was very proportionate on the facts, having regard to the figures in this case. Sky submits that although the STB has functionality which Rapture does not use, in practice Rapture is not contributing to the cost of these functions.

*The Tribunal's Analysis*

69. OFCOM has not included the direct costs associated with CA and AC services in its calculation of relevant common costs. Accordingly Rapture's submissions address only common costs associated with CA and AC services which are not direct costs.
70. The revenues from EPG charges included only a small contribution to common costs. Accordingly we consider that it would not have been proportionate for OFCOM to have undertaken an analysis of the common costs associated with CA and AC services, which were not direct costs.

*(d) Was the return on Sky's investment in the platform excessive?*

71. The 2002 Guidelines include the following:

“2.4 Oftel recognises that there are different levels of risk in agreements entered into and so would consider it appropriate for providers to take into account the level of risk for a novel service.

2.5 Oftel also would consider the relationship between input costs and expected revenues. Oftel’s approach would be to consider whether the pricing framework was such that the provider would be expected on average to make a return on its investment that was neither inadequate nor excessive, taking proper account of risk and uncertainty applying to the investment at the time it was made. In a competitive market, neither excessive nor inadequate returns could be sustained over an extended period.

2.6 The treatment of risk over time is important: Oftel would not use the benefit of hindsight to review the pricing structure. The existence of high returns in the short to medium term, if the investment turned out to be more successful than originally projected, would not necessarily be regarded as evidence that prices were too high. The supplier would have the [sic] bear the losses if the business were less successful, and must conversely be allowed to reap the benefits of greater success than was guaranteed. ...

2.7 Oftel would also need to consider whether the expected rate of return used by the provider in calculating prices was consistent with the appropriate cost of capital. ...”

72. OFCOM considered Sky’s rate of return at paragraphs 5.76 to 5.102 of its Determination. It concluded that the expected rate of return fell within the lower and upper bounds of the range which OFCOM considered appropriate and was not sufficiently high so as to conclude that Sky’s overall return was excessive. Paragraph 5.102 states:

“The evidence before Ofcom in this dispute does not support a finding that Sky’s EPG listing charge to Rapture was unfair or unreasonable on the basis of excessive returns by Sky.”

*The Parties’ Submissions*

73. Rapture submits that the EPG service was not put together purely as a stand-alone service to be provided to third party broadcasters, but also for Sky’s own broadcasting purposes. Any risk that Sky took by setting up and providing EPG services for third party broadcasters was diluted, as Sky also intended to use the EPG services for its own channels. In essence, Sky has had it both ways. It has established a proprietary system for its own use and shared that risk with third party broadcasters. The level of risk faced by Sky at launch should therefore be adjusted by OFCOM to take account of the fact that the risk was shared between Sky and third party broadcasters.

74. With regard to paragraph 2.4 of the Guidelines, Rapture submits that, given that the Sky platform was launched in 1998, the level of risk for the period from November 2005 to November 2006 cannot be said to relate to a novel service anymore. Therefore the level of risk for the relevant period cannot be considered to be the same as in 1998 and should be reduced. Sky should not be able to recover indefinitely for the same risk taken on its initial investment in establishing the EPG.
75. Rapture submits that OFCOM should have considered the issue of over how long a period of time Sky should be entitled to recover the subsidy of the STB from third party broadcasters such as Rapture, and that in failing to do so OFCOM has failed properly to exercise its discretion. Rapture submits that had OFCOM considered this issue, it would have concluded that the time over which Sky could recover the STB subsidy has elapsed or that any subsidy payable should only relate to new boxes sold to new subscribers over the previous year.
76. Rapture submits that OFCOM erred in relying on Sky's "Platform Model" for calculating individual contribution to EPG services: see paragraph 5.26 of the Determination for a description of the Platform Model. Rapture submits that OFCOM has not scrutinised Sky's Platform Model or, if it did, has not set out such examination in the Determination. Rapture submits that the Platform Model was out of date and never intended to be used as a tool for calculating the individual charges for platform services (including EPG services).
77. OFCOM accepts that it is necessary to take into account the level of risk that existed at the time that the investment was made, and submits that it took the risk on Sky's investment into account in precisely that way. OFCOM submits that Rapture's argument on dilution of the risk is difficult to understand.
78. OFCOM submits that the "Sky Platform Model", which OFCOM used in assessing Sky's expected internal rate of return, does not envisage an indefinite return on Sky's investment, but rather utilises a discounted cashflow analysis: see further paragraphs 5.76 to 5.77 of the Determination.

79. OFCOM submits that it does not consider that the recovery of costs plus a reasonable rate of return over the relevant period is inconsistent with the 2002 Guidelines. If Sky's current commercial strategy had not been pursued and it had attempted to recover costs plus a reasonable rate of return in a very short time period then this might have led to relatively high costs per subscriber for potential platform customers in the early years of the platform's life, thus disincentivising entry onto the platform both from a broadcaster and subscriber perspective.
80. In response to Rapture's submission that the level of risk for the period from November 2005 to November 2006 did not relate to a novel service, OFCOM submits that insofar as Sky is still recovering investments that were made early in the platform's life, it is appropriate for OFCOM to assess the return on that investment by reference to the risk as it existed at the time the investment was made.
81. OFCOM submits that Rapture has presented no evidence which might indicate that Sky is earning an excessive return on capital.
82. OFCOM submits that Rapture's argument that the cost of the STB should be recovered within a twelve-month period is flawed for a number of reasons, in particular because there is no evidence that the minimum period of subscription has been set by reference to the cost of the STB.
83. OFCOM submits that it was reasonable for it to rely on the Platform Model in reaching the Determination.
84. Sky submits that Rapture offers no evidence or analysis to support its allegations that OFCOM erred in assessing whether Sky's return on the platform was excessive, and that the arguments which Rapture makes are very hard to follow. In the absence of any analysis and evidence, Rapture's arguments on the maturity of the platform are misconceived and must fail. Sky submits that it is entitled to a return on investments made in the very early stage of the platform's development commensurate with the risk it faced at the time.

85. Sky submits that Rapture fails to explain how and to what extent Sky's usage of the platform affects the risk of the platform. As far as Sky is concerned, its usage of the platform has no bearing on the assessment of the platform risk.
86. Sky submits that it does not earn a rate of return indefinitely and does not expect to do so. Rapture fails to explain why the period used in the OFCOM analysis is excessive.
87. Sky submits that Rapture has failed to advance any basis for its argument that it should only contribute to the previous year's STB subsidies. Were Sky to have sought to recover costs on this basis it would have resulted in higher platform service charges in the early years of the platform which would have deterred channels from using the platform.
88. Sky submits that Rapture's criticisms of OFCOM's use of the Platform Model are unfounded: the Platform Model was not out of date, and it shows the direct costs and revenues for the different services, as well as the common costs, which cannot by definition be attributed to a particular service.

*The Tribunal's analysis*

89. Paragraph 2.5 of the 2002 Guidelines provides that OFCOM would consider the relationship between input costs and expected revenues. These Guidelines state that OFCOM's approach would be to consider whether the pricing framework was such that the provider would be expected on average to make a return on its investment that was neither inadequate nor excessive, taking proper account of the risk and uncertainty applying to the investment at the time it was made. They further state that in a competitive market, neither excessive nor inadequate returns could be sustained over an extended period. Paragraph 2.6 of the Guidelines allows the platform provider to profit from investing in a risky venture.
90. Rapture did not apply in this Appeal for disclosure and inspection of the Sky Platform Model. It made its submissions without having seen this Model. Without having done so there is a lack of foundation for its submissions which purport to address the Sky Platform Model and the use which OFCOM made of it.

91. In the Tribunal's judgment, OFCOM's and Sky's criticisms that Rapture has failed to adduce sufficient evidence or otherwise substantiate its arguments under this ground are valid. We do not consider that Rapture has done enough to make out a compelling case. There is no material before us to suggest that OFCOM's determination was flawed and the return was excessive. We accept OFCOM's submissions which we consider adequately respond to the points raised by Rapture.

3. *What is the relevance of commercial negotiations?*

92. The 2002 Guidelines provide:

**“Approach to regulation**

1.11 The current statutory provisions were framed in terms which enabled Oftel to intervene in firms' pricing only in the event that commercial negotiations fail to arrive at an outcome which is fair, reasonable and non-discriminatory. The statement confirmed that Oftel does not propose to modify the licence to allow the Director General to set prices for conditional access services. Oftel considers that the ex post regulatory mechanism for such services combines the advantages of flexibility to take account of different circumstances, with valuable scope for incentives. It allows for negotiation but at the same time offers the safety net of a complaint to Oftel in the event of negotiations failing.

1.12 The purpose of these guidelines is to enable parties to negotiations to understand the principles which Oftel would be likely to apply if it received a complaint that the prices offered were not fair, reasonable and non-discriminatory.

1.13 The process Oftel would undertake to assess whether prices for conditional access or access control services are fair, reasonable and non-discriminatory incorporates consideration of a number of factors, including the following:

- the structure of tariffs and tariff setting;
- assessment of whether charges are reasonably related to costs; in particular, whether the terms offered by the provider were consistent with those which would be expected in a competitive market;
- assessment of whether prices are non-discriminatory; and
- how the tariffs should approach the distribution of common costs.

This process is described in more detail below.

1.14 In the event that the Director General took the view, after investigation and consultation, that the prices offered were not fair, reasonable and non-discriminatory, he would then take enforcement action in the form of a statutory direction to require the provider to revise its prices in order to comply with the requirement to offer such prices.”

*The Parties' Submissions*

93. Rapture refers to the references in the 2002 Guidelines to “commercial negotiations” and to the expectation that these will arrive at an outcome which is FRND. Rapture submits that the 2002 Guidelines include a requirement to negotiate which it submits is a necessary part of the process of arriving at a price which is FRND. Rapture submits that negotiations carried out in accordance with the 2002 Guidelines should not result in the default application of the indicative price. Rapture submits that a failure to negotiate the price as would be done in a competitive market is likely to result in the price not being FRND and that OFCOM was obliged to consider whether or not such negotiations had occurred. Rapture submits that OFCOM should have taken into account that the inequality of bargaining power between Sky and Rapture meant that the chance of meaningful negotiations between Sky and Rapture was limited or non-existent.
94. OFCOM submits that negotiation is absolutely critical to the application of the guidelines. OFCOM submits that what it has to do is to see whether the negotiations followed the Guidelines.
95. OFCOM submits that it cannot consider material not put forward during the negotiation in determining whether the price was FRND in respect of the period of time relevant to the dispute. OFCOM submits that if it concludes on the basis of new material that the price is not FRND then it is open to the broadcaster to go back to Sky and say “We want to have another negotiation in relation to a different period of time”. However the conclusion on the new material would not permit OFCOM to determine that the price was not FRND in respect of the period of time relevant to the dispute. OFCOM submits that its role is effectively to act as a sort of long-stop to see whether this negotiation was properly carried out in the way that it thought it was going to be.
96. Sky submits that whether as a matter of law OFCOM was confined to determining the dispute on the arguments and material evidence put before Sky, OFCOM looked at the additional material and concluded that even on the basis of that additional material the price was FRND. Sky submits that the question for the Tribunal is did OFCOM get it

wrong on the material before OFCOM, not the material before Sky. Was it outside OFCOM's margin of appreciation?

97. Sky submits that the 2002 Guidelines do not require counterfactual analysis by OFCOM nor do they require that competitive market conditions are replicated or that the parties should pretend there was a competitive market for EPG services and to negotiate accordingly.

*The Tribunal's Analysis*

98. The 2002 Guidelines address the prices to be charged for EPG services. The 2002 Guidelines envisage a two stage process. The first stage is commercial negotiations. The second stage kicks in if the first stage fails. The second stage is an *ex post* regulatory mechanism which offers the safety net of a complaint to OFCOM in the event of negotiations failing. We refer for this to paragraphs 1.11 to 1.14 of the 2002 Guidelines.
99. The 2002 Guidelines set out the process which OFCOM would undertake to assess whether prices are FRND. In paragraph 1.12 the purpose of the 2002 Guidelines is stated to be "to enable parties to negotiations to understand the principles which [OFCOM] would be likely to apply if it received a complaint that the prices offered were not FRND". The premise underlining the 2002 Guidelines is that the parties should negotiate a price applying the principles set out in the 2002 Guidelines and if they do so then, since those principles are those which it is likely that OFCOM will apply, the negotiated price is likely to be considered by OFCOM as FRND.
100. The 2002 Guidelines are framed on the basis that if those negotiations fail to arrive at an outcome which is FRND then OFCOM will take enforcement action in the form of a statutory direction to require the provider to revise its prices in order to comply with the requirement to offer prices that are FRND (see paragraph 1.14).
101. Under the 2002 Guidelines, commercial negotiations are prerequisite to enforcement which is described in the 2002 Guidelines as the *ex post* regulatory mechanism. Sections 185 – 191 of the Communications Act 2003 interpose a separate mechanism

pursuant to which OFCOM can determine certain disputes between, inter alia, communications providers.

102. Under the 2002 Guidelines, before entertaining a complaint, OFCOM should satisfy itself that commercial negotiations have taken place. However we do not consider that the Guidelines require OFCOM to review in detail the discussions and exchanges which took place between the parties during the negotiations and whether they were such as would be expected in a competitive market. Nor is there anything in the 2002 Guidelines which indicates that the material provided during the negotiations is the only material which OFCOM can take into account if a complaint is made to them.
103. In the present case Rapture disputes that the price offered by Sky was FRND. Rapture submits that Sky did not negotiate with it properly or at all. Rapture referred this dispute to OFCOM under the dispute resolution procedures set out in sections 185 – 191 of the CA. OFCOM determined that it was appropriate for it to handle this dispute. In considering the dispute OFCOM followed the requirements of the 2002 Guidelines that negotiations were a prerequisite to a reference under section 185.
104. The issue which has arisen in this appeal is whether OFCOM was required to review the discussions and exchanges which took place between the parties during the negotiations and whether it is constrained in its consideration of the dispute under sections 185 – 191 by the information presented by the parties during the negotiations.
105. The dispute is whether the price offered by Sky is FRND. It is not as to the conduct of the negotiations between Rapture and Sky or as to their relative bargaining power. We do not consider that OFCOM was required to conduct a detailed review of the discussions and exchanges which took place between the parties during those negotiations.
106. Under section 188(2), having decided to handle the dispute, OFCOM must consider the dispute and make a determination for resolving it. The procedure for consideration and determination of the dispute is to be the procedure which OFCOM considers appropriate (section 188(3)). Except in exceptional circumstances a determination of the dispute must be made by OFCOM within 4 months, or sooner if practicable, of

OFCOM deciding to handle the dispute (see sections 188(5) and (6)). The powers of OFCOM when making a determination of the dispute are set out in section 190. The most appropriate powers there set out in the context of the present determination are to make a declaration setting out the rights and obligations of the parties to the dispute and to give a direction fixing the terms or conditions of transactions between the parties to the dispute (see section 190(1) and (2)).

107. Section 191 contains OFCOM's powers to require information in connection with a dispute. Under this provision OFCOM can require certain persons (see section 191(2)) to provide them with all such information as they may require for the purposes of considering and making a determination for resolving the dispute (see section 191(1)). The persons who are so required include a person who is not a party to the dispute but who appears to OFCOM to have relevant information (see section 191(2)(b)).
108. OFCOM's submission, summarised in paragraph 95 above, that it is constrained by the information presented during the negotiations would appear to us to be inconsistent with these statutory provisions. In our judgment an error of law would have arisen if OFCOM approached its consideration and determination of the dispute and the information which it sought in accordance with section 191 within such narrow confines. OFCOM's approach would be open to similar criticism if it excluded material provided to it pursuant to its request under section 191, which may otherwise be relevant, on the basis that it was not material provided during the negotiations. On the other hand OFCOM would properly have in mind the four month period within which a determination is to be made in the absence of exceptional circumstances, when exercising its powers under section 191.
109. The question before the Tribunal is accordingly whether OFCOM's determination is wrong on the material before OFCOM (and any additional evidence which may be properly adduced before the Tribunal) rather than the material before Sky. In our judgment this requires OFCOM when making a determination under its dispute resolution jurisdiction to consider objectively the issue in dispute so as to determine whether the charges to Rapture offered by Sky are FRND.

110. The powers of the Tribunal are set out in section 195 of the 2003 Act. The Tribunal’s jurisdiction is an appeal on the merits and by reference to the grounds of appeal as set out in the Notice of Appeal. The Tribunal’s jurisprudence as to further evidence being adduced by the Appellant on an appeal on the merits to the Tribunal may apply equally to appeals under section 192.
111. Rapture has not adduced further evidence before the Tribunal, but is instead requesting the Tribunal to remit the decision under appeal to OFCOM for OFCOM to reconsider and re-determine the dispute, the subject matter of the determination. The question which is posed by Rapture in this respect is whether OFCOM properly took into consideration the information which was before it. This arises particularly in respect of the information provided to OFCOM (which was not provided to Sky) relating to the financial circumstances and viability of Rapture and also with respect to the financial and other information which OFCOM considered on the “willingness to pay” factor contained in the 2002 Guidelines.
112. Rapture submits that the charge was not FRND for various reasons. We have rejected certain of these above, viz: that the charge included the STB subsidy as part of the common costs; that OFCOM failed to consider whether the price arrived at was one which would be expected in a competitive market; whether the return on Sky’s investment was excessive; that OFCOM failed properly to consider the negotiations (or lack of them) between Rapture and Sky. We now turn to consider Rapture’s other submissions supporting its case that the charge was not FRND.

***4. Have Rapture’s ‘willingness to pay’ and other relevant factors (including non-discrimination) been properly taken into account?***

***(a) Willingness to pay***

113. The 2002 Guidelines provide as follows:

**“Willingness to pay**

3.7 Where a channel generates retail revenues, either through subscription, advertising or otherwise, Oftel considers that such revenue is a key indicator of ‘willingness to pay’ and would expect a reasonably close linkage between retail revenues and conditional access or access control charge. This is not the only factor to be taken into account, as there would be other attributes a broadcaster

might ask to be considered in negotiations, such as those outlined at paragraphs 3.13-3.14. Oftel is not suggesting that this should form the basis of a 'formula' between retail price and conditional access/access control charges, but would expect the agreements as a whole to be broadly reflective of the retail revenues expected by the broadcaster when offering its service to the end-user.

3.8 This approach should also ensure that a single channel broadcaster would not be unduly impaired in competing with a similar channel provided by another broadcaster as part of a package of channels.”

114. OFCOM stated in paragraph 5.168 – 5.171 of the Determination (footnotes omitted):

5.168 Ofcom considers that willingness to pay is a relevant factor in ensuring that prices are fair and reasonable because it is a significant part of the process of commercial negotiation. The 2002 Guidelines consider a range of factors following an underlying principle that prices should be broadly in line with those which could be expected in a competitive market. Therefore, the 2002 Guidelines argue that it is legitimate to take into account a customer's willingness to pay in considering the appropriate charge for access to the Sky Platform, because this reflects what would be found in a competitive market. In such markets, prices are set as a result of commercial negotiation that is influenced by, among other factors, a customer's willingness to pay.

5.169 A broadcaster's willingness to pay for an EPG listing can be measured by the amount of sustainable profit it reasonably expects to make from being on the platform. At the extreme, therefore, the reasonableness of an EPG listing charge can be addressed by the test: "Does the price being charged amount to one which could price the channel off the platform?" Ofcom notes that this does not imply that Sky could reasonably charge broadcasters the entire amount of a channel's profits as an EPG listing charge. Rather, that if the proposed charge approaches the sustainable level of profits the principles of fairness and reasonableness would require Sky to negotiate a reduced charge, subject to the other requirements of non-discrimination, fairness and reasonableness. The test is however not in itself determinative, and the charge would also need to take account other factors as described in the 2002 Guidelines which would feature in commercial negotiations.

5.170 In considering whether Rapture was "priced off" the platform, Ofcom has noted Oftel's 2003 Decision. In that case, Oftel considered whether the pricing of EPG listings on the Sky Platform was fair, reasonable and non-discriminatory. In its decision document, Oftel stated [at paragraphs 17-18]:

*“Given the relatively low level of the EPG listing charges, the Director considers that the “willingness to pay” threshold (as set out at paragraph 12 above) is not a difficult one to pass. This is in contrast to the threshold for encryption charges which is typically many times higher. Nevertheless, this does not imply that SSSL can simply assume willingness to pay at these level of charges. Whilst the Director has found that EPG channel listing charges do fall between the floor of the incremental cost and the ceiling of the stand-alone costs of the service, it remains the case that SSSL must also take into account willingness to pay.*

*In this case, the evidence available to the Director suggests that rational parties are in general willing to pay charges at the new levels. The Director understands that nine (9) EPG agreements have been signed on the new*

*terms. The Director further considers that the new EPG charges cannot reasonably be said to be fatal to the business plans of either of the two complainants when the scale of other costs which are involved in the running of a TV or radio channel on the digital satellite platform (not least the significant costs associated with the purchase of satellite transponder capacity) far outweigh the level of the new charges.”*

5.171 Ofcom has considered Rapture’s willingness to pay by reviewing its business plans and actual financial results.”

115. In paragraph 5.172, OFCOM explains the analysis it undertook.

“5.172 In order to assess Rapture’s willingness to pay, Ofcom has examined whether or not the EPG listing charge levied by Sky of £76,000 was sufficiently high to “price off” Rapture from the Sky Platform.”

116. OFCOM continued:

“5.173 In principle, Ofcom notes that a preferred approach to setting charges on the Sky Platform is one which provided for charges which reflected the relative willingness to pay of different channels. In practice, Ofcom accepts that the use of an indicative rate card charge to set prices is one which is administratively convenient and can help to reduce administration costs. However, in applying a unitary rate card charge significantly in excess of the incremental cost of providing a service, Sky must also ensure that the application of the rate card takes into account those factors which would feature in negotiations in a competitive market. One such factor is a broadcaster’s willingness to pay.

...

5.175 In order to assess whether Rapture’s business case justified an EPG listing charge lower than the indicative rate card charge, Ofcom obtained various business plans and financial information from Rapture in order to determine whether the EPG listing charge levied by Sky was one which could be argued to have priced Rapture off the Sky Platform. ...”

117. From paragraphs 3.83 – 3.90 and 3.99 of the Determination it can be seen that OFCOM:

- (a) sent two information requests to Rapture on 15 December 2006 and 16 January 2007 pursuant to its powers under section 191 of the 2003 Act;
- (b) met with Rapture on three occasions to discuss the case;
- (c) sent information requests to Sky pursuant to its powers under section 191;
- (d) engaged in correspondence and telephone conversations with Rapture and Sky; and

- (e) sent information requests to four smaller broadcasters on the Sky platform who provided information on channel operating costs which OFCOM used in its analysis of the willingness to pay issue.

118. Paragraph 5.176 of the Determination lists the information provided by Rapture to OFCOM pursuant to the information requests and which OFCOM took into account in OFCOM's determination. It states (footnotes omitted):

“Rapture provided Ofcom with the following information relating to its financial performance:

- 5.176.1 a 2004 business plan which was not updated at the time Rapture entered into its 2005 EPG contract with Sky (the “2004 Business Plan”);
- 5.176.2 a cash flow projection dated May 2005 (the “2005 Financial Projections”);
- 5.176.3 a spreadsheet detailing Rapture's cash receipts, cash payments, cheques paid and invoices issued for the period 17 March 2005 to 10 December 2006;
- 5.176.4 a schedule of Rapture's estimated accruals and prepayments as of February 2006; and
- 5.176.5 a document entitled “[...]” which was prepared subsequent to the period of this dispute.

Ofcom notes that these documents were not supplied by Rapture to Sky in their negotiations to seek a lower price.”

119. OFCOM, in its Determination, considered that:

- (a) The 2004 Business Plan did not suggest that Rapture was being priced off the platform as a result of Sky's proposed level of charges and shows that such charges were clearly affordable on the basis of the plan.
- (b) The 2005 Financial Projections did not cover a sufficiently long period and were insufficiently detailed or supported to be able to illustrate that Sky's indicative rate card charge would be unfair or unreasonable in Rapture's case.
- (c) Based on costs data from a number of small, free-to-air channels, OFCOM believed that it was possible that the level of the EPG listing charge could price a channel off the Sky platform, but that OFCOM was not at that time aware, through complaints or responses to the dispute, of any comparable

broadcasters being priced off the Sky platform due to the level of the rate card EPG listing charge.

120. OFCOM's conclusions on the 'willingness to pay' factor are set out at paragraphs 5.201 to 5.204 of the Determination. Paragraph 5.204 states:

“On the facts of this case, Rapture's 2004 Business Plan indicates that the indicative rate card charge for an EPG listing was not set at a level which would price Rapture off the Sky Platform and was clearly “affordable”. The 2005 Financial Projections are of insufficient duration or detail to draw any meaningful conclusions about Rapture's willingness to pay in respect of the indicative rate card charge. In Ofcom's view, even if Rapture had submitted details of its 2004 Business Plan or 2005 Financial Projection to Sky, these would not have provided a compelling case for Sky to reduce its EPG listing charges in Rapture's case. On the contrary, the 2004 Business Plan would have indicated that Sky's EPG listing charge was not at a level which could have plausibly priced Rapture off the Sky Platform.”

*The parties' submissions*

121. In paragraphs 77 -79 of the Notice of Appeal Rapture states that:
- (a) OFCOM should have either requested more specific figures from Rapture or itself produced forecast figures that could reasonably be attributed to Rapture.
  - (b) The onus was on OFCOM to request all necessary information from Rapture.
  - (c) OFCOM could have assessed Rapture's revenue by using BARB figures (estimates of TV viewing audiences).
  - (d) OFCOM could have assessed whether Sky's EPG charge to Rapture was FRND.
122. Rapture submits that OFCOM's conclusions on willingness to pay were erroneous or unreasonable in that it declined on incorrect or irrational grounds to take account of Rapture's 2005 Financial Projections, in particular:
- (a) by failing to take account of the fact that the charges could increase as Rapture's audience and revenue developed; and
  - (b) by erring in relying on its belief that the projections did not cover a sufficiently long period, even though the dispute considered a lesser one year period and was confined to the charges for that year.

123. OFCOM submits that it is common ground that willingness to pay is a relevant factor in determining whether the price charged is FRND and that it did consider this ground in making its determination.
124. OFCOM submits that willingness to pay is a factor that may mean that a small broadcaster might pay less than a large broadcaster. Consideration might then be given to information such as the business plan. Willingness to pay is a factor which must be balanced against the criteria of non-discrimination. OFCOM refers in this respect to the fact that it looked at other channels in the same position as Rapture.
125. OFCOM further submits that on the evidence provided to it as to Rapture's finances it properly concluded that there was not a compelling case for Sky to reduce its EPG listing charge in Rapture's case on willingness to pay grounds. OFCOM submits that Rapture has provided no evidence on the basis of which the Tribunal could conclude that either OFCOM's specific conclusions at paragraphs 5.175 and 5.201 to 5.204 or the overall outcome of the Determination was wrong.
126. In response to Rapture's allegation that OFCOM should have requested more specific financial figures from Rapture, or should itself have produced financial forecast figures that could reasonably have been attributed to Rapture, OFCOM submits that:
- (a) OFCOM did request a wide range of financial information from Rapture but Rapture only provided the financial information listed in paragraph 5.176 of the Determination;
  - (b) OFCOM does not consider that its role under section 185 of the 2003 Act requires it to go so far as to create evidence in the form of financial forecasts on behalf of one party in furtherance of that party's case against the other party to the dispute;
  - (c) OFCOM does not accept that it could sensibly have produced revenue forecasts on the basis of BARB data, as suggested by Rapture; and
  - (d) Rapture's own forecasts of advertising revenue in its supplied business plans were at a significant variance to the advertising revenues actually recorded in its supplied cash book.

127. Sky submits that there is no evidence that the EPG charge is set at a level which would price an efficient channel with a viable business model off the platform.

*The Tribunal's Analysis*

128. Paragraphs 3.7 and 3.8 of the 2002 Guidelines refer to 'willingness to pay' as a factor to be taken into account. Those paragraphs state that OFCOM would expect the agreements as a whole to be broadly reflective of the retail revenues expected by the broadcaster when offering its service to the end-user and that there would be a reasonably close linkage between retail revenues and the charge.
129. OFCOM assessed Rapture's willingness to pay by examining whether or not the EPG listing charge levied by Sky of £76,800 was sufficiently high to "price off" Rapture from the Sky platform. In doing so it considered the information provided to it by Rapture which we have referred to above as well as the overall business costs of comparable broadcasters in order to assess the materiality of the indicative EPG listing charge to their business. OFCOM concluded that the 2004 Business Plan indicated that the EPG listing was clearly "affordable" and that the 2004 Business Plan and 2005 Financial Projections did not provide a compelling case for Sky to reduce its EPG listing charges in Rapture's case. The responses received from comparable broadcasters did not provide any evidence of comparable broadcasters being priced off the Sky platform due to the level of the rate card EPG listing charge. Rapture submits that OFCOM should have requested further information from Rapture or carried out its own investigations and should not have concluded on the basis of this information which was provided to it.
130. As we have mentioned in paragraph 107 above, under section 191 of the 2003 Act OFCOM may require specified persons to provide them with all such information as they may require for the purpose of considering the dispute and making a determination for resolving it. Accordingly OFCOM has a power but not a duty to request information.
131. OFCOM used these information powers to obtain information from Rapture, Sky and from comparable broadcasters. We consider that the criticisms made of OFCOM by

Rapture in this regard are unfounded. Rapture had sufficient opportunity to place before OFCOM such information as it considered relevant to OFCOM's determination of the dispute. Rapture cannot now complain if there was further information which was relevant but which Rapture did not provide OFCOM. In any event Rapture has not sought to identify or put such information before this Tribunal or shown its relevance. Rapture's assertions are bald and devoid of particularity. On the material before us we do not consider that there is any substance in Rapture's submissions on the 'willingness to pay' issue.

**(b) Other relevant factors – including non-discrimination**

132. Chapter 3 of the 2002 Guidelines includes the following:

**“Costs and benefits**

3.12 There may be other costs and benefits to the broadcaster and the platform provider that Oftel would expect to be taken into account in negotiations over the conditional access or access control charges to be borne.

3.13 For the broadcaster, factors relevant to carriage on the platform might include:

- any increase in revenues expected to be associated with broadcast on the platform (which may include subscriptions, advertising or other);
- the number of viewers available through the platform;
- the type of service offered; and
- the number of channels in the package which the broadcaster wishes to offer.

3.14 Oftel also expects broadcasters and the provider to give consideration to the counterbalancing benefits to the platform from carriage of the broadcaster's channel or channels. Such benefits may include:

- the attractiveness of the content offered to the platform's current viewers – with the likelihood of a positive effect on retention;
- the complementarity between the platform and the content which may attract new viewers to the platform; and
- the element of risk for the platform, including factors such as the length of contract and the certainty of income for the platform provider (see 2.4-2.7).”

133. Chapter 2 of the 2002 Guidelines includes the following:

*“Non-discrimination*

“2.8 ...

2.9 ...

2.10 ...

2.11 In order to ensure compliance with the non-discrimination obligation, a provider should ensure, amongst other things, that:

- it applies equivalent conditions in equivalent circumstances to other broadcasters providing equivalent services;
- it provides services and information to other broadcasters under the same conditions and of the same quality as it provides to its own broadcasting channels; and
- it can objectively justify any differentiation.”

*The Parties’ Submissions*

134. Rapture submits that OFCOM failed to ensure that the charges were FRND and failed to take account of the 2002 Guidelines in that it failed properly or at all to take account of Rapture’s particular circumstances as a new and relatively low audience and low revenue channel.
135. Rapture submits that the financial projections provided to OFCOM showed the need for there to be a lower price. At the hearing, Rapture submitted that while there is an indicative rate charge, and one would expect there to come a point in time at which the indicative rate charge would apply, one would be surprised if the indicative rate charge always applied in the first year of a channel’s operation.
136. Rapture submits that broadcasters who are starting up should not bear the same burden of costs as large and substantial players. Rapture submits that OFCOM should have but failed to take into account that such broadcasters require the opportunity to build up advertising and revenue in order to have any real access to the platform in determining the appropriate charges for EPG services. Rapture submits that OFCOM has a positive duty to differentiate between users, since it has a statutory duty to ensure sufficient plurality and variety for the benefit of ultimate consumers. Rapture submits that OFCOM was obliged to pay due regard to the fact that Rapture was in a substantially

weaker bargaining position than Sky, and in a weaker bargaining position than it would have been in a competitive market.

137. Rapture submits that, in determining whether the price imposed by Sky is FRND, OFCOM is required to consider the relative size of a broadcaster; and that it belies commonsense that a broadcaster the size of Rapture has the same willingness to pay as much larger broadcasters to whom Sky charges the same price.
138. Rapture submits that, in assessing charges, OFCOM should have taken into account the benefits to the Sky platform from the carriage of Rapture. Rapture refers to paragraphs 3.12 and 3.14 of the 2002 Guidelines in this regard. Rapture submits that such an assessment would have revealed that Rapture was an innovative channel. Rapture also highlights in its submissions that while Sky subscribers pay a subscription fee to Sky to view Sky's pay TV channels, they are able at the same time to watch free-to-air channels such as Rapture carried on the Sky platform and that Sky does not pay free-to-air channel broadcasters for providing those channels to Sky's subscribers free of charge.
139. Rapture submits that OFCOM has not properly applied paragraph 3.10 of the 2002 Guidelines, which states that "different broadcasters may benefit to different extents, in which case their relative charges should reflect this." Rapture is an entertainment channel intended for a youth audience, and therefore not everyone with a STB would watch Rapture.
140. OFCOM submits that Rapture's submissions under this head are inconsistent both with the principle of competitive neutrality and with the principle of maintaining investment incentives, which it submits are the cornerstones of the 2002 Guidelines. OFCOM submits that the principle of competitive neutrality is set out in paragraph 3 of the Summary to the 2002 Guidelines under the first bullet point and the major point of this is to ensure that Sky does not favour its operations as against third parties. Rapture also refers to paragraph 3.11 of the 2002 Guidelines where it submits another aspect of competitive neutrality is set out.

141. OFCOM submits that there is no duty in the 2002 Guidelines to require Sky to discriminate in favour of start-ups. OFCOM submits that the basic principle is non-discrimination, so for Rapture to have a special deal it would be necessary for there to be evidence that Rapture was in a different position from another broadcaster. Different treatment must be objectively justified.
142. OFCOM submits that contrary to Rapture's submissions, OFCOM did take the benefit to broadcasters into account in assessing whether Sky had properly allocated the costs of the Sky platform and concluded that it was reasonable to expect broadcasters such as Rapture to make some contribution towards the common costs of the Sky platform, including the STBs.
143. OFCOM submits that it would be discriminatory for Sky to charge channels different amounts for EPG services except where objectively justifiable reasons existed for doing so and that Rapture provided no detailed information or evidence to OFCOM which indicated that Rapture would in fact provide particular benefits to the Sky platform or to Sky.
144. Sky submits that in order to offer lower charges to Rapture, Sky would have had to be able to demonstrate an objective justification for doing so, otherwise many other channels could have complained to OFCOM that Sky was in breach of its non-discrimination obligations. Sky submits that there are a significant number of other small channels which appeal to small audiences (there are over 200 free-to-air TV channels) and that Rapture has failed to explain why it is in a different position to these other channels.
145. Sky submits that the benefit that an additional, small, free-to-air channel, such as Rapture, can bring to its digital satellite platform is unlikely to be sufficiently great as to justify a reduction in the EPG charge. In any event Rapture failed to provide any information to Sky or OFCOM which would have resulted in a justified reduction in the EPG charge on the basis of its financial position.

*The Tribunal's Analysis*

146. Rapture's submissions are that because it is a new, start-up channel with a relatively small audience and lower revenues than established or larger channels it ought to be entitled to a lower EPG charge, at least in its initial years of operation. Rapture's approach would, in effect, mean that any new entrant or small broadcaster would be subsidised to some extent either by Sky (as the platform provider) or other established or larger channels operating on the same platform. In addition it submits that it is entitled to a lower EPG charge because it is an innovative channel which derives less benefit from the Sky platform than do other channels and that the Sky platform derives benefit from including Rapture on it.
147. The fact that Rapture's programming appeals only to a limited proportion of those television viewers is a matter for Rapture and its choice of business plan, rather than a matter for Sky. In any case, Rapture's assertion that it benefits to a lesser extent than other channels has not been substantiated by any evidence before us.
148. We consider on the material before us that Rapture's submissions on this issue are misconceived.
149. We accept OFCOM's submission that there is no duty to discriminate in favour of start-ups or small companies per se. The fact that Rapture is a start-up or small company with a channel which has limited audience appeal is not a sufficient reason for charging a different price. In our judgment, for Rapture to make out this ground of complaint it would be necessary for it to have provided some evidence that it was in a different position to other broadcasters so that the charge to it should be different. Rapture has not done so. Accordingly, we reject this ground of appeal.

**CONCLUSION**

150. For the reasons set out above, the Tribunal unanimously dismisses the appeal.
151. We would just add that this appeal has raised some important points of principle, particularly as to the interpretation of the 2002 Guidelines and the dispute resolution procedure set out in sections 185 to 191 of the 2003 Act. Rapture's advisers

represented it before us on a pro bono basis, and it should not be left unrecorded that it is commendable that they did so.

Marion Simmons

Paul Stoneman

David Summers

Charles Dhanowa  
Registrar

Date: 31 March 2008

## ANNEX

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### SUMMARY OF RAPTURE'S CASE REGARDING DETERMINATION With indicative cross-references to Rapture's Written Argument

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1. Ofcom failed properly to identify the costs which were reasonably and necessarily incurred in providing the EPG listing service. It therefore failed properly or correctly to ascertain the costs which Sky could or should be entitled to recover from Rapture. (see heading above para 5.15 of Determination)

Either

- a. Ofcom incorrectly treated the STB subsidy as a common cost; or
- b. Ofcom failed properly to assess the costs which Sky were entitled to recover. It ought to have identified the specific costs of providing the EPG service to a broadcaster and then sought to ascertain any additional value that Rapture was afforded by being provided with the EPG service. It should have treated this value as an externality to be valued. Instead it identified a number of matters which it could and should have considered (para 5.54 of the Determination; especially para 5.54.5) and decided not to undertake the necessary review (para. 5.55).

(See Rapture skeleton paras. 55-79, 95-97; for other matters regarding incorrect cost calculation not developed orally see paras 80-87<sup>[1]</sup>)

2. Ofcom drew incorrect inferences from the fact that Sky's charges were set between the "floor" of incremental cost and "ceiling" of stand-alone cost (see heading above para 5.70 of Determination). In effect, Ofcom drew undue or incorrect reassurance that the charges were FRND from this finding.

(See Rapture skeleton paras. 46-54)

3. In taking account of the outcome of the "negotiations" between Sky and Rapture, Ofcom
  - a. took account of matters that were irrelevant ; and/or
  - b. drew incorrect inferences from this outcome as to whether the charges imposed were FRND and / or
  - c. drew incorrect inferences from the facts in that it failed properly or at all to take account of the circumstances of Rapture and Sky and their relative bargaining power.

(See heading above para. 5.103 of the Determination); (See Rapture skeleton paras. 92-94 & 99-110)

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<sup>[1]</sup> To the extent that Ofcom failed to establish the correct cost base for its assessment, its assessment of the appropriate rate of return would also have been affected.

4. Ofcom failed properly or at all to take account of Rapture's particular circumstances as a new, relatively low audience and low revenue channel. In so doing it failed to ensure that the charges were in the circumstances FRND, and failed to take account of the 2002 Guidelines, in particular those passages quoted in paragraphs 5.159 to 5.162 of the Determination.

(See headings above para . 5.159 and 5 .205 of the Determination) ; (See Rapture skeleton paras. 88-91 & 111-114)

5. In taking account of the "other factors" (see headings above para. 5.159 and 5.205 of the Determination) it took account only of "willingness to pay" and its conclusions on this were erroneous or unreasonable, in particular on account of the fact that Ofcom declined to take account of Rapture's 2005 Financial Projects on grounds that were incorrect or irrational and failed to take account of the fact that the charges could increase as Rapture's audience and revenue developed. (In particular Ofcom erred in relying on its belief that the projections did not cover a sufficiently long period, even though the dispute considered a lesser one year period, and was confined to the charges for that year).

(See Rapture skeleton paras. 106-110)

**Michael Bowsher QC**  
**Elisa Holmes**  
**Fiona Banks**

**19 December 2007**