

This Transcript has not been proof read or corrected. It is a working tool for the Tribunal for use in preparing its judgment. It will be placed on the Tribunal Website for readers to see how matters were conducted at the public hearing of these proceedings and is not to be relied on or cited in the context of any other proceedings. The Tribunal's judgment in this matter will be the final and definitive record.

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

Case No. 1082/3/3/07

Victoria House,  
Bloomsbury Place,  
London WC1A 2EB

19<sup>th</sup> December 2007

Before:  
MARION SIMMONS QC  
(Chairman)

PROFESSOR PAUL STONEMAN  
DAVID SUMMERS

Sitting as a Tribunal in England and Wales

**BETWEEN:**

**RAPTURE TELEVISION PLC**

Applicant

- v -

**THE OFFICE OF COMMUNICATIONS**

Respondent

Supported by

**BRITISH SKY BROADCASTING LIMITED**

Intervener

---

*Transcribed by Beverley F. Nunnery & Co.  
Official Shorthand Writers and Tape Transcribers  
Quality House, Quality Court, Chancery Lane, London WC2A 1HP  
Tel: 020 7831 5627 Fax: 020 7831 7737*

---

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

Mr. Christopher Vajda QC and Phillip Woolfe (instructed by the Director of Telecommunications and Competition Law, Office of Communications) appeared for the Respondent.

Mr. Peter Roth QC and Stephen Wisking (Partner, Herbert Smith) appeared for the potential Intervener, BSKyB.

---

**HEARING**  
**DAY TWO**

1 THE CHAIRMAN: Good morning. Can I thank Mr. Bowsher and Mr. Vajda for their notes this  
2 morning which have been very useful.

3 MR. BOWSHER: I know I have already sat down, but I should explain the documents.

4 Obviously, there is the summary of our challenges which is the document which was  
5 contemplated. As I said yesterday, we were going to present a short list of what was in the  
6 platform. There is obviously more evidence on all of this - relevant evidence - in Mr.  
7 Henry's second statement at paras. 21 to the end where he goes through the material which  
8 is already referred to in the skeleton. One point I should just highlight, of course, is that the  
9 way we have categorised the term 'Sky platform' includes equipment and so forth which is  
10 not necessarily owned by Sky. So, while one may talk in the vernacular about the Sky  
11 platform, and people have always talked about the Sky satellite, there has never been, as far  
12 as I am aware, a satellite owned by Sky. Getting access to the transponder is something  
13 broadcasters have always done. But, since the 1980s people have always talked about the  
14 Sky satellite in some general way as being part of platform. I just wanted to qualify that  
15 note.

16 THE CHAIRMAN: Mr. Vajda?

17 MR. VAJDA: What I would like to do is to say something about the parameters of this appeal  
18 because obviously that is quite important. I want to start by going back over some of the  
19 ground that Mr. Bowsher went to yesterday in relation to the legal obligations imposed on  
20 Sky. Mr. Bowsher took us to what I think he called the top of the legal tree which is the  
21 Access Directive. I would like to go back to that, if I may. If I have got my references right,  
22 that is 1722 of the Grey Book. As always with these treaty directives it is important to look  
23 at the structure of the directive. Mr. Bowsher referred us yesterday to Article 5. Just to  
24 refresh our memory it is Article 5(1)(b) where you get the origin of the FRND. The point I  
25 want to make is that if one goes back to p.1721 one sees that this falls within the general  
26 provisions, Chapter II of the Access Directive. That is important because what Ofcom had  
27 to determine is whether or not the price offered by Sky was FRND. This not an exercise in  
28 price control. I will come back to Chapter III in a moment. As Madam Chairman pointed  
29 out yesterday, one can have a range of prices that are FRND. We would say that even in the  
30 case of one purchaser there could be a range of prices. So, if one goes to the facts of this  
31 case, the £78,000 may not have been the only FRND price.

32 Now, what one needs to do as a matter of law is to contrast the FRND obligation which we  
33 see in Article 5 with the more intrusive obligations in Chapter III, which you see is headed  
34 'Obligation on Operators and Market Review Procedures'. If one goes to Article 8, this

1 provides for the imposition of additional obligations where an operator is designated as  
2 having what is called in the jargon significant market power - SMP. For an operator to be  
3 so designated, the NRA has to carry out a market analysis (as we see from Article 8(2)) in  
4 accordance with Article 16 of the Framework Directive. One sees from Article 8(2),

5 “Where an operator is designated as having SMP, NRAs shall impose the obligations  
6 set out in Article 9 to 13 of this directive as appropriate”.

7 We see that in contrast sub-paragraph (3),

8 “Without prejudice to the provisions in Articles 5(1), 5(2) ... NRAs shall not impose  
9 the obligations set out in Articles 9 to 13 on operators that have not been designated  
10 in accordance with para. 2”

11 Now, one of the additional obligations which might be imposed if you have SMP is price  
12 control. One sees that at Article 13 at 1726. We just need to glance at that very briefly.

13 There you see that this is a much more intrusive form of regulation where,

14 “An NRA may, in accordance with the provisions of Article 8, impose obligations  
15 relating to cost recovery and price controls, including obligations for cost orientation  
16 of prices and obligations concerning cost accounting systems, for the provision of  
17 specific types of interconnection ---“

18 Now, the distinction between what I call a Chapter III price control obligation and Chapter  
19 II FRND is extremely important in the present case because, as I heard Mr. Bowsher  
20 yesterday, much of his case appears to proceed on the basis that this is a price control issue  
21 and you have to fix a right price. For example, and I hope I got my note accurate, he said at  
22 some point yesterday that Ofcom has to establish ‘a proxy market price’. With respect, that  
23 is not the correct test.

24 THE CHAIRMAN: I think that is when I went back and said, “Well, what was the question that  
25 had to be answered?”

26 MR. VAJDA: Absolutely. In fact, he said in opening yesterday that one of the issues in this case  
27 is, “Did Ofcom do enough?” He said that too often Ofcom accepted Sky’s position without  
28 drilling down further. We then had a criticism -- These are points I will come back to, but  
29 it is important that one sees the framework of what is going on. There has also been a  
30 criticism - and, of course, this has been running throughout the case - that Ofcom has not  
31 investigated what percentage of common costs should be recovered from third party users.  
32 We remember the passage in the determination at 5.54 to 5.55 which I will deal with. But,  
33 it is important for the Tribunal to appreciate that we are dealing here with an FRND  
34 exercise - not a price control exercise.

1 The next point in terms of legal obligation is how Ofcom has sought to discharge the FRND  
2 obligation through the 2002 Guidelines. It is common ground - if I can just give the  
3 Tribunal the two passages in Rapture's skeleton at paras. 28 and 37 - that both guidelines  
4 apply. We will need to look at the guidelines in a moment or two.

5 That then brings me to my second parameter point, which is, "What is the role of this  
6 Tribunal in this case?" The Tribunal, as we know, hears this case as an appeal from the  
7 Ofcom determination on the merits and I just want to make three short points – the Tribunal  
8 already has our defence and our skeleton which go into this in a little detail. First, the  
9 burden must be on the appellant. Secondly, this appeal is not by way of rehearing. Mr.  
10 Bowsher suggested yesterday that an appeal could be by way of rehearing and indeed that is  
11 correct, but he gave no reason why there should be a rehearing in this case, and we say there  
12 should be no such thing.

13 THE CHAIRMAN: Although he has said it he is not really suggesting it because his relief is to  
14 send it back.

15 MR. VAJDA: Yes, he accepted that it should be sent back.

16 THE CHAIRMAN: That is what his relief has been all the time, that it should be sent back.

17 MR. VAJDA: Yes, but the question of whether or not one has a rehearing or not is also relevant,  
18 as it were, whether one starts *de novo* with a fresh piece of paper, and we say one does not.  
19 The third point that I wished to make is that we would adopt the observations that you,  
20 madam Chairman, made yesterday that the national regulatory authority – Ofcom in the  
21 present case – has a margin of appreciation to which an appeal body must give some  
22 deference. We well accept that this is not judicial review, but the point that you, madam  
23 Chairman, made is well established and is well supported by the case law and I refer to  
24 para.94 of our defence.

25 We would add this, that that point is of particular importance in the present case since the  
26 principal attack on Ofcom is a misapplication of the 2002 Guidelines, and the application of  
27 the 2002 Guidelines involves issues of judgment by Ofcom. When one is looking at the  
28 application of the 2002 Guidelines one is not looking at a case of error of law, or indeed  
29 error of fact, but one is looking at a question of judgment.

30 The third and final point that I wish to say on parameters – and I will deal with this  
31 extremely shortly – is pleadings. Plainly pleadings are of great importance in all litigation.  
32 In this case we have had the benefit of a 41 page Judgment, over which the Tribunal plainly  
33 took a lot of time and paid a lot of attention to in deciding what could and could not be

1 advanced. We say the Tribunal needs to examine very carefully whether what is now being  
2 advanced falls within the parameters of the very careful Judgment.

3 What I would ask the Tribunal to do is that in relation to the piece of paper that Mr.  
4 Bowsher put in yesterday, rather than taking up time now, if we would have the  
5 opportunity, say, by the end of the week if there was anything that we wanted to reply to in  
6 writing we could do so; I suspect if we do it will be very short – there may be nothing but I  
7 certainly would not want to take up time this morning. That deals with parameters.

8 The next topic I would like to come to is some definitions, and this really arises out of the  
9 Tribunal's questions yesterday and really the two key terms is what is meant by the Sky  
10 "platform" and what is meant by "EPG services". I hope that there is some common ground  
11 now between the parties. We have prepared a short note which I hope is of assistance to the  
12 Tribunal, indeed, Mr. Bowsher has also prepared a note and I will comment on that in a  
13 moment, but I do not think the parties are hugely apart on this. If I could ask the Tribunal to  
14 take up our little note first? Ofcom uses the term "Sky platform" (para.2) to refer to a  
15 collection of services provided by Sky to channels, i.e. to broadcasters, such as – and the  
16 words "such as" shows that is illustrative and not exhaustive, because those are obviously  
17 the key matters that we are looking at here, EPG, CA and AC, that is if you like software. If  
18 one looks at Rapture's brief outline of "Sky platform", you see that he has put in ----

19 THE CHAIRMAN: Conditional access, access control, EPG listings.

20 MR. VAJDA: And then he has also put in "computers and other electronic systems".

21 THE CHAIRMAN: And components of the set top.

22 MR. VAJDA: Yes, I will come back to the component element of the set top box in a moment,  
23 but he has put in, for instance, computers, and electronic systems, those do not figure in  
24 para.2 but there are computer systems that are running there that we say fall within the  
25 platform.

26 THE CHAIRMAN: In order to do this you have to have some sort of computer system.

27 MR. VAJDA: So if you like you have a lot of technical services and they are called "TPS", that is  
28 one aspect of the platform. The other aspect of the platform is, if you like, the hardware  
29 which is, if you like, which is the set top box which, of course, will itself contain some  
30 software within it. The hardware is essentially a set top box which includes the dish, and if  
31 you see in Mr. Bowsher's little outline "satellite dish".

32 THE CHAIRMAN: Yes.

33 MR. VAJDA: Without the hardware (the set top box) you are not going to be able, as a user to  
34 use your EPG, so you need the two.

1 THE CHAIRMAN: That is part of the access facility?

2 MR. VAJDA: Yes. When one is looking at the hardware, the STB, which includes the dish, one  
3 is looking here, and this is what Mr. Roth took us to yesterday, and what is in our  
4 determination – it is perhaps better if we look at the determination where really the same  
5 point is made. It is paras.3.10 to 3.14. Sky launched its digital platform satellite in 1998  
6 and, as of 30<sup>th</sup> September, the platform was viewed in over 8.5 million households. That  
7 means that there are effectively 8.5 million STBs out there and one has to take account of  
8 those; those are part of the Sky platform. Of course, that is of great importance in the  
9 present case because one of the issues – the second issue that Mr. Bowsher is complaining  
10 about – is the allocation of cost of the platform and, as we know and I will explain this in a  
11 little more detail in a moment or two, the largest element of cost in the Sky platform is  
12 common cost, that is to say common across the board for all broadcasters. The largest  
13 element of that common cost – using it in the sense that I have just described – is the cost of  
14 the set top box which, in fact, Sky subsidises. So, if one is just looking at it at the moment  
15 - what is the cost of the Sky platform? - if the Sky platform, for instance, comprises one  
16 million set-top boxes it would have a very different cost from a platform that comprises 8.5  
17 million boxes. That, of course, is of fundamental importance to the present case because a  
18 platform that comprises 8.5 million boxes as opposed to the platform that comprised one  
19 million boxes is of greater benefit to a broadcaster. You cannot compare the two. One of  
20 the things, again, which is very important in this case - with the greatest respect to Mr.  
21 Bowsher - is that effectively Rapture is seeking to argue that it wants to pay for a particular  
22 product that is not the market. The product on the market is a Sky platform which gives  
23 you access to 8.5 million people. That is the cost. That is what the question is: what is an  
24 FRND price in relation to that product?

25 If we go back to our little note at para. (3) - and again I do not think this is in dispute - it is  
26 possible for a channel to broadcast via satellite without taking any of the platform services.  
27 A viewer may receive such a channel via a Sky set-top box. Now, that would be effective if  
28 you engage in what is called manual tuning. The position is that that is not very satisfactory  
29 for a broadcaster. If it was satisfactory for a broadcaster we would not be here today  
30 because that is what Rapture would be doing. What Rapture wants access to is the EPG. The  
31 point about the EPG is that it is a ready way of directing a viewer to a channel. It is offering  
32 a service to a viewer which is of tremendous benefit to the broadcaster. We go on to make  
33 the point that if you are somebody like Rapture, you are broadcasting off a satellite. You

1 could also receive that channel via a non-Sky set-top box. Indeed, I think that was the point  
2 being made yesterday.

3 However, what we say - and, again, this is of fundamental importance to the position that  
4 Ofcom have taken - is that the broadcaster is only on the Sky platform if he is taking one of  
5 the services of the Sky platform. Again, it is question of comparing apples and oranges.

6 What Rapture what to do is to be on the platform and therefore that is the product that they  
7 wish to buy. The platform then gives you access to the 8.5 million viewers.

8 That is all I want to say on the platform. I now come to EPG services. As a court of law  
9 one looks to the definition in the Act first. It may be helpful if we just go back to that at  
10 p.910.

11 “Electronic programme guide means a facility by means of which a person’s access  
12 to any service which consists of:- the listing or promotion, or both the listing and the  
13 promotion, of some or all of the programmes included in any one or more  
14 programme services; and (b) a facility for obtaining access, in whole or part, to the  
15 programme service or services listed or promoted in the guide”.

16 If we can perhaps go back to para. 6 first, this is effectively what it does.

17 “ The EPG listing services provided to the broadcaster involves assigning an EPG  
18 channel number to each broadcaster’s channel and providing a technical interface by  
19 which the broadcaster can deliver and amend programme schedules and related data.  
20 The essence of the EPG listing services is that the channel may then be seen by  
21 viewers with a set-top box”.

22 So, going back to para. 5,

23 “As a matter of practice, viewers of digital TV use EPGs primarily to navigate  
24 between channels, access channels by unique channel numbers, and browse  
25 programming schedules and related data”.

26 So, it is really a ready means of access for the viewer to a channel.

27 THE CHAIRMAN: Can I just ask you - really just to clear up my own mind so that I am not  
28 confused about what I personally do on these things: BBC World News is 80. Now, that is  
29 the unique number, is it? It is not what I would do if I could programme myself. If I put 80  
30 in it will not work. It is a unique number.

31 MR. VAJDA: I think that is right.

32 THE CHAIRMAN: That is on Freeview - not on Sky

33 MR. VAJDA: On Freeview, yes. Rapture presumably have a number ----

34 THE CHAIRMAN: I do not know what it is on Sky.

1 MR. VAJDA: When Rapture was on the Sky platform ----  
2 THE CHAIRMAN: It would have had a number like 254, or something.  
3 MR. VAJDA: Yes. That is how you would access it. The important point is that the viewer can  
4 only benefit from the EPG if you have got a set-top box. A set-top box is required for the  
5 viewer to use the EPG. So, again, coming back to, "Is one on or off the Sky platform if  
6 there is no EPG listing? -- One is not on the platform, albeit if you are a bit of a technical  
7 geek you may still be able to move your dish around and receive it.  
8 THE CHAIRMAN: The numbers that used to be in the Radio Times - I do not know if they are  
9 still there - are actually not this unique number, but the number you could do yourself?  
10 (After a pause): No. No. So, something completely different.  
11 MR. VAJDA: Yes. (After a pause): I think the answer is 'No'.  
12 THE CHAIRMAN: Yes. That was video-plus apparently.  
13 MR. VAJDA: So, in terms of the EPG which, of course, is being paid for by the broadcaster, the  
14 broadcaster is paying effectively for, if you like, ready access. We accept that access might  
15 technically be possible, although we all know that it is going to be of little use to anybody.  
16 He is paying for access to the customer. That is what this case is all about.  
17 PROFESSOR STONEMAN: May I just ask for clarification? Are you saying that, as you put it,  
18 the geek is in any way acting illegally in accessing the data through unauthorised channels?  
19 MR. VAJDA: No. No. I think the position is that programmes like Rapture, which are free to  
20 view, you can access in any way. There is no copyright problem. Perhaps I might mention  
21 it now before I forget it actually. This is a point which is not, in a sense, relevant to this case  
22 at all, but arose yesterday I would just like to clear up what might have been a  
23 misconception. Access to the Sky platform is not the only way that Rapture can broadcast.  
24 If we can just look at Mr. Henry's second witness statement, which is at tab 7 of  
25 supplementary bundle 1. Paragraph 15 on p.176:  
26 "Rapture continue to be broadcast on satellite by Arqiva until approximately the  
27 end of April or beginning of May 2007."  
28 It appears, I am not sure what the date of this statement is – July of this year – it is now  
29 being broadcast by virtue of broadband. "A broadband stream of the channel is now  
30 established from this location." So that is the way, if you want to access Rapture at the  
31 moment, you would do. As I say, it is not a point that is at all relevant to this case, because  
32 the question is, is this price FRND, but I think there was some suggestion yesterday that the  
33 only way Rapture could broadcast would be if it got on to the Sky ----  
34 THE CHAIRMAN: Because the others are closed, Freeview ----

1 MR. VAJDA: That is technically – I am instructed – not entirely correct either. It is perfectly  
2 true that there are less channels available on Freeview, but it is actually done by auction, so  
3 anybody could bid, but I am told that you would be having to pay a lot more than £76,000  
4 to get on to Freeview, so as I say it is not relevant to this case, but the Tribunal did indicate  
5 yesterday that it may this was the only method for rapture.

6 THE CHAIRMAN: Before we indicated that is what we had heard. I think Professor Stoneman  
7 has a question.

8 PROFESSOR STONEMAN: I want to go back to the point you made before you made the point  
9 that you did not want to forget ... (laughter) ... which is, what it is that the price being  
10 charged by Sky for EPG services covered? I think we agreed yesterday that Sky did offer  
11 some value-added services to the information that comes from the broadcasters. So  
12 basically the broadcaster supplies Sky with a certain amount of material, Sky will then  
13 make sure that it is spelt correctly, that it is not offensive, etc., and one or two other  
14 services, and that will then go out on the EPG listing?

15 MR. VAJDA:

16 PROFESSOR STONEMAN: So part of the price will cover those services. The other part of the  
17 price will be the price being charged for access to the 8.5 million set top boxes on the Sky  
18 platform? Is that correct? I am just dotting “i’s” and crossing “t’s”

19 MR. VAJDA: The access to the 8.5 million is common cost, and the issue is how much of the  
20 common cost should somebody who is just wanting EPG contribute to? But in terms of  
21 what Sky is doing, apart from correcting spelling mistakes and so on, they are providing the  
22 set top box which will enable a viewer – because without set top box the viewer does not  
23 have EPG, so there is an element in the set top box that is necessary so that your EPG works  
24 if you are sitting at home, or wherever.

25 PROFESSOR STONEMAN: I thought that was what I was saying.

26 MR. VAJDA: Well the service that they are providing is not just correcting, if you like, spelling  
27 mistakes from broadcasters, but part of the STB plainly relates to EPG, there may be other  
28 parts of the STB which relate to CA or AC, that is the point I was seeking to make.

29 THE CHAIRMAN: Can I just ask you, when you said that you can access it by broadband, that  
30 means that you can access it on your PC?

31 MR. VAJDA: Yes.

32 THE CHAIRMAN: Not on your television unless you ----

33 MR. VAJDA: I am told it depends on your ----

1 THE CHAIRMAN: That is why I said “unless”, because if you have one or these systems that ---

2 -

3 MR. VAJDA: You can hook your computer into your TV.

4 THE CHAIRMAN: Right, and it comes that way?

5 MR. VAJDA: Yes. You can tell from that answer that I have not actually done that myself!

6 (Laughter). What I would like to do next and, indeed, perhaps I will just give the Tribunal  
7 a route map now where I am going, having dealt with parameters in some depth. I am going  
8 to look briefly again at the guidelines – the guidelines are very, very important in this case  
9 for obvious reasons. Then what I am going to do is to look again in a little detail at the  
10 determination to try and explain what Ofcom did. I will then refer to that confidential table  
11 that I put in yesterday without, I hope, revealing any figure in open court. After that I will  
12 go through my skeleton, I hope relatively rapidly, and then pick up the main points that Mr.  
13 Bowsher made yesterday.

14 So if we could start at the guidelines, which are at tab 6 of the Ofcom defence. Just for the  
15 Tribunal’s note we deal with the significance of the guidelines, at paras. 9 to 18 of our  
16 skeleton, so I am not going to repeat what is in 9 to 18, but if the Tribunal bears that in  
17 mind.

18 Could I ask the Tribunal to begin at p.3, which is the summary, and if we can just look at S3  
19 for a moment, just pick up some of the bullets there. This is “Key points amplified within  
20 these guidelines”:

21 “The obligation on providers of conditional access and access control is to offer such  
22 services on a fair, reasonable and non-discriminatory basis to third parties wishing to  
23 purchase services regulated under that licence.”

24 That is, if you like the origin of what we term in our skeleton “competitive neutrality”, and  
25 Mr. Bowsher wondered yesterday aloud “where does this expression appear in the  
26 guidelines”? “Competitive neutrality” as such does not appear in the guidelines but that is,  
27 if you like, the principle underlying that. We will see as we go through the guidelines that  
28 the whole point of this – or one of the major points – is to ensure that, if you like, Sky does  
29 not favour its operations as against third parties.

30 Then we see the second bullet:

31 “in assessing fairness and reasonableness, Oftel will consider whether the terms offered are  
32 consistent with those which would be expected in a competitive market.”

33 We then have the ‘floor’ and the ‘ceiling’ point, and then if I can just look at the last two  
34 bullet points:

1 “a range of factors should be taken into account in assessing prices including the service  
2 required, the benefits to the platform for carrying the service, the benefits for the  
3 broadcaster or service provider of inclusion on the platform, the revenues accruing to the  
4 broadcaster from the carriage on the platform, and the willingness to pay of the broadcaster  
5 for the service.”

6 So it is a flexible approach.

7 “in assessing non-discrimination, Oftel regards it as acceptable for differential prices to be  
8 offered where there is no material adverse effect on competition; but the basic approach  
9 should be that comparable prices should be offered to comparable users, for comparable  
10 services, at comparable times.”

11 Just pausing there, it is part of Mr. Bowsher’s case, if you like, on discrimination and  
12 willingness to pay that Rapture should have got – if I can put it like this – a special deal.  
13 Now, the basic principle is non-discrimination, so for Rapture to have a special deal it  
14 would be necessary for there to be evidence that Rapture was in a different position from  
15 another broadcaster, because put it this way, if Mr. Henry had gone to Sky and said, as I  
16 think he did at some point, “I would just like to pay £1 for this EPG service”, and Sky said  
17 “Okay, that’s a deal”, there would no doubt have been a number of other broadcasters who  
18 would have to my clients to say “Well, hang on a moment” how is this £1 FRND when we  
19 are paying all this money to Sky”, so it is important to bear in mind, it does not mean that  
20 everybody always has to pay the same, but if people are going to pay differently then we  
21 need to know why.

22 If we can then go to p.5 Chapter 1, which is “Introduction”. I would just like to draw the  
23 Tribunal’s attention to para. 1.7. These guidelines represent OFTEL’s current view of the  
24 way it would interpret its responsibilities and exercise its discretion under the current  
25 legislation. I emphasise because it is an exercise of discretion. If we go to 1.11 on p.6, this  
26 is setting out the approach to regulations. Again, this is very different from the price control  
27 approach of Chapter III of the Access Directive.

28 “The current statutory provisions were framed in terms which enabled OFTEL to  
29 intervene in firms’ pricing only in the event that commercial negotiations fail to  
30 arrive at an outcome which is fair, reasonable and non-discriminatory. The  
31 statement confirmed that OFTEL does not propose to modify the licence to allow the  
32 DG to set prices for CA services. OFTEL considers that the ex post regulatory  
33 mechanism for such services combines the advantages of flexibility to take account  
34 of different circumstances with valuable scope for incentives”.

1 That is what we talk about in the skeleton - the importance of investment.

2 “It allows for negotiation, but at the same time offers a safety net of a complaint to  
3 OFTEL in the event of negotiations failing”.

4 We will see in a moment, but it is important to bear in mind, that an aspect of FRND is  
5 negotiation. Negotiation, when it was suggested yesterday that negotiation was a legally  
6 irrelevant matter, we would disagree because in fact negotiation is absolutely critical. Had  
7 Ofcom failed to look at negotiation, they would have been subject to a valid criticism,  
8 because they would have departed from the guidelines, as we will see.

9 We then see at 1.13 what we call in the skeleton the multi-layered approach.

10 “The process OFTEL would undertake to assess whether prices for conditional  
11 access or access control serves are fair, reasonable and non-discriminatory  
12 incorporates consideration of a number of factors, multi-layered, including the  
13 following: the structure of tariffs and tariff setting; an assessment of whether  
14 charges are reasonably related to costs, in particular, whether the terms offered by  
15 the provider were consistent with those which would be expected in a competitive  
16 market; assessment of whether prices are non-discriminatory; and how the tariffs  
17 should approach the distribution of common costs”.

18 Then they say they describe that in more detail.

19 That takes us then to Chapter II - assessment of whether terms are FRND. OFTEL first  
20 considers fair and reasonable. Mr. Bowsher took us to this yesterday. I hope the Tribunal  
21 forgive me if we just look at this again in a moment. We can pick it up in the second  
22 sentence.

23 “In assessing fairness and reasonableness, OFTEL will consider whether the terms  
24 offered are consistent with those which would be expected in a competitive market”.

25 The whole point of the guidance is that you have this multi-layered approach to try and  
26 replicate what is not in fact the position. The important starting point is that the primary  
27 consideration is ---

28 “-- to ensure that intra-platform competition (i.e. competition on the same platform  
29 [so, in this case, competition on the Sky platform as opposed to competition between  
30 platforms] between broadcasters is not adversely affected”.

31 We will see later that the prime focus on that is that Sky should not favour its own. That is a  
32 real concern because Sky is vertically integrated and has upstream and downstream whereas  
33 all these other people are effectively relying on the upstream.

1 Yesterday Mr. Bowsher said in relation to the phrase, “OFTEL will consider whether terms  
2 offered are consistent with those which would be expected in a competitive market” -- He  
3 said this was a logical oddity. He was trying to construct what is in a competitive market,  
4 and that there is not a competitive market. That is true. There is not a competitive market.  
5 That is why you have this guidance. But, he is not able, in a sense, to attack the guidelines  
6 because he has accepted the guidelines are the correct way of going. The guidelines offer a  
7 template for seeing whether or not the charge is FRND.

8 If we go into 2.2,

9 “In any assessment as to whether charges are fair and reasonable, OFTEL will  
10 usually need to consider whether input costs are reasonably and necessarily incurred  
11 in supplying the services in question”.

12 Then, at 2.3,

13 “OFTEL takes ‘reasonableness’ to mean, amongst other things, that terms and  
14 conditions under which products offered are fair between the parties; sensible,  
15 practical and proportionate. [Again, this is an element of exercise of judgment.] The  
16 following offers some guidance as to what OFTEL would consider to be  
17 ‘reasonable’. The provider [that is, the platform provider] should be able to recover  
18 its officially incurred costs over a reasonable period of time; the services offered  
19 must, if technically feasible, be sufficient ‘unbundled’, so that the broadcaster only  
20 pays for what it needs”.

21 We then have a section at 2.4 to 2.7 on the treatment of risk. This really designed to ensure  
22 that investment incentives are preserved. We see at 2.5 in the second sentence,

23 “OFTEL’s approach would consider the relationship between input costs and  
24 expected revenues. OFTEL’s approach would be to consider whether the pricing  
25 framework was such that the provider [that is, the platform provider] would be  
26 expected on average to make a return on its investment that was neither inadequate  
27 or excessive, taking proper account of risk and uncertainty applying to the  
28 investment at the time it was made. In a competitive market, neither excessive nor  
29 inadequate returns could be sustained over an extended period.

30 The treatment of risk over time is important. OFTEL would not use the benefit of  
31 hindsight to review the pricing structure. The existence of high returns in the short to  
32 medium term, if the investment turned out to be more successful than originally  
33 projected, would not necessarily be regarded as evidence that prices were too high.  
34 The supplier would have to bear the losses if the business were less successful, and

1 must conversely be allowed to reap the benefits of greater success than was  
2 guaranteed”.

3 Then they explain that a bit more in the annexes. They then deal with non-discrimination.  
4 This is now the point about favouring their own, which is obviously of primary importance  
5 to Ofcom. The second sentence of 2.8,

6 “A vertically integrated provider may have an incentive to provide products on terms  
7 which discriminate in favour of its own business. Therefore an important aim of a  
8 non-discrimination condition is to ensure that a vertically integrated supplier does  
9 not treat itself in a way that benefits itself, its subsidiaries or its partners in such a  
10 way as to have a material effect on competition”.

11 That, if you like, is another expression of what we call competitive neutrality. Then, going  
12 to 2.9, which Mr. Bowsher took us to yesterday,

13 “Non-discrimination does not necessarily mean that there should be no differences in  
14 treatment between broadcasters, rather than any differences should be objectively  
15 justifiable ----“

16 That, again, is important. It is evidence-based. If a treatment is not objectively justifiable,  
17 the difference in treatment would be discriminatory. They say,

18 “ --- for example, differences in underlying costs or the absence of a material adverse  
19 effect on competition”.

20 If we then go down to 2.11, the last bullet,

21 “In order to ensure compliance with the non-discrimination obligation, a provider  
22 should ensure, amongst other things, that ... it can objectively justify any  
23 differentiation”.

24 You need to have evidence to see why it is that Rapture should only pay £1.

25 I think I drew the Tribunal’s attention to 2.13 as to the potential categories of broadcasters  
26 that Sky need to consider - free to air, pay-tv and interactive.

27 Then at 2.15,

28 “Within any one category of broadcaster, OFTEL presumes that comparable terms  
29 and conditions offered to one would be available to another similarly situated at the  
30 same time”.

31 So, that is the basic principle - that if you are comparable, you should be offered the same  
32 price.

33 Then Chapter 3 - the Tariff Structures. What one sees when we go to the determination, the  
34 determination really goes through the checklist of what are the points that are made in

1 Chapter 3. First of all, the question is what costs are going to be allowed. The answer is  
2 perhaps not surprisingly that Ofcom would allow those costs that should be reasonably and  
3 necessarily incurred in the provision of those services. That is the test for allowable costs.  
4 We then come on to the issue of fixed and common costs, which is a very important issue in  
5 this case.

6 “With a conditional access or access control system, most of the actual costs involved  
7 in the set up and running of the system do not vary significantly with the number of  
8 channels provided”.

9 Pausing there, if you take the EPG, the cost of setting up the EPG is not going to vary  
10 hugely whether you have ten broadcasters or five hundred broadcasters.

11 THE CHAIRMAN: Do you think 3.3 may be relevant in relation to the subsidy?

12 MR. VAJDA: (After a pause): Yes. The subsidy is dealt with specifically later on, but 3.3 is  
13 important. The subsidy is actually dealt with expressly at 3.9 to 3.11. There is, in relation  
14 to the set-top box, an element of marketing.

15 If I could just finish at the bottom of 3.4,

16 “As the fixed and common costs of running the system must be recovered through  
17 the charge, it is not possible for the provider to charge a price equal to the  
18 incremental cost to every purchaser. Such a price would not cover all the costs  
19 associated with the infrastructure that makes the operation of the service possible”.

20 Pausing there, we know that the figure - and I cannot remember whether it is a confidential  
21 figure or not - there is actually the figure in the determination as to what the incremental  
22 cost of this service is. That is the justification, if you like, for the floor to ceiling approach  
23 which we see at 3.5.

24 “OFTEL considers that it is appropriate that all users of the service should pay a  
25 charge that is equivalent to incremental costs together with a reasonable contribution  
26 to common costs (i.e. a price that falls between the floor of incremental costs and a  
27 ceiling of the ‘stand alone’ cost of provide the system). This is the outcome that  
28 would be expected in a market where there was a competitive supply of conditional  
29 access or access control services, although the relative contributions might well vary  
30 between different users”.

31 Then at 3.6,

32 “OFTEL would expect that the result of negotiations between providers and the  
33 broadcaster is that common costs are likely to be distributed amongst different

1 bundles or single channels at differential levels depending on the overall balance of  
2 benefits which could accrue to the provider and the broadcaster”.

3 So, what they are saying there, and we will see this, in the sense of allocation of common  
4 costs, that one looks first to the question of negotiation and then if negotiation fails or is not  
5 satisfactory, there is the long-stop of going to Ofcom for a determination.

6 One of the factors in negotiation is willingness to pay. We see that that is in bold type above  
7 3.7.

8 “Where a channel generates retail revenues, either through subscription, advertising  
9 or otherwise, OFTEL considers that such revenue is a key indicator of ‘willingness  
10 to pay and would expect a reasonably close linkage between retail revenues and  
11 conditional access or access control charge”.

12 Pausing there, there was quite a lot of criticism yesterday about small broadcasters.

13 Leaving aside for a moment the pleading point, and whether this is a point to be taken, this  
14 willingness to pay factor feeds into a small broadcaster because obviously you would then  
15 look at the business plan and that sort of thing. So, if you are a small broadcaster it is not  
16 that there is nothing that you can latch on to in the guidelines. Willingness to pay is a factor  
17 that might mean that a small broadcaster might pay less than a large broadcaster - not  
18 ‘would’, but ‘might’. As the guidelines go on,

19 “This is not the only factor to be taken in to account, as there would be other  
20 attributes a broadcaster might ask to be considered in negotiations, such as those  
21 outlined at paras. 3.13 to 3.14.”

22 It goes on to say, and this is why this is not, if you like, mechanistic:

23 “OFTEL is not suggesting that this should form the basis of a ‘formula between  
24 retail price and the conditional access/access control charges, but would expect the  
25 agreements as a whole to be broadly reflective of the retail revenues expected by the  
26 broadcaster when offering its service to the end user”.

27 PROFESSOR STONEMAN: Can I stop you there? I have a lot of problems with the willingness  
28 to pay criterion. Why does that reflect the characteristics of a competitive market? If I go  
29 along to the car dealer and say, “I’m only a poor academic and I can’t afford to pay that sort  
30 of price, he is not going to say “Well, this is a competitive market, you can have it cheaper”.  
31 He will charge me the same price whether I am poor or rich. So why should it be that in a  
32 competitive market the willingness to pay criterion should be in place?

33 MR. VAJDA: There are two answers to that question. The first is for the purposes of this appeal  
34 this Tribunal has to proceed on the basis that willingness to pay is in there, because there

1 has been no attack made on the guidelines and, in my submission, it would be wholly wrong  
2 for this Tribunal in any Judgment to say: “We do not understand willingness to pay”,  
3 because , as I say, it has been accepted by the applicant in this case that the guidelines  
4 apply.

5 PROFESSOR STONEMAN: I think it is perfectly okay for the Tribunal to ask you to explain to  
6 us ----

7 MR. VAJDA: Yes! (laughter)

8 PROFESSOR STONEMAN: -- why the willingness to pay guideline is consistent with the rest of  
9 the guidelines?

10 MR. VAJDA: Well the view was taken in 2002 that it is consistent, that this is a factor that comes  
11 into play. In a negotiation there may be an element of horse trade, if somebody says “I am  
12 going to offer you something” and again one has to go back to the start of the platform in  
13 1998, it may well have been in Sky’s interest, because of course it was an unknown quantity  
14 how successful the platform was in those days, to take into account what people could  
15 afford to pay, and that is something that does happen in competitive markets. It may be that  
16 if you went along to the dealer on 24<sup>th</sup> December (Christmas Eve) and you said “I am a poor  
17 academic, you need to give me a discount” in fact he might well give you a discount  
18 because he wants to make that extra sale so he reaches his target. If you go along three  
19 months later when he has sold all his cards he might not be interested.

20 PROFESSOR STONEMAN: If you go along on Christmas eve and say “I am a lawyer” we will  
21 all know that you will not get a discount, although he would still like to make the sale. Let  
22 us look at it another way. How do you put together the willingness to pay criterion with the  
23 non-discrimination criterion?

24 MR. VAJDA: There is a balance. This all comes back to the question of judgment and  
25 discretion, because plainly, if you were to say: “Willingness to pay trumped everything”,  
26 and if we take, say, the case of Rapture, let us assume that Rapture had said: “I am only  
27 willing to pay £1, that is all I can afford, and a deal was then done. That would, of course,  
28 immediately run into difficulties in relation to non-discrimination, which is why one needs  
29 to balance the matter, when you look at what Ofcom did in the determination on willingness  
30 to pay they looked not just at the position of Rapture, but effectively other channels in a  
31 similar position.

32 This is why it is a multi-layered approach, you have to look at it in the round, and certainly  
33 willingness to pay is not a factor that effectively can trump every other factor because as

1 indeed is implied by your question, if it did you might run into problems with non-  
2 discrimination.

3 MR. SUMMERS: I seem to recall yesterday that the word “ability” in relation to pay was also  
4 used – “willingness to pay” and “ability to pay”.

5 MR. VAJDA: Yes.

6 MR. SUMMERS: How are you distinguishing the two? I may be very willing to pay, I may not  
7 actually be in funds. Do these guidelines take account of that situation?

8 MR. VAJDA: When we come to the determination, I am sure the Tribunal has read the  
9 determination very carefully, I will pay special attention when I come to that bit of the  
10 determination because you can then see how Ofcom have applied the willingness to pay,  
11 because it is absolutely right, as you suggest, Mr. Summers that within willingness to pay is  
12 also ability to pay, because plainly somebody might say “I am only willing to pay £1”  
13 although they are actually able to pay much more.

14 Of course, you have to bear in mind the question of treatment of risk, because people might  
15 say “I am only willing to pay £1”, and then they go along to Ofcom and say: “This is  
16 outrageous because Sky is not offering it to me for £1”, well if everybody says: “I am only  
17 going to pay £1” then Sky is never going to get their money back on the platform. There  
18 are no absolutes here, these are guidelines which apply; the test itself has a degree of  
19 flexibility. The test is not “What is the correct price?” It is “Is it FRND?” which itself is a  
20 range, the guidelines are there, if you like, to give some guidance to the platform provider,  
21 give some guidance to prospective broadcasters, and then they are applied by Ofcom, and  
22 they apply one would hope – and indeed in my submission that is what the determination  
23 does – in a flexible and non-mechanistic way which is, if I may respectfully say, how  
24 guidelines should be applied.

25 PROFESSOR STONEMAN: Just to go back, I asked a general question about what this  
26 “willingness to pay” was trying to pick up, and I am now going to ask you a very specific  
27 question about it. To what extent is this something to do with barriers to entry and limit  
28 pricing?

29 MR. VAJDA: Can I come back – I am conscious of the time – I am sure those behind me have  
30 heard your question, can I press on and come back to that and I will then have an answer  
31 that I can give you?

32 PROFESSOR STONEMAN: Yes, fine.

33 MR. VAJDA: If we can then move from willingness to pay to 3.9 “Treatment of consumer  
34 subsidy”, this really lies at the heart of this case, because as we know the real case of

1 Rapture is that they should not have to pay anything to the STD, and so it repays a little  
2 study.

3 “3.9 A vertically integrated supplier may wish to subsidise consumer equipment  
4 to promote take-up of its retail services. The question arises whether this subsidy  
5 may be treated as a cost to be recovered via conditional access or access control  
6 charges, or whether this should be borne entirely by the vertically integrated  
7 company”

8 i.e. that there should be no subsidy.

9 “3.10 In principle, Oftel considers that other broadcasters ...”

10 non-Sky broadcasters, third parties:

11 “... typically benefit from such a subsidy (in terms of increased viewer base), so it  
12 is therefore reasonable to expect them to contribute to the costs. [of the subsidy]  
13 Different broadcasters may benefit to different extents, in which case their relative  
14 charges should reflect this.”

15 Now, 3.10 is absolutely key to this case, because this is a policy decision that was taken by  
16 Ofcom. You will note that 3.9 starts with the words: “A vertically integrated supplier may  
17 wish”, this is not prescriptive, this is saying: “This is a business model that a vertically  
18 integrated supplier may wish to choose”. As we know, this is in fact the business model  
19 that Sky has chosen, and it is not for Ofcom to second guess the Sky business model;  
20 Ofcom’s responsibility is to ensure that the price that Sky charges third parties is FRND.  
21 What this guideline is saying very clearly is that Ofcom is not going to challenge that  
22 business choice, it considers that there is a reason why other broadcasters should pay for  
23 that and that is the position. Looking at this, because there has been a lot of argument: how  
24 are these to be treated? Are they really common costs? Are they incremental costs? Are  
25 they externalities? What one sees quite clearly in chapter 3 is a section which is “Fixed and  
26 common costs” (3.4 to 3.6). Then one has a totally separate section which is “Treatment of  
27 subsidy of consumer equipment” where Oftel is directing its mind to the specific question:  
28 Should people like Rapture contribute to the STB subsidy? And the answer is “yes” in  
29 principle. Then we see at 3.11, which is, if you like, again a reference to competitive  
30 neutrality:

31 “3.11 However, in certain cases, recovery of subsidy via conditional access or  
32 access control charges [from third parties] may have anti-competitive effects. In  
33 such cases, recovery would not be permitted. Each case would be examined on its  
34 merits. However, one example where Oftel would have serious concerns is where

1 the granting of subsidy was tied to a requirement to subscribe to a retail service of  
2 a vertically integrated supplier.”

3 Because that would infringe the principle of competitive neutrality.

4 THE CHAIRMAN: Is the real importance not the last sentence of 3.10?

5 MR. VAJDA: Well, it is no more important than the first sentence. Yes, 3.10 is absolutely key,  
6 first and second sentence.

7 THE CHAIRMAN: Yes.

8 MR. VAJDA: No one sentence is more important than the other.

9 THE CHAIRMAN: In principle broadcasters should pay, but different broadcasters may benefit  
10 to different extents, so as I understand it, because Rapture is not taking the CA and AC part  
11 of it they benefit to a different extent from those who do?

12 MR. VAJDA: That is in a sense an issue in dispute. That is a point that is dealt with in the  
13 determination. The point to bear in mind in relation to Rapture, if we are looking at Rapture  
14 specifically, is first of all Rapture, at the time that this dispute was going, was not  
15 broadcasting in any other form, so this was actually of great benefit to Rapture because this  
16 was the only way that they could broadcast. This is a point that we then make in the  
17 skeleton, that when you are looking at access to the platform you have 8.5 million viewers.  
18 Let us assume we have people – there may be a number of people in this room – who have  
19 taken Sky simply because they want to watch Premiership football; they have no interest in  
20 anything else, so they have to have CA, because you cannot have Premiership football  
21 without CA, so they are part of that 8.5 million. That is actually of benefit to Rapture  
22 because it is a pool of potential viewers, even though the man who is a dead keen Arsenal  
23 supporter will never ever have heard of Rapture that is of a benefit to Rapture because when  
24 he presses his EPG Rapture will be on there. This is all a question when one comes to  
25 judgments, but it is simply -----

26 THE CHAIRMAN: But you are saying that they do not benefit to a different extent, they benefit  
27 to the same extent because they benefit from the 8.5 million, therefore you cannot just take  
28 out the CA and AC because they are benefiting from those who come in because of the CA?

29 MR. VAJDA: We have to be careful because in relation to the CA and AC the direct cost of CA  
30 and AC have been taken out in any case, all that we are concerned with, if you like, are the  
31 common costs. It is perfectly true that there is an element, if you started unscrewing the  
32 STB which might relate to CA and AC, and the question is, and this is a question of  
33 judgment which Ofcom looked at very carefully at 5.54 to 5.56, and we will look at this in  
34 the determination, whether or not it needed to go down to that level of detail. The answer

1 was “no”, because the very short point is that the contribution that third party EPG  
2 providers were making was so tiny that it did not matter. It is as simple as that.

3 In view of the time I am going to leave the guidelines. I think all parties urge the Tribunal  
4 to look at the guidelines, obviously 3.12 and 3.16 are also important, but I think it is time I  
5 move on to the determination.

6 THE CHAIRMAN: There was a question yesterday as to whether these paragraphs that we have  
7 just referred to apply to EPG, and ----

8 MR. VAJDA: The answer is ‘Yes’.

9 THE CHAIRMAN: You are saying they do apply because the whole thing applies mutatis  
10 mutandis.

11 MR. VAJDA: Yes. Absolutely. It is the point we have made in our skeleton, yes. Indeed, it was  
12 common ground yesterday between all the parties that they apply, yes.

13 THE CHAIRMAN: I am not sure it was common ground in relation to Rapture.

14 MR. VAJDA: No. It was common ground.

15 THE CHAIRMAN: It was common ground.

16 MR. VAJDA: Yes. Mr. Bowsher will get up to ----

17 THE CHAIRMAN: It was common ground that the guidelines applied, but it was not common  
18 ground that everything in the guidelines ----

19 MR. BOWSHER: Let me clarify that. Indeed, it was Mr. Roth who made the point first that while  
20 the guideline always apply, in construing the guidelines you do have to bear in mind that  
21 they were written ----

22 THE CHAIRMAN: For some other purposes.

23 MR. BOWSHER: They are written as apply to conditional access. So you do in each case have to  
24 consider what the words ‘conditional access’ do cover.

25 THE CHAIRMAN: But you can say ‘and also’.

26 MR. BOWSHER: Exactly. I do not want to take it any further now. I have said what I have said.  
27 Someone can look it up on the transcript.

28 MR. VAJDA: We do not accept Mr. Roth’s point. We have a paragraph in our skeleton. The  
29 guidelines are flexible. So, plainly, if somebody has a point on EPG which says that they  
30 are entitled to make it -- We do not accept that, in a sense, the guidelines were not written  
31 with EPG in mind. I give the reference in our skeleton to that.

32 MR. ROTH: Given what Mr. Bowsher has said - that the interpretation is flexible - I do not think  
33 there is really anything between us.

34 MR. VAJDA: There we are. I am very grateful for that observation. It is para. 9 of our skeleton.

1 Can we now then look at the determination? I am actually going to be working off a  
2 confidential version, but I quite understand why the Tribunal wants to work off a non-  
3 confidential version.

4 THE CHAIRMAN: I thought I was working from it yesterday, but, no ----

5 MR. VAJDA: Does the Tribunal also have the little note that we handed in at lunch-time?

6 (After a pause): Paragraph 5.15. It is the heading ‘Were the costs that Sky sought to  
7 recover from EPG customers reasonably and necessarily incurred ----‘ Of course, the  
8 Tribunal will immediately recognise that that was a passage that I took the Tribunal to from  
9 the Guideline which are, in fact, quoted at 5.15 itself. There is, if you like, the first  
10 application of it. Ofcom point out that there is a problem in determining the cost of a  
11 particular service because the direct costs are relatively low. We see that at the first sentence  
12 of 5.17. “This is because the largest costs of establishing and running the platform ... are  
13 used in providing a number of different technical platform services to third parties. Ofcom  
14 estimates that around ----

15 I had better not mention the figure in open court ----

16 THE CHAIRMAN: I am actually looking at the non-confidential version.

17 MR. VAJDA: I do not know whether it has a figure, does it?

18 “Ofcom estimates that around 80 percent of the total cost of the Sky platform is  
19 currently made up of such ‘common costs’”.

20 I would now like to go to the note that we produced. Just to be clear, if I can read this,

21 “To assist the Tribunal, Ofcom has produced this note summarising certain  
22 information in relation to costs and revenue of the Sky platform taken from the Sky  
23 platform model which is at ----“

24 So, this is not new evidence. This is effectively evidence already in the case.

25 THE CHAIRMAN: That would be in the confidential version.

26 MR. VAJDA: That would be in the confidential version. This note has gone to Mr. Bowsher and  
27 his team on the normal confidentiality basis. The purpose of this is not to get into all the  
28 detail, but to try and illustrate to the Tribunal what is actually going on here in terms of  
29 common costs and direct costs. If we then go over the page, we say that in each case the  
30 figures for revenue and costs have been derived simply by adding together the figures in the  
31 relevant row of the model. That will be over a ten year period. So, as you see from Footnote  
32 2, there has been no form of DCF analysis. However, the purpose of the note is simply to  
33 illustrate to the Tribunal the relative magnitude of the costs and revenue involved in the Sky

1 platform and a DCF analysis would not materially change the percentage stated in the tables  
2 contained in the note.

3 If we start off by looking at the revenue information -- This is the revenue that Sky obtains  
4 for its services. You see that the largest producer of revenue is the CA services. I am not  
5 going to mention any of these figures, but you see what they are. You see that the revenue  
6 for EPG is less than 5 percent. You see the figure there. You see it in terms of both the  
7 percentage and actual. Now, that is what it gets both from Sky broadcasters and non-Sky  
8 broadcasters. The last revenue stream there, which is headed 'Other Revenue' covers a  
9 number of items, but essentially it covers payments that the consumer -- the viewer have  
10 made for STB. It does not cover all of that because we know there is a subsidy. But, it  
11 covers some of it. I hope that that goes some way to answering the question that Professor  
12 Stoneman asked yesterday.

13 We then break down Table 1 because we then split it out in Table 2 so that you can see  
14 how it is done as between Sky and non-Sky. You see that by far the largest chunk of  
15 revenue comes from Sky, which is not surprising, given that they have got a large number  
16 of channels on their own platform. Then you see the third party contribution. Obviously,  
17 the one that we need to focus on is third party EPG, which you can see. The figure in the  
18 left-hand column is in fact half the figure that we saw in Table 1. You see that as a  
19 percentage of total revenue that you are getting from third parties, that has now -- You can  
20 see the percentage is considerably lower. Of course, the Rapture fee for EPG would fall  
21 within that column - third party EPG revenue. So, you can see that a very, very small  
22 amount of revenue, both in percentage and actual terms, comes from third parties paying for  
23 EPG services.

24 We then have other revenue again. That is the same as was given in Table 1. What have  
25 done, if the Tribunal wish to do it, is that in footnotes we have indicated where these figures  
26 come from, if you want to print out the Excel spreadsheet.

27 PROFESSOR STONEMAN: Could you clarify something for me? These is the revenues of the  
28 platform. I know we are just talking about an accounting identity here. If we think of  
29 conditional access, there will be programmes which are broadcast by Sky that the viewer  
30 has to pay for. Yes?

31 MR. VAJDA: Yes.

32 PROFESSOR STONEMAN: The amount paid by the viewer to Sky will go to Sky. Some of that  
33 will then be cut off from that payment and credited against the platform as a conditional

1 access charge by Sky. Some of it will stay with Sky for the programme. Is that correct? Is  
2 that how this works?

3 MR. VAJDA: Yes. There is nodding to my right.

4 PROFESSOR STONEMAN: So, these conditional access payments that are made by the viewers  
5 are split into two parts - probably somewhat artificially. Sky is getting, sort of, two bites of  
6 the cherry. It is getting the payments from the viewers for the use of the platform and the  
7 difference between the amount paid and the amount paid for the use of the platform; is that  
8 correct?

9 MR. VAJDA: Sir, this is not concerned with any content revenue. This is simply revenue for the  
10 platform.

11 PROFESSOR STONEMAN: It comes from payments for content revenue?

12 MR. ROTH: Sir, you are absolutely right. The split of that, of course - the conditional access  
13 charge that is credited to the platform - has to be non-discriminatory by reference to the  
14 conditional access charge, charge to third party programmes that want conditional access,  
15 according to the Guidelines. Those principles very much apply. So, that is how the figure  
16 that is taken from the payment and credited to this ----

17 PROFESSOR STONEMAN: Has that been explored? That split is non-discriminatory?

18 MR. ROTH: That the conditional access charge that is credited to the platform is non-  
19 discriminatory compared to the conditional access charge actually imposed on third party  
20 broadcasters. I do not think it has been explored in this determination because it did not  
21 concern it, but I am sure that third party broadcasters who are paying Sky sometimes quite  
22 significant conditional access charges - because that is the main part - would be very quick  
23 to complain if they felt that they were being charged more than Sky was charging for its  
24 own programmes.

25 PROFESSOR STONEMAN: Those third party broadcasters - they will charge their viewers for  
26 the programmes that they broadcast with conditional access. So, some of that revenue will  
27 be paid to Sky and will be charged as revenue for the platform.

28 MR. ROTH: Whether they charge their own viewers will depend on what arrangement they have.  
29 There is some conditional access, I think ----

30 PROFESSOR STONEMAN: We will forget the ITV regions, but the others ----?

31 MR. ROTH: Even the BBC, apparently, with Wimbledon, I am told -- you could switch courts  
32 using the red button. That is access control.

33 PROFESSOR STONEMAN: All right. We are talking about conditional access. It could be the  
34 films that you watch in the middle of the night, or whatever.

1 MR. VAJDA: I have just been informed by those behind me that so far as the revenue from Sky  
2 is concerned, if one takes Sky conditional access -- What it is, is effectively a charge which  
3 is made by the platform to the Sky broadcaster. It is a notional charge. As Mr. Roth said,  
4 obviously the charge has to be non-discriminatory. So, if you are then making a charge to a  
5 broadcaster who is using CA, who is not Sky, it would have to be the same subject -- You  
6 would have to comply. It would have to be FRND.

7 PROFESSOR STONEMAN: So, the charges made by the platform to Sky, and then Sky factor  
8 that in to the amount you have to pay to watch your Premier Division football matches.

9 MR. VAJDA: Yes.

10 MR. ROTH: The only thing to add, I am told, is that one of the conditions imposed on Sky is that  
11 we have to provide accounting information to Ofcom so that they can monitor the way the  
12 thing is split. So, there is a control

13 PROFESSOR STONEMAN: Thank you.

14 MR. VAJDA: Could I just give the Tribunal a cross-reference? It may not actually be in the non-  
15 confidential version of the decision, but if one goes to 5.62 and 5.63 of the determination --  
16 it is confidential, yes. Figure 2 and figure 3 ----

17 THE CHAIRMAN: That has come out?

18 MR. VAJDA: That has come out. Well, figure 2 ----

19 THE CHAIRMAN: Do we look at the confidential one?

20 MR. VAJDA: No, I do not think it is necessary, because I realise there is an element of time  
21 pressure, it is simply for the purpose of cross-referencing your note, that effectively table 1  
22 mirrors what you will find in figure 2 in the confidential version which is 5.62 to 5.63, and  
23 if you go to table 2 that mirrors what you have got at figure 3, which is 5.64 and 5.65.  
24 If we can then look at the costs' side what we have done is we now look at it costs by  
25 source -- this is table 3 of the note -- and one sees three direct costs, CA, AC and EPG, and  
26 one sees that those are pretty small compared to the common costs, which include the  
27 provision of STB. What one can also do, if you see that there is a total figure there, that is  
28 total cost, and then you can see in table 2 there is a total figure for total revenue, and that  
29 obviously is important in looking at whether one is earning too much money on the  
30 platform.

31 THE CHAIRMAN: This says including costs such as the provision of a set top, that is a subsidy,  
32 or is that something else?

33 MR. VAJDA: It is what is in footnote 21, which is equipment costs, marketing costs, smartcard  
34 costs -- it is the gross cost.

1 THE CHAIRMAN: I am with you.

2 MR. VAJDA: Because we have, as you have seen from tables 1 and 2 there is other revenue  
3 which comes in on the revenue side, some of which is in relation to the ----

4 THE CHAIRMAN: The total cost less the revenue is the subsidy in relation to the STB.

5 MR. VAJDA: One perhaps cannot be quite as precise as that because ----

6 THE CHAIRMAN: That is how the calculation is being done.

7 MR. VAJDA: Not necessarily because in the other revenue line, not all of it is actually payment  
8 in relation to STB, but it does not terribly matter, it is not material for this case.

9 PROFESSOR STONEMAN: Just to clarify that point, this is a cost to the platform ----

10 MR. VAJDA: Yes.

11 PROFESSOR STONEMAN: -- associated with the provision of set top boxes. The fact that the  
12 customer is also paying £100 or something, that is not included in here?

13 MR. VAJDA: No.

14 PROFESSOR STONEMAN: So it is just what the platform incurs for the provision of every  
15 extra set top box, which is the subsidy as we have been defining it?

16 MR. VAJDA: Yes. As I said, the amount that is paid by the consumer in relation to STD is  
17 included in the revenue line, but not in the cost line, so it is a gross cost.

18 PROFESSOR STONEMAN: It is included in the revenue line you mean in table 2?

19 MR. VAJDA: Yes, in table 2 and table 1 – I said that the largest element of other revenue are  
20 consumer payments for STBs.

21 THE CHAIRMAN: Can we work out from this what the common costs would be excluding the  
22 costs of the set top boxes?

23 MR. VAJDA: We are coming on to table 4.

24 THE CHAIRMAN: Can you tell us.

25 MR. VAJDA: Because what we have in table 4 is common costs by type, and one sees that the  
26 largest element of common cost is consumer equipment.

27 THE CHAIRMAN: Is that the set top boxes? I suppose it is the set top boxes including the  
28 satellite, is it not – the satellite dish?

29 MR. VAJDA: Not the satellite but the dish, yes.

30 THE CHAIRMAN: Is there anything else/

31 MR. VAJDA: There is some element of marketing cost, that sort of thing.

32 THE CHAIRMAN: That would not be in the consumer equipment point, would it? (After a  
33 pause) Marketing costs is “other” because if you look at the footnote ----

34 MR. VAJDA: Yes, I apologise, “marketing cost” is “other”, yes. So that is just the STB.

1 THE CHAIRMAN: And not the smart card apparently?  
2 MR. VAJDA: Yes, that is right.  
3 THE CHAIRMAN: That has gone into “other” as well.  
4 MR. VAJDA: That is right.  
5 PROFESSOR STONEMAN: Can I come back to this question of the consumer payments for the  
6 boxes being in the revenue and in the costs’ line?  
7 MR. VAJDA: Yes.  
8 PROFESSOR STONEMAN: I think this is a crucial issue, because when you start looking at  
9 rates of return, if you include the consumer payments as part of costs and parts of revenue,  
10 you are going to get a completely different rate of return than if you exclude the consumer  
11 contribution. I think it is important that we know what the treatment is here. I would have  
12 thought the logical thing here was that the only charges that would be charged to the  
13 platform would be those that are not incurred by the consumer, that is not incurred by the  
14 household or the owner of the set top box, and therefore it is taken out of the revenue, and it  
15 is taken out of the costs, because otherwise you are including somebody else’s costs in a  
16 platform where they should not be included.  
17 MR. VAJDA: I do not think it matters at all for the present case. There is no issue in this case  
18 about the IRR of Sky, the issue in this case is how one treats the set top box subsidy. What  
19 is important in the present case is question 1: should, as a matter of principle, the  
20 broadcaster make a contribution to the subsidy at all, which the guidelines say “yes” in  
21 principle. Question 2: how much should he contribute to it? That is dealt with in the  
22 determination on the basis that the contribution that is being made to common cost is so  
23 small that there is no need when one is looking at that aspect of the guidelines to drill down  
24 any further.  
25 PROFESSOR STONEMAN: But that contribution will look a great deal smaller if the common  
26 costs are calculated to include the consumer cost of the set top boxes than if the common  
27 costs are not calculated to include the consumer contribution for the set top boxes.  
28 MR. VAJDA: Yes, but in either case ----  
29 THE CHAIRMAN: That is the percentage, is it, between the percentage on table 4 of consumer  
30 equipment and the percentage on table 3 of consumer equipment. Is that how you work it  
31 out?  
32 MR. VAJDA: No, no. If one goes back to table 3, if we can go to 5.17 of the determination, the  
33 last sentence of 5.17:

1 “Ofcom estimates that around [ ] percent of the total cost of the Sky Platform is  
2 currently made up of such ‘common costs’.”

3 So those are all costs that are not ----

4 THE CHAIRMAN: Actually that percentage has not been redacted – we might be wrong there, I  
5 do not know.

6 MR. VAJDA: Now, if we then go to 5.35 of the determination, we see:

7 “The largest single cost in the Platform Model is the cost of consumer equipment”.

8 THE CHAIRMAN: That has been redacted.

9 MR. VAJDA: Mr. Woolfe was just reminding me not to read that figure out. “This accounts for  
10 approximately [X%] of total nominal costs.” If you go table 4 of the note you can see that  
11 consumer equipment accounts for a percentage of the common costs, which is a percentage  
12 of the costs that one has in table 3, but in the last line “common costs”, and when you look  
13 at that as a percentage of total cost that comes to the figure which is in the confidential  
14 version at para. 5.35.

15 THE CHAIRMAN: That is why I was saying you take one away from the other, and then you get  
16 to the answer.

17 MR. VAJDA: It is not quite ----

18 THE CHAIRMAN: It is not quite how it works?

19 MR. VAJDA: No, because you have a different denominator. The position is that you have  
20 common costs which are by far the largest element of cost. When you break down common  
21 cost the largest element within common cost is the set top box subsidy and that is what the  
22 confidential version of 5.35 shows you, the figure that is in the confidential version.

23 PROFESSOR STONEMAN: I do really want to get it clear because it does not seem logical to  
24 me to set it out this way. Take table 4 – “Common costs by type” and you have “Consumer  
25 equipment”, now what you are saying is that consumer equipment is basically total cost of  
26 all the set top boxes, no matter who paid for it, whether the consumer paid for it or whether  
27 Sky paid for it. Now, Sky is shaking their heads.

28 MR. VAJDA: (After a pause) What I have been told is this: if the box cost the platform £150 to  
29 procure then £150 is counted in the common costs, which is tables 3 and 4. If the  
30 consumer, makes a payment, say, of £50 towards the box the £50 is in the “other revenue”,  
31 which is in tables 1 and 2. That is how these tables have been produced.

32 PROFESSOR STONEMAN: So the revenues include the costs of selling the hardware?

33 MR. VAJDA: Some of the costs.

1 PROFESSOR STONEMAN: Then the total investment in the platform is that the £100 or the  
2 £150?

3 MR. VAJDA: Well the costs are £150, but you get back £50.

4 PROFESSOR STONEMAN: Well if you are taking a ratio of profits to capital, and there is your  
5 rate of return, if you add a fixed amount to the top and bottom – the numerator and the  
6 denominator – it rather affects the ratio or the percentage, not independent of whether you  
7 include the consumer contribution on both figures?

8 MR. VAJDA: I accept that this case has not been about the rate of return. The rate of return is  
9 dealt with in the determination, there is no attack on the rate of return. I will certainly take  
10 instructions on what you put to me, Professor, but this is not a case of rate of return, the  
11 issue in this case is whether or not it is right as a matter of principle that Rapture should  
12 make a contribution to the set top box subsidy and, if so, whether it is right that it is making  
13 the contribution that it is making by paying £76,000.

14 PROFESSOR STONEMAN: I am quite willing to be directed on that but it seemed to me that an  
15 important part of that is that the rate of return is not excessive, it is a key part of the  
16 determination and as such it is used to show that the price is FRND?

17 MR. VAJDA: Yes, that is true. I will look at the way it has been done over the adjournment, and  
18 perhaps come back to you on that. But the purpose of these tables is simply to illustrate  
19 what is happening in terms of direct and common costs and how Ofcom then approached  
20 this in the determination because obviously that is absolutely critical. We come back to the  
21 question: is Rapture entitled to say “no, I do not want to pay any contribution to the STB”  
22 or not?

23 We can now put away the table and we can move, I hope rapidly through the determination.  
24 We were on 5.15. I have taken you to 5.17, and the next section that we now need to look  
25 at – the first section was “reasonably and necessarily incurred”, and the next section which  
26 begins just above 5.26 is “common costs.” That is the basis of assessing common costs,  
27 one sees being done by reference to the platform model, and we then come to 5.32 and 5.33.

28 “The key factor in determining whether individual charge lies, within this wide  
29 range of potential charges, is the contribution each customer makes towards the  
30 common costs of the platform.”

31 Then moving down:

32 “The 2002 Guidelines provide that the allocation of common costs across individual  
33 services and customers should be achieved through commercial negotiation (reflecting a  
34 number of different factors ...).

1 Then 5.33:

2 “EPG listing customers make only a very small aggregate contribution towards  
3 common costs (their combined contribution being less than [blank] of the total  
4 common costs).”

5 And one has seen that from tables 1 and 2. It then goes on to say that they pay a charge that  
6 is less than [X] per cent of the stand alone cost of providing a service. If we could just go  
7 forward to 5.72 you will see there what Ofcom say in relation to stand alone cost.

8 “... the stand alone cost of providing an EPG listing service in this context is very  
9 sensitive to the question of whether the cost of the STB subsidies should be  
10 included. In Ofcom’s view, the relevant platform to consider in assessing the  
11 stand alone cost would be one with similar numbers of viewers as those on the  
12 Sky Platform. It is reasonable to argue that the volume of viewers on the Sky  
13 Platform is at least in part attributable to its strategy of providing subsidised set  
14 top box subsidies, and that, in the absence of those subsidies, the number of  
15 viewers would not be as large as it is.”

16 That is the point I have already made, the importance of the population of the platform.

17 “Therefore, for the purpose of assessing the facts of this case Ofcom considers that  
18 the costs associated with those subsidies should be included in the stand alone cost  
19 used to set a ceiling price.

20 5.73 Calculating the stand alone cost of an EPG service using the Sky Platform is  
21 not straightforward. It would require assumptions regarding the elimination of  
22 incremental costs of providing encryption and interactive services. However,  
23 given the relative stand alone cost would include an element of STB subsidy costs,  
24 it is clear that the relevant stand alone cost would amount to hundreds of billions  
25 of pounds.”

26 You can obviously see on what basis Ofcom reached that view given the figures that one  
27 has in the table.

28 Now, if we go back to 5.32, you see the point that is made there is that again express  
29 reference is made to the guidelines, that allocation of common costs across individual  
30 services should be achieved through commercial negotiation. That is exactly what the  
31 guidelines say and that is exactly how the determination works.

32 THE CHAIRMAN: At the moment I have some difficulty about what the relevance of the  
33 negotiations is. The guidelines are guidelines that assist in the negotiations as well as  
34 assisting if the negotiations fail, ought to be applied in the negotiations as well, and so all

1 this is saying is that the services and customers should be achieved through commercial  
2 negotiation, if it is not achieved and the negotiation fails because it is not achieved then  
3 Ofcom have to consider the position?

4 MR. VAJDA: Oh indeed, but it is not any commercial negotiation because you have the bracket  
5 which says “reflecting a number of different factors such as willingness to pay”.

6 THE CHAIRMAN: Yes, if it all fails, I still do not understand why the negotiations are relevant.  
7 I am telling you that so that you address the point.

8 MR. VAJDA: Well negotiations are relevant because in looking at FRND, it is multi-layered, and  
9 you do not simply look at IRR floor to ceiling. When you look at common costs you say  
10 “That is something to be negotiated”. For example if a broadcaster comes along and says “I  
11 offer something different to the platform” and came along in 1998 Sky might have said in  
12 the same way, for example, in a shopping mall you want to get an anchor tenant, so Marks  
13 & Spencer – everybody woo Marks & Spencer – but Marks & Spencer may actually pay  
14 much less rent because they are the anchor tenant, and so that would be a negotiation and  
15 they would bring something – if you have Marks & Spencer in there then you can get  
16 Carphone Warehouse, all these other people that can come along. That is the sort of thing  
17 that happens ----

18 THE CHAIRMAN: Yes, but what happens in that is that the developer is not prepared to give  
19 enough discount to Marks & Spencer and therefore negotiations break down. Now, if there  
20 was a structure like this in relation to that Marks & Spencer would come along and say:  
21 “Look, in those negotiations they are not dealing with it properly, will you please tell us  
22 whether the price is fair, reasonable, and non-discriminatory. Therefore, Ofcom have to  
23 look at it again and should not be having to look at the results of the negotiations because  
24 the negotiations have broken down. That is where I have the difficulty.

25 MR. VAJDA: With respect, no. The position is this, negotiations are relevant and it is not just  
26 any negotiation, it is the one conceived in 5.32, to negotiate by reference to factors that are  
27 mentioned in the guidelines.

28 THE CHAIRMAN: The negotiations have to be by reference to your guidelines.

29 MR. VAJDA: Exactly, so that if Sky had said to Rapture “We see it says ‘willingness to pay’ but  
30 we are going to ignore that”, and Rapture had come along to Ofcom, one would say “This is  
31 not a negotiation that ----”

32 THE CHAIRMAN: If they say “Willingness to pay, we are not ignoring it but we do not accept it  
33 in this case because ...” then Rapture can come along and say “The negotiations fell down  
34 because they came to one conclusion on this and would not – and that goes to fair,

1 reasonable, and non-discriminatory, and therefore will you please look at it again?" You  
2 cannot be bound by what Sky said in those negotiations.

3 MR. VAJDA: This is the whole process, this is a long stop, this is what 1.11 of the guidelines  
4 say. It is to be settled by negotiation, but you have a long stop to come to Ofcom, which is  
5 what Rapture took advantage of in the present case.

6 THE CHAIRMAN: At that stage, Ofcom will have to look at the price that Sky say and decide  
7 themselves whether it is fair reasonable, and non-discriminatory, and therefore at the  
8 moment I have difficulty seeing how much you ought to be looking at what happened  
9 during the negotiations.

10 MR. VAJDA: No, well that is absolutely fundamental because what Ofcom has to do is it has to  
11 look to see whether the negotiations – if I can put it like this –followed the guidelines. If  
12 Rapture had come to Ofcom and put a completely different case to Ofcom from what it had  
13 put to Sky, it had put a whole lot of new evidence – let us assume that it had convinced  
14 Ofcom that there had been a breach of the non-discrimination principle, that they had not  
15 put that evidence to Sky. The determination would still be that the price offered by Sky was  
16 FRND, because assuming on the basis of the evidence available to Sky, Sky's price was  
17 FRND. That is very, very important to ----

18 THE CHAIRMAN: All right, so what you say is that you are constrained, or limited by what  
19 factors were featured in those negotiations. Anything that was not featured in those  
20 negotiations you do not have to take account of?

21 MR. VAJDA: No, not necessarily because if, for example, as I said Sky said "We are going to  
22 ignore 3.7 of the guidelines so it did not feature in the negotiations."

23 THE CHAIRMAN: Then you would have to take account of the new material? No, you would  
24 not have to take account of new material because the material is in the negotiations what  
25 Rapture said, it was rejected, it was wrongly rejected in those circumstances, you would  
26 then take account of that material, but what you would not do is have new submissions.

27 MR. VAJDA: Exactly.

28 THE CHAIRMAN: Is that right? It does say that you can investigate and get new evidence.

29 MR. VAJDA: Yes, again this is FRND is a flexible approach, there is no one FRND price, it is a  
30 multi-layered approach and it is important – and I am glad that the Tribunal have got this on  
31 board now – that, if you like, towards the back end of FRND negotiation is an important  
32 element to determine whether or not the price is FRND, but it is not the case that there is, if  
33 you like, *de novo* price regulation by Ofcom.

1 THE CHAIRMAN: We understand all that. But you can go and investigate and get new  
2 evidence, so if Rapture in this case provides you with matters of one part of the negotiations  
3 then you can take that into account, so you are not constrained by the negotiations.

4 MR. VAJDA: That is correct. What in fact happened in this case, as the Tribunal will no doubt  
5 recall, is that Ofcom did look at material that was not put to Sky, which was the 2004  
6 business plan and the 2005 financial projections. They looked at that material and came to  
7 the conclusion that that material did not lead to the conclusion that ----

8 THE CHAIRMAN: It did not add anything.

9 MR. VAJDA: It did not add anything. Now, supposing they had looked at that material and  
10 thought actually that really makes a difference, the determination that Ofcom would have  
11 made in relation to the commercial dispute between Sky and Rapture would have been  
12 exactly the same, which is that the price was FRND, but it would have been open to Rapture  
13 in the light of new evidence that it had put forward to Ofcom, what Ofcom had said in the  
14 decision, then to go back to Sky to say – because also one has to bear in mind that this was a  
15 determination in relation to a specific period of time. So Rapture could then go back to Sky  
16 and say: “The circumstances have changed, we want you to consider this new material  
17 because with this new material we think that your price is no longer FRND”, that is how it  
18 would work.

19 THE CHAIRMAN: So what you are saying is that Ofcom would look at it and say that “On the  
20 material that was available it is FRND. However, we have seen some new material and we  
21 think that on that material it is not FRND, so go back to negotiating with them”, and  
22 effectively you are giving a direction, are you, that they should renegotiate taking that into  
23 account?

24 MR. VAJDA: The position is this, that we would still say that it was right for Sky to have offered  
25 the price that it did, let us come back to the point, £78K would still be FRND, but it would  
26 be open to Rapture to go back to Sky and say “We want to have another negotiation in  
27 relation to a different period of time.

28 THE CHAIRMAN: No, in relation into the same period of time I am talking about.

29 MR. VAJDA: (After a pause) No, this is a resolution of a dispute in relation to a particular period  
30 of time between Sky and Rapture, and part of how that dispute is to be resolved, if I can put  
31 it like that, is whether or not there has been negotiation, and whether or not the  
32 negotiation ----

33 THE CHAIRMAN: -- has failed.

1 MR. VAJDA: Well the fact that negotiation fails does not mean that the price is not FRND – that  
2 is a complete *non sequitur* with respect. The question is if there has been negotiation which  
3 one party does not like, and then brings it to Ofcom, let us assume Ofcom is just focusing  
4 on negotiation, what Ofcom does is it looks at a guideline and says: “Has the negotiation  
5 effectively taken account of, say, willingness to pay?” I come back to the point if Sky had  
6 written a letter saying “We are just going to ignore that”, that would be a case where one  
7 would say even though there has been a negotiation it has been a flawed negotiation and  
8 because willingness to pay is a factor ----

9 THE CHAIRMAN: “You failed to take that into account”.

10 MR. VAJDA: Exactly.

11 THE CHAIRMAN: I understand that.

12 MR. VAJDA: But if they had taken it into account, and then out of the back pocket of Mr. Henry  
13 comes a lot of material that was not put to Sky it would not change the position in relation  
14 to that period of time.

15 THE CHAIRMAN: What you are saying is that you are constrained by the material that was in  
16 the negotiations?

17 MR. VAJDA: Yes, because we are ----

18 THE CHAIRMAN: I just wonder, I am trying to find the provision – 191 at p. 991- I do not quite  
19 see why 191 is saying that you can ask for information if you are constrained by the  
20 information that is within the negotiations. Shall we have the short adjournment and come  
21 back to it at 2 o’clock, unless you have a simple answer to it?

22 MR. VAJDA: We will come back to it. I am slightly concerned about the time, I am very happy  
23 to answer all these questions, this particular point so far as I see is not really in play, but I  
24 am very happy to ----

25 THE CHAIRMAN: I think it is, because you are saying that it is only what is within the  
26 negotiation.

27 MR. VAJDA: That is right.

28 THE CHAIRMAN: Now, it might be that there is no other information provided to you and  
29 therefore it is not in play but it might, be and I am not sure about this, that there was  
30 information provided to you which you have not taken into account – I do not know if that  
31 is what is being said, I do not think so.

32 MR. VAJDA: No, it is not being said.

33 THE CHAIRMAN: My problem is that it is not the negotiation that is relevant but it is what  
34 information is provided to you and if no other information was provided to you, well fine.

1 MR. VAJDA: With respect I do not see what the problem is. 191 entitles the Office to obtain  
2 information ----

3 THE CHAIRMAN: Yes.

4 MR. VAJDA: -- and for example one would be, say, the Sky platform model, another would be  
5 evidence of negotiation because obviously in determining whether or not Sky said "We are  
6 not going to take account of willingness to pay, one actually needs to see the  
7 correspondence. You cannot read into 191 ----

8 THE CHAIRMAN: I am not saying that you do not – my reading of the way you were putting it,  
9 which might be wrong, was that you are looking very much at what those negotiations are,  
10 rather than looking at whether the price that was offered is FRND? That is where the cross  
11 purposes are.

12 MR. VAJDA: Well then the fault is entirely mine. The point of FRND is a multi-layered  
13 approach.

14 THE CHAIRMAN: I understand that.

15 MR. VAJDA: And one of the layers in the multi-layered approach is negotiation but all this is  
16 designed to see whether there is FRND, and this is the point we come back to the floor to  
17 ceiling point, supposing one had ignored that step ----

18 THE CHAIRMAN: I understand all that?

19 MR. VAJDA: -- again if you ignore the negotiations' step you cannot say it is FRND, but it is  
20 one layer in a multi-layered approach; it is not the only layer, it is one layer. If there was no  
21 negotiation at all, if Sky had simply said: "We are not going to negotiate" full stop, that  
22 would be a departure from the guidelines, and it would not have been possible for the Office  
23 to say that the price was FRND because it was one layer that had not been gone through. So  
24 if there is no inconsistency it is not that they were looking at negotiation or they were  
25 looking at the price, they are not two different things. The legal obligation is to offer a price  
26 which is FRND. The way that Ofcom does it is through the guidelines, which have been  
27 accepted by everybody, including the Tribunal, and one of the factors in the guidelines is  
28 the negotiation and you have to go through that to determine whether or not the price is  
29 FRND, and this in a sense shows why this is so different from normal price control, because  
30 in a normal price control case you do not get into the question if there is negotiation you just  
31 look at accounts and that sort of thing. This is a flexible approach to something which is  
32 very different from price control.

1 THE CHAIRMAN: Well it is saying that if you fail to take something into account in the  
2 guidelines, within the negotiation then that will give you 100 points and will mean that they  
3 have not satisfied you it is FRND because you have not taken that bit into account.

4 MR. VAJDA: Yes, maybe, but again one has to be a little careful because the guidelines are  
5 guidance they are not written in concrete and it may be that if there was some factor that  
6 had not been taken account of ----

7 THE CHAIRMAN: It was irrelevant.

8 MR. VAJDA: -- which might have been irrelevant. But the point is this, that negotiations are  
9 plainly a relevant factor, the guidelines make that clear. There were negotiations in this  
10 case, Ofcom examined those negotiations and it came to the conclusion on the basis of the  
11 evidence that those negotiations that took place satisfied the FRND test so far as the  
12 guidelines are concerned. It is true that the Office then looked at additional information,  
13 because as I said that was, if you like, in an English sense *obiter* to the resolution of this  
14 dispute.

15 THE CHAIRMAN: Well we have your submissions.

16 MR. VAJDA: It is plain I have not been making myself clear enough, but it is actually  
17 fundamental that the Tribunal understands that there is absolutely no inconsistency between  
18 looking at the negotiation and looking to see whether the price is FRND, the two are  
19 intimately connected.

20 THE CHAIRMAN: Shall we say 5 past 2?

21 (Adjourned for a short time)

22 MR. VAJDA: I think we were at 5.35 of the determination. In view of the time, I propose to  
23 continue going through the determination and then, when I come to the end, I will deal with  
24 the two questions that Professor Stoneman put to me during the morning, if that is all right  
25 with the Tribunal.

26 THE CHAIRMAN: Can I just ask you: is one of those questions about whether -- If, instead of  
27 putting the whole cost of the set-top box in cost, one put the subsidy in and did not put  
28 anything in relation to the revenue?

29 MR. VAJDA: Yes, that is one of them.

30 THE CHAIRMAN: Right. Thank you.

31 MR. VAJDA: We looked at 5.35. I cannot now recall whether we looked at 5.34. It is important  
32 to see that Ofcom consider two questions: (1) are all the categories of common costs  
33 included in the platform model relevant to EPG? We have answered that question, 'Yes',  
34 but it is important to examine that. The second question is: is the contribution to common

1 costs from Rapture reasonable, taking into account factors which would be reflected in a  
2 charge negotiation?. That has also been answered, 'Yes'.

3 Now, what we looked at was 5.35, which was, if you like, the split of common costs. This  
4 is important at 5.37.

5 "In resolving this dispute Ofcom does not consider that it is necessary to consider in  
6 detail either the absolute level of each common cost, or the reasonableness of  
7 contributions to common costs or other technical platform services. This is because  
8 the reasonableness or otherwise of the charge for Rapture's EPG listing will be  
9 insensitive to even quite large changes in the amount of any one cost included as a  
10 common cost, and also because of the very small proportion that EPG listing charges  
11 contribute to common costs".

12 That is absolutely fundamental because that was part of the attack of Rapture. One needs to  
13 be aware as to why Ofcom took the view that it did - that it did not need, to use Mr.  
14 Bowsher's expression, to drill down. There are two reasons given: the reasonableness for  
15 the insensitive and even quite large changes in the amount of any one cost -- We explore  
16 that even further in our skeleton - even if you take out all the set-top box costs. Also,  
17 because of the very small proportion that EPG listing charges contribute to common costs.  
18 We have seen that from the tables we looked at this morning.

19 Again, to see how this replicates the guidelines, the next heading is Consumer Equipment  
20 Costs. You see that they reproduce there those very important passages at 3.9 to 3.11 that I  
21 took the Tribunal to this morning at 5.40. They then set out Rapture's and Sky's views. If  
22 we can go to 5.50, you see the conclusion of Ofcom, "The provision of subsidised set-top  
23 boxes by Sky to viewers increases the number of viewers with access to the Sky platform  
24 and, in Ofcom's view, this confers some benefit on channels such as Rapture who broadcast  
25 exclusively on the Sky platform. It is not unreasonable for Sky therefore to seek to recover  
26 a proportion of the costs of subsidising set-top boxes form channels such as Rapture".

27 They then make the point about the contribution,

28 "-- the contribution of EPG listing customers towards common costs represents only  
29 a very small proportion of those costs (EPG customers make a combined  
30 contribution of less [the Tribunal now has the figures] and is at a level which does  
31 not appear to Ofcom to be unreasonable".

32 PROFESSOR STONEMAN: Just before you move on from that, we were curious as to the extent  
33 to which that very small number - the contribution towards the common costs from EPG -  
34 was partly a function of actually including CA and AC costs in the calculation. In other

1 Rapture argument, I understand, they do not have CA/AC services and it should not be  
2 included in the common costs when it comes to looking at the contribution of these free-to-  
3 air channels without CA or AC services. So, is the question to do with sensitivity of these  
4 calculations to the way that the platform model treats CA and AC costs as common to all  
5 broadcasters as opposed to just some?

6 MR. VAJDA: No. The way that it is dealt with - and I will be corrected if I have got it wrong - is  
7 that what one strips out are the direct costs of CA and AC, which Rapture does not bear.  
8 But, there is an element of common costs which apply across the board, which Rapture  
9 contributes to.

10 PROFESSOR STONEMAN: Given the way it is calculated, this would be the higher cost of a set-  
11 top box which has CA and AC facilities.

12 MR. VAJDA: Absolutely.

13 PROFESSOR STONEMAN: That is included both the costs and the revenue of the platform  
14 model.

15 MR. VAJDA: This comes back to my point that what you have is the product out in the market. I  
16 come back to the example I gave this morning. Somebody who is an Arsenal support, who  
17 goes and buys Sky for that reason - he needs CA to watch Arsenal. But, he also is one of the  
18 8.5 million ---- I do not know how many supporters Arsenal have, but it is probably more  
19 than one or two.

20 THE CHAIRMAN: I think, Mr. Vajda, we have got that point. We understand that point.

21 MR. VAJDA: That is why there is a benefit to having ----

22 THE CHAIRMAN: That is why you say that you put the whole thing in, including AC and CA.  
23 We have got that point. We understand that point.

24 MR. VAJDA: I am delighted.

25 THE CHAIRMAN: I am not saying we accept that point, but we understand it.

26 PROFESSOR STONEMAN: The thing then is: how sensitive is the percentage we are not  
27 allowed to mention to that treatment -- less than 5 percent ---- to that means of including the  
28 CA and the AC costs.

29 MR. VAJDA: I only can go back to what I said before - which is that insofar as their direct costs  
30 are both CA and AC, they have been excluded. What has not been excluded has remained  
31 in. (After a pause): The point also which we make in our skeleton is that in relation to the  
32 common costs -- We can perhaps look at this by going back to the table. (After a pause):  
33 If we look at Table 3 - Costs. You see there a figure in billions at the bottom. You see a  
34 figure there for common costs. This is in terms of sensitivity. If I understand the Professor's

1 question -- You compare that to the revenues that are received from EPG customers. If one  
2 looks at all the EPG customers and one goes to Table 1, and you look at the figure -- both  
3 the figure and the percentage -- that gives you some idea of the degree of magnitude as to  
4 the difference between the two. It is a point we make in our skeleton at para. 38.

5 PROFESSOR STONEMAN: The general feeling is that these percentages which we are relying  
6 upon must, of necessity, be dependent upon how the different concepts are defined. So,  
7 what happens is that the electronic programme guide has a proportion of revenue which is  
8 less than 5 percent as a proportion of costs. (After a pause): Let us move on, shall we?

9 MR. VAJDA: I am going to come to that. I am going to come to what we say on the  
10 determination. But, in terms of the sensitivity point, that is the point that I made this  
11 morning, and is made again. In view of the shortage of time, and not being able to go  
12 through the skeleton in the detail I wanted to - but I am sure the Tribunal will pay careful  
13 attention to our skeleton even though we are unable to go through it orally - I wanted to go  
14 to para. 38 which seeks to deal with that.

15 THE CHAIRMAN: As you know, we do pay careful attention. That is why the judgments tend  
16 to be of a long length.

17 MR. VAJDA: I was actually then at 5.50. That is the first point we make - that it is not  
18 unreasonable for Sky to seek to recover a proportion of the costs because there is a benefit.  
19 Then, as noted in 5.33, the contribution of EPG listing customers towards common costs  
20 represents only a very small proportion of those costs. Then we come to 5.54 which was  
21 probably the bit of the determination that Mr. Bowsher concentrated most of his fire on  
22 because he said, "Well, there are all these very interesting issues which basically Ofcom did  
23 not go into". Well, it is perfectly true that Ofcom did not go into it, but that does not mean  
24 to say that there was an error. What we are looking at here is: did Ofcom err in the exercise  
25 of their discretion? It is not an error of law here. An exercise of their discretion. What  
26 Ofcom's reasons are for not going into that are set out, we say fully, at 5.55 to 5.56. Indeed,  
27 yesterday, Professor Stoneman took Mr. Bowsher to 5.56. The first point that is made at  
28 5.55 is the benefit point that we have already seen - the benefit to Rapture. Then, at 5.56,  
29 "Ofcom accepts that EPG customers should not be expected to contribute to the direct  
30 cost of components of the Sky platform from which they derive no benefit. Whilst  
31 there are components of the Sky Platform that are not used by free-to-air channels  
32 (such as access control technology and encryption), the direct costs associated with  
33 conditional access and access control services comprise only a relatively small  
34 proportion of total platform costs. [As I said a moment ago, they have been stripped

1 out of common costs.] Given that the majority of platform costs relate to the common  
2 cost of building up a base of viewers and the contribution of EPG listing customers to  
3 common costs is small, it is reasonable to conclude that EPG customers are not  
4 contributing towards the direct costs of other technical platform services from which  
5 they do not derive a benefit”.

6 So, what we are saying is that they are not having to pay for the direct costs of CA or AC.  
7 They are paying a small, but a very, very small proportion of common costs. So, that is the  
8 approach that Ofcom takes.

9 Then, mirroring the Guidelines, one comes to 5.57.

10 “The relevant question then become what level of contribution is ‘fair, reasonable, and  
11 non-discriminatory’, and, in particular, whether the recovery of the set-top box  
12 subsidies was set at a level likely to price Rapture off the platform. To answer this  
13 question, the willingness to pay of each channel would need to be considered on a case  
14 by case basis in order to determine whether a charge was reasonable”.

15 So, we are now getting into the negotiation layer of the guidelines. That is precisely where  
16 the determination goes later on because the whole question of negotiation is gone into in  
17 great detail towards the end of Section 5.

18 THE CHAIRMAN: Does it mean in 5.57 that Ofcom did not look at this question - it closed the  
19 door when it saw what was going on in the negotiations?

20 MR. VAJDA: No, because what Ofcom did was to examine ---- When one looks at that bit of the  
21 determination which looks at the negotiations, it effectively examined the evidence of the  
22 negotiations between the parties.

23 THE CHAIRMAN: It did not have any other evidence before it? I am not criticising.

24 MR. VAJDA: That is right. As I understood it, it sought, insofar as it did not have evidence,  
25 evidence from Sky and Rapture as to what happened in the negotiations. The Tribunal may  
26 recall that it set out in that part of the determination correspondence and argument that were  
27 put by Rapture and Sky.

28 THE CHAIRMAN: It considered independently the information which was received.

29 MR. VAJDA: When, Madam Chairman, you are saying ‘the information received’, what  
30 information ----

31 THE CHAIRMAN: Whatever happened in the negotiations, which is the only information it  
32 received.

33 MR. VAJDA: It also received information which was not available at the time of the  
34 negotiations. It received two sorts of information.

1 THE CHAIRMAN: It looked independently - without taking account of where the negotiations  
2 were and what was said by each party as to whether there was willingness to pay. It looked  
3 independently to see what its conclusions would be.

4 MR. VAJDA: It looked independently in the sense that it was looking at it independently from  
5 Sky and Rapture. But, it did not look at it independently in a vacuum. It looked at it like a  
6 court would do - on the basis of the evidence that was before Sky and what Rapture put  
7 before Sky. It looked at it, yes, independently, but not ----

8 THE CHAIRMAN: Independently as the Court of Appeal would do, or independently as the  
9 High Court would do?

10 MR. VAJDA: It looked independently on the evidence and it reached conclusions on the  
11 evidence.

12 THE CHAIRMAN: In other words, it used the negotiations as the submissions to it.

13 MR. VAJDA: What it was concerned to ensure was that the negotiations, if I can put it like this,  
14 replicated the guidelines. I come back to 'willingness to pay' because we have seen  
15 willingness to pay is in the guidelines. In doing that, you only have to look at two things:  
16 first of all, was willingness to pay, if you like, on the table, if I can put it like that?  
17 Secondly, what was, or was not, said about willingness to pay? The same issue about  
18 discrimination ----

19 THE CHAIRMAN: Willingness to pay on the table. Yes. It was on the table. What was said?  
20 What did it then do? We may be getting there -- I do not want to take you off course.

21 MR. VAJDA: I am conscious of the time. It is not that I do not enjoy answering questions from  
22 the Tribunal, but we are going to get to that part ----

23 THE CHAIRMAN: Let us get to it in the course of your submissions, as you plan to do it. I can  
24 always come back.

25 MR. VAJDA: Certainly.

26 THE CHAIRMAN: You can see it is still worrying me.

27 MR. VAJDA: Yes. Absolutely. What I would just like to do in terms of structure is to then go to  
28 5.67. There you see that that is the conclusion - 5.67 to 5.69. It is the conclusion in relation  
29 to, "Were the costs sought to be recovered reasonably and necessarily incurred?" That is, if  
30 you like, Stage 1 of the Guidelines. I am not going to read that out because we are running  
31 short of time. Then the next layer is the floor/ceiling point. That is dealt with at 5.70 to 5.73.  
32 Again, that is following the Guidelines. The next layer is whether the return on the platform  
33 is excessive. I will come back to that right at the end in relation to Professor Stoneman's  
34 question.

1 We then come to what I might call the negotiation layer of the Guidelines. That begins at  
2 5.103. Again, here, you can see how Ofcom very carefully start off by looking at the  
3 Guidelines - as to what the 2002 Guidelines are. They then set out at 5.106 Rapture's view.  
4 Then they set out Sky's view. For example, one of the things they refer to, as we see at  
5 5.113,

6 "Sky has acknowledged that Rapture sent an e-mail to it on 7<sup>th</sup> November, 2005 in  
7 which Rapture stated that, 'Rapture is one of a handful of channels that offers  
8 satellite viewers some real entertainment not just a rip-off quiz games or religious  
9 doctrine pretending to be entertainment, frankly, I think Sky should be paying us or  
10 the added value we offer'".

11 That was part of the negotiation process that was going on.

12 We then see a section headed 'Sky stated basis for negotiation'. We then see another  
13 section which is 'Negotiations between Sky and Rapture' which begins at 5.120. Again,  
14 because of time I am not going to go through that with you. But, you can see that very  
15 careful consideration is given. All the history is set out here, the correspondence. Then you  
16 find at 5.149 that this is where Ofcom sets out its views. Again, you see carefully it begins  
17 by looking at para. 3.7 of the Guidelines, willingness to pay. You will see that at 5.153,

18 "Ofcom does not Sky's view that a broadcaster's inability to pay the indicative  
19 rate card EPG listing would not be a significant consideration in negotiation. In  
20 particular, if the broadcaster was able to demonstrate credibly that Sky's proposed  
21 EPG listing charge had a material adverse impact on the viability of the  
22 broadcaster's business and that an alternative charge set above the incremental  
23 floor would result in a viable opportunity to use the Sky platform, the 2002  
24 Guidelines would require Sky to take this into account during negotiations".

25 So, you can see it is not that Ofcom is simply accepting everything Sky says. Ofcom puts  
26 the position thus:

27 "In Ofcom's view the relevant issue is whether, in negotiations, Sky complied with  
28 its regulatory requirement to treat Rapture, as a purchaser of EPG services, in a  
29 fair, reasonable and non-discriminatory manner. Ofcom has assessed whether the  
30 evidence suggests that Sky offered Rapture a reasonable opportunity to  
31 demonstrate in commercial negotiations that the indicative rate card charge for an  
32 EPG listing would have been unfair, unreasonable or discriminatory in Rapture's  
33 particular circumstances".

1 Then you see that Ofcom makes certain findings, effectively at 5.155 to 5.158. If I can just,  
2 again in the interests of speed, just highlight one passage which is the second sentence of  
3 5.156,

4 “Ofcom considers that Rapture’s arguments were general in nature and that Rapture  
5 failed to provide Sky with any specific evidence to demonstrate that the viability of  
6 the channel was materially affected by the EPG listing charge. On each occasion,  
7 Rapture chose not to substantiate its arguments with documentation about its  
8 business or any other objectively justifiable evidence which would justify Rapture  
9 benefiting from a lower charge”.

10 This comes back to the point that I made: it has got to be evidenced-based - otherwise if  
11 Rapture is given it for £1, everybody else is going to come along and say, “I want it for £1  
12 as well”. 5.155 to 5.158 is the answer to Mr. Bowsheer’s Point 5 in his little note that he  
13 produced for the Tribunal this morning.

14 Then, there is another heading. The determination did not finish, even at that stage. It went  
15 on to consider whether all relevant factors were taken into account, including the service  
16 required benefits to the Sky platform and willingness to pay. Again, here is a reference to  
17 the Guidelines, as one would expect. Ofcom set out Rapture’s view. They set out Sky’s  
18 view. Then we find at para. 5.168 Ofcom’s conclusion. In the interests of speed - and I  
19 have no doubt the Tribunal will look at all of this very carefully - I will go to 5.173 where I  
20 will look at the last part,

21 “However, in applying a unitary rate card charge significantly in excess of the  
22 incremental cost of providing a service, Sky must ----“

23 So, pausing there, it is not right to say, “Oh, we just said it’s between the floor and the  
24 ceiling. That’s all right”. What we are saying here is that if you are going to apply a card  
25 which is significant in excess of the incremental cost, you must ensure the ‘application of  
26 the rate card takes into account those factors which would feature in negotiations in a  
27 competitive market. One such factor is a broadcaster’s willingness to pay’. Ofcom  
28 concludes at 5.175, if one looks at the last bit of that paragraph, “As set out in paras. 5.149  
29 to 5.157, Ofcom considers that, on the basis of the submissions made to it, Sky acted  
30 reasonably in not agreeing to a discounted EPG listing charge to Rapture, on the basis that  
31 Rapture failed to demonstrate that the indicative rate card charge was not justified in  
32 Rapture’s particular circumstances”.

1 Pausing there, again, consideration of that -- evidence base -- there was not sufficient  
2 evidence. What then happens at 5.176 is that Ofcom then goes on - and this is what I said  
3 this morning ----

4 THE CHAIRMAN: This is the additional information.

5 MR. VAJDA: This is the *obiter* point. It effectively goes on to consider information that was  
6 provided to it, but not to Sky. You see at the end of 5.176 it says,

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

9 The long and the short of this is that if we look at the 2004 business plan -- If I can ask the  
10 Tribunal to sideline 5.184. I am not going to read it out aloud. That was the conclusion in  
11 relation to the business plan. Then there is the financial projections. Again, we see the  
12 conclusions which are at 5.190 to 5.192. I have made the point already this morning that  
13 even if the conclusion had been different, if Ofcom had taken the view that, yes, for  
14 instance, the 2005 financial protections indicated to Ofcom that there might be a pricing off  
15 the channel, it would not have altered the determination in relation to the period 2005/06  
16 because these were documents which were not presented to Sky in the negotiations.

17 THE CHAIRMAN: That is where I have my concern - but it may not be relevant.

18 MR. VAJDA: We say that we are not in a position to ----

19 THE CHAIRMAN: You only look at the evidence.

20 MR. VAJDA: Absolutely. Again, we are not in price control. To say to Sky, “You have now got  
21 to retrospectively reduce your price ----”

22 THE CHAIRMAN: That is not what I am saying though. If they provide further information  
23 which was not in the negotiations ----

24 MR. VAJDA: It is purely hypothetical. Of course, the end result was that it made no difference  
25 whatsoever. It is hypothesis upon hypothesis here.

26 THE CHAIRMAN: If we decided it did make a difference ----

27 MR. VAJDA: If the Tribunal were to reach the view that effectively (if I can put it this way)  
28 Ofcom’s analysis of the 2004 and 2005 material was in some way flawed -- I say ‘in some  
29 way’ -- Obviously one has got to look at the errors. Is it an error of law? An error of fact?

30 THE CHAIRMAN: Just assume.

31 MR. VAJDA: Let us just assume. My submission is that that would not lead to a quashing of this  
32 determination because this determination is in relation to -- You see at 3.81 of the  
33 determination what the scope of the dispute was - was the EPG price November 2005 to  
34 November 2006 FRND?

1 THE CHAIRMAN: In doing that you are only entitled to take into account the information  
2 provided within the negotiation.

3 MR. VAJDA: Yes. The whole point of having negotiations in the Guidelines (if I can put it like  
4 that) is that that then gives an opportunity to ----

5 THE CHAIRMAN: I just do not understand how that fits in with Section 191.

6 MR. VAJDA: Section 191 is simply an information-gathering ----

7 THE CHAIRMAN: But you would not need to do that - except to gather information in relation  
8 to the negotiations.

9 MR. VAJDA: I am sorry. Madam Chairman has lost me. Could you put the question again?

10 THE CHAIRMAN: Section 191 is an information-gathering condition.

11 MR. VAJDA: Yes.

12 THE CHAIRMAN: It is not restricted to information-gathering in relation to the negotiations.

13 MR. VAJDA: Correct.

14 THE CHAIRMAN: It extends beyond it. It does not limit it anyway.

15 MR. VAJDA: That is correct.

16 THE CHAIRMAN: As I understand your submission, the only thing you can take into account is  
17 what information was provided in the negotiations. Therefore I do not understand why s.191  
18 in relation to this aspect is there. All you are saying is that you have to read it restrictively.

19 MR. VAJDA: No. Section 191 is a general power for getting information -- getting any form of  
20 information.

21 THE CHAIRMAN: Irrelevant to considering the dispute and making a determination to resolve  
22 it. That is 191(c).

23 MR. VAJDA: Absolutely. What we say is strictly relevant for the determination, if one is looking  
24 at the multi-layered approach, is evidence on floor/ceiling, IRR, negotiation.

25 THE CHAIRMAN: But only in relation to the evidence that has been put in in the negotiations.

26 MR. VAJDA: For instance, in relation to things like IRR, that will not have been in the  
27 negotiation at all because one may well wish to seek -- Indeed, the whole Sky platform  
28 model, even today -- Mr. Henry has not seen it, and it does not figure in the negotiation.  
29 That is obviously relevant evidence in Ofcom resolving this dispute.

30 THE CHAIRMAN: Why is it not relevant evidence to do with the business plan and all that sort  
31 of thing?

32 MR. VAJDA: Because the question is: is the price FRND? One of the layers is: has there been a  
33 negotiation which reflects the guidelines? You look at evidence to see whether it has or  
34 has not.

1 THE CHAIRMAN: The fact that Sky put in its business plan to you which you would not show  
2 to Rapture, quite appropriately, Rapture could put in their business plan to you, which they  
3 have not shown to Sky in the negotiations. Are you saying that that cannot be taken account  
4 of?

5 MR. VAJDA: No, I am not trying ----

6 THE CHAIRMAN: What they are trying to do - and it may not be relevant evidence - is to put  
7 that sort of evidence to you.

8 MR. VAJDA: Well, it was not that they were trying to - they did.

9 THE CHAIRMAN: Yes. But you are saying that even if it had been evidence which was relevant  
10 and would have made a different conclusion, that would not have changed your view.  
11 (After a pause): It could not change, is what you are saying.

12 MR. VAJDA: That is right.

13 THE CHAIRMAN: Why looking at Sky's business plan changes it -- You can take it out of that,  
14 but you cannot take it out of what Rapture was putting forward.

15 MR. VAJDA: I think I said Sky's platform model.

16 THE CHAIRMAN: All right - Sky's platform model.

17 MR. VAJDA: Sky's platform model is quite important because we have Sky's platform model  
18 and one is going to get no cost information at all.

19 THE CHAIRMAN: But you are not getting the cost information - especially in relation to  
20 willingness to pay.

21 MR. VAJDA: With respect, one is looking at two totally different things. The Guidelines say that  
22 you have got to look at costs which are reasonably and necessarily incurred. You have got  
23 to have an IRR which is not excessive. You have got to be between the floor and the ceiling.

24 THE CHAIRMAN: And you have got to look at willingness to pay.

25 MR. VAJDA: If I could just pause there -- In relation to that, Ofcom needs to have evidence. It  
26 seeks that evidence from Sky. We then come to the negotiation layer, if I can put it like that.  
27 Now, the negotiation layer is, if you like, different in concept from the IRR layer and the  
28 costs layer. The negotiation layer is effectively to say, "Well, there should be some  
29 negotiation that takes place". What one is seeking to avoid is, if I can put it like this, 'a take  
30 it or leave it' situation. What Ofcom is saying is, "We need to be satisfied that there is  
31 evidence of negotiation". That is what one is looking for in the negotiation layer of the  
32 multi-layered approach. In relation to, if you like, the Rapture business plan, that has a  
33 different degree of relevance because that would be relevant to the question of willingness  
34 to pay, but it is not going to be relevant to the floor/ceiling, or anything like that. So, I am

1 not saying that these matters are irrelevant. What I am saying is that in relation to the  
2 negotiation, Ofcom's role is effectively to act as a sort of long-stop to see whether this  
3 negotiation was properly carried out in the way that we thought it was going to be. What  
4 Ofcom is not doing is to have a situation -- Supposing Rapture simply said, "Well, we're  
5 not going to negotiate with Sky at all. We are just going to come to you, Ofcom. We're  
6 going to put all this information ----"

7 THE CHAIRMAN: You say there was no negotiation ----

8 MR. VAJDA: Exactly.

9 THE CHAIRMAN: You are not going to accept the relevance. I understand all that. The point  
10 that I am concerned about is that you say that you would not be looking at the -- your  
11 decision has to be the same whether or not they produce to you evidence or a business plan  
12 which might make your decision different. But, you are not allowed to do that ----

13 MR. VAJDA: No, it would not make our decision different. Our decision would be exactly the  
14 same. It would be that the price was FRND.

15 THE CHAIRMAN: Yes. But, if that evidence was such that your decision might have been that  
16 it was not FRND ---

17 MR. VAJDA: It is not what it might have been. It is a binary situation. The price is either FRND  
18 or it is not. The question is: in looking at the negotiation element of the layer you say,  
19 "Look at the negotiation. Was there, if you like, a guidelines-style negotiation?" If the  
20 answer is, "Yes", and it met the guidelines, then it is FRND regardless of whatever happens  
21 subsequently. It is *res inter alia actos*. It just does not matter.

22 THE CHAIRMAN: I think you had better get on, otherwise we are going to be here -- I still do  
23 not follow it; I will have to think about it.

24 PROFESSOR STONEMAN: I know you want to get on, but can I characterise what is going on  
25 here? You have negotiations between Sky and Rapture. Your determination is that  
26 Rapture was not very forthcoming in those negotiations in terms of convincing Sky or  
27 providing evidence to convince Sky that Rapture should have a lower price. You looked at  
28 that material that Rapture took to Sky and said, "No, it does not convince us either".

29 However, if I go to para. 5.153 of the determination --

30 "Ofcom does not accept Sky's view that a broadcaster's inability to pay the indicative  
31 rate card EPG listing charge would not be a significant consideration in negotiation". I  
32 am Rapture and I go along to negotiate with Sky and they say, "Well it does not matter  
33 to us whether you can afford to pay it, or not. It is not a significant factor to take into  
34 account".

1 Why should I provide them with any evidence - that is, Sky - that I am not willing to  
2 pay, because they say I am not taking it into account? If I do not provide them with  
3 any evidence that I am not willing to pay, you are going to say, as Ofcom, that I did  
4 not provide enough evidence to have meaningful negotiations with Sky.

5 MR. VAJDA: That has been dealt with in the next paragraph.

6 "Ofcom has assessed whether the evidence suggest that Sky offered Rapture a  
7 reasonable opportunity to demonstrate in commercial negotiations that the  
8 indicative rate card charge for an EPG listing would have been unfair or  
9 unreasonable or discriminatory in Rapture's particular circumstances".

10 PROFESSOR STONEMAN: But as long as it is not on the ground of inability to pay, which is  
11 what 5.153 says.

12 MR. VAJDA: Yes, but what Ofcom has done is that it has set out in some detail - if one goes  
13 back to 5.121 - the whole negotiating process which in fact goes back to 2002 with Power  
14 TV and it sets out the points that Rapture had made and Sky had made. So, they have  
15 looked at that, and they have come to the evidence-based conclusion that Rapture were  
16 offered an opportunity to demonstrate, but they failed to do so.

17 PROFESSOR STONEMAN: But not on the grounds of willingness to pay. Sky does not accept  
18 that. It says it in 5.153.

19 MR. VAJDA: That is effectively Sky's submission ----

20 PROFESSOR STONEMAN: But that is before negotiating. It is no good negotiating with  
21 somebody if somebody says, "Well, we won't accept evidence on those grounds", and then  
22 you come along and say, "Well, you didn't provide evidence on those grounds".

23 MR. ROTH: I do not want to interrupt, but -- I fully appreciate Professor Stoneman's point. It is  
24 dealt with at 5.193 in the determination, at the end of that paragraph.

25 PROFESSOR STONEMAN: (After a pause): But that is not the point, is it? The point is that  
26 it is no good Rapture providing that evidence to Sky - which you say they did not provide  
27 and therefore they did not negotiate properly - if Rapture knew in advance that Sky were not  
28 going to take any notice of it because it was Sky policy not to do so.

29 MR. VAJDA: One has to look at this in context. If we can go back to 5.153, one sees that the  
30 view that Ofcom did not accept was a statement that Sky made to OFTEL in 2003. That is  
31 not a public statement. It is not a statement it made to Rapture. That is a statement that it  
32 made to OFTEL.

33 PROFESSOR STONEMAN: This was not the stance that Sky took in the negotiations, you  
34 mean?

1 MR. VAJDA: The stance that Sky took in the negotiations is set out -- There is a stance. It is  
2 effectively set out at paras. -- The first comment we see at 5.126, which is where they offer  
3 to pay £1. Then there is a meeting that took place between Sky and Power TV in May  
4 2003. There is a record of that meeting. Then we have a letter that Sky wrote in 2003  
5 which says, "We have carefully considered the arguments that you put forward for lower  
6 charges ..." If one looks at the second paragraph,

7 "We have also made it clear to you that we would need to have strong, economically  
8 justifiable reasons for treating Rapture differently from other free-to-air channels if  
9 we are to consider lower charges. We therefore confirm our verbal offer of  
10 [£75,000] ... We are willing to consider any further arguments that you may wish to  
11 put forward on this issue if you feel that relevant issues have yet [sic] been taken into  
12 account".

13 We then go into 2005 when Rapture wrote to Sky.

14 PROFESSOR STONEMAN: I do not see anywhere a statement that says that Sky would accept  
15 willingness to pay as a reason for producing a lower charge.

16 MR. VAJDA: You have the letter of 8<sup>th</sup> May, 2003 which says, "We are willing to consider any  
17 further arguments that you may wish to put forward on this issue if you feel that relevant  
18 issues have yet to be taken into account".

19 PROFESSOR STONEMAN: I do not know what was said before that. I do not know whether  
20 that includes willingness to pay, or not.

21 MR. VAJDA: We have to proceed on the basis of evidence here. I come back to the point that if  
22 Rapture simply said, "I am going to take you, Sky, out to a jolly good lunch and get me a  
23 low price". Everybody else would say, "Well, we want a low price as well". You have to  
24 put forward a case. What the Guidelines say is that the rate card can be a starting point and  
25 you have to put forward a case if you want to be differently treated. There is nothing to stop  
26 Rapture putting forward a case -- Indeed, we see what Rapture's case was. Part of its case  
27 was that we are providing rip-off quiz games; we are providing ----

28 PROFESSOR STONEMAN: We are specifically talking here about the willingness to pay  
29 facility.

30 MR. VAJDA: Yes.

31 PROFESSOR STONEMAN: I cannot see any incentive here for Rapture to have argued with  
32 Sky, other than the willingness to pay ground because it seems to me from what I have got  
33 here that Sky were not going to accept that argument. Given what you have said to the

1 Chairman -- given that that argument was not made, you would not consider it as part of  
2 your inquiry to look into that.

3 MR. VAJDA: The 2002 documents there are public guidelines.

4 PROFESSOR STONEMAN: You told me that 5.153 was dated 2003/04, did you not - the Sky  
5 statement that inability to pay is not relevant? Did that not come after?

6 MR. VAJDA: The fact that it comes in 2003 does not mean it is in the public domain. The point  
7 is that willingness to pay is in the Guidelines. Those are the public -- The reason that you  
8 have guidelines is that people know where they stand. That means to say that both people  
9 who want access to the platform and the platform themselves. Both of them have to take  
10 that into account. It is not for Ofcom, in a sense, to make Rapture's case to Sky. Rapture  
11 could see - as could any broadcaster - that, "These are the Guidelines. You have got to take  
12 willingness to pay into account. Our case on willingness to pay is X, Y, and Z". Sky then  
13 look at it. But, you cannot say, "Simply because Rapture did not raise a willingness to pay  
14 argument, that this determination is flawed because you failed on the negotiation point".  
15 The point is that no evidence has been put forward to Sky to say that, "I want to make  
16 points, X, Y, and Z on willingness to pay". If evidence had been put forward that I want to  
17 make X, Y, and Z, and Sky had written back and said, "We think these are completely  
18 irrelevant. Get lost", then one might have an argument for saying, "Well, actually, looking  
19 at what actually happened, we do not think that negotiations gave sufficient weight to  
20 willingness to pay".

21 THE CHAIRMAN: As you can see, I am actually very concerned about what Ofcom's role in the  
22 dispute resolution procedure is. It looks to me as if your submission is that it is a reviewing  
23 role of the negotiations and not a consideration of what price ought to be paid. I know  
24 about the other sections ----

25 MR. VAJDA: Again, the dispute that one has to resolve is whether £76,800 was FRND. As I  
26 said at the beginning, this morning, that may not be the only point. There may be a  
27 whole ----

28 THE CHAIRMAN: From your submissions it seems to me that, yes, that is what you said the  
29 question is, but you do it by reviewing the negotiations. You do not do it by looking again  
30 to see whether that price is FRND.

31 MR. VAJDA: No. No. You do, because in deciding whether it is FRND one of the inputs is  
32 negotiation.

33 THE CHAIRMAN: It is one of the inputs. It depends how significant that input is. From your  
34 submissions it seems that you think that that input is a constraining factor.

1 MR. VAJDA: Yes. If we had finished our FRND analysis and we had not looked at negotiations,  
2 we would not have followed guidelines and there would have been quite a strong case for  
3 saying that the determination ----

4 THE CHAIRMAN: But in looking at the other factors, you are looking and seeing what was said  
5 in the negotiations rather than looking ----

6 MR. VAJDA: Yes. When one is looking at the negotiation factor in the Guidelines, one is  
7 looking at what actually was said between the parties; whether there was an evidence-based  
8 case. I come back to the point that if Sky were to offer Rapture a lower price without an  
9 evidence-based case. If Sky said, “We are not going to listen to an evidence-based case on  
10 anything”, then one could say, “Well, it has not just been a failure of negotiation, but the  
11 negotiations have failed to take account of some principles in the guidelines”.

12 THE CHAIRMAN: I understand that, but if you get past that stage -- That is why I find it odd  
13 that it is in the middle of your determination rather than the beginning of your  
14 determination. It is the first thing you would consider - whether they have taken into  
15 account ----

16 MR. VAJDA: No. With respect, that is not right. What I have tried to do - perhaps  
17 unsuccessfully - is to show how Section 5 mirrors what is in Chapter 3 of the Guidelines.  
18 Negotiations comes after costs. That is absolutely fundamental, Madam Chairman. There is  
19 no oddity with negotiating coming at the end. This determination has very carefully tracked  
20 the Guidelines. You start off with the first things in Chapter 3, which is reasonable and  
21 necessarily incurred. You then look at floor/ceiling. You look at IRR.

22 THE CHAIRMAN: Then you look and see whether or not there are negotiations.

23 MR. VAJDA: Yes. So, there is absolutely nothing startling about this coming at the end.

24 THE CHAIRMAN: I think we will have to try and see where we sort this out. I think we are just  
25 going round in circles.

26 MR. VAJDA: I am obviously keen to assist the Tribunal. The important thing is that the  
27 Tribunal has my submission.

28 THE CHAIRMAN: I have your submissions.

29 MR. VAJDA: I am reminded that at 5.144 the letter that Rapture wrote to Sky makes it clear that  
30 Rapture was aware of the Guidelines. This was written by Mr. Henry himself. The last  
31 sentence, “I read the official Ofcom Guidelines and in line with them are [sic] giving this  
32 opportunity for ‘Sky’ to agree a ‘fair and non-discriminatory’ level of fee for the supply of  
33 EPG service”.

1 PROFESSOR STONEMAN: There is also the phrase in the middle, “The charges are too high  
2 and small channels like ours cannot afford them”. Does that mean willingness to pay?

3 MR. VAJDA: Again, it comes back to the question of looking at the evidence. Is that really  
4 sufficient submission?

5 I was, I believe, on Other Relevant Factors which is at 5.159. I hope the Tribunal  
6 appreciates that this is, again, tracking the Guidelines because it is looking at other factors.  
7 The factor that is looked at here -- We see Rapture’s view of benefit at 5.163.

8 “Rapture has stated that it considers that Sky has ‘benefited substantially’ from the  
9 presence of free-to-air channels which broadcast unique content that ‘enhances the  
10 Pay TV offering’”.

11 The point here is that Rapture is unique. That is the argument that was put. That was an  
12 argument that was not accepted.

13 We have looked at the financial plans, and before going to the last section, if we go to 194  
14 one sees in fact that Ofcom also looked at the question of willingness to pay from other  
15 broadcasters and then what they say – this is Ofcom – they reach a conclusion at 5.201:

16 “Ofcom has not considered the actual willingness to pay of comparable  
17 broadcasters in the context of this dispute. Ofcom has, however, considered the  
18 overall business costs of comparable broadcasters in order to assess the materiality  
19 of the indicative EPG listing charge to their businesses.”

20 Then it reaches the conclusion at 5.203:

21 “However, Ofcom is not currently aware, through complaints or by way of  
22 responses to this dispute, of any comparable broadcasters being priced off the Sky  
23 Platform due to the level of the rate card EPG listing charges.”

24 The last thing is discrimination. Again, the first thing, the application of the guidelines,  
25 they are set at 5.204. We then see Rapture’s views which are set out at 207, which is  
26 effectively that it is being charged the same as people like ITV2. Then we see Ofcom’s  
27 view, which recites Sky submission at 209, 419 television channels were listed on the EPG,  
28 and the only exceptions to the rate card channels on the Sky platform were, and then they  
29 set those out and explain why those exceptions were justified, and they then come to the  
30 conclusion at 5.215:

31 “... it was not discriminatory for Sky not to have charged rapture a lower price  
32 than that charged to other larger channels. Rapture was charged the same price as  
33 other smaller broadcasters purchasing EPG listings.”

1 Again, that is very important in relation to the discrimination point because if it is going to  
2 be charged a lower price that needs to be evidenced based and justified.

3 Then they look at other factors, again, they come to the conclusion that other factors do not  
4 alter the position and what I would like to do is come to the overall conclusion which is at  
5 5.250. What one sees there in the second sentence is:

6 “Ofcom has concluded that Sky has satisfied the requirements of each of the  
7 following components ...”

8 And then one goes to what we call the “multi-layered” approach over the page. That multi-  
9 layered approach mimics the guidelines, it applies the guidelines, and then we have the  
10 conclusion at 5.251: “On the basis of the evidence available to Ofcom and this analysis,  
11 Ofcom considers ...” that the charge during that period was FRND.

12 So there we have it. We say that the determination follows the guidelines, it is fully and  
13 carefully reasoned, both in relation to the cost issue, which is the main point of substance  
14 that Mr. Bowsher has raised, and it explains why it was not necessary to drill down any  
15 further.

16 Now, in view of the time, I think I have to sit down.

17 THE CHAIRMAN: You have the two questions.

18 MR. VAJDA: I have the two questions, but what I am going to say is this: that all the points that  
19 Mr. Bowsher made yesterday and today are dealt with in our skeleton and if I could  
20 particularly draw the Tribunal’s attention to what we say at paras. 22 to 28 on cost, and 36  
21 to 52 as well, and in relation to negotiation we deal with that at 29 to 30. I need perhaps say  
22 one final word about negotiation. Mr. Bowsher referred, as he put it, yesterday to the  
23 “myth” of negotiation, and this was based on the fact that there was a disparity in size. Of  
24 course, there is a disparity in size, but the fact there is a disparity of size does not mean that  
25 there was no ability to negotiate. Rapture knew that it could rely on the guidelines, and  
26 there was no evidence before Ofcom that any evidence that Rapture put forward to Sky was  
27 not properly considered by Sky in reaching the conclusion that there should be no reduction  
28 especially for Rapture.

29 Coming to the two questions of Professor Stoneman. Dealing first with the limit pricing and  
30 barriers to entry point, and I think this the point that will raise up the willingness to pay  
31 guideline, 3.7. The thinking behind that fact, if I can put it like that, is that Sky should not  
32 inefficiently exclude channels from the platform, that is to say where a channel can afford a  
33 price which is above the incremental cost and bring a benefit to the platform, for example,  
34 because it is different, it would be inefficient for Sky to exclude it. Indeed, there is some

1 reference to that in the material that I took the Tribunal to in the determination a moment  
2 ago. As I said this morning, and I am sure the Professor has it well in mind, the principle of  
3 willingness to pay of course needs to be balanced against other principles, and obviously the  
4 principle of competitive neutrality and non-discrimination, it is the balancing exercise.

5 In the present case there is in a sense no need to get into that balancing exercise because  
6 when you looked at each layer the result came out the same way.

7 That I hope is an answer to the limit pricing point.

8 PROFESSOR STONEMAN: It makes sense, but it is a very strange way to put it in the  
9 guidelines.

10 MR. VAJDA: I am glad that at least I am on the right lines – or rather those behind me, are on the  
11 right lines in answering the question.

12 The second question asked was, as I understood it, whether when one is looking at Sky's  
13 profitability in relation to the platform, does it matter whether one looks at it on a net or  
14 gross basis? The way that Ofcom have looked at it, if one takes a set top box at, say, £150  
15 that is a cost. Say you get £50 from the consumer, we say that there is a net cash flow of  
16 minus £100. That is the way that we have done it.

17 The other way that one could look at it is that one could say there is a subsidy of £100, full  
18 stop, there is no revenue in at all. Now, what the office did in terms of looking at  
19 profitability is looking at the internal rate of return, which is a discounted rate applied to the  
20 cash flows to give a net present value. That is dealt with at 5.75 to 5.100. They did not  
21 look at it by reference to a return on capital employed, or a return on investment, where  
22 obviously the calculations as to what capital is employed, would alter, depending on  
23 whether you looked at it in the way that Ofcom looked at it which is costs £150, revenue  
24 £50, net cash flow £100, or you look at it the other way which is you say that you have costs  
25 of £100 because that would affect the capital. The way that we have done it, we were  
26 looking at net cash flows, it does not make any difference.

27 PROFESSOR STONEMAN: I will not give a big response to that because I do not think it is a  
28 major part of the case. It does make a difference – the internal rate of return is a return on  
29 investment, and basically I think the area where it makes the greatest difference as to how  
30 you treat it is that you have in your model the weighted average cost of capital.

31 MR. VAJDA: Yes.

32 PROFESSOR STONEMAN: Now, if the capital excludes the parts of the set top boxes for which  
33 the consumers have paid then you have a very different weighted average cost of capital  
34 than if it included the amount for which the consumers had paid. So, for example, if you

1 have a set top box that costs £150 and you are saying that the capital employed in this  
2 industry is £150, then the weighted average cost of that capital depends upon who has  
3 provided that £150, whether it is the consumer or whether it is Sky. So it does make a  
4 difference, but I do not think for this particular case that it is an issue that we really need to  
5 explore any further.

6 MR. VAJDA: On the last point I am happy to concur, we have actually looked back at the  
7 pleadings on this and the point that was taken, even now the accepted notice of appeal, is  
8 that the risk factor, this particular point that has been raised now was not taken but the  
9 whack that has been used in the calculations here was not on a project basis but was  
10 estimation of Sky as a whole.

11 PROFESSOR STONEMAN: Sky platform as a whole, or the Sky plus Sky Broadcasting.

12 MR. VAJDA: Sky's platform as a whole.

13 PROFESSOR STONEMAN: That is what I had in mind.

14 MR. VAJDA: Subject to that –I apologise that I have taken ----

15 THE CHAIRMAN: I do not think you need apologise, because I am sure it is partly the questions  
16 that have been asked, but it has been very useful.

17 MR. VAJDA: Yes, but as you, madam Chairman said at an earlier CMC this case is obviously  
18 important to all parties, and plainly of great importance to my clients, and if there is  
19 anything that the Tribunal feels I have not dealt with which troubles them, please let me  
20 know, otherwise I am more than happy to sit down.

21 THE CHAIRMAN: Thank you very much. Mr. Roth?

22 MR. ROTH: Thank you, madam,.

23 THE CHAIRMAN: Can I ask you whether you think your 45 minutes to an hour is still a  
24 reasonable estimate?

25 MR. ROTH: I hope 45 minutes, and I respectfully adopt the submissions of Mr. Vajda for  
26 Ofcom, in particular at the outset of his submissions to you this morning regarding the  
27 statutory framework he addressed you about in some detail on the scope of this appeal, and I  
28 shall not repeat any of that. I shall divide my brief submissions under three heads. First,  
29 what Rapture calls its central complaint, secondly, the relevance of AC and CA. Services to  
30 common costs, a point that has arisen today. Thirdly, Ofcom's approach in the  
31 determination to the FRND requirement.

32 First, the central complaint. If you have the Rapture skeleton argument and go to para.42:  
33 "Rapture's central complaint is that Ofcom failed to analyse properly or at all the  
34 common costs to which free-to-air broadcasters should contribute in pricing the

1 EPG services provided by Sky. In particular, in relation to set top boxes,  
2 Rapture's primary case is that set top boxes should not be treated as a common  
3 cost of EPG services because in fact it is a common cost of the provision of  
4 television satellite services provided to Sky subscribers. In the alternative, the  
5 cost of the set top box subsidy should be treated as an externality."

6 So the phrase "the central complaint" I have taken from that. It is put slightly differently  
7 later when, in para.64 on p.16 there the set top box subsidy you see is described as I think an  
8 "incremental cost to the provision of access to satellite TV services for retail subscribers".

9 In 42 it is said to be a common cost. But altogether there is some confusion in all this as to  
10 the proper analysis and that that confusion lies at the heart of Rapture's case. Sky, as we all  
11 know, does not operate a satellite. The broadcaster of a channel arranges and pays for  
12 transmission of its channel independently of Sky by making its own arrangements with the  
13 operator of – I think there are two satellites at present. When the broadcaster of such a  
14 channel comes to Sky and says it wants to launch [quote] "on to the Sky platform" – I will  
15 not take up time in discussing what that means, but just observe in parenthesis that  
16 "platform" is not a legal term, it does not appear in the Directives or the Statute.

17 THE CHAIRMAN: That is why it has caused so much confusion.

18 MR. ROTH: And as long as one is clear what it means to people who use it, no doubt people use  
19 it different ways, as Professor Stoneman pointed out even my client seems to use it different  
20 ways in different places. But when Rapture came to Sky and says it wants to launch on to  
21 the Sky platform, what that means is that it wants to be able to access the audience that  
22 comprises the 8.5 million households who have Sky set top boxes, and satellite dishes. That  
23 is, it wants to be included in the EPG so that householders with a Sky set top box and dish,  
24 will be able easily to view its programmes. I say easily because we have heard about the sort  
25 of "technical geek" - as Mr. Vajda put it – who could fiddle with the box and get it without  
26 an EPG.

27 Mr. Henry said in his personal intervention yesterday that the public does not need a Sky set  
28 top box to view a free to air channel such as Rapture, you can buy, he told us, a set top box  
29 and a dish at - I cannot remember if it is "B&Q" or "Homebase" or somewhere similar ----

30 THE CHAIRMAN: B&Q.

31 MR. ROTH: -- and install it oneself, and that will work to access Rapture – or would have while  
32 it was being broadcast from satellite – and that set top box will have some kind of EPG  
33 facility in it which will link with the EPG information that is actually broadcast with the  
34 programme, for example, those who watch Sky will know that there is a line at the bottom

1 when you choose a programme showing what is on and what is coming next, and the jargon  
2 in the trade it is called “now and next”, well you will no doubt get that from one of those set  
3 top boxes and maybe some of those third party set top boxes will have some software that  
4 formats all the channels on to some grid on the screen which the viewer can select by  
5 pressing the “select” button – I do not know, it will depend on the particular set top box. It  
6 obviously will not have the Sky programme number, but there may be other ways of  
7 navigating, but that is not material to the issues in this case.

8 Sky will say that the EPG which it provides gives much more than the third party EPG that  
9 you get in a third party set top box, it gives better information, it gives more functions, it  
10 gives seven day forward listing of channels, and certainly Sky invests a lot of money in  
11 improving its EPG services, which are automatically downloaded from satellite on to the  
12 Sky set top box. But whether the Sky EPG is all that much better, as I am sure my clients  
13 contend it is, then the third party set top box is also not material. What is material is this: if,  
14 as Mr. Henry says, anybody can buy a set top box and dish for less than £60 and could use it  
15 to receive Rapture, then “why”, one asks rhetorically “are we all here?” “Why was it so  
16 important for Mr. Henry to get the Rapture channel on to the Sky EPG. The answer, of  
17 course, is that Rapture wanted that so as to be able to access the 8.5 million viewers with  
18 the Sky set top box, the large potential audience which Sky calls the Sky platform and, as  
19 Mr. Henry said in his evidence: “In reality you could not launch a digital channel in the UK  
20 without an EPG listing”, and he means, as one sees in the context, a listing from Sky. That  
21 is his first witness statement at para.20 – I do not think you need turn it up but it is clear that  
22 he means the Sky EPG listing. So what Sky provides to the broadcaster is the potential of  
23 being viewed in all those households with Sky STBs, and in that respect the set top box that  
24 you get, and the EPG listing on the screen complement each other, and that is the service  
25 that Sky offers broadcasters – they do not offer them any less. They can get more, such as  
26 conditional access, access control but no less, and the only charge that Sky levied on the  
27 broadcaster for this at the material time was the EPG charge unless the broadcaster wanted  
28 the enhanced facilities of conditional access, or access control in which case there were  
29 special agreements, and a very much higher overall charge – substantially higher.

30 The cost to Sky of adding a new channel to the EPG listing is small. There are certain start-  
31 up costs involved, explained in the witness statement that we have put in, but I do not think  
32 you need turn that up, it is in our bundle – your bundle 4 – at tab 1, the statement of Miss  
33 McCormack, from Sky. She explains at para.14 that there is basically some technical work  
34 on software, and then of course the transaction costs of the agreement. One sees in the

1 determination there is set out, not the additional cost of a new channel but the contribution  
2 to direct costs – the average contribution of direct costs for purely adding a new channel, it  
3 is 5.70 and 5.71 of the determination. It is perhaps worth looking at that for a moment if  
4 you would be so kind.

5 As you see in 5.70:

6 “The incremental costs of providing an EPG listing to a new channel are very  
7 small in comparison to the total costs ...”

8 it explains what they involve, and I sort of told you that. 5.71:

9 “Sky’s Platform Model identifies those direct costs which Sky has allocated to  
10 EPG services (such as staff costs, computer costs and transponder capacity). The  
11 average direct cost per channel over the life of the Platform Model is ...”

12 and there is a confidential figure, but it is between £10,000 and £20,000 per channel per  
13 annum, and that is the average, so the incremental cost will be lower than that – so it is  
14 small.

15 But in return for that EPG charge, the broadcaster gets access to all householders with Sky  
16 set top boxes and dishes who are then able to view its channel, and building up that viewing  
17 population (to use a neutral term) is something to which Sky has devoted considerable  
18 investment to develop and expand, since it started from scratch in 1998. So the charge to  
19 the broadcaster, the basic charge that every broadcaster pays includes a contribution to the  
20 cost of having created and developed the “platform” and in particular the subsidy to the  
21 provision of set top boxes to viewers. That is noted in the determination, the rationale for  
22 that, at 5.50:

23 “The provision of subsidised set top boxes by Sky to viewers increases the number  
24 of viewers with access to the Sky Platform and, in Ofcom’s view, this confers  
25 some benefit on channels such as Rapture who broadcast exclusively on the Sky  
26 Platform. It is not unreasonable for Sky therefore to seek to recover a proportion  
27 of the costs of subsidising set top boxes from channels such as Rapture.”

28 Again at 5.67, much the same point, under the heading “Conclusion”:

29 “As discussed above ... Ofcom considers it is a reasonable requirement that free-  
30 to-air channels with an EPG listing on the Sky Platform, such as Rapture, make a  
31 contribution towards the common costs of operating the Sky Platform. In  
32 particular, there is no basis for a finding on the evidence before Ofcom in this  
33 investigation that it would be unreasonable for Rapture to contribute to the largest  
34 single common cost, that of providing set top box subsidies, during the period

1 covered by this dispute. Such subsidies increase the number of viewers on the  
2 Sky Platform and free-to-air channels (particularly in the case of a channel such as  
3 Rapture that is not available on other distribution platforms) will benefit to some  
4 extent from an increased pool of potential viewers.”

5 Rapture’s whole approach involves the fallacy that one sees in their skeleton argument  
6 where, at the beginning of their analysis of what is fair and reasonable, Rapture’s skeleton at  
7 para.45 (second sentence):

8 “Rapture’s dispute with Sky concerns the pricing of Sky service that is the  
9 provision of access to the EPG for channel providers. This is a separate service to  
10 that which Sky provides to its retail subscribers, namely access to satellite TV  
11 services by a set top box.”

12 So it talks about two separate services, one to channel providers, broadcasters, and the  
13 others to – it says “subscribers”, but in fact both those elements are essential to the service  
14 which the broadcaster needs, and which Sky provides for the benefit of the broadcaster – of  
15 course, for the benefit of viewers too.

16 So the access to the broadcast via the set top box, the access to the EPG is something the  
17 broadcaster needs which is why Mr. Henry came to Sky in the first place, and did not leave  
18 it to people who wanted to view Rapture to go and get their set top box at B&Q. There is  
19 another, less significant, error in that statement in para.45, namely, it is not just the  
20 subscribers of Sky who have a Sky set top box, there is also in the total 8.5 million quite a  
21 significant number of people who used to be subscribers but no longer pay, they keep the set  
22 top box and can still access the channels. According to this goes an argument, Mr. Henry  
23 estimates that number is 1 million out of the 8.5 – we do not formally accept that figure, but  
24 it is a significant part, it is not just the subscribers (para.15, skeleton).

25 If one approaches this as a matter of common costs and says if Sky ceased to include the  
26 Rapture channel in the EPG, in fact it is not hypothetical, it has happened, would it still have  
27 to incur the costs of the STB subsidy? The answer, of course, is “Yes”. That is the  
28 approach to common cost that is clearly set out in the guidelines at para.3.4. You have had  
29 them read so many times that I hesitate to ask you to look at them again, but it is very clear  
30 in para.3.4: “The presence of economies of scale and scope means the incremental cost of  
31 supplying the service to one additional broadcaster channels is likely to be low” – indeed it  
32 is in this case.

33 “As the fixed and common costs of running the system must be recovered through  
34 the charge, it is not possible for the provider to charge a price equal to the

1 incremental cost to every purchaser. Such a price would not cover all the costs  
2 associated with the infrastructure that makes the operation of the service possible.”  
3 and, as I say the service has to include as an element the set top box and then it is in the  
4 light of that one comes on indeed to the particular section dealing with subsidy to which Mr.  
5 Vajda referred, namely paras. 3.9 and 3.10, it is right that broadcasters should contribute to  
6 subsidies of equipment.

7 If I can just add some history here, Sky was launched, as you heard, in 1998. I do not think  
8 it is contentious to recall that at the outset viewers who wanted to access Sky had to pay for  
9 their set top box, it was not given away free. The result was that after about a year Sky had  
10 very few viewers, and it had to review its strategy and that is when it introduced the set top  
11 box subsidy to encourage the take up of satellite viewing and broadcasting and, as Ofcom  
12 notes, the provision of the free STB and dish has been, as you would expect, a very  
13 significant factor in the great expansion of the population with Sky STBs because if  
14 consumers can get it for free they are much more likely to get one and so it has got up to the  
15 8.5 million, so it is entirely reasonable. It is economic logic and principle that a broadcaster  
16 such as Rapture should pay a contribution to the cost of the set top box subsidy. The  
17 central question of Rapture’s appeal therefore can receive a resounding negative answer.

18 So I come to my second head, which is the relevance of the AC and CA element to the  
19 common costs and the validity of Ofcom’s approach. The standard set top box includes the  
20 software which enables CA or AC services to be accessed; there is no set top box that does  
21 not have that in it. For most of those services you also need a viewing card to decrypt.  
22 Rapture’s argument, as I understand it, is that Ofcom should, as it were, have deconstructed  
23 the cost of the set top box so as to remove such costs as are attributable to the incorporation  
24 of the functionality to provide AC and CA, and Ofcom did not do that.

25 In that regard what Ofcom did, we submit, was a very proportionate approach on the facts,  
26 having regard to the figures in this case. They looked at how much do the EPG charges  
27 contribute to the total revenues and costs in the model, and they found that the contribution  
28 is, in fact, so small that it is not necessary to go to the length of working out what some  
29 hypothetical STB without AC and CA in it might cost, because, on any view, the  
30 contribution is at such a small level that it is reasonable. Had the contribution been much  
31 higher this point might have much force. One sees that on the figures in the determination,  
32 what they did, those are the figures Mr. Vajda referred to. The allocation of cost they look  
33 at starts at 5.60 and then one has the confidential graphs. In particular they looked at the

1 contribution of third party EPG customers such as Rapture, and that enabled them to reach  
2 the conclusion that you see in 5.65 and 5.66.

3 “5.65 Figure 3 above shows over the period of the Platform Model EPG listing  
4 charges to third parties (i.e. other than Sky’s own channels) have averaged less  
5 than [x] ...”

6 a small figure there:

7 “... of the total platform revenues.

8 “5.65 In Ofcom’s view, the small proportion of the total revenues represented by  
9 the EPG charges to third parties is consistent with the relative benefits to Sky and  
10 third parties of being on the Sky Platform. In particular, it does not provide  
11 evidence that would suggest that third party broadcasters are making a  
12 disproportionately high contribution towards common costs compared to Sky  
13 itself.”

14 So that is why it was not necessary in this case on these figures to strip out AC and CA  
15 functionality by a complex and hypothetical calculation.

16 On the IRR point, that Professor Stoneman raised, all I would say is echoing what Mr.  
17 Vajda said, Sky has not seen Ofcom’s IRR calculation, nor have we asked to see it. We did  
18 not ask to see it because it did not appear relevant on the appeal on the grounds of appeal,  
19 whether amended or indeed in the arguments in the skeleton argument and, had that been an  
20 issue, we certainly would have wanted to look at it.

21 PROFESSOR STONEMAN: On that particular point it is related, is it the case then – given what  
22 you have argued about all set top boxes have AC and CA facilities – that the subsidy to the  
23 box is completely independent of whether it has AC or CA facilities?

24 MR. ROTH: Yes, they all do. Most people, I think, get them free. There are a smaller number of  
25 people who pay something for them, but in those cases it is the same; it is no different.

26 PROFESSOR STONEMAN: So the subsidy is the same whether you have AC or CA or not?

27 MR. ROTH: There is no “not”.

28 PROFESSOR STONEMAN: Yes, all right, yes.

29 MR. ROTH: That is a point, yes. That is all I want to say on the second point, the relevance of  
30 AC and CA to common costs, and I come to the third of my three headings: “Ofcom’s  
31 approach to the FRND requirement.” As a legal requirement on Sky the FRND obligation  
32 is, in fact, imposed under the continuation notice, which is pursuant to a statutory power  
33 which perhaps is worth looking at, which you find in the first defence bundle (bundle 2 tab  
34 5). This is a notice given under para. 9 of schedule 18 to the Act, which are the transitional

1 provisions of the Act. They were mentioned in Mr. Bowsher’s useful sheet of statutory  
2 provisions that he gave us at the outset.

3 “The Director General of Telecommunications (“the Director”) in accordance with  
4 paragraph 9 of schedule 18 to the Communications Act 2003 hereby gives notice  
5 to a class of persons defined as the licensee for the purpose of the provision of  
6 EPG services that the conditions set out in the class licence to run  
7 telecommunication systems for the provision of conditional access services  
8 granted by the Secretary of State ...” etc “... is modified to the extent set out in  
9 schedule 1.”

10 Then you have the modification. It is under that modification that you find on p.9 within  
11 this tab, condition 1, on p.9:

12 “Where a third party requires the provision of an EPG service in respect of  
13 decodes, administrators’ licences shall offer the service to that person on a fair,  
14 reasonable and non-discriminatory basis.”

15 There is a definition of EPG which mirrors the statutory definition which you have seen in  
16 the earlier part of this notice. It is also under this notice, under the provision of the  
17 schedule, that Sky has to operate what has been referred to as an “open platform” i.e.  
18 anyone who pays the charge and meets the technical requirements can go on it, Sky cannot  
19 pick and choose, unlike the cable providers who can; they can say: “No, we do not want  
20 you, we do not think your content is good enough, and so on”, but as you see from condition  
21 1.1 “Licensees shall offer it where a third party requires it.”

22 So on that basis I would make eight points. First, it was reasonable for Sky to publish an  
23 indicative rate card, and I would ask you to keep this document out. It was reasonable for  
24 Sky to publish an indicative rate card for EPG charges, especially so as to ensure that any  
25 terms that were agreed were non-discriminatory, and the publication by Sky of an indicative  
26 rate card is not in itself challenged by Rapture and, indeed, it flows in a sense from the  
27 regulatory obligation under the licence condition that you find at condition 14. “Publication  
28 of charges, terms and conditions”, this is in the same tab 5, on p.11. Condition 14:

29 “The licensee shall, except insofar as the Director may otherwise consent in  
30 writing (a) publish in the manner and at the time specified by para.14.2(a) a  
31 notice specifying the method that is to be adopted for determining the charges and  
32 other terms and conditions on which it offers to provide each EPG service or  
33 package for such services.”

1 So they have to publish something and they did indeed publish an indicative rate card, in  
2 fact, it is annexed to the determination and that is the rate card at the end of the  
3 determination specifies the price that Rapture was then asked to pay and the different  
4 categories of pricing, 76.8K.

5 My second point is that EPG is a commodity product; it is the same service that is given as  
6 an EPG service to every broadcaster who signs up for it, and the evidence is there are now  
7 some 500 channels (or were at the time) listed. It is not a tailored service like the CA or AC  
8 can be, that varies with the requirements of the particular broadcaster, what are the  
9 conditions for access, what kind of control do they want, and so on, obviously great  
10 differences in different cases which have therefore much more complicated agreements and  
11 much higher prices.

12 Thirdly, Ofcom reviewed in the determination the full history of the discussions and the  
13 exchanges between the representatives of Rapture and Sky – that is the long section of the  
14 determination, paras. 5.120 to 5.148. Ofcom concluded that Rapture had provided no  
15 justification for a lower charge in its case.

16 In answer, madam, to your question: “Was Ofcom confined to looking at the arguments put  
17 in the negotiation?” whether as a matter of law they were or not, and whether, as a matter of  
18 policy they now say, or as a matter of submission they say they were, in fact, in this case it  
19 is quite clear they did not confine themselves in determining the dispute to look at the  
20 arguments and material evidence put before Sky. They did that, they went through that, but  
21 then they went on to look at the additional material that Mr. Henry (for Rapture) provided to  
22 Ofcom, which had not been provided to Sky. They looked at that and analysed it quite  
23 carefully and said: “No, even on the basis of that additional material there would be no basis  
24 for departing from the default charge in the rate card, and that one sees if you could please  
25 turn to the determination at para.5.175:

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

31 and you will note at the bottom of 5.176:

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

1 But nonetheless they are set out in 5.176 what they are, and you see over the page, just  
2 above 5.180, that Ofcom devotes some degree of attention to analysing first of all Rapture's  
3 2004 business plan, not provided to Sky but Ofcom looks at it, and then it goes on to devote  
4 considerable attention to analysing Rapture's 2005 financial projections, not provided to  
5 Sky but nonetheless Ofcom has a thorough look at it.

6 Then it concludes at 5.193:

7 "As stated in para.5.157 Ofcom has concluded on the basis of Rapture's  
8 submission to Sky, Sky had no grounds on which to justify a reduced EPG listing  
9 charge to Rapture."

10 But it does not stop there, it goes on:

11 "In Ofcom's view even if Rapture had submitted details of its business plan or  
12 financial projections to Sky, these would not have provided a compelling case for  
13 Sky to reduce its EPG listing charges in Rapture's case."

14 THE CHAIRMAN: My concern is that if we came to the view – and I am not saying what view  
15 we will come to – that their analysis of those documents was wrong, and therefore there  
16 could be a different result, what is our jurisdiction in relation to that? That is why I was  
17 pressing it.

18 MR. ROTH: Yes, well I think if you found that the analysis of the Rapture business plan, or  
19 financial projections was wrong I can see there may be questions whether this determination  
20 can stand, but the only submission has been, I think, that it looks over too long a period – it  
21 should not have looked forward. We say there is nothing with the analysis that Ofcom  
22 carried out at all. Then they went on to do a third exercise which comes just after 5.193,  
23 just above 5.194, they say that is Rapture, but let us look at other small broadcasters. So at  
24 5.194 they obtained details of channels' operating costs from a sample of broadcasters, of  
25 smaller free-to-air channels to consider whether there was any evidence that the charges  
26 could be considered to be capable of pricing smaller commercial channels off the platform.  
27 They look all that and they reach the conclusion. It is a result of all that that you get to the  
28 conclusions at 5.204:

29 "On the facts of this case, Rapture's 2004 Business Plan indicates that the  
30 indicative rate card charge for an EPG listing was not set at a level which would  
31 ;price Rapture off the Sky Platform and was clearly 'affordable'. The 2005  
32 Financial Projections are of insufficient duration or detail to draw any meaningful  
33 conclusions about Rapture's willingness to pay in respect of the indicative rate  
34 card charge. In Ofcom's view, even if Rapture had submitted details of its 2004

1 Business Plan or 2005 Financial Projection to Sky, these would not have provided  
2 a compelling case for Sky to reduce its EPG listing charges in Rapture's case. On  
3 the contrary, the 2004 Business Plan would have indicated that Sky's EPG listing  
4 charge was not at a level which could have plausibly priced Rapture off the Sky  
5 Platform."

6 So they did, in fact – whether they were legally required to or not (your point on s.191) but I  
7 do not need to take a position on that because in this case they did it.

8 THE CHAIRMAN: Yes.

9 MR. ROTH: That brings one to my fourth point, which is the fallacy in Rapture's skeleton  
10 argument at para.100, which was clearly a major part in Mr. Bowsher's submissions for his  
11 client, drawing on the reference to negotiation. After the quotation in para.100, on p.26:

12 "The requirement to negotiate is properly considered in the guidelines as a  
13 necessary part of the process of arriving at a fair, reasonable, and non-  
14 discriminatory price. It is clear that such negotiations should result in individually  
15 applicable prices for EPG services, and not simply the default application of the  
16 indicative prices."

17 In other words, there should be, as it were, an individual price for each of the channels  
18 working away from the indicative rate card price; that is their position. That, we say, is  
19 fundamentally wrong. It ties in with the argument that we are a small channel so we should  
20 have a lower price, but when you have a commodity product like this the requirement of  
21 non-discrimination that is imposed, and the basic rate card price, that would be a recipe for  
22 complaints from other broadcasters. The departure from the rate card indicative price – and  
23 this is where negotiation comes in – depends on what justification is put forward by the  
24 broadcaster to say "we should have a special price". Professor Stoneman asked, if I may  
25 respectfully say so, the very pertinent question: "What were Rapture's arguments", and we  
26 heard about those today, and they are summarised indeed in our skeleton argument at  
27 para.74 – I hope fairly.

28 They come really from a letter and an email at the time that the agreement was being  
29 discussed and before it was signed. They are a small independent channel, the EPG charge  
30 is 38 per cent. of its uplinking and satellite transponder costs. EPG charge has increased  
31 significantly since 1<sup>st</sup> January 2003, whereas uplinking satellite transponder costs had fallen  
32 over the same period and Rapture was one of a handful of channels, and you see what was  
33 said there, and the answer given to each of those points in para.75.

1 Not only did Sky consider that they did not justify a lower price, but the determination  
2 concludes that if, on that basis, Sky had given Rapture a lower price, Sky would probably  
3 have infringed its non-discrimination obligation (para . 5.157, determination). Ofcom  
4 concludes in para. 5.157:

5 “... the evidence suggests that Sky had no basis on which to justify a reduced  
6 charge to Rapture that met with its obligations to offer terms on a non-  
7 discriminatory basis.”

8 and of course Ofcom went on to look at “Well what additional evidence have we seen?  
9 Does that change it?” and I have explained it held that it did not.

10 By contrast Sky was willing to negotiate lower charges when justified as you see in 5.208  
11 and 5.209, there are certain categories of broadcasters who, at that time, were given  
12 different charges, mostly non-commercial channels and that is looked at down to 5.215  
13 where Ofcom conclude:

14 “In Ofcom’s view, it was not discriminatory for Sky not to have charged Rapture a  
15 lower price than that charged to other larger channels. Rapture was charged the  
16 same price as other smaller broadcasters purchasing EPG listings.”

17 That is why I say if we had given them a special deal immediately all the other smaller  
18 channels would have said “That is discrimination.”

19 My sixth point is that the fact that it is not discriminatory and that it is properly charged  
20 would not be enough to be a FRND charge if it was shown to be excessive – you can charge  
21 the same price to everyone but it is just too much. So Ofcom looked at that, and they  
22 examined the return being earned by Sky on the platform business and they found that it is  
23 not excessive, and that is the conclusion at 5.102:

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

27 Although there is a challenge to excessive pricing – a conclusion on excessive pricing – in  
28 the notice of appeal, it is not addressed in the skeleton argument from Rapture, or in oral  
29 submissions (but it is in the notice of appeal) Rapture has not put in any evidence to rebut  
30 that conclusion, to challenge Ofcom’s conclusion. We were not quite sure to what extent it  
31 was advanced, but the arguments that were made we have dealt with in schedule 2 to our  
32 skeleton argument, but they do not include examination of the IRR because that was not  
33 being challenged, and so we did not look at it, we have not addressed it and we say it is not  
34 open to challenge at this stage of the appeal.

1 Point 7 – as for the contention that Sky’s actions are responsible for bringing Rapture’s  
2 business “to its knees” (Mr. Henry’s first witness statement, para.35) that is just a complete  
3 fallacy, and we ask the Tribunal to note the confidential figures in schedule 3 to our  
4 skeleton.

5 Put bluntly, this was just not a viable business for reasons that have nothing whatever to do  
6 with the level of the EPG charge. Then you see what is set out – it is a very short document,  
7 schedule 3.

8 So we say, and this is point 8, this appeal – as Mr. Vajda mentioned at the outset – is not a  
9 rehearing, the question for the Tribunal is: Did Ofcom get it wrong – to put it colloquially –  
10 on the material before Ofcom – I put it that way, not the material before Sky, the material  
11 before Ofcom – outside any margin of appreciation. We say quite clearly they did not, and  
12 that, with all respect to the appellants, is the end of it.

13 Unless you have any questions.

14 THE CHAIRMAN: Thank you very much, Mr. Roth. Do you want five minutes, Mr. Bowsher?

15 MR. BOWSHER: Could I have just a couple of minutes. I should not be very long, but it would  
16 help me if I could have a couple of minutes.

17 THE CHAIRMAN: Yes.

18 (Short break)

19 MR. BOWSHER: Madam, I am much obliged for that short adjournment? Can I just pick up two  
20 points of detail from Mr. Roth's submissions. My points fit on one page in a rather chaotic  
21 way.

22 THE CHAIRMAN: They do go round in circles from what I can see there.

23 MR. BOWSHER: They do go round in circles - they do indeed!

24 These are points of factual issue which we may not entirely be able to get to the bottom of  
25 this afternoon, given the way they have arisen. Let me venture a response now, and, if  
26 necessary, if it becomes important, we can follow them up in the future. The first is the  
27 question of as to whether or not all boxes have the same subsidy. We have not, on the  
28 material before the Tribunal, quite got to the bottom of that. Perhaps we are not in the best  
29 position in this Tribunal to do that. However, our starting position seems to us really, for  
30 the purposes of this case, and all we need to rely upon, is the determination itself. Paragraph  
31 5.54.5 - I am not sure you really need to turn it up - is in the list of matters which Ofcom did  
32 not look at. It is the paragraph saying,

33 "Ofcom does not consider that it is necessary to investigate these issues beyond this  
34 summary in the context of this dispute as explained below.

1 5.54.5 In addition to the 'standard' set-top boxes, Sky also provides Sky+  
2 boxes ..."

3 I think I probably took you to it at least twice yesterday, and I specifically referred to it in  
4 our note. However, it goes on to say,

5 "However, the platform business also receives a notional monthly subscription fee  
6 for each Sky+ registered subscriber which from the platform business' perspective  
7 offsets the cost of the subsidy".

8 I am not quite sure which company is the platform business or quite what the platform  
9 business means, but we do not want to re-open that semantic exercise. There seems to be, at  
10 the very least, the contemplation of a larger subsidy which somehow reflects increased, or  
11 improves audience. I am not quite sure what lies behind that statement. That paragraph is  
12 an old friend! There are two points about it.

13 THE CHAIRMAN: Whether it means offsets the cost of that part of the subsidy, and therefore  
14 they get the additional bit, and therefore it makes no difference.

15 MR. BOWSHER: Miss Banks and I both have a recollection that there is something else on this,  
16 but I am afraid we have not been able to dig it out to specifically follow up that point. If we  
17 do, then we will come back on it. In any event, sufficient for this purposes, in our  
18 submission, is to say that as far as Ofcom was concerned there certainly seems to be more  
19 than the possibility that certainly at this point, when, there were different kinds of boxes  
20 being marketed - as is common knowledge - certainly Ofcom thought it was a possibility  
21 that there were different subsidies. I am not quite sure from this paragraph what Ofcom  
22 actually knew or thought might be the case. That is all I wanted to say on that.

23 MR. ROTH: Can I just clear that up? In answer to the questions earlier from Professor Stoneham,  
24 I was talking about the standard set-top box. The standard set-top box. Everyone has AC  
25 and CA functionality built in. There are also these rather sort of high grade set-top boxes  
26 that have a video recording aspect which is not the standard box. They are given under the  
27 Sky Plus subscription which you pay much more for. There is an element of subsidy to  
28 those Sky Plus boxes, but in the model that is offset by an amount which comes back, which  
29 is charged from the subscription from the subscriber as revenue.

30 THE CHAIRMAN: But the actual subsidy is the same across the board.

31 MR. ROTH: It is less for these. It is less for the Sky Plus ones. It is a minority of the total  
32 number of the 8.5 million. So, some have no subsidy at all in fact to the charge made for  
33 Sky Plus.

1 MR. VAJDA: Actually perhaps I can come in at this point as well? The revenue there is how the  
2 revenue in 1 and 2 that we looked at this morning - the confidential note.

3 THE CHAIRMAN: That probably has cleared it up.

4 MR. BOWSHER: It may have done. It is not entirely inconsistent with what we thought might be  
5 the position - that there was increased income which further offset the subsidy, but clearly  
6 there are further issues there.

7 The second point is this: Mr. Roth has raised an issue as to whether or not Rapture was  
8 viable in any event. In our submission that has arisen for the first time in the way it has in  
9 that annex to that skeleton. There is evidence in Mr. Henry's second statement about the  
10 position of Rapture at the time that it ceased broadcasting. In our submission, what you  
11 have in the annex you have been shown is a rather partial snapshot. What you will see from  
12 Mr. Henry's evidence is that there was a particular revenue figure at that point. At about  
13 that point or a couple of months earlier he had been looking at investors. Plainly what the  
14 investors were looking for was to increase the revenue. The real question as to viability is  
15 whether you have sufficient investors to be able to cover you until the revenue reaches the  
16 requisite figure. For what it is worth, the cost figure that is quoted from that annex has  
17 changed subsequently, but I do not think that matters particularly. But, it has changed quite  
18 dramatically. There is also a live issue - which Mr. Henry has followed up in Freedom of  
19 Information Act applications to Ofcom - as to the accuracy of the note on which that annex  
20 is based. You will see it is a note of a meeting, but apparently there were a number of  
21 questions that Mr. Henry raises which are not reflected in the note. In my submission that  
22 really is a blind alley which we will never get out of if we start.

23 THE CHAIRMAN: It is not a blind alley to go down. That is not the issue in this case.

24 MR. BOWSHER: Exactly. I just wanted to give you a flavour of why we should not go there.

25 Can I fairly swiftly take some of the points that have arisen in the course of the day? What  
26 I propose to do is to give a number of documentary references to take away. I hope that that  
27 way it will not be necessary to read everything that I refer to. Perhaps it would be helpful  
28 though just to go back to the guidelines - not that I intend to read them, but just so that you  
29 have them in front of you to remind you of the point. As you see the paragraph, you will  
30 remember where the point fits.

31 It seems to us that if negotiation has any role at all in this process then it must work  
32 something like this: it must be that the legal starting point is that the price must be FRND.  
33 Now, whether there is a single FRND price or a range of FRND prices I do not think  
34 matters particularly for this purpose. The question is whether or not £76,800 either is the

1 FRND price or is within the FRND range. That is the simple legal question. If we were  
2 talking about a fully competitive market in which there were negotiations between parties of  
3 roughly equal bargaining power, it would be a fair assumption that the product of that  
4 negotiation was FRND. There are probably some interesting issues around the fringes of  
5 that question about whether or not the market has to be a market that fully supplies demand.  
6 Professor Stoneman's question about the second-hand salesman who just says, "No", and  
7 where does that get one ----? I do not think we need to deal with that. In general terms you  
8 can see why, as a matter of logic, you might start using the product of a successful  
9 negotiation, as the answer to the FRND question. It is not so different, for example, from  
10 what happens in other similar areas of law, such as state aid(?) law where, sometimes, if  
11 you want to establish that a contract has actually been established on the basis of a proper  
12 market value, one proxy test of that is, "Was that contract concluded as the result of a  
13 properly competitive process?" Nothing very surprising.

14 In our submission though Ofcom can draw nothing from a failed negotiation. A failed  
15 negotiation really tells you nothing about market conditions. To start getting into an  
16 examination of how and why it failed, and whose responsibility it was, is unlikely to tell  
17 you anything significant. In our submission, it did not here. Ofcom was wrong to try to do  
18 so. Indeed, if I can just give you some references which you can go back to, when you look  
19 at the rather extraordinary chronicle of the negotiations between Sky and Rapture, it is, at  
20 the very least, odd - and we would say, in fact, wrong and inappropriate - for Ofcom to have  
21 really looked at this by going right back to the negotiations in 2002 with Power TV - a  
22 different channel, albeit it was the same name for the channel and Mr. Henry was involved.  
23 However, we are not talking about those charges for this year. The dispute is focused on a  
24 particular year. To go back to 2002 and talk about a debate in 2002, which is clearly an  
25 entirely separate negotiation - if negotiation is anything to do with it - in our submission  
26 smacks of desperation and a wrong-headed approach to this whole thing. It is quite striking,  
27 if you look at what is presented as a sort of single narrative of a negotiation, that if you look  
28 between 5.130 and 5.132 we jump seamlessly from 8<sup>th</sup> May, 2003 to June 2005. I do not  
29 think you need to look it up now. It is a point to take away. This is not a seamless thread  
30 where nothing happened for two years. That is not the way it is presented in the  
31 determination. It is a most extraordinary way of trying to present, really making far too  
32 much of what was nothing.

33 Negotiation, therefore, in our submission, is something of a red herring. If one needs any  
34 legislative starting point for the importance that Ofcom should have placed on considering

1 differences in negotiating power, we would commend the Sixth Recital of the Access  
2 Directive - that is 2002, 19, to be found at p.1717 of the Grey Book. It is a fairly lengthy  
3 recital.

4 "In markets where there continue to be large differences in negotiating power  
5 between undertakings and where some undertakings rely on infrastructure provided  
6 by others for delivery of their services, it is appropriate to establish a framework to  
7 ensure that the market functions effectively. National regulatory authorities should  
8 have the power to secure where commercial negotiation fails adequate access and  
9 interconnection and inter-operability".

10 It goes on and on, and on thereafter. That recital, in our submission, is talking about this  
11 general situation. Of course, it is just a recital.

12 THE CHAIRMAN: The Access Directive is the directive that starts ----

13 MR. BOWSHER: It is the head of the FRND tree.

14 THE CHAIRMAN: And the dispute resolution procedure.

15 MR. BOWSHER: Yes. So, in our submission clearly a relevant place to start if one is looking at  
16 the legal basis. Just finally before I finish on that, I just notice that the determination itself  
17 at 5.34.2, in a rather different part of the territory, does seem to state the question about  
18 negotiation in a rather more sensible and coherent way. It says, "Ofcom has considered the  
19 following questions .. Is the contribution towards common costs from Rapture reasonable,  
20 taking into account the factors which would be reflected in a charge negotiated in a  
21 competitive market?"

22 That makes sense because a charge negotiated is the outcome of a final discussion. So, even  
23 within the determination there is just an internal illogic. What they go and investigate is not  
24 the question that they say they should have been looking at.

25 That, then, is negotiation.

26 On willingness to pay - I do not think I need to spend very long on that. Willingness to pay  
27 and ability to pay are phrases which obviously mean different things, but they do have this  
28 nasty habit in legal, and in other texts, of sometimes becoming merged. In our submission,  
29 one reason, of course, why willingness or ability to pay is bound to be a factor in this  
30 regime is really going back again to the community legislation. Given the higher  
31 requirements in the community legislation of plurality, and so forth, it is necessary for this  
32 process to be, as it were, weighted in favour of a presumption that there will be a deal done,  
33 so that those who are unwilling or unable to pay should be given assistance in the  
34 negotiating process. That may simply be a consequence of their different negotiating

1 positions, but I submit it is not just that - it is also because it is deemed by the community  
2 legislator necessary that people be given that leg up, if I can put it in that way.

3 THE CHAIRMAN: It is saying to those who are negotiating on the other side, "You really have  
4 to think about this".

5 MR. BOWSHER: Yes. Exactly. Of course, the legislative basis for that - I think I have already  
6 put that in our note. That is the 2003 Act. Ss.3.2 and 4.2 takes one back to the Community  
7 legislation. Again, I do not think we need to take that Act.

8 You will be glad to know that I do not propose to get stuck into the detail of the whole  
9 common cost/incremental cost question now. We have set out our position in writing. Can I  
10 start though with one sort of factual issue. There was some discussion with my learned  
11 friend, Mr. Vajda, about what material Ofcom might have had and what it might have done  
12 differently. In our submission, the short answer, and where we are, is that if Ofcom have  
13 failed to do their job, the proper course in this circumstance is certainly to remit the matter.  
14 When you go back to look at the materials, it is interesting to note that Ofcom did have  
15 material - some material, but certainly not comprehensive material - by Rapture which at  
16 least would enable them to get started on the set-top box subsidy issue. If I can simply refer  
17 you to Tabs 52, 53, and 55 of the Ofcom defence -- Two of them are e-mails from Rapture  
18 and one a meeting note between Rapture and Sky dealing with a number of issues. You will  
19 see in there that some material has been sent (in 52 and 53) by Rapture to Sky about the set-  
20 top box subsidy. Obviously there was a limit to what Rapture had access to. In our  
21 submission we did at least try to get them started down that road. None of that material, I  
22 think, is reflected in the determination anywhere.

23 Before I come on to some of the specific points on common cost, I should mention of  
24 course that it is true that we have not made a full frontal attack on the whole IRR WACC  
25 issue. It is not true that there is no challenge to it in this case. Again, I have referred you to  
26 the accepted notice of appeal, paras. 91 and 92 where we do challenge certain issues under  
27 the WACC. If I can just pause for a moment to consider procedurally where we are? There  
28 is a serious practical impediment to a party such as Rapture actually making any serious  
29 challenge to the IRR. If I can offer some free advice to anyone who is in Rapture's position  
30 in future, the only way you could comprehensively make a sensible challenge before this  
31 Tribunal and get it into a notice of appeal would be, once one has the determination, to  
32 appoint an expert accountant, come to the Tribunal, and ask for a confidentiality rate to be  
33 set up before you prepare your notice of appeal because only with that sort of assistance,  
34 done at an early stage before you have even made your appeal, would you in fact be able to

1 get to the sort of analytical level that you would need to do to make a proper attack on the  
2 rate of return calculations. To put it simply, there is a limit to what we can do without  
3 getting to grips with the Sky platform model. It exists. The three of us can look at it, but  
4 we are not accountants and it is not appropriate for us to make up expert evidence about it.  
5 So, in our submission there is not a lot to be said about us not challenging directly,  
6 wholeheartedly the IRR calculation. What we would say is the obvious point - and I have  
7 put a footnote to this in our note this morning: the challenge we make to the proper  
8 evaluation of common cost is closely related to the IRR calculation. That is the point that  
9 we can attack in principle rather than in terms of getting out the facts and trying to get to  
10 grips with the quantitative issues.

11 THE CHAIRMAN: Going back to what you were saying, what one would have to do is to put in  
12 a notice of appeal which said that you wanted to raise that point, but you needed expert  
13 evidence, and then apply.

14 MR. BOWSHER: I am sure there is a way of doing it, but it is something you would have to take  
15 on board at a very early stage of the proceedings.

16 THE CHAIRMAN: At a very early stage. Absolutely.

17 MR. BOWSHER: We know how we got here - I am not going to go over that. It is not  
18 something that is easily dealt with.

19 THE CHAIRMAN: It is easily dealt with if you deal with it at an early stage.

20 MR. BOWSHER: Hence the free advice.

21 On common cost, again, we have dealt with this in some detail at paras. 55 to 79 of our  
22 skeleton. We would invite the Tribunal to review that - and I am sure you will. There  
23 remains unresolved, perhaps, some question as to whether or not one or two paragraphs  
24 there are in some way objectionable because they repeat bits of Mr. Borwick's statement. I  
25 should just make clear that the reason why Mr. Borwick's statement is in the files is not  
26 because we put it there. It is because it was put there by those who wanted to pursue that  
27 challenge and by being able to point out where we had heinously copied words.

28 THE CHAIRMAN: Yes. Do it against you rather than ----

29 MR. BOWSHER: Indeed. We are not trying to make a point there with it, lest it be thought ----

30 That objection is there. You have our skeleton. That is what, in our submission, you should  
31 look at when you get into the detail.

32 One of the things we find surprising though about this whole approach is really back to the  
33 5.54 list of things which were not looked at. There is a general sense which permeates  
34 Ofcom's position, which is, "Well, it's only £76,000. It's only Rapture. It just isn't worth it".

1 One can understand that, but what we do not understand is how you make that point in the  
2 face of Emma McCormack saying, "There is a proliferation of channels". Now, it may be it  
3 is right that all of them should be paying £76,000, but we have seen that at least five of  
4 them, at the point of the determination, were not. There is a list of those who were not in  
5 the confidential part. It would be difficult, given the confidentiality, to get very far there.  
6 However, there is at least a live issue here. It is a bit odd to say, "Well, it's just not worth  
7 doing a proper job on common cost or an externality analysis [whichever one thinks is the  
8 right approach] simply because it's only Rapture". It is actually a general issue. It may be  
9 that when one actually does the proper job, you would say, "Well, it is a general issue, but  
10 actually out of 400 broadcasters it only applies to seven". It does actually apply to all 400.  
11 In our submission, if it is something that should be done, it should not be just forgotten  
12 about, just because it is one broadcaster.

13 That is the general approach point.

14 Once one gets down to the gory detail, whether you would take the proper characterisation,  
15 or proper allocation of common cost approach, or whether you strip out the value of the  
16 EPG and then value the externalities – Either of those may be an intellectually correct  
17 approach, but they did neither. Externality may very well be significant. We know what the  
18 incremental cost of the EPG services is – or, at least we know the range from the non-  
19 confidential determination. The externality may have a value, and it may double that figure.  
20 We have no means of knowing. It may more than double that figure. The value will depend  
21 on the different broadcaster. The value of that externality to Rapture - which, as the point  
22 has been made, to put it bluntly, it is a channel which would interest my sons more than it  
23 interests me - is particular. That is a different externality. However, that is not a reason not  
24 to do the job. In our submission, that is a peculiar approach.

25 In our submission, when you are getting into the calculation, there are two conceptual errors  
26 that Ofcom falls into: firstly, by treating the subsidy as a common cost. The reason why we  
27 say this is problematic is that you get yourself to the position that you actually put it off  
28 limits to proper analysis. The analysis ought to be by trying to come up with a proper value.  
29 By putting it in common cost, you say, "It is a common cost. I do not have to look at it. It  
30 is not that I do not have to. I cannot look at it any more" effectively. That seems to be a  
31 strange way of looking at matters. It is a way which almost prevents one from properly  
32 addressing parts of the conditional access guidelines.

33 If I can just give you some references where it seems to us the Guidelines mandate an  
34 individualised approach these matters? Paragraph 2.3, the last sentence:

1 "The services offered must, if technically feasible, be sufficiently unbundled so that  
2 the broadcaster only pays for what it needs".

3 That relates to the question Professor Stoneman, I believe, raised - the question about, "Is  
4 there only one product?" The answer is that there is not. You have to look at what the  
5 product is. Paragraphs 3.9 and, in particular, 3.10 under the heading of 'Treatment of  
6 Subsidy of Consumer Equipment'.

7 "Different broadcasters may benefit to different extents, in which case their relative  
8 charges should reflect this".

9 Insofar as it is applicable, it must be applicable here. Paragraph 3.13, under 'Costs and  
10 Benefits'. Paragraph 3.12,

11 "There may be other costs and benefits to the broadcaster that you would expect to  
12 be taken into account in negotiations".

13 Those include, in 3.13, increase in revenues and number of viewers. I have taken you to  
14 that. Finally, and perhaps most significantly, Annex 1, which I do not think we have taken  
15 you to. Annex 1, 'Estimating Incremental and Stand-Alone Costs'. It is talking about the  
16 way one prices conditional access and access control services. At A1.2,

17 "Ofcom recognises that in all these cases costs estimates will be approximate and  
18 subject to a degree of uncertainty. However, in order to be fair, reasonable and non-  
19 discriminatory, the pricing structure needs to take account of the differences in levels  
20 of sophistication of services required by different broadcasters".

21 It really could not be clearer. The point in the accounting approach that Ofcom have taken  
22 is to really put common costs outside the bounds of proper regulation.

23 The final point is really just an arithmetic point, but it is still important. The 'shrug your  
24 shoulders and do not worry' attitude is, "Well, it's only a piffling percentage of a very large  
25 amount, and so it cannot really matter" just does not make any arithmetic sense. If the very  
26 large amount is very, very large, into the millions and millions, then a very small percentage  
27 is still going to skew the EPG charge way beyond what in fact it ought to be. I do not  
28 imagine the Tribunal needs help with that. I have put that in a rather general folksy way, but  
29 I think you probably understand the arithmetical basis of what I am saying. We simply do  
30 not know, but the rather folksy way in which it is put by Ofcom and Sky just is not rigorous.  
31 In our submission it really should not be given much weight.

32 I think, rather to my surprise, I have reached the end of my circle of points. If there is  
33 anything else I can assist with? Thank you very much.

1 THE CHAIRMAN: Can I thank everybody for both their written and oral submissions which  
2 have been very interesting. We have got to go away and see where we get to. In due course  
3 there will be a judgment. Thank you very much.

4  
5

\_\_\_\_\_