



Australian Government

**Department of Communications,
Information Technology and the Arts**

**Review of
Australian and New Zealand Content on
Subscription Television Broadcasting Services**

REPORT

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EXECUTIVE SUMMARY AND KEY FINDINGS

This report of the review of Australian and New Zealand content on subscription television broadcasting services has been prepared by the Department of Communications, Information Technology and the Arts following investigations conducted by the Australian Broadcasting Authority (ABA) into certain matters relevant to the Review. These investigations have substantially informed the Review. The review is required under subsection 103ZJ(1) of the *Broadcasting Services Act 1992* (BSA).

Australian content requirements currently apply to subscription television drama services only. The new eligible drama expenditure requirement commenced on 1 July 1999. Division 2A of Part 7 of the BSA provides the legislative framework for ensuring that subscription television broadcasting licensees spend at least 10 per cent of total program expenditure on new eligible drama programs in each financial year.

The requirement reflects the role of drama in shaping a sense of ‘Australian identity, character and cultural diversity’, one of the objects of the BSA. It also reflects the view that the economics of local production and the cost differentials between Australian and foreign programs mean that drama programming is particularly susceptible to import replacement.

On 26 August 2002, the then Minister for Communications, Information Technology and the Arts directed the ABA, under subsection 171 of the BSA, to investigate the practical operation of Division 2A of Part 7 of the BSA relating to eligible drama expenditure requirements for subscription television and the need for any amendments to Division 2A.

The ABA released a discussion paper for public comment in December 2002. Seventeen submissions were received from a range of industry groups. The ABA provided a report of its investigation to the previous Minister for Communications, Information Technology and the Arts. Because much of the ABA’s report is commercial-in-confidence in nature, it is not suitable for public release. This report takes into account the findings of the ABA investigation and the views put forward by interested parties. It also includes the Australian Government’s response to the findings of the Review.

The appropriate level of the new eligible drama expenditure requirement

The Review, based on the ABA’s investigation, has found that the new eligible drama expenditure requirement imposed on subscription television operators is highly valued by the production industry and underpins a wide range of drama projects for theatrical, subscription and free-to-air television release.

In three years of operation to 2001-02, the new eligible drama expenditure requirement resulted in investment of more than \$45 million in Australian film and television projects. In terms of both numbers of programs and expenditure on programs, the majority of the industry’s expenditure under the scheme has supported feature films.

The subscription television industry has also made a substantial contribution in relation to the production and broadcast of Australian content outside the context of the requirement, including sports and news programming and children’s and documentary programming.

The Review has found that the current obligation meets the objects of the BSA without being an unreasonable burden on the industry. The subscription television industry in Australia is small relative to comparable countries and has not experienced the high take-up of those countries. While recent developments suggest the outlook is improving, there is short to medium term uncertainty in relation to the impact of digitisation on subscriber growth rates and profitability.

The 10 per cent expenditure requirement contains an implicit growth component that will apply to an expanding range of drama channels as a result of digitisation.

Government response

The Government has decided that there is no compelling case to increase the 10 per cent new eligible drama expenditure requirement. However, it may be appropriate to re-examine this requirement in the context of the further review proposed (see page 5 of this report).

Treatment of pre-production expenditure

The ABA reported that no subscription television entity has reported any pre-production expenditure under the scheme to date. The Review has found that the current rules provide insufficient incentive for the subscription television industry to direct funds towards new and innovative programming.

As script development plays an important role in the process of creating successful film and television content, the Review considers that allowing limited pre-production expenditure on script development to count towards the new eligible drama expenditure requirement may encourage the production of higher quality screenplays, and involvement by subscription television entities in projects at an earlier stage of development.

Government response

The Government has decided to allow limited pre-production expenditure on script development to count towards the new eligible drama expenditure requirement. Allowable spending on script development will be limited to third parties for eligible projects (i.e. projects which have an Australian or New Zealand producer and writer/s). In addition, script development expenditure will be allowed prior to the commencement of principal photography and will be capped at a maximum of 10 per cent of the total eligible drama obligation.

These changes will require legislative amendment and may require a determination by the ABA to provide additional certainty.

Treatment of carry over of qualifying expenditure

The Review, on the basis of data provided by the ABA, did not find any lack of compliance with the scheme. It has found that the requirement in its current form offers little incentive for expenditure in excess of the minimum requirement and that there has been evidence of tension between the commercial pressures to spend funds in one financial year to ensure particular programs are produced (e.g. television drama series) and the timing of payments to meet the regulatory expenditure requirement.

Government response

The Government has decided that expenditure in excess of the 10 per cent requirement will be allowed to be carried forward and treated as new eligible expenditure in the following year. This will provide greater incentive for expenditure in excess of the minimum 10 per cent and is intended to remove potential constraints on investment decisions.

This change will require legislative amendment.

Extension of the requirement to cover documentary programming

The local production industry bodies have supported an extension of the requirement to cover documentary programming in their submissions to relevant ABA investigations. The ABA in its report to the Minister recommended regulatory intervention to increase support for subscription television documentary programming.

The Review has found that the local documentary production sector remains well supported by government both directly and indirectly with 62 per cent of finance for local documentaries being made available through government film funding agencies, the public broadcasters and tax incentives. The sector is further supported by broadcast quotas for commercial free-to-air broadcasters amounting to 60 hours of documentary programming per annum.

Government response

Based on the data available, the Government has decided there is not a compelling case for providing further funding support to the documentary sector by making documentary channels subject to content regulation.

The global documentary networks which are also the parent companies for some of the local documentary channels already invest substantially in the Australia production sector. In addition, the levels of first release Australian documentaries broadcast on subscription television increased from 28 hours in 2000 to 41 hours in 2001.

Further review

Given the rapid change occurring in the subscription television sector, the Review considers it important to examine the impact of developments such as the Foxtel Optus Content Supply Agreement and digitisation on subscription television penetration rates.

Government response

The Government has decided that a further review of the operation of the new eligible drama expenditure requirement should be conducted in 2008.

In addition, changes to the requirement implemented as part of this review will need to be taken into account in assessing whether any further revision to the regulatory framework for Australian content on subscription television is necessary.

1. INTRODUCTION—REQUIRED REVIEW AND PROCESS

1.1 The Review

Subsection 103ZJ(1) of the *Broadcasting Services Act 1992* (BSA) requires the Minister for Communications, Information Technology and the Arts to cause to be conducted, before 1 March 2003, a review relating to Australian and New Zealand content on subscription television broadcasting services.

This is the report to Parliament on the outcome of the review. It includes the Government's response to the review. The review has been substantially informed by investigations conducted by the ABA into certain matters relevant to the review as outlined below.

On 26 August 2002, the then Minister for Communications, Information Technology and the Arts directed the ABA, under section 171 of the BSA, to investigate the practical operation of Division 2A of Part 7 of the BSA relating to the new eligible drama expenditure requirement for subscription television and the need for any amendments to Division 2A. In addition, the then Minister requested the ABA, in conducting its investigation, to have particular regard to a number of factors including:

- the capacity for subscription television broadcasters to produce, commission or purchase Australian programs
- the costs and benefits for commercial operations of subscription television broadcasting licensees and the Australian film and television production industry of any proposed amendments to Division 2A
- relevant findings of related ABA investigations into subscription television.

The ABA released a discussion paper for public comment on 20 December 2002. The paper was posted on the ABA's website. A total of 17 submissions were received from industry groups. These submissions, with the exception of two where the submitters requested the submissions be treated as confidential, were posted on the ABA's website.

This report takes into account the outcome of the ABA's investigation. The commercial-in-confidence nature of much of the material contained in the ABA report to the previous Minister makes it unsuitable for public release.

1.2 Related inquiries

The then Minister for Communications, Information Technology and the Arts previously made a direction under section 171 of the BSA on 18 December 1999, in which the ABA was directed to report on the extent to which pre-production expenditure should be taken into account for the purposes of the eligible drama expenditure rules for subscription television broadcasting and whether subscription television broadcasting licensees who provide a subscription television documentary service should be required to ensure the maintenance of minimum levels of expenditure on new documentary programs.

As part of this investigation, the ABA undertook a public consultation process. A discussion paper was published for public comment in September 2000 and the ABA received 15 submissions in response. The discussion paper and 12 submissions were posted on the ABA website (the other submissions were confidential).

The review has taken into account the outcomes of this investigation.

The Australian Film Commission's (AFC) discussion paper, *Documentary Production and Funding in Australia* (December 2003, revised February 2004) has also been taken into consideration in the preparation of this report.

2. LEGISLATIVE BACKGROUND

2.1 Regulatory policy

Subscription television has a role to play in achieving the community's cultural and industry support objectives for television broadcasting. Since 1 July 1999, Division 2A of Part 7 of the BSA has provided the legislative framework for ensuring that subscription television broadcasting licensees spend at least 10 per cent of total program expenditure on new eligible drama programs in each financial year. From 1995–1996 to 1998–1999, there was a voluntary 10 per cent drama expenditure requirement under section 102 of the BSA. Low spending by subscription television licensees during the voluntary period led to the introduction of the enforceable scheme for Australian content on subscription television.

The requirement reflects the role of drama in shaping a sense of 'Australian identity, character and cultural diversity' and the view that the achievement of the cultural objective relies on the development of the local production industry. It also reflects the view that the low marginal cost of 'manufacture' of films and television programming content means that some forms of programming are particularly susceptible to import replacement.

The importance of local drama being available to Australian audiences is also reflected in the *Broadcasting Services (Australian Content) Standard 1999* (the Australian Content Standard) for commercial free-to-air television. The Australian Content Standard (ACS), established under section 122 of the BSA, requires that at least 55 per cent of all programming broadcast in a year, between 6 am and midnight, be Australian programs. In addition there are specific minimum annual sub-quotas for first release Australian drama (measured by a points system), children's drama (32 hours) and documentary programs (20 hours). Since 1999, the ACS has recognised New Zealand and Australia/New Zealand programs in accordance with Australia's obligations under the Closer Economic Relations Trade Agreement. Compliance with the ACS is a licence condition for all commercial television broadcasters.

The different regulatory arrangements imposed on the subscription television sector compared to free-to-air commercial television, reflects the policy set out in section 4 of the BSA that:

- different levels of regulatory control be applied across the range of broadcasting services according to the degree of influence that different types of broadcasting services are able to exert in shaping community views in Australia
- broadcasting services in Australia be regulated in a manner that, in the opinion of the ABA, enables public interest considerations to be addressed in a way that does not impose unnecessary financial and administrative burdens on providers of broadcasting services.

2.2 New eligible drama expenditure requirement

It is a licence condition of the subscription television licensee that at least 10 per cent of the total program expenditure on a drama service is expenditure on 'new eligible drama programs'. Eligible programs under the subscription television requirement must meet the definition of one of the programs eligible for quota under the ACS i.e. an Australian program,

an Australian/New Zealand program, a New Zealand program or an Australian official co-production.

These programs have to be made under the creative control of Australians and/or New Zealanders. This means that the producer/s of the program, the writer/s or directors, 50 per cent of the leading cast and 75 per cent of the major supporting cast must be Australian or from New Zealand. Also, the program must be produced and post produced in Australia or New Zealand whether or not it is filmed in either country.

A drama program is a program that has a fully scripted screenplay in which the dramatic elements of character, theme and plot are developed to form a narrative structure and includes a fully scripted sketch comedy program, an animated drama or a dramatised documentary. It is not a drama program if it involves incidental use of actors or advertising or sponsorship matter.

An eligible program is 'new' if the whole or a substantial part of the program has not been televised in Australia or New Zealand on a broadcasting service at any time before the expenditure is incurred.

Expenditure incurred in acquiring, producing or investing in the program or program material and pre-production expenses (once principal photography has commenced) is eligible under the scheme.

The regulatory framework recognises that drama channel program expenditure can be incurred by licensees, channel providers (i.e. providers that package a channel and supply it to the licensee) and pass-through channel providers (i.e. channel providers not based in Australia). Subscription television operators can claim expenditure on co-productions with free-to-air broadcasters.

The legislation places the responsibility for the minimum 10 per cent new eligible drama expenditure requirement on the channel provider in the first instance. The licensee has limited control over channel provider expenditure but it is a condition of the licensee's license that the obligation is met. Therefore, the scheme anticipates there may be a 12-month lag in expenditure to allow the ABA to inform the licensee of any shortfall incurred by its channel providers and to enable the licensee to ensure any shortfall expenditure is made up in the next year.

Some criticism has been directed towards the adequacy of the current expenditure quota. Using January 2002 subscription television programming, the AFC has suggested that the 10 per cent new eligible drama expenditure requirement on subscription television equates to 3.8 per cent of broadcast hours. This figure was derived from an examination of the content of predominantly drama and documentary channels at that time.

The Review has found that caution needs to be exercised in reaching conclusions about the impact of an expenditure quota on overall transmission of Australian content. A sample period of a single month does not provide a sound basis for firm conclusion regarding the level of Australian content on broadcast channels. The expenditure quota which requires expenditure on new production cannot be directly compared to the overall level of content made available on broadcast channels. Further, the very nature of subscription television—a platform which provides a large number of channels seeking to address a diverse range of

consumer preferences (including many addressing an interest in international programming) —means that an overall assessment of the level of Australian content across a diversity of channels is not necessarily a useful measure of the effectiveness or impact of a regulatory intervention.

As noted earlier, the regulated requirement for Australian content must not be unduly onerous on the broadcaster or content supplier and should neither damage their business nor inhibit the quality of their offering.

Finally, the funding that results from the 10 per cent expenditure requirement has largely been used to produce high quality feature films that are both expensive to produce and likely to have high cultural significance. This is largely accepted as a positive outcome of the expenditure requirement. However, this type of investment can not be expected to result in high numbers of broadcast hours.

2.3 The Australia US Free Trade Agreement (AUSFTA)

For subscription television, provision has been made to enable expenditure quotas not exceeding 10 per cent to be applied to arts, children's, documentary and educational services. Upon a finding by the Australian Government that its expenditure quota for drama is insufficient to meet its stated objectives, the existing 10 per cent requirement may be increased to a maximum of 20 per cent. Such a finding would be made through a transparent process that would include consultation with affected parties. Any increase would be non-discriminatory and no more burdensome than necessary.

The Government has indicated that the provisions of the AUSFTA do not indicate a current intention to exercise this capacity. However, if subscription television were to become a significantly more influential or even the dominant form of media its contribution to cultural objectives via the current drama expenditure requirement alone might need to be reconsidered.

3. THE AUSTRALIAN SUBSCRIPTION TELEVISION INDUSTRY

3.1 Status of the industry

The Australian subscription television industry is highly concentrated, with three major players (Austar, Foxtel and Optus) and a limited number of niche and/or regional players (e.g. Neighborhood Cable and TransACT). The three major operators are estimated to have around an 80 per cent share of industry turnover.

An Australian Bureau of Statistics industry survey reported that pay television licensees had revenues of \$910.9 million and expenses of \$1616 million in 1999–2000. In 2002–03, industry revenue had increased to an estimated \$1348 million, with expenses of \$1837 million. This compares with commercial television licensees' total revenue of \$3451 million and expenses of \$2945 million in 2002–03.

The subscription television industry derives around 87 per cent of its revenue from fees on subscribers. The remainder is generated from advertising and other sources. By 2004, revenues from advertising had reached \$115 million per year (i.e. around four per cent of Australia's \$3 billion television advertising market). No subscription television operator has generated profits from their pay television business. The ABA reported that since 1997 the industry has been characterised by a series of rationalisations and a refinement of its business models in an effort to improve profitability.

The current penetration rate of pay television in Australia is estimated to be 1.6 million homes¹ or 21 per cent of households² compared to over 85 per cent in the United States, 42 per cent in the United Kingdom and 43 per cent in New Zealand. When the pay television content scheme commenced in 1999, around one million households subscribed to pay television. Licensees have experienced lower than expected household penetration rates and a slower rate of subscriber growth than predicted. Reports by the Bureau of Transport Economics and James Capel Australia in 1995 estimated that 30–35 per cent of Australian households would subscribe to subscription television by 2005.

According to the ABA, there were around 50 pay TV channels operated in Australia in 2002–03, of which 17 were drama channels (i.e. where more than 50 per cent of programming consisted of drama programs)³. Subscription viewing as a percentage of total Australian television viewing was around 13 per cent at this time.

¹ Based on information available from ASTRA website <http://www.astra.org.au> , viewed February 2005.

² Based on information available from ASTRA website <http://www.astra.org.au> , viewed February 2005.

³ Drama channels identified by the ABA in 2002–03 were the Cartoon Network, Disney Channel, Encore, Fox 8, Fox Kids/Classics, Hallmark, Movie Extra, Movie Greats, Movie One, Nickelodeon, Oh!, Optus Near Video on Demand, Showtime, Showtime 2, Turner Classic Movies, TV1, UKTV.

3.2 Recent developments

Recent developments which will have an impact on the structure of the industry into the longer term include:

- the sale of Optus production facilities in February 2003
- the restructuring of Austar's \$400 million debt facility and Castle Harlan Australian Mezzanine Partners' (CHAMP) acquisition of a controlling interest in Austar in April 2003
- the new Optus C1 satellite which became operational in June 2003
- the ACCC approval of the content sharing deal (the Content Supply Agreement) between Foxtel and Optus subject to undertakings made under Section 87B of the *Trade Practices Act 1974* in November 2002—these undertakings deal with access to content to ensure that movie, sports and general entertainment channels continue to be available non-exclusively
- Foxtel investing around \$600 million in digitising its cable network and launched its new digital service of around 130 digital channels in March 2004. Austar has also launched a digital service. In December 2004, Foxtel had around 560,000 digital subscribers and Austar reported almost 300,000 subscribers to the digital service. The Foxtel digital service includes around 30 near-video-on demand movie channels, 10 movie services, seven sports channels including interactive sports services, seven news channels including interactive news services, six music video channels, 30 audio music channels, 11 documentary channels, five children's channels, eight lifestyle channels and 14 general entertaining channels. Similar programming is available on Austar
- closure of the Odyssey documentary channel in March 2004.

Significant infrastructure investments in the sector indicate the outlook for the subscription television industry in Australia is improving. However, there is also evidence of ongoing industry restructuring and consolidation, both locally and internationally. The Australian industry will continue to undergo structural and market change as a result of the Foxtel Optus Content Supply Agreement as well as digital implementation.

3.3 Role of channel providers

Generally, subscription television operators distribute programming which has been compiled into channels of programs by 'channel providers'. Subscription television operators do not tend to purchase, commission or produce individual programs themselves. It is generally the channel provider that deals directly with program producers and distributors while the broadcasters distribute and sell the channels to consumers.

Channel providers obtain programming by paying licence fees, commissioning independent and in-house production or taking equity investment in programs. Licence fees can be a flat rate for a particular number of showings over a certain period, or can be on a scale rate linked to box office receipts where applicable. Programs can also be licensed on a cost per subscriber basis.

Generally, subscription television operators pay the channel provider a licence fee for each subscriber to the service over a set period. The cost of programming to the subscription television operator is linked to the number of subscribers and changes as the number of subscribers change. The final costs of programming are not known until the number of subscribers for a particular year is known.

Non-movie channel providers have lower program expenditure budgets compared to movie channel providers (The Premium Movie Partnership and The Movie Network Channels). Movie channel providers access the majority of their programming through output deals with United States studios and other distributors. Around 50 per cent of programming on movie channels is derived from United States studios. The deals are usually in the form of a contract to license for a period of time for either the output of a studio or an agreed number of minimum titles. It has been reported that the cost of United States movies for Australian subscription television is high by international standards.

A number of factors influence the degree to which Australian content is offered on channels: the contractual basis by which the channel is acquired; it's programming genre; and the availability of relevant content.

4. REVIEW FINDINGS AND GOVERNMENT RESPONSE

4.1 Operation of the current new eligible drama expenditure requirement

Consistent with the ABA's investigation, the Review has found that the legislative requirement for expenditure on new eligible drama expenditure by subscription television operators (enforced by a licence condition), is highly valued by the production industry and underpins a wide range of drama projects for theatrical, subscription and free-to-air television release.

In its three years of operation to 2001–02, the new eligible drama expenditure requirement resulted in investment of more than \$45 million in Australian film and television projects.

ABA data indicates that in 2003–04, spending by the subscription television industry on new eligible drama programs was \$17.7 million. This expenditure represented financial involvement in a range of productions ranging from short films such as *Hooked* and *Essington*, feature films such as *Somersault*, and television drama series such as *McLeod's Daughters*, *Love My Way* and *The Cooks*. This compares to \$19 million spent on new eligible drama programs in 2002–03.

In terms of both numbers of programs and expenditure on programs, the majority of the industry's expenditure under the scheme has supported feature films. Over three years of the scheme to 2001–02, feature films have comprised between 59 and 78 per cent of program formats. Expenditure on programs as a proportion of total new eligible drama expenditure on feature films decreased from 72 per cent in 1999–2000 to 61 per cent in 2001–02 and on series rose from 16 per cent in 1999–2000 to 34 per cent in 2001–02. Telemovies and short movies made up the remainder.

Data provided by the ABA indicates that in each reporting year, of the total amount of the new eligible drama expenditure:

- more than 50 per cent has been investment expenditure
- 35–45 per cent has been licence fee expenditure (i.e. where a presale arrangement is entered into and a license fee is paid in advance for the pay television rights)
- 1–6.5 per cent has been production expenditure
- no pre-production expenditure⁴ has been reported under the scheme.

According to ABA data, the contribution of channel providers to the scheme outweighs that of licensees in terms of numbers of programs and level of expenditure incurred. Over three years of the scheme to 2001–02, around 82 per cent of the expenditure requirement has been incurred by channel providers, with 16.6 per cent of expenditure being reported by licensees and 1.2 per cent made up by pass through providers.

⁴ Pre-production expenditure is defined as expenditure incurred in developing the screenplay for the program or program material or any other expenditure incurred by way of pre-production costs for the program and program material.

The Review has found that channel providers supplying movie channels have undertaken most of the new eligible drama expenditure to 2001–02 (almost 60 per cent of the total new eligible drama expenditure incurred by all entities, or 72 per cent of the total new eligible drama expenditure undertaken by channel providers). Optus is the only licensee with its own drama service.

In 2001–02, subscription television had an interest in nine out of ten features financed by Film Finance Corporation Australia (FFC) and, in five of these subscription television investment was identified as a primary trigger for production. In television drama for the same year, subscription television invested in three out of a total of five children’s drama series, in one adult mini-series and in two of the five telemovies financed by the FFC.

The FFC has reported that subscription television pre-sale licence fees have also assisted the theatrical release of films by providing a source of guaranteed revenue to the domestic distributor.

The ABA reported in its 2003 investigation that co-productions with free-to-air broadcasters are generally viewed as mutually beneficial. It was stated that free-to-air broadcasters receive a valued source of funding while subscription television operators are provided with high quality concepts in which to invest. The ABA suggested that subscription television investment in co-productions ensures that some quality productions, which otherwise may not have proceeded to the production stage, are realised.

The ABA also reported that the subscription television industry has made a substantial contribution in relation to the production and broadcast of Australian content outside the context of the requirement, including sports and news programming, children’s and documentary programming.

Although subscription television operators are not required to allocate expenditure to independently produced programs, the Review has found that the majority of programs claimed under the requirement have been sourced from independent production groups.

4.2 Compliance with the current new eligible drama expenditure requirement

Based on information obtained during the ABA’s investigation, the Review did not reveal any issues regarding lack of compliance with the provisions of the scheme. Licensees and channel providers complied fully with the expenditure provisions between 1999–2000 and 2003–04. There was only one licensee, Optus, which supplied its own drama programming. The industry also fully complied with the information requirements under the legislation.

ABA data showed that a shortfall occurred in each year of the requirement with the shortfall amounts having been made up in the subsequent financial year.

The shortfalls increased from \$5 488 289 in 1999–2000 to \$7 804 134 in 2000–01, \$8 246 506 in 2001–02 and \$8 937 272 in 2002–03.

The main reasons suggested for the shortfalls were:

- channel providers' expenditure obligations for a particular year are often uncertain until the end of the financial year. For example, a channel provider may agree to license a feature film but the cost of the licence fee may depend on the theatrical performance of the film, with the actual licence fee unknown until later in the financial year
- conservative foreign exchange rates projections may be made when planning new eligible drama expenditure which result in an underspend
- because finalising programming expenditure is often not possible until late in the reporting year, qualifying expenditure is often deferred until the following year.

While it is difficult to draw conclusions in relation to the increases in shortfalls, the Review, taking into account the outcomes of the ABA investigation, found that:

- the vast majority of channel providers make up their own shortfalls as allowed under the scheme with the shortfall amounts incurred in one year having been made up in the subsequent financial year
- the scope for licensees to vary programs in a drama channel (and increase the amount of new eligible drama expenditure) is limited because channel providers supply licensees with complete channels for broadcast on licensees' platforms.

The Review has found that the expenditure requirement was not well understood within certain areas of the production industry and funding agencies, particularly the role of make-up expenditure. The ABA has reported that some areas of the production industry and funding agencies viewed the shortfalls as evidence of subscription television licensees' lack of commitment to Australian content.

However, the Review has concluded that there was no evidence that this was the case. As allowed under the legislative provisions, the licensee's expenditure obligation is based on what was spent independently by a channel provider, therefore, a 12-month delay in meeting the full obligation for a particular year is necessary to allow licensees to ensure the obligation was met.

Based on submissions to the ABA's investigation, the Review has found that the current requirement has not proved an unreasonable financial burden to the subscription television industry. However, there was evidence of tension between the commercial pressures to spend funds in one financial year to ensure particular programs are produced (such as television drama series) and the timing of payments to meet the regulatory expenditure requirement.

4.3 International comparisons

International comparisons are useful reference points for considering the current Australian arrangements. Organisation for Economic Co-operation and Development (OECD) research relating to the domestic and local content requirements suggests that a number of OECD countries (including Austria, Italy, Japan, Luxembourg, New Zealand and Norway) have no local content requirements applying to cable or satellite television broadcasts.

The ABA in its 2003 investigation examined national content requirements for subscription television in other countries and suggested that Canada and the European Union (EU) were the most useful reference points for comparison.

In Canada, minimum local content transmission and expenditure quotas are determined on a case-by-case basis according to the nature and business plan of each channel. Broadcast quotas are calculated on the supply, cost and nature of programming and the revenue potential of each channel while expenditure quotas are based on annual revenues and subscriber numbers. Subscription television penetration in Canada is significantly higher than in Australia.

Europe's framework legislation, the Television Without Frontiers Directive (TWFD), forms part of a wider EU audiovisual policy aimed at removing barriers within the EU by promoting the free movement of TV broadcasts between member states. The TWFD provides a regulatory framework only, and the terms of implementation by member states are discretionary. Member states must ensure that broadcasters meet the set quotas only where practicable and by appropriate means. The ABA noted that implementation among member states differs considerably, and there is little consistent data on how effective implementation has proven.

The ABA also reported that detailed comparisons with Canada and the EU are problematic because their subscription television environments raise significantly different concerns and regulatory responses to those in Australia.

4.4 Appropriate level of the new eligible drama expenditure requirement

The Review has found that it would not be reasonable to increase the 10 per cent expenditure requirement given the uncertainty and change in the short to medium term outlook for the subscription television industry. In addition, it is not yet known what impact the Foxtel Optus Content Supply Agreement and the digitisation of the Foxtel network will have on the profitability and long-term sustainability of the industry. This is consistent with the finding of the ABA's investigation.

The 10 per cent expenditure quota requirement also contains an implicit growth component that will respond to developments such as the expanding range of channels available as a result of Foxtel's digitisation.

Government response

The Government has decided to maintain the current 10 per cent new eligible drama expenditure requirement. The Government considers that it would be appropriate to re-examine the 10 per cent expenditure requirement in the further review proposed.

4.5 Treatment of pre-production expenditure

Script development has an important role to play in the process of creating successful film and television content and the current rules provide insufficient incentive for the subscription television industry to direct funds towards new and innovative programming.

Derived from information provided to the ABA in its investigation, the Review has found that no subscription television entity under the scheme has yet reported incurring any pre-production expenditure. New eligible drama expenditure under the current scheme has been predominantly incurred in relation to feature film investment and licence fees by the subscription television industry, with no expenditure being claimed as development (pre-production) expenditure. Subscription television entities currently tend to contribute to established projects later in the development phase.

Consistent with ABA findings, the Review has found that the introduction of more flexible arrangements for the treatment of pre-production expenditure could:

- promote additional development funding leading to the production of better quality screenplays and programs
- encourage subscription television licensees and channel providers to become involved in supporting projects at an earlier stage or initiating new productions
- encourage development of drama projects which should lead to the most promising projects proceeding to production
- facilitate exploration of innovative approaches to projects in an effort to differentiate subscription television from commercial free-to-air television and develop riskier Australian productions suitable for a subscription television environment.

This limited increase in flexibility is unlikely to have a negative impact on the policy objectives of the requirement or change significantly the strategies used by the subscription television industry. The acquisition and production of programs for broadcast could remain the focus of the new drama expenditure if a cap on pre-production expenditure was introduced.

Government response

The Government has decided that subscription television could be encouraged to engage in the development of new and innovative projects by providing that certain pre-production expenditure is allowed to count towards the requirement in the year that it is incurred rather than when a project goes into principal photography as allowed at present.

To provide certainty for the industry and enhance compliance, the Government has decided that there will be a number of limitations on the type of pre-production expenditure which may be claimed under the scheme. These are:

- allowable spending on script development, prior to the commencement of principle photography, would be limited to third parties, such as an independent producer, a freelance writer or writer/director
- the writer/s developing the script and producer for the project must be Australian or New Zealand citizens

- script development spending prior to commencement of principal photography would be capped at a maximum of 10 per cent of the total eligible drama obligation of a channel provider or licensee
- previously counted script development expenditure would be disallowed if the project proceeded to production as a foreign, rather than eligible program.

The changes will require legislative amendment. To provide additional certainty, it may be necessary for the ABA make a determination under the BSA identifying the type of expenditure that could be taken to be allowable script-related development expenditure.

4.6 Treatment of carry forward of expenditure above 10 per cent

A number of submissions to the ABA's investigation argued that the 10 per cent new eligible drama expenditure requirement is not sufficiently flexible and restricts investment in some new eligible drama programs.

The Review has found that although under the BSA, expenditure on Australian drama is required to be at least 10 per cent, expenditure under the requirement has rarely exceeded 10 per cent. The new eligible drama expenditure in its current form offers little incentive for expenditure in excess of the minimum requirement.

Channel providers argued that it is very difficult to meet the expenditure requirements within a one-year financial year timeframe and make financially sound investment decisions in relation to current and future programming, particularly television production. Commercial Television Australia (CTVA) (now Free TV Australia) also argued that the inability to count expenditure in excess of 10 per cent has acted as a 'brake' on subscription television investment in some drama projects. CTVA was of the view that a rigid 12-month window in which a specific amount of expenditure must be made can create timing difficulties which may impact on the cash flow needs of productions.

The ABA noted in its report to the Minister that there was evidence in some subscription television industry submissions that the inability to carry forward expenditure had resulted in decisions not to finance programs that would otherwise have met the new eligible drama requirement.

The Review has found that if new eligible drama expenditure by a licensee or channel provider in excess of the 10 per cent requirement was permitted to be carried forward and treated as new eligible drama expenditure in the following year, constraints on some investment decisions could be removed.

This possible measure is consistent with the operation of the Australian Content Standard where commercial free-to-air broadcasters have the flexibility of three year averaging in relation to Australian drama programming.

Government response

The Government has decided to permit expenditure in excess of the 10 per cent requirement to be carried forward and treated as new eligible expenditure in the following year.

Limiting the carry over provisions to the next financial year only will provide some additional level of flexibility without reducing significantly the sector's cumulative expenditure on Australian drama. The increased flexibility may encourage the making of more expensive Australian drama programs and series and the funding of projects on a merit basis rather than on the basis that the project meets the requirement for a particular financial year.

The change will need to be implemented by legislative amendment.

4.7 Extension of the requirement to cover documentary programming

During the ABA's 2000 investigation into whether subscription television licensees which provide a documentary service should be required to maintain minimum levels of expenditure on new eligible documentary programs, the production industry and film agencies submitted that there was a need for regulation in the area. These groups also raised this issue in their submissions to the ABA's more recent investigation and indicated support for an extension of the requirement to cover documentary programming. The subscription television industry in its submissions, argued that levels of new eligible documentary programs were increasing as the industry grew and that international documentary networks contribute to the Australian production industry.

The ABA, in its report to the Minister indicated that while there had been growth in expenditure on, and broadcast of, new documentary programs, the level of support for new documentary programming remained low.

The Review has found that Australian companies have been involved in producing documentary programs directly for the international market through commissioning or co-production arrangements with international documentary channels. This has been facilitated by the development of global networks specialising in documentary programming (e.g. Discovery Channel and National Geographic Channel).

The amount of data available on documentary programming is limited and much of it is commercial-in-confidence in nature. According to the ABA, total investment by international documentary channels in the activities of Australian and New Zealand production companies was estimated at \$15 million in 1999–2000. A 1999–2000 Australian Bureau of Statistics survey reported total documentary production costs of \$74 million for that year. According to the AFC, the total production cost of Australian documentaries averaged \$45 million per annum between 1996–1997 and 2002–03.

In assessing the state of the sub sector in 1999–2000, the ABA found that the four pay TV documentary channels operating in Australia (Discovery, History Channel, National Geographic and Odyssey) expended around 10 per cent of aggregate program expenditure on new Australian documentary programs, up from five per cent in 1998–99. The ABA did not update its data for the 2003 investigation.

However, the ABA remained of the view that there were few incentives for subscription television documentary channels to increase substantially the levels of new Australian documentary programs broadcast as cheaper imported programs are readily available. The ABA also considered the sector is financially capable of increasing its expenditure and recommended in its report to the Minister that licensees who provide a subscription television documentary service be regulated in order to increase support for new eligible documentary programs.

It further proposed that two options be considered amending the BSA to:

- give the ABA the power to determine a standard in relation to the amount of eligible documentary programming on these services. Such a standard would establish a minimum on-air requirement.
- require licensees who provide a subscription television documentary service to ensure 10 per cent of total program expenditure be spent on new eligible documentary programs.

The Australian Government has since made a commitment not to impose transmission quotas on subscription television in the AUSFTA. This commitment reflects the Government's views that transmission quotas would be inappropriate for subscription television (for the reasons outlined in section 2.2 above).

Documentary production in Australia is heavily subsidised. The AFC reported that around 62 per cent of the finance for local documentaries (made by production companies) is funded both directly and indirectly by government annually:

- approximately \$15 million was provided through federal and state government film funding agencies and Film Australia
- \$5-6 million was gained through pre-sales from ABC, SBS and funding from SBS Independent
- \$3 million was accessed via tax incentives.

In addition, broadcast quotas for new documentary programming on free-to-air commercial television amounts to 60 hours per annum.

The Review has found that Australian production companies have benefited substantially from investment by the global documentary networks (even though the material produced under Australian or New Zealand creative control is not necessarily broadcast in Australia).

The Review has noted that around 10 per cent of aggregate program expenditure was spent on new Australian documentary programming in 1999–2000 (a similar proportion to the 10 per cent new eligible drama expenditure requirement). A substantial reduction in this figure is unlikely to have occurred since that time. AFC data shows that there were 41 hours of first release Australian documentaries broadcast on pay TV in 2001, up from five hours in 1999 and 28 hours in 2000⁵.

⁵ Comprises only programs that had not been previously broadcast on a free-to-air network.

The ABA reported that the sector exhibited market failure and that the subscription television documentary sector was unlikely to increase its support for new eligible documentary programs to an appropriate level. However, the figures above indicate that the sector is reaching a 10 per cent expenditure level via market pressures and that the broadcast of new Australian documentaries has increased substantially over time. On this basis, the Review has found it unreasonable to support regulatory intervention at this time.

The Review has considered the ABA's proposal to regulate minimum levels of expenditure on subscription television. Based on the data available and given the small size of the subscription television documentary industry in Australia, the Review is of the view that there is not a case for making local documentary channels subject to content regulation at this stage.

The Review considers that any future review relating to Australian content requirements for the subscription television industry could consider whether an expenditure requirement for documentary programming is necessary.

Government response

Based on the data available, the Government has decided there is not a compelling case for providing further funding support to the documentary sector by making documentary channels subject to content regulation.

The global documentary networks which are also the parent companies for some of the local documentary channels already invest substantially in the Australia production sector. In addition, the levels of first release Australian documentaries broadcast on subscription television increased from 28 hours in 2000 to 41 hours in 2001.

4.8 Further review of the new eligible drama expenditure requirement

Regular review of the operation of the requirement is justified given the rapid developments in the sector and the potential for increased household penetration.

In line with the ABA's advice, the Review has supported a further review of the operation of the new eligible drama expenditure requirement given the changes that are occurring in the sector and the continuing uncertainty about the rates of subscriber growth and revenues.

Government response

The Government has decided a further review of the operation of the new eligible drama expenditure requirement should be conducted in 2008.

A review in 2008 would allow the impact of digitisation and the Content Supply Agreement to be assessed. In addition, developments in the free-to-air broadcasting sector could be better taken into account if the review were conducted on this timing.