



Submission to Government
on the report of the
Australian Competition and Consumer Commission
on Emerging Market Structures
in the Communications Sector

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Executive Summary

This is a submission by FOXTEL Management Pty Limited on behalf of the FOXTEL Partnership (*FOXTEL*) in response to the Australian Competition and Consumer Commission's (*the Commission's*) report to Senator Alston, Minister for Communications, Information Technology and the Arts on Emerging Market Structures in the Communications Sector dated June 2003 (*the Report*).

This submission responds to a number of issues considered by the Commission in its Report. By way of executive summary, FOXTEL makes the following submissions:

- **Investment incentives**

The Commission's recommendations in relation to access to content seek regulatory intervention on a scale without any local or international precedent. The complete lack of foundation for these claims is highlighted by the fact that the subscription television sector is uniquely constrained by over-regulation, low penetration rates, high content costs and low prices, industry features which are consistent with a competitive market and which are ignored by the Commission. The Commission has made a number of recommendations (particularly in relation to access to content and multi-channelling) which would completely undermine the economic incentives that FOXTEL's shareholders require in order to invest in digital television and has not proposed any recommendations that, in reality, would enable infrastructure operators, such as FOXTEL, to earn reasonable returns on investment. This is dealt with further in section 2.

- **Consumer Benefit**

The Commission has ignored the fundamental underpinning of its statutory authority - to promote the interests of end-users or consumers - in favour of championing particular competitors. Many of the Commission's recommendations in fact have the potential to harm the quality of services consumers receive. In particular, the Commission's recommendations on access to content legislation have the potential to reduce the number and quality of subscription television programs offered to consumers by reducing incentives to invest in such programming. Maintaining property rights in programming and allowing a program or channel provider to license

those rights exclusively may allow a program provider to obtain greater revenue for its service, which in turn, can be invested in new content. Similarly, subscription television providers may benefit from having some exclusivity allowing them to differentiate their offerings and provide greater choice to consumers. Rather than being a 'vicious' circle as described by the Commission, FOXTEL submits that this is a 'virtuous circle'. This is discussed further below and in section 6.

- **Competition in the open broadcast and subscription television industries**

FOXTEL does not believe that the Commission has conducted a thorough or considered investigation into the state of competition in the telecommunications sector and has placed insufficient weight on and failed to give due consideration to the Content Supply Agreement (*CSA*) and various section 87B undertakings accepted by the Commission in November 2002 from FOXTEL, Telstra, Optus and Austar. This is dealt with in section 2.

Subscription television is an immature and developing industry and has been uniquely challenged by inappropriate regulation (eg anti-siphoning), modest advertising revenue, high content costs (eg US movies), small scale, cable overbuild, dominant open broadcasters and unsustainable financial losses.

In contrast, the open broadcast industry is mature and entry into the open broadcast sector has been strictly regulated, containing competitive possibilities. In addition, the open broadcasters have enjoyed a near monopoly in relation to the acquisition of premium sports content in Australia. The balance between subscription television operators and open broadcasters has for too long been tilted in favour of the open broadcasters. This is dealt with in section 3.

- **Anti-siphoning**

FOXTEL submits that fundamental reform of the anti-siphoning regime is required. Uniquely in Australia, an 'event' on the anti-siphoning list is, in most cases, an entire competition (eg each match in the Wimbledon tennis tournament) whereas in other jurisdictions, an event is an 'occurrence' (eg equivalent of the Wimbledon Men's Final). FOXTEL advocates the implementation of a shorter list and the introduction of a system of dual rights enabling both subscription television operators and open broadcast television to deal separately and directly with sports rights holders. FOXTEL believes that the Government should amend the regime as a matter of

priority in light of the Commission's concerns in relation to access to premium sports content. This is dealt with in section 4.

- **Multi-channelling**

FOXTEL strongly submits that the current prohibition on multi-channelling be maintained and that all participants adhere to the specified statutory review which is to be finalised by 2005. FOXTEL submits that the current multi-channelling prohibition and the prohibition on the fourth commercial television licensee are complementary and provide certainty for industry participants under the current investment framework. Accordingly, the current policy should not be revised. This is dealt with in section 5.

- **Access to content**

The Commission's Report does not have sufficient regard to the impact that the Content Supply Agreement between FOXTEL and Optus Vision and the section 87B undertakings have already had and will continue to have in terms of access to content. The impact of these arrangements cannot be overlooked or underestimated in considering competition issues in the subscription television and other telecommunications industries. Any comprehensive analysis of the state of competition in the subscription television industry, particularly in relation to the issue of content, must have regard to the state of competition now and in the near future as a result of those arrangements.

The Commission's recommendations in relation to access to content seek industry specific regulatory intervention on a scale without any local or international precedent. The Commission cannot point to any overseas legislative precedent to justify its arguments to interfere with individual program licences.

The court-enforceable section 87B undertakings deal comprehensively with access to content and it is not necessary to enshrine those undertakings in legislation. The undertakings ensure that movie and sports channels, as well as numerous general entertainment channels, continue to be available non-exclusively for other subscription television providers to license directly. In addition, FOXTEL and Austar have undertaken to supply their service to network providers who have real flexibility in the way in which they can offer the FOXTEL service bundled with other subscription television and non-subscription television services.

The existing regime contained in Part IV of the Trade Practices Act 1974 is sufficient to deal with any issues of market power and other anti-competitive arrangements. This was most recently comprehensively acknowledged by the Dawson Committee in its review of Part IV of the Act.

In these circumstances, a legislated content access regime would be an unnecessary and inappropriate interference with the economic rights of program suppliers and subscription television providers. This is dealt with in section 6.

- **Re-transmission and dual tuners**

FOXTEL does not believe there is any basis for mandating re-transmission of open broadcast channels in a digital environment. FOXTEL currently re-transmits open broadcast channels as part of its analogue cable service and has offered to retransmit the open broadcast services over the digital network (subject to them obtaining satellite capacity). FOXTEL agrees with the Commission's recommendation that there is no need to impose a legislative requirement on the re-transmission of open broadcast channels. In addition, FOXTEL does not support, for entirely practical and operational and economic reasons, the introduction of dual tuners. This is dealt with in section 7.

1. Introduction

FOXTEL welcomes the opportunity to respond to the Report as the Commission has made a number of statements, comments and recommendations which are of major concern to FOXTEL and which have the potential to significantly and negatively impact on FOXTEL's core business, the viability of the subscription television industry and the future of subscription television in Australia.

This submission considers:

- the background to and state of competition in the subscription television industry in Australia;
- regulation of open broadcast television and subscription television (including anti-siphoning, multi-channelling and datacasting);
- access to content for subscription television networks; and
- access to carriage for open broadcast re-transmission.

This submission does not respond to the Commission's recommendations in relation to Telstra's ownership of the HFC cable or its ownership interest in FOXTEL¹, however FOXTEL agrees with the view expressed by Senator Alston that such a proposal, which has the ability to completely undermine Telstra and FOXTEL's business case and require enormous restructuring, must be regarded with the 'utmost caution'². This submission also does not cover bundling issues³ (except to the extent that it is relevant to access to content).

2. The Commission's Report

On 12 March 2002, the Minister for Communications, Information Technology and the Arts, Senator Alston, requested advice from the Commission on the extent to which emerging market structures are likely to affect competition across the communications sector. The Minister's request followed the announcement of the Content Supply Agreement (*CSA*)

¹ Australian Competition & Consumer Commission, report to Senator Alston, Minister for Communications, Information Technology and the Arts, on Emerging Market Structures in the Communications Sector dated June 2003 (*ACCC Report*) (Chapter 4).

² Senator Alston, Media Release entitled 'ACCC Report on Pay TV competition' dated 20 June 2003.

³ ACCC Report (Chapter 8).

between FOXTEL and Optus Vision on 5 March 2002 which was subsequently approved (as amended) by the Commission on 21 November 2002 subject to certain undertakings pursuant to section 87B of the Trade Practices Act 1974 (Cth) (*the Act*). The Commission released its Report on 20 June 2003.

As a general observation, FOXTEL is disappointed that the Report does not provide as thorough or considered an investigation into the state of competition in the telecommunications sector as it could have. Further, the Report has placed insufficient weight on and has failed to give sufficient consideration to the CSA and the various section 87B undertakings offered by FOXTEL, Optus and Austar in November 2002. It is surprising that the weight and force of these undertakings have not been afforded the status they deserve given their unprecedented scope and the fact that the Commission accepted them and their enforceability.

The Commission has not conducted a rigorous analysis of the state of competition in the telecommunications, broadband and subscription television markets. Rather, the Commission has merely put forward its opinion on a number of issues by way of assertion. These issues include the state of competition in telecommunications markets, the 'apparent lack of consumer choice' between the FOXTEL and Optus services, the incentives relevant to FOXTEL and Telstra and the ability of subscription television operators to access content. The Commission has not made out its case for any additional regulation (let alone the extremely interventionist legislation proposed by the Commission) and has not supported its recommendations with any evidence or sufficient analysis. Instead, the Commission has suggested that regulation should be imposed unless there is good reason not to impose it. This inappropriately reverses the onus of proof and departs from the usual approach before imposing legislation. That is, FOXTEL submits that there must be demonstrated market failure before such regulation should be imposed, with the benefits clearly outweighing the costs. The Commission has not undertaken any cost/benefit analysis and indeed seems to suggest that, contrary to the normal practice, FOXTEL should have to prove that the costs of the legislation will outweigh the benefits. FOXTEL regards this as highly inappropriate in such a public policy report from an adjudicative body.

The Commission's recommendations in relation to access to content seek industry specific regulatory intervention on a scale without any local or international precedent. The Commission cannot point to any overseas regulatory precedent to justify its arguments to interfere with individual programme licences.

The complete lack of foundation for these claims is highlighted by the fact that the subscription television industry in Australia is amongst the most competitive in the world: Australia has no territorial monopolies despite having a maximum of 7.1 million television homes⁴ (cf 108 million in the US); low industry penetration of 22%⁵; among the lowest subscription prices in the world and the most stringent anti-siphoning regime anywhere.

The Commission refers to the form of but ignores the substantive economic principles underlying its charter in the administration of telecommunications, namely to further the long term interests of consumers of telecommunication services by promoting competition and the efficient use of, and investment in, telecommunications infrastructure⁶ in its review of the telecommunications sector. The Commission's recommendations will so alter the regulatory framework in which the subscription television operators operate so as to fundamentally undermine investment in telecommunications infrastructure and services to the ultimate detriment of end-users.

Following the partial industry rationalisation achieved last year as a result of the CSA and ancillary arrangements and assuming that the Commission grants FOXTEL and Telstra the digital exemptions which are currently being considered by the Commission, FOXTEL's shareholders are poised to make the single largest investment in Australian digital television for the short, medium and long term benefit of Australia's television consumers. Yet the Commission, without any basis, makes recommendations for access to content which would completely remove any incentives FOXTEL's shareholders have to make that investment, notwithstanding the unrecovered investments made to date and FOXTEL's ongoing losses.

Part of the role which the Government has entrusted to the Commission is to consider the impact of decisions it makes on the economically efficient use of, and the economically efficient investment in infrastructure. The Report focuses on theoretical market structures rather than on the reality of the need for infrastructure owners like FOXTEL to earn a reasonable return from their investments. Such an approach would appear to contradict the approval of the CSA and the related undertakings in 2002.

⁴ ABA Website, FAQ, Paul Budde Communication, estimates.

⁵ ABA Website, FAQ.

⁶ ACCC Report at x.

3. Background to the subscription television industry

The open broadcasters successfully lobbied the Government to delay the introduction of subscription television until 1995. By comparison, subscription television started in the USA in 1940, the UK in 1981 and New Zealand in 1990. Whilst subscription television is mature in some countries, it is still young and developing in Australia.

In the 7 years since inception, the subscription television industry has failed to achieve financial viability and has struggled to reach adequate levels of penetration. Penetration rates have plateaued generally in the financial year ending June 2002. While there has been some increase in the take-up rates through the introduction of FOXTEL's satellite service in 1999, from Optus bundling at discounted rates, the offering of the AFL (Fox Footy) channel by FOXTEL to third parties, the CSA and the resale arrangements with Telstra, industry penetration is still at 22% which is very low by international standards⁷. For example USA penetration is 84%⁸, UK is approximately 40%⁹ and New Zealand is in excess of 40%. Australia's rate of penetration is significantly lower than the level required by viable businesses. The Commission's penetration figure for the USA is misleading as it is a cable penetration rate only¹⁰ and ignores the 18.2 million satellite subscribers in the USA¹¹.

In addition, the industry has been uniquely challenged by inappropriate regulation (eg anti-siphoning), modest advertising revenue, high content costs (eg US movies), small scale, cable overbuild, dominant open broadcasters and unsustainable financial losses.

3.1 Unprofitable

The industry has suffered financially and the incentive to continue to invest in a high risk, and, to date, unprofitable business is low. Over \$8 billion has been invested in the subscription television industry since 1995¹² and none of the subscription television

⁷ ABA Website, FAQ.

⁸ ABN-AMRO, Global Media, Sub-sector analysis, January 2002 at 106.

⁹ Independent Television Commission, *ITC Multichannel Quarterly* – Q1 2003 (as at 31 March 2003).

¹⁰ ACCC Report at 9.

¹¹ FCC, Ninth Annual Report: *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 31 December 2002 at 7. EchoStar website states that it has over 8 million customers nationwide, Directv Inc website states that it has 11.8 million customers.

¹² FOXTEL Media Release, 13 November 2002.

operators have reached profitability. All operators (including FOXTEL, Optus and Austar) have made, and continue to make, substantial losses. FOXTEL, for example, has made an aggregate loss of approximately \$1 billion, including approximately \$100 million in the last financial year¹³. Optus and Austar have continued to incur large losses with Austar seeking to restructure its \$400 million debt facility last year¹⁴. Assuming FOXTEL launches a full digital service by June next year, on current estimates, FOXTEL will not return its first dollar of profit to its shareholders before the financial year ending 2006.

Part of the reason for these large losses is the high programming liabilities that the operators have incurred, particularly in regard to movies. To date, FOXTEL has paid (and continues to pay) hundreds of millions of dollars in licence fees for its movie channels. It has been reported for example that Optus has Hollywood movie content liabilities worth \$300 million¹⁵. FOXTEL discusses issues in relation to the acquisition of content in more detail in section 6.

3.2 High degree of regulation

The subscription television industry is arguably the most highly regulated start-up business in Australia. Subscription television was prohibited until 1995 in order to protect the open broadcasters. Even on introduction, subscription television operators have been subjected to a high degree of regulation including:

- no advertising on subscription television services until 1997;
- no new satellite licences until 1997;
- mandated digital satellite technology from the outset; and
- the imposition of the most stringent sports anti-siphoning rules anywhere in the world.

FOXTEL discusses some of these regulatory issues below including anti-siphoning in section 4, multi-channelling, datacasting and the moratorium on new commercial television broadcast licences in section 5 and re-transmission in section 7.

¹³ ABN-AMRO, Media & Telecoms Australia: 21st Century FOXTEL, May 2002 at 15.

¹⁴ The Australian, 10 May 2002 at 21.

¹⁵ The Australian, 6 March 2003 at 23.

3.3 Power of the open broadcasters and dominance of open broadcaster television

Subscription television operators face competition from open broadcasters, DVDs and video sales and rentals. In particular, FOXTEL continues to battle in developing its business against the entrenched and regulation-assisted market power of the open broadcasters in various ways.

Subscription television in Australia is currently only connected to 22% of Australian homes¹⁶ and accounts for 11-13% of total television viewing¹⁷. The open broadcasters, on the other hand, control 87 – 89% of total television viewing¹⁸. In addition, open broadcasting and print and radio remain the dominant voices in news and current affairs in Australia.

3.4 Content Supply Agreement and associated arrangements

FOXTEL entered into the CSA with Optus on 5 March 2002 in an attempt to rationalise the industry, improve financial viability and invigorate penetration and take-up. On 21 June 2002, the Commission expressed the view that the CSA, as then drafted, was likely to contravene the Act and voiced six main concerns. On 21 November 2002, the Commission accepted comprehensive undertakings from FOXTEL designed to address the Commission's concerns.

The Commission is currently considering FOXTEL and Telstra's analogue undertaking and associated analogue access agreement (*analogue inquiry*) and FOXTEL and Telstra's digital exemption application and associated digital access agreement (*digital inquiry*).

Whether or not the Commission accepts or rejects these undertakings will significantly affect FOXTEL's core business and the viability of the subscription television industry in Australia.

Whilst the CSA provides an opportunity for growth in the subscription television industry and, in particular, provides a more secure environment for FOXTEL's transition to a digital cable service and an expanded digital satellite service, industry

¹⁶ ABA Website, FAQ.

¹⁷ Lachlan Murdoch, Deputy CEO of News Corporation, Keynote Address, 'Television from a global perspective – issues for Australia', Australian Subscription Television and Radio Association Conference, 28 February 2003.

¹⁸ ABN-AMRO, Media Australia – FTA Developments, July 2002 at 54.

stakeholders remain concerned about the viability of the subscription television industry which to date has been unprofitable. The industry is clearly still in an early stage of development, more so in respect of the development and provision of digital services (including interactivity).

Any material detrimental changes to the regulatory environment in which subscription television currently operates will, in FOXTEL's opinion, be likely to jeopardise the significant and costly improvements which have been (and will be) made possible by the CSA. Such change includes legislation which has the effect of¹⁹:

- (a) preventing subscription television providers (or anyone of them) from acquiring content, programs or channels (other than movie channels) exclusively;
- (b) requiring subscription television providers to provide programs or channels to other providers; and
- (c) allowing open broadcasters to multi-channel.

Such regulatory changes are included in the section 87B undertakings so that if any of them occur, FOXTEL's commitment to digitise ceases to apply²⁰.

FOXTEL deals specifically with access to content and on-supply requirements in section 6 below and multi-channelling in section 5 below.

3.5 Section 87B undertakings

The CSA and associated section 87B undertakings have and will continue to significantly change the structure of the subscription television industry in Australia and the impact of these arrangements must not be overlooked or underestimated when considering competition issues in the subscription television and other telecommunications industries.

FOXTEL submits that the Commission did not have due regard to the impact that the CSA and section 87B undertakings have already had and will continue to have on this industry.

In particular, the Commission has failed to acknowledge:

- the strengthened position of Optus;

¹⁹ Definition of 'Regulatory Change' in FOXTEL's 87B undertakings.

²⁰ FOXTEL's section 87B undertaking, clause 5.1.

- the substantial undertakings that FOXTEL, Optus and Austar have provided in relation to the issue of content including:
 - (i) FOXTEL and Optus' undertakings not to acquire those channels shared between them exclusively²¹;
 - (ii) FOXTEL and Optus' undertaking not to acquire the 'Movie Network' channels exclusively²²;
 - (iii) FOXTEL and Optus' undertaking not to acquire the 'PMP' channels exclusively²³;
 - (iv) FOXTEL's undertaking to sub-license AFL (Fox Footy) content to network providers and resellers on terms and conditions which do not discriminate unfairly²⁴;
 - (v) FOXTEL and Austar's undertaking to license their services to Infrastructure Operators²⁵;
 - (vi) FOXTEL's undertaking that at least 30% of channels in its basic package will comprise non-affiliated channels with itself or any of its shareholders²⁶;
 - (vii) FOXTEL and Optus' undertakings to spend a minimum amount on local Australian content²⁷; and
 - (viii) FOXTEL's undertaking to place a cap on the price of FOXTEL's basic package for a period of 3 years²⁸;

²¹ FOXTEL's section 87B undertaking, clause 7.1; Optus' section 87B undertaking, clause 3.1

²² FOXTEL's section 87B undertaking, clause 7.2 and 7.3; Optus' section 87B undertaking, clauses 3.1, 4.1 and 4.2.

²³ FOXTEL's section 87B undertaking, clause 7.4; Optus' section 87B undertaking, clause 3.1.

²⁴ FOXTEL's section 87B undertaking, clause 10.

²⁵ FOXTEL's section 87B undertaking, clause 8 and Schedule 3; Austar's section 87B undertaking, clause 3.1.

²⁶ FOXTEL's section 87B undertaking, clause 12. Non-affiliated channels are defined in FOXTEL's section 87B undertakings as channels in which FOXTEL or its shareholders or their related parties hold shares in the operator of that channel, or otherwise have management control over programming decisions.

²⁷ FOXTEL's section 87B undertaking, clause 11; Optus' section 87B undertaking, clause 6.1.

²⁸ FOXTEL section 87B undertaking, clause 13.

- the likelihood of further structural change as a result of the analogue undertakings (which are currently being considered by the Commission);
- the likelihood of major industry rationalisation and development, together with significant consumer benefits if FOXTEL and Telstra's digital undertakings are accepted.

3.6 FOXTEL's attitude to access

The Commission has gratuitously commented that²⁹:

While Telstra and FOXTEL have offered access undertakings, which the Commission is currently assessing, it is pertinent that they only chose to offer these to assist in meeting the Commission's concerns about the content supply agreements. Some of these undertakings could have been offered to the Commission when disputes about access to the analogue [subscription television] service first arose, in 1999 and 2000.

FOXTEL submits that this is not the case. The Commission's comments relate to the matters between the Channel Seven owned subscription television service, C7, and FOXTEL.

FOXTEL initially refused to carry the C7 channel as part of the FOXTEL service for a number of reasons including concerns with the quality of the channel and the price of the channel. FOXTEL offered to carry the C7 channel if C7 addressed these concerns. C7 declined to do so and subsequently sought access. FOXTEL refused and C7 notified the Commission of a dispute relating to access to the cable. FOXTEL sought to enforce legal rights which it genuinely believed it had as to why it was entitled to refuse access. As soon as those rights were decided by the Full Federal Court in mid-2000, FOXTEL and Telstra fully co-operated with the Commission in the arbitrations and also made a reasonable commercial offer to carry the C7 channels.

Notwithstanding this, High Court appeals were pending which, if successful for FOXTEL, would have meant that FOXTEL had a legal basis for refusing to give access. The High Court appeal was determined in August 2001. There was no reason why FOXTEL or Telstra would have offered access undertakings before that time. It was, in fact, less than 12 months later, when FOXTEL and Telstra offered section 87B undertakings to the Commission in a form which included the full terms and conditions on which access would be provided (including price). FOXTEL also made a further

²⁹ ACCC Report at xvi.

offer to Seven in February 2002. FOXTEL believes its offers represented a better position for C7 as it would have acquired the benefit of the FOXTEL brand as part of these offers.

It is unprofessional and inappropriate for the Commission to offer the kind of gratuitous comment about the undertakings that it has made in the Report.

3.7 Competition in subscription television markets

The Commission has made a number of statements, many of which are inaccurate, about the state of competition in telecommunications markets generally, and specifically in relation to subscription television. FOXTEL responds to a number of these statements below.

(a) Competition in telecommunications markets

The Commission states that 'there is lack of effective competition in many telecommunications markets' and that this means that 'consumers continue to pay higher prices and receive lower quality services across the entire communications sector than they otherwise would'³⁰.

This is an unsubstantiated opinion and a broad generalisation that the Commission has failed to support with any empirical evidence or even mere example. FOXTEL suggests this is an unacceptable basis for a public body to make recommendations on.

FOXTEL notes that the Commission's analysis of the 'state of competition' is in any event inadequate and that the Commission has not conducted a rigorous analysis of the state of competition in any of the telecommunications markets. The Commission has the ability to conduct thorough investigations of competition and does so in the context of, for example, declarations when it is required to have regard to the long term interests of end users which are the principles enshrined in Part XIC of the Act. For example, in determining whether to declare local services, the Commission examined current market shares, substitutability of infrastructure, barriers to entry and substitutability of other services.

³⁰ ACCC Report at ix.

(b) Incentives

The Commission states that open broadcasters and subscription television operators are motivated by different incentives by virtue of the fact that an open broadcaster's revenue is obtained through advertising whereas a subscription television operator's main source of revenue is through subscriptions³¹. The Commission says that this means the open broadcasters have an incentive to broadcast programs that attract large audiences whereas subscription television operators can cater for minority interests through their numerous channels.

FOXTEL submits that whilst open broadcasters and subscription television operators obtain their revenue through different sources (open broadcasters through advertising revenue and subscription television operators through subscription), open broadcasters and subscription television operators are both seeking to maximise profits by appealing to the maximum number of viewers. In other words, both open broadcasters and subscription television operators are competing for 'eye-balls', they just obtain their revenue through different means. Both seek to achieve this by providing attractive programming.

In addition, both subscription television providers and open broadcasters can and do target both general and niche markets. FOXTEL has numerous general entertainment channels (such as FOX 8) and its basic package covers a wide variety of genres. While open broadcasters only have one channel each, they cover the same genres in their programming, and, in addition, some open broadcasters target different audiences (eg SBS and Network Ten which targets 18 –39's). Whilst each open broadcaster may only show one genre at a time, consumers have a choice of 5 open broadcast channels at any one time.

(c) Choice in programming

The Commission states that despite the CSA, consumers may 'see little choice in programming and pricing' as between the FOXTEL and Optus services³² due to the similarity of services they both offer.

This view is unsubstantiated and appears to be mere speculation. FOXTEL is not aware that consumers are dissatisfied with the available services or any

³¹ ACCC Report at 75.

³² ACCC Report at xii.

such lack of choice. In any event, Optus does differentiate its service by having some additional channels in basic and some FOXTEL channels in different tiers to FOXTEL. Optus can also include additional channels as tiers as well as through bundling its subscription television services with other telecommunications services.

Optus is also free to price the FOXTEL basic and tiered services at its discretion and the pricing of its service in fact differs to FOXTEL's.

(d) Entry to the open broadcast sector

The Commission states that open broadcasters are 'provided a level of protection from competition that is not given to firms in other industries' and that entry into the open broadcast sector is 'strictly controlled by government regulations that limit the number of commercial broadcasting licenses'³³.

FOXTEL agrees with the Commission about the difficulty of new entry into the commercial broadcast sector³⁴ and submits that this is to be contrasted against the 'openness' of the subscription television industry to competition. FOXTEL disagrees with the Commission that there are 'high barriers to entry' to the subscription television sector, particularly given the section 87B undertakings provided by the industry allowing for both access to content and access to carriage and related infrastructure (eg set-top-units). Aside from FOXTEL, Optus and Austar there have been a number of new entrants in recent years: TARBS, Neighborhood Cable, TransACT and Telstra, with a number of others considering entry.

There are a number of historical structural differences between open broadcasters and subscription television operators that have tilted the balance of power too often towards open broadcasters:

- open broadcasters have been given exclusive access, at a concessional price unrelated to fair market valuation, to the scarce and valuable public resource of prime VHF and UHF spectrum bandwidth in order to generate private income (cf subscription television which exists as a result of private investment);

³³ ACCC Report at xii.

³⁴ ACCC Report at 74.

- open broadcasters have obtained nearly universal access to Australian homes through the use of the public spectrum resource (cf subscription television penetration of only 22%³⁵); and
- open broadcasters enjoy a prohibition against the granting of new commercial television broadcast licences which is a protectionist measure unique to the open broadcast sector (cf the subscription television sector which has faced competition from a number of operators from time to time including Australis, TARBS, Neighborhood Cable, TransACT as well as open broadcasters, DVDs and videos and where there are no legislated barriers to new licence provision).

(e) Market definition

The Commission states that there is a wholesale subscription television market for the on-supply of channels between some subscription television operators³⁶.

FOXTEL is well aware of the Commission's view in relation to market definition as the Commission has previously found that retail subscription television (regardless of delivery platform) constitutes a market separate from other entertainment and news services such as open broadcast television, home video rentals, cinema, radio and newspapers and magazines³⁷.

FOXTEL disagrees with the Commission's view on the relevant market. FOXTEL has previously argued and again submits that subscription television competes in at least a broader television entertainment market with open broadcast, videos and most recently DVD sales and rentals. In fact, the Commission has recognised that open broadcast and home video rentals may be considered the closest substitutes for subscription television³⁸. The Government should take into account the level of competition between subscription television, open broadcast and DVD/videos in assessing the

³⁵ ABA Website, FAQ.

³⁶ ACCC Report at 5 and 78.

³⁷ ACCC, Declaration of Analogue Subscription Television and Broadcast Carriage Service, August 1999 at 24 (**Declaration**).

³⁸ Declaration at 24.

Commission's recommendations, particularly as regards multi-channelling, anti-siphoning and access to content.

(f) Impact of digitisation

There is an air of unreality about the Commission's assumptions about FOXTEL's incentives to digitise. The Commission has stated that³⁹:

...the Commission expects that digitisation of the Telstra/FOXTEL HFC network will provide increased opportunities for FOXTEL to provide interactive [subscription] TV services which can be increasingly competitive with Telstra's communications services.

and⁴⁰:

In a more competitive market, [subscription] TV operators may have greater incentive to facilitate the supply of digital [open broadcast] and interactive services in an effort to seek competitive advantage.

FOXTEL has already spent, together with other subscription television operators, over \$1 billion in the subscription television industry, however none of the operators have yet reached profitability. In this context, the subscription television operators' reluctance to make further investments without regulatory certainty is rational and the Commission's rejection of those concerns without substantiation is naïve and uncommercial⁴¹.

The Commission states that the subscription television industry and related industries are likely to significantly change as a result of digitisation⁴². In this context, FOXTEL submits that it would be premature for the Commission to make any recommendations in relation to further regulatory or legislative or structural change to the subscription television industry in light of the foreseeable impact that digital subscription television services will have on the nature of the subscription television industry and attendant benefits to consumers. FOXTEL further submits that digital television is likely to revolutionise subscription television and as such any analysis of the 'state of

³⁹ ACCC Report at xv.

⁴⁰ ACCC Report at 143.

⁴¹ See ACCC Report at 132.

⁴² ACCC Report at 17.

competition' of the subscription television industry and associated telecommunications industries must take these factors into account.

4. Anti-siphoning

4.1 Introduction

FOXTEL welcomes the Commission's recommendation that Australia's anti-siphoning regime be amended. Australia's anti-siphoning regime is too proscriptive and fundamental reform of the regime, including a substantial reduction in the number of listed events together with the introduction of a 'dual rights' regime is required.

If the Government was truly interested in creating an environment in which subscription television operators have the incentive to make the investment in digital subscription television services, then it would amend the anti-siphoning regime.

Sport is one of the key drivers of subscription television and is also a major influence on the ratings of the open broadcast networks which attract advertising. The anti-siphoning regime significantly weighs market power in favour of the open broadcasters and against subscription television operators in bidding for such rights⁴³. As such, it is imperative that the Government acknowledges the extent to which Australia's current anti-siphoning regime has assisted the position of open broadcasters to the detriment of subscription television operators and the take-up of subscription television in Australia, and amends the anti-siphoning regime.

FOXTEL submits that the Government should amend Australia's anti-siphoning regime as a matter of priority as it is the most stringent anti-siphoning regime anywhere in the world, is more intrusive than is necessary to achieve the policy objective of ensuring key-sporting events are available to viewers on open broadcast television⁴⁴ and has a number of anti-competitive effects including⁴⁵:

- the reduction in the number of sports programs that may be broadcast and less consumer choice;

⁴³ See section 115 of the Broadcasting Services Act 1992.

⁴⁴ ACCC Report at 92.

⁴⁵ ACCC Report at 92.

- less competition between open broadcast and subscription television broadcasters in both acquiring rights and at a retail level as open broadcasters are essentially the 'gatekeepers' of major sporting content; and
- increased barriers to entry for subscription television operators.

FOXTEL submits that the Government should reduce the number of listed events (including tournament, match and series descriptions) to include events which meet an established list of objective criteria and amend the anti-siphoning regime to include a dual rights system. FOXTEL suggests that an event must only be included on the anti-siphoning list if the event:

- is of high national and cultural significance which has been and continues to be consistently broadcast live and in its entirety by the open broadcasters⁴⁶; and
- is held in Australia and involves the most senior Australian national representative team.

FOXTEL deals with the problems associated with the anti-siphoning regime in sections 4.2 - 4.4 and the nature of the dual rights system in section 4.5.

4.2 The anti-siphoning regime is too restrictive

Australia's anti-siphoning regime is the most stringent anywhere in the world. Australia has at least 4 times the amount of sports on its anti-siphoning list than any other country in the world and the Australian Broadcasting Authority (*ABA*) has noted that 'Australia's anti-siphoning scheme and its list of events are both more extensive and restrictive than those in operation overseas'⁴⁷. Uniquely in Australia, an 'event' on the anti-siphoning list is, in most cases, an entire competition (eg each match in the Wimbledon tennis tournament) whereas in other jurisdictions, an event is an 'occurrence' (eg equivalent of the Wimbledon Men's Final). The table below shows a comparison of the various international anti-siphoning schemes:

⁴⁶ *FOXTEL Cable Television Pty Ltd v Nine Network Australia Pty Ltd and Anor* 143 ALR 516 is authority for the proposition that the anti-siphoning list should be concerned with live broadcast of events of a national nature which are likely to attract widespread public interest: per Wilcox, Lee and Nicholson JJ at 520 – 521.

⁴⁷ Australian Broadcasting Authority, Investigation into events on the anti-siphoning list, Report to the Minister for Communications, Information Technology and the Arts, June 2001, at 12.

International Anti-Siphoning Schemes	
NZ	No list
USA	No list
Austria*	7 sports events
France	7 sports events
Germany*	8 sports events
Italy*	9 sports events
Ireland*	10 sports events
England Group A*	11 sports events
England Group B*	An additional 7 sports events
Australia	40 sports events ⁴⁸

Source: Updated from FOX Sports Submission, April 2001 and also Publication of Consolidated Measures by European Commission dated 8 September 2002. Only those European countries marked with an asterisk have notified the European Commission of 'listed event' measures taken under Article 3A of Directive 97/36/EC.

From an international perspective, most countries in the world favour self regulation. FOXTEL is of the view that substantial reform of the anti-siphoning regime is necessary to align Australian regulation and policy with world standards. This is critical to ensuring that the penetration of subscription television in Australia can reach that of other international markets.

Australia's anti-siphoning laws were amended in 2001 in an attempt to address concerns that the regime was anti-competitive and required reform.

The Commission refers to the fact that the Government introduced the amendments in 2001 to allow for the automatic de-listing of events six weeks before commencement in order to improve the anti-siphoning scheme by 'streamlining' subscription television operator's access to listed events where open broadcasters do not intend to buy the broadcasting rights⁴⁹. Whilst FOXTEL commends the Government's initiative in

⁴⁸ FOX Sports Media Release "Free to air TV broadcasts of sports- the sorry state of affairs continues" 16 May 2002.

⁴⁹ ACCC Report at 92.

amending the anti-siphoning regime and providing for the automatic de-listing of events, FOXTEL does not believe that these new provisions have reduced the anti-competitive effects of anti-siphoning particularly as an event will only be de-listed if an open broadcaster has had a reasonable opportunity to purchase the broadcast rights but has chosen not to do so. Despite the automatic de-listing provisions, the anti-siphoning regime continues to operate inefficiently and to the detriment of sports rights holders, subscription television providers and consumers.

For example, it is rarely in the commercial interests of FOXTEL and other industry participants to utilise and rely on the automatic de-listing of an event because it does not provide adequate lead time to negotiate the acquisition of broadcast rights and then effectively market such acquisition to existing or potential subscribers. Instead, it continues to be the case that the subscription television industry is forced to accept contractual terms which are sub-standard and not in the best interests of Australian sports fans. This is evidenced by the fact that the de-listing procedure has only been utilised on very few occasions. Further, there is always the risk that an open broadcaster may request the Minister to override an automatic de-listing because it is of the view that it has not had a reasonable opportunity to purchase the rights to the event.

In practice, third parties wishing to acquire subscription television rights to listed events must still make an application to the Minister for an event to be de-listed in order to afford them sufficient lead time to acquire, schedule and promote a particular event. FOXTEL submits that this essentially defeats the purpose and intention of the automatic de-listing provisions.

4.3 The anti-siphoning regime has reduced the amount of sports broadcast and resulted in less choice for consumers

The Commission has stated that Australia's anti-siphoning regime may actually reduce the broadcasting of listed events by preventing subscription television operators from broadcasting them⁵⁰. The Productivity Commission has also stated that the anti-siphoning provisions do not actively encourage open broadcasters to exercise the rights reserved for them⁵¹.

⁵⁰ ACCC Report at 93.

⁵¹ ACCC Report at 93.

FOXTEL agrees with these comments. Australia's anti-siphoning regime has failed to achieve its objective of ensuring that Australian consumers have access to events of national importance and cultural significance. This is evidenced by the fact that of the hours of sport protected for open broadcast on the anti-siphoning list in 2002, less than 17% were broadcast live by open broadcasters and more than 75% were not broadcast by them at all⁵². Australia's highly restrictive anti-siphoning regime has distorted rights acquisition and has had a pronounced anti-competitive effect. The current regime permits open broadcasters to 'hoard' sports rights, prevents subscription television providers from competing for the rights in the market until very late in the process and restricts rights holders for sports events from being able to deal with both open broadcasters and subscription television providers equally. The result has been that the majority of the events listed on the anti-siphoning list are not broadcast⁵³.

For example:

- The Seven Network held all rights to the entire National Soccer League final series for the 2002/2003 season yet broadcast only the grand final on its open broadcasting service out of the 31 finals matches protected for open broadcast under the anti-siphoning list.
- The Australian Broadcasting Corporation held all rights to the recent Netball World Championships held in Jamaica in July 2003 but only chose to broadcast two of the eight matches involving the Australian team.
- Sports Investments Australia Pty Limited (*SIA*), including the Fox Sports channels, which distributes a number of subscription television sports channels, was recently blocked from acquiring the rights to broadcast each race in the Formula One Grand Prix by Network Ten. The reason for this was that Network Ten was not willing to allow SIA to provide live coverage on the Fox Sports channels when Network Ten was only prepared to commit to providing delayed coverage of most races due to scheduling conflicts with its more popular programming. The unfortunate outcome is that Australian F1 fans miss

⁵² Key Findings of research and analysis undertaken by Fox Sports and audited and verified by Ernst & Young in April 2003.

⁵³ Fox Sports, Submission to the Australian Broadcasting Authority's Investigation- Review of the anti-siphoning list, April 2001.

out on seeing live coverage due to an open broadcaster acting in its commercial interests rather than in the best interests of the Australian viewing public.

- Regional open broadcasters, especially those in Western Australia and South Australia also often choose not to broadcast a listed event if it conflicts with their regular programming schedule. For example, Channel Nine's affiliate station in Perth, STW9, chose not to broadcast the Men's final of the US Open tennis tournament in 2002.
- Open broadcasters often own both the open broadcast and subscription television rights to many sporting events or are in a position to control how subscription television rights to these events are sold. For example, Seven has, but has not utilised or on-licensed, the Australian subscription television rights to the Australian Open Tennis, the Australian Open Golf and National Soccer League finals series.

Clearly, the anti-siphoning regime has been misused by the open broadcasters and national broadcasters and has failed to achieve its objective and consumers are suffering as a result. Rather than promoting the maximum number of sporting events for consumers (its intention), Australia's current anti-siphoning regime maintains the position of the established, incumbent open broadcasters at the expense of not only subscription television operators, but also consumers.

4.4 Impact on competition between open broadcasters and subscription television operators

The Commission has stated that competition between open broadcasters and subscription television operators to acquire sports broadcast rights is not as strong as it would be in the absence of the anti-siphoning provisions and that the provisions 'obviously limit' competition between open broadcasters and subscription television operators for the purchase of listed content⁵⁴. The Commission has also commented that anti-siphoning laws have restricted subscription television operators' ability to purchase attractive sports content that would be likely to increase the take-up of subscription television services⁵⁵.

⁵⁴ ACCC Report at 93.

⁵⁵ ACCC Report at 94.

FOXTEL agrees that the anti-siphoning regime has seriously limited the ability of subscription television operators to effectively compete with open broadcasters in relation to sports, restricted growth and take-up of subscription television and acted as a barrier to entry for potential subscription television operators.

It is well regarded that premium sports and movie content drives take-up of subscription television. On this basis, it is not difficult to understand how the subscription television industry has suffered as a result of the anti-siphoning regime. FOXTEL is concerned however with the Commission's 'dismissal' of the fact that subscription television operators have been restricted in being able to purchase attractive content as merely an 'incremental' increase in the significant barriers to entry that already exist in the subscription television sector⁵⁶. This dismissal is a cavalier and inadequate response to what are real issues facing the subscription television sector. The Commission has also placed insufficient emphasis on the fact that 'additional purchases would be likely to increase penetration'⁵⁷ for the benefit of consumers. Frankly, the Commission's opinion and conclusions ignore solid evidence often put before it over recent years.

FOXTEL also refers to the Commission's statement that the potential benefits of liberalising the anti-siphoning regime could be greater still if the Government accepted the Commission's recommendations that further legislative action is required to prohibit the Fox Sports channels being provided exclusively to FOXTEL. The Commission argues that this would allow subscription television competitors to include the Fox Sports channels in a package of services most suited to their customers⁵⁸. FOXTEL regards this recommendation as highly objectionable on a number of grounds. First, a requirement that FOXTEL not acquire the Fox Sports channels exclusively is effectively limiting the ability of FOXTEL to differentiate its sports offering from other subscription television providers. Second, such a recommendation illustrates the Commission's ignorance of the nature of the anti-siphoning regime as already restricting the subscription television industry's ability to acquire premium sports content compared to the open broadcasters.

⁵⁶ ACCC Report at 94.

⁵⁷ ACCC Report at 94.

⁵⁸ ACCC Report at 94.

Since the establishment of subscription television in Australia, open broadcasters have enjoyed a virtual monopoly over premium Australian sports footage and it is anomalous for the Commission to recommend that FOXTEL on-supply its premium sports content when it is the open broadcasters that have the strangle-hold on what is regarded as the most important sports content in Australia (indeed sports content of 'national significance'). The ACCC has not made any similar recommendations in relation to the open broadcasters that they 'on-supply' their sport content to each other. The ACCC has also inexplicably ignored FOXTEL's court-enforceable undertaking to supply the Fox Footy Channel and FOXTEL and Austar's undertakings to supply their service (including sport content) to infrastructure operators. FOXTEL discusses these issues in more detail in section 6 below.

The Government should amend Australia's anti-siphoning laws and introduce a dual-rights (as described below) regime as a matter of priority given the Commission's concern that access to premium sports content is a key driver of subscription television and its ancillary concern that new and existing network providers have had difficulty in accessing premium content including sport. FOXTEL believes that such a regime will have attendant benefits to consumers and will lower the barriers to entry to subscription television providers.

4.5 Dual rights

As a means of lessening the anti-competitive effects of the anti-siphoning regime, FOXTEL advocates the introduction of a regime for dual rights which ensures that open broadcasters only acquire open broadcast rights to listed events and subscription television participants only acquire subscription television rights to listed events – thus preventing one party from acquiring and hoarding all broadcast rights which will, in turn, facilitate national coverage of those listed events.

Ideally, a dual rights regime would commence concurrently with the reduction of the anti-siphoning list. The introduction of a dual rights system would ensure that the regulatory regime reflects and complements the actual market for the acquisition of broadcasting rights which is comprised of rights holders who own and control a variety of rights for multiple broadcast media. Under a dual rights legislative regime, rights holders will have greater access to open broadcast television and subscription television, thereby increasing consumer choice and ensuring that sports events of national and cultural significance are afforded national coverage on television.

The most important outcome of the introduction of a dual rights regime is that it returns the control of decision making to the sporting body by giving them the unfettered power to determine the best allocation of broadcast rights for its sport. Unfortunately, sporting bodies are precluded from making such decisions due to the operation of the current scheme.

FOXTEL is aware of concerns about the impact of a dual rights regime and uncertainty about whether open broadcasters will continue to broadcast events on the anti-siphoning list if such events are available to subscription television operators as well as open broadcasters.

FOXTEL regards such concerns as unfounded. In the United States and New Zealand where there is no anti-siphoning regime at all and there is a variety of premium sports available on open broadcast television. Such concerns ignore the incentive that open broadcasters have to maximise viewership (and therefore advertising revenue). Clearly, if an event is of 'national significance', consumers will want to view the programming and open broadcasters would be ignoring their customers (and forfeiting advertising revenue) if they did not show that content. It would not only be commercially ignorant for an open broadcaster not to televise an event on the anti-siphoning list but it would also be irrational. Further, sporting bodies will generally seek as much television exposure as possible on both open broadcast television and subscription television to maximise revenue and develop their sport. It is highly unlikely that in the Australian sports television market, a sporting body would constructively refuse to deal with an open broadcaster.

FOXTEL submits that its proposed 'dual rights' model presents a marked improvement on the current regime which is significantly flawed and has a number of anti-competitive effects.

4.6 Conclusion

FOXTEL supports the view that the anti-siphoning regime in its current form as set out in section 115 of Schedule 1 and Part 6 of Schedule 2 of the Broadcasting Services Act 1992 is anti-competitive and requires fundamental legislative reform⁵⁹. This is a view

⁵⁹ PC Report at 444 and ACCC Report at 92-93.

similarly held by numerous industry participants and statutory bodies in Australia including most recently the Commission⁶⁰.

Moreover, the operation of the anti-siphoning regime in Australia has been detrimental to rights holders. As the Productivity Commission noted, the anti-siphoning regime restricts competition for broadcasting rights, reducing returns to sporting bodies and to the community participating in these sports, to the benefit of the open broadcasters⁶¹.

FOXTEL submits that fundamental reform of the anti-siphoning regime is required. FOXTEL advocates the implementation of a shorter, more culturally and nationally relevant list and the introduction of a system of dual rights enabling both subscription television and open broadcast television to deal separately and directly with sports right holders.

Limiting the number of sports to which the open broadcasters have guaranteed access, and introducing a system of dual rights for those sports should ensure that the landscape for the acquisition of sporting rights is more competitive and better serves the interests of consumers. Further, FOXTEL submits that such changes will go to some extent to reducing the power of open broadcasters and increasing the ability of subscription television operators to compete against the open broadcasters in relation to sports programming.

5. Multi-channelling

5.1 Introduction

The Commission recommends that the prohibition on open broadcasters from multi-channelling be removed⁶². FOXTEL strictly opposes any relaxation or removal of the multi-channelling provisions on the basis that they have been fundamental to investment decisions already taken where capital has been deployed.

⁶⁰ PC Report, Chapter 12; ABA, Investigation into events on the anti-siphoning list: Report to the Minister for Communications Information Technology and the Arts, June 2001, Executive Summary; FOX Sports, Submission to the ABA; April 2001; Broadcasting Legislation Amendment Act (No. 2) 2001, Explanatory Memorandum.

⁶¹ PC Report at 444.

⁶² ACCC Report at 85.

FOXTEL notes that the Government was quick to reject the Commission's proposal of an early review of the number of commercial network television licences on the grounds that the incumbents require breathing space from further competition while spending up to \$1 billion on their requirement to convert to digital⁶³. However, FOXTEL finds it disconcerting that the Government did not at the same time rule out any change to the prohibition on multi-channelling, particularly in view of the proposed investment of the subscription television industry as part of full digital conversion.

Clearly, the prohibition on multi-channelling and the moratorium on new commercial television broadcast licences are complementary and provide certainty for industry participants. This is especially given that the policy issues surrounding new entry and the viability of new investment in the subscription sector are so similar to those applying to the moratorium on open broadcasters.

The prohibition on multi-channelling was imposed in 1998 to allow open broadcasters to use digital spectrum capacity at no charge for high definition television (*HDTV*) but not multi-channelling. This was done to ensure that subscription television operators were provided with sufficient investment incentives to continue to develop the sector and its services to consumers. Simultaneously however, the Government introduced legislation prohibiting the granting of any new commercial broadcast television licenses until 2007. This was done to protect open broadcasters from competition.

The Government has previously indicated that there would not be a review in relation to the prohibition on multi-channelling until 2005. The Explanatory Memorandum to the Television Broadcasting Services (Digital Conversion) Bill 1998 states at 16:

In 2005, there will be a statutory review into whether:

- all spectrum available for allocation has been identified and efficiently structured;
- legislative amendments should allow new commercial television entrants after 31 December 2008;
- legislative amendments should allow commercial television broadcasters to provide multi-channel and / or pay TV services using digital technology; and

⁶³ Senator Alston, Media Release entitled 'ACCC Report on Pay TV competition' dated 20 June 2003.

- a simulcast period longer than 8 years should be prescribed in regulations dependent on consumer take-up rates.

The Government's commitment to the prohibition against multi-channelling has underpinned and encouraged FOXTEL's substantial capital investment in its existing satellite roll out and also in the digital subscription television network. Any shift in Government policy at this stage would clearly compromise the subscription television sector, further entrench the domination of the open broadcasters without commensurate public benefits and seriously damage Australia's reputation in the global investment community. It would also further consolidate the position of the incumbent open broadcasters without commensurate public benefits and without any increase in competition. The Government should be consistent in its approach when it comes to this issue. FOXTEL is only asking that the same rules apply. It is apparent that the Commission treats the subscription television sector as a 'poor cousin' and applies differential treatment to the rules for capital deployment.

The Government should therefore resist the Commission's recommendation that the prohibition on multi-channelling be removed for a number of reasons including that it would:

- be inconsistent with the Government's proposal not to bring forward the prohibition on new commercial television broadcast licenses⁶⁴;
- undermine legislative policy;
- undermine the existing expenditure made by FOXTEL and others on the basis that there would be no review of multi-channelling until 2005;
- impact on FOXTEL's commitment to provide digital subscription television services;
- further entrench the domination of open broadcasters; and
- seriously damage Australia's reputation in the global investment community.

5.2 Legislative policy

The Commission's analysis of multi-channelling ignores the political context in which the prohibition on multi-channelling was introduced.

⁶⁴ Senator Alston, Media Release entitled 'ACCC Report on Pay TV competition' dated 20 June 2003.

In 1998, the Government constructed a digital broadcasting plan and legislated to allow the open broadcasters to use digital spectrum capacity (at no charge) for HDTV but not multi-channelling. The issue of multi-channelling was hotly contested at the time and it was proposed that the legislation should be reviewed in 2005.

The policy behind the prohibition on multi-channelling was introduced to ensure that there was 'competitive neutrality' between the commercial and national television broadcasting sector, the subscription television sector and other communications sectors⁶⁵. The Government acknowledged the need to provide investment incentives and protection to subscription television operators who had invested in and would continue to invest in the development of the digital television industry in Australia.

The Government stated in the Explanatory Memorandum to the Bill⁶⁶:

the prohibition on the provision of multi-channel/[subscription] TV services would ensure that the developing [subscription] TV sector is not unfairly disadvantaged by digital conversion of existing commercial and national television broadcasters.

At the same time, legislation was introduced prohibiting the granting of any new commercial television broadcast licences. This 'moratorium' was established to protect the open broadcasters from competition from subscription television operators.

The prohibition on multi-channelling was constructed to protect subscription television operators and the prohibition on new commercial television broadcast licenses was established to protect open broadcasters. FOXTEL submits that it is important that the Government acts consistently with its stated policies to ensure certainty for investors in Australia and that the review of neither prohibition should be brought forward.

However, the impact on the subscription television industry would be even greater if the Government were to remove the prohibition on multi-channelling but not the prohibition on the new commercial television broadcast licences. Such action would be anomalous, incongruent and unjustified. The Commission itself stated that the relationship between different regulatory policies means that the Government should consider legislative amendment comprehensively⁶⁷. The Commission also stated that unscrambling the regime should occur 'across the board' and not be limited to

⁶⁵ Television Broadcasting Services (Digital Conversion) Bill 1998, Explanatory Memorandum at 6.

⁶⁶ Television Broadcasting Services (Digital Conversion) Bill 1998, Explanatory Memorandum at 14.

⁶⁷ ACCC Report at 80.

individual changes. The Commission acknowledged in particular that it may be 'poor policy' to allow multi-channelling by open broadcasters using spectrum that the Government has loaned to them at the expense of not allowing new entry⁶⁸. The Government must ensure that any legislative action is consistent with, and acknowledges the policy behind, the introduction of those provisions.

Again, the Commission's recommendations in this regard ignore the impact which this significant regulatory change would have on FOXTEL's shareholder's incentives to make further investment in subscription television infrastructure. Importantly, this appears to be inconsistent with the Commission's charter in relation to telecommunications.

The current prohibition on multi-channelling should be retained and all participants should adhere to the specified statutory review timetable set for 2005. Multi-channelling and the prohibition on new commercial television broadcast licenses are complementary as they were introduced at the same time in order to afford protection to subscription television operators and open broadcasters respectively. As mentioned above, a mid-stream policy change to the current prohibition on multi-channelling would further consolidate the position of the open broadcasters without commensurate public benefits and without any increase in competition to open broadcasters. Accordingly, it would be inconsistent for the Government to make any recommendation that multi-channelling be allowed.

5.3 FOXTEL's digital commitment

As the Commission is aware, the FOXTEL shareholders are prepared to invest over \$600 million in the development of a digital cable network and expansion of its digital satellite service, provided that the regulatory and operating environment in which that investment is made remains certain and stable. If multi-channelling is allowed, FOXTEL's commitment to provide a digital service will fall away, a factor accepted by the Commission in November 2002⁶⁹.

⁶⁸ ACCC Report at 80.

⁶⁹ See FOXTEL's section 87B undertaking, clause 5.1 and definition of 'Regulatory Change'.

5.4 Multi-channelling would further entrench the domination of the open broadcasters

The introduction of multi-channelling prior to the 2005 timetabled review would undermine the investment made to date in subscription television, reduce the economic incentives for FOXTEL and other subscription television operators to continue investing in the industry in the future⁷⁰ and further tilt the balance of power in favour of the open broadcasters.

The potential concern from a subscription television perspective can be best illustrated by the following example. If open broadcasters were currently permitted to multi-channel in an unrestricted manner using their free spectrum, their ability to use the anti-siphoning regime to develop sophisticated multi-channel sports services would disadvantage the subscription television sector immeasurably at a very sensitive stage. The example used by the Commission as to how open broadcasters may choose to multi-channel highlights this⁷¹. The Commission states that if open broadcasters are allowed to multi-channel, they would use it to provide sporting channels. For example, the open broadcaster could show a key match (eg centre court match) of a tennis tournament on one channel and use the other channels to show other matches (eg matches with Australian players)⁷². This demonstrates the serious harm that the current anti-siphoning regime combined with the removal of the prohibition on multi-channelling would have on the ability of subscription television operators to compete against open broadcasters.

FOXTEL further submits that any change to the current prohibition on multi-channelling would consolidate the position of the incumbent commercial television broadcasters without commensurate public benefits and very much more importantly without any increase in competition given that there would be no new entrant participating in competition against the existing open broadcasters⁷³.

⁷⁰ Letter dated 15 July 2002 to Prime Minister the Honourable John Howard from Debra Richards, Executive Director, ASTRA.

⁷¹ ACCC Report at 82.

⁷² ACCC Report at 82.

⁷³ Letter dated 15 July 2002 to Prime Minister the Honourable John Howard from Debra Richards, Executive Director, ASTRA.

Some metropolitan commercial network television interests, and the regional commercial networks, have said publicly that they are strongly opposed to "free-to-air" multi-channelling because it would increase their operating costs and fragment their audiences without increasing their advertising revenue. It is logical, therefore, that if they are allowed to move into multi-channelling, the networks will seek to pay for it by eventually shifting to a subscription television model which would be of enormous concern to FOXTEL. Arguably, in a market of Australia's size, multi-channelling is only viable on a subscription model. Allowing the open broadcasters to multi-channel on a subscription basis would also severely negatively impact on the existing subscription television sector and would undermine Australia's "free-to-air" terrestrial television system. The open broadcasters were granted free use of digital spectrum for the provision of up to high definition digital services (*HDTV*) on a "free-to-air" basis that would be available to all Australians without charge. The open broadcasters, therefore, should not be allowed to use this spectrum to provide subscription services, particularly given that the subscription television industry must pay for "spectrum" by either investing in or licensing the use of cable or satellite.

The Commission has stated that 'no persuasive evidence' has been presented to date to indicate that removing the prohibition on multi-channelling would harm the open broadcast sector⁷⁴.

The serious risks to the wider television system of allowing open broadcasters to multi-channel were starkly highlighted in the United Kingdom with the recent collapse of ITV Digital, a terrestrial subscription multi-channelling service. ITV Digital lost more than one billion pounds and its failure has placed a major strain on the ability of its parent companies, Carlton and Granada, to perform their primary role of providing open broadcasters commercial television services.

In any case, the relevant consideration is not what effect multi-channelling will have on the open broadcaster, but rather the effect that removal of the prohibition on multi-channelling will have on the subscription television sector, particularly given that the prohibition was enacted in order to protect subscription television operators (rather than open broadcasters). Clearly, allowing open broadcasters to multi-channel will remove the investment basis which subscription television operators have been assured they will be afforded until at least 2005 (and have acted accordingly on). As discussed

⁷⁴ ACCC Report at 85.

in section 5.6 below, such a radical shift in policy will not only undermine FOXTEL's confidence in Australia's regulatory regime and undermine FOXTEL's investment in digital technology, it will also have a detrimental impact on Australia's reputation in the global investment community.

5.5 Open broadcasters should pay for any multi-channelling

If open broadcasters are eventually permitted to multi-channel, FOXTEL believes that incumbent commercial television broadcasters must be required to contribute financially in a significant manner for any use of the broadcasting service bands for multi-channelling as it transforms the application of the relevant spectrum. This requirement is consistent with the Government's requirement that open broadcasters pay for the use of any spare transmission capacity on their allotted digital transmission channels for datacasting services⁷⁵.

5.6 Investment in infrastructure

A mid-stream change in policy would seriously damage Australia's reputation in the global investment community by sending a message to Australian and international industry that it cannot rely on commitments given by the Government to encourage investment. This would be of particular concern in industries (such as the subscription television industry) which involve long term and substantial highly speculative capital investment.

5.7 Regulatory certainty

The Commission argues that there is a strong case for the Government to review the prohibition on multi-channelling by open broadcasters at this time rather than in 2005 because subscription television operators are currently considering digitising infrastructure and if subscription television operators are concerned about whether multi-channelling will be permitted, it would seem reasonable for the Government to consider the merits of legislative change now so as to assist subscription television operators to make investment decisions⁷⁶.

⁷⁵ Broadcasting Services Act 1992, Schedule 4, Part 2, clause 6 and Datacasting Charge (Imposition) Act 1998, which provides for the imposition of a charge in relation to the provision of datacasting services using residual transmission capacity on channels allocated for digital conversion: Explanatory Memorandum at page 2.

⁷⁶ ACCC Report at 84-85.

As explained above, FOXTEL's commitment to commence a digital subscription television service is conditional upon no 'Regulatory Change' occurring which includes 'allowing open broadcasters to multi-channel prior to January 2007 or provide subscription television services using the terrestrial broadcasting services bands'⁷⁷. Clearly, multi-channelling is considered to be a significant issue by FOXTEL. The Commission is well aware of the significance of multi-channelling as it accepted that FOXTEL be entitled to an 'out' to its digital commitment (a fundamental platform of the section 87B undertakings) if multi-channelling was allowed.

In addition, the Commission's argument that it would be best for industry participants to know the basis of the regulatory environment in which they compete now, so as to assist operators in making the best investment decision, does not hold true and it clearly ignores the fact that subscription television operators have already begun to invest in digital technology on the basis that open broadcasters will not be entitled to multi-channel until at least sometime after the review in 2005. This knowledge was fundamental to FOXTEL's investment for the roll-out of its existing satellite service since 1999.

5.8 Datacasting

The Commission notes that there are currently restrictions on the use of spectrum by open broadcasters. Open broadcasters are only entitled to use spectrum, which could otherwise supply broadcast television or similar services for datacasting (which includes news, financial and weather information, educational programs, interactive computer games, email and internet content and parliamentary broadcasts)⁷⁸.

The Commission states that it does not believe that the existing restrictions on the use of the datacasting spectrum have achieved their desired policy outcome of encouraging the provision of innovative services that are different from traditional broadcasting services⁷⁹ and argues that the content restrictions on datacasting be removed.

FOXTEL does not agree with the Commission that the restrictions on datacasting be removed. This may lead to open broadcasters having the ability (through a back-door mechanism) to provide additional open broadcast services which would undermine the

⁷⁷ FOXTEL Section 87B undertakings clause, 5.1 and definition of 'Regulatory Change'.

⁷⁸ ACCC Report at 86.

⁷⁹ ACCC Report at 86.

objective behind the prohibition on multi-channelling and the allied industry protection measure seen in the prohibition on new commercial television broadcast licences. Indeed, the Commission has acknowledged that the issue of datacasting and the restriction on the number of new commercial television broadcast licences are related and that removing restrictions on datacasting provisions would effectively allow a datacasting licence to closely replicate the service provided by existing open broadcasters⁸⁰. FOXTEL would further submit that datacasting is also related to the prohibition on multi-channelling.

As FOXTEL submitted in relation to multi-channelling, the industry requires certainty in terms of the regulatory regime and it would be inconsistent for the Government to remove the restrictions on datacasting.

5.9 Moratorium on additional commercial open broadcast licences

The Commission has stated that it is concerned about whether the current number of open broadcast licences is the most appropriate number of broadcasters and whether the current commercial open broadcasters are the most 'efficient' firms to supply open broadcast services.

The Commission has recommended that the moratorium on new commercial open broadcast television licences be brought forward. FOXTEL disagrees with the Commission in this regard as it would undermine the policy behind the prohibition on new commercial broadcast licences and it would be inappropriate to make a mid-stream policy shift of this nature. In any event, FOXTEL notes that Senator Alston has stated that 'the Government remains committed to maintaining the moratorium until December 2006 and will undertake a review of the moratorium at an appropriate time'⁸¹. For the same reasons of regulatory certainty as discussed in section 5.1 above, the prohibition on multi-channelling and timetable for review should remain. Any other action would favour the open broadcast community (which is already profitable) over the subscription broadcast community (which is not).

⁸⁰ ACCC Report at 86.

⁸¹ Senator Alston, Media Release entitled 'ACCC Report on Pay TV competition' dated 20 June 2003.

6. Access to content

6.1 Introduction

The Commission's recommendations in relation to access to content seek industry specific regulatory intervention on a scale without any local or international precedent. The Commission cannot point to any overseas regulatory precedent to justify its arguments to interfere with individual program licences. The Commission also ignores the impact it may ultimately have on investment decisions and the quantity and quality of programming provided to consumers. It is a breathtaking suggestion absent cogent objective analysis reliant on ideology rather than being real substantial evidence.

The Commission states that it has been difficult in the past for new network providers to obtain access to premium subscription television content based on existing market structures and exclusivity arrangements.⁸² The Commission regards sport (including FOX Footy and FOX Sports) and movies (Movie One and Showtime) as the key drivers of subscription television in Australia.

The issue of access to content has been the subject of discussion between industry participants and the Commission and other regulatory bodies in the past. The issue was considered at some length by the Productivity Commission in its 2001 inquiry into specific competition regulation in the telecommunications industry. The Productivity Commission found that the case for legislative intervention had not been made out at all.⁸³

Most recently, the issue of access to content was addressed by the CSA and the section 87B undertakings offered by FOXTEL, Optus and Austar and accepted by the Commission in November 2002. The arrangements contained in the CSA and the various section 87B undertakings substantially addressed the Commission's concerns in relation to access to content given that they were accepted and the transaction was allowed.

The Commission's Report does not have sufficient regard to the impact that the CSA and section 87B undertakings have already had and will continue to have in terms of access to content. It also inexplicably ignores the Productivity Commission's

⁸² ACCC Report at 98.

⁸³ Productivity Commission, Report, 'Pay TV and Regional Telecommunications (Chapter 17).

conclusions and rejection of its exclusive programming legislative model (which was the subject of careful appraisal by the Productivity Commission). The impact of these arrangements cannot be overlooked or underestimated in considering competition issues in the subscription television and other telecommunications industries. Any comprehensive analysis of the state of competition in the subscription television industry, particularly in relation to the issue of content, must have regard to the state of competition now and in the future as a result of those arrangements.

In these circumstances, a legislated content access regime would be an unnecessary and inappropriate interference with the economic rights of program suppliers and subscription television providers.

The imposition of a legislative obligation to open access to programming is unwarranted and is likely to have unforeseen consequences. As discussed previously, the subscription television industry is still developing and responding to investment interests and is yet to provide any return for investors. To date, \$8 billion has been invested in the industry and none of the subscription television operators have reached profitability. All operators (FOXTEL, Optus, Austar) have made, and continue to make, substantial losses.

Whilst the CSA will assist in the growth of the subscription television industry, penetration in Australia is still significantly lower than overseas markets. Industry penetration is only 22%⁸⁴ (cf: 84% USA⁸⁵, approximately 40% UK⁸⁶ and in excess of 40% in NZ) and the industry is still in the developing stages.

The industry is already subject to a high degree of regulation compared to the industry in overseas jurisdictions at the same stage of development. It is also subject to general competition laws which will ordinarily apply in relation to the acquisition of content.

In its superficial overview, the Commission does not properly consider the significant issues of compensation if existing contracts were to be overturned by legislative action.

⁸⁴ ABA Website, FAQ.

⁸⁵ ABN-AMRO, Global Media, Sub-sector analysis, January 2002 at 106.

⁸⁶Independent Television Commission, *ITC Multichannel Quarterly* – Q1 2003 (as at 31 March 2003).

6.2 History of exclusive programming

The Commission appears concerned that exclusivity is a market distortion and not the consequence of rational competitive behaviour, that is, that non-affiliated content suppliers would never choose to supply their programming exclusively as they are concerned to maximise distribution and revenue. Assertion does not make for proven analysis.

The Commission also appears concerned that the presence of exclusive contracts can lead to a market which takes on 'winner-takes-all' type characteristics with a 'vicious circle' under which the subscription television operator buys premium content under an exclusive licence, attracts a large number of subscribers by virtue of that content and the channel supplier wishes to continue to deal exclusively with that subscription television operator to obtain maximum exposure for its channels.⁸⁷

However, channel suppliers are concerned with maximising revenue, not just penetration, and often choose to license programming with a premium for exclusivity or minimum subscriber guarantees (MSGs) to any provider who is willing to pay them, not just the provider with the most subscribers. This is clearly demonstrated by the fact that in Australia, exclusive arrangements were entered into before the subscription television operators commenced operations and had any subscribers.

Exclusive programming was recognised by subscription television operators as the only way in which the start-up subscription television providers could build brand equity and attract subscribers in the emerging industry. Consequently, they were willing to pay high prices.

(a) Movies

The first subscription television providers, Optus Vision and Australis, both secured exclusive rights to movies from the major US movie networks - Optus Vision with Disney, Time Warner and MGM (The Movie Network) and Australis with Columbia, Paramount, Universal and Twentieth Century Fox (the Premium Movie Partnership or PMP). Optus wanted exclusive programming to sustain the 80% cable overbuild with Telstra Multimedia's cable.

⁸⁷ ACCC Report at 11.

When FOXTEL commenced its subscription television service in October 1995, it had to sub-license the PMP movies from Australis at an unsustainably high price. When Australis collapsed in 1998, FOXTEL took over the arrangement directly with PMP.

The MSGs required by the movie studios meant that it was necessary to appeal to and attract large numbers of subscribers which could only be done on the basis of exclusive programming. In addition, it was necessary to attract these subscribers to recover the large initial investment in the infrastructure necessary to provide subscription television.

In 1999, Optus renegotiated its minimum guaranteed price arrangement with The Movie Network on a non-exclusive supply basis, which meant that The Movie Network was able to supply content to other operators. However, the content could only be made available if the other operators in turn made their content available to Optus on comparable terms. This occurred last year with the CSA.

(b) Sport

The anti-siphoning regime ensures that open broadcasters essentially have the first right of refusal over the sporting rights on the anti-siphoning list and can acquire and even 'hoard' those exclusive rights. Open broadcasters (and separately and always the sports codes themselves) have been, and continue to be the 'gatekeepers' of major Australian sporting content.

Because so much popular sport is on the anti-siphoning list and open broadcasters have the exclusive ability to broadcast a great deal of popular sport live, it was considered necessary to enter into exclusive arrangements for sporting events not on the anti-siphoning list. Subscription television operators entered into exclusive arrangements with sports rights holders in order to compete with the open broadcasters on sport and differentiate their sport offerings. As with movies, Optus was amongst the first pay TV operators to enter into exclusive arrangements in relation to sport with SportsVision which held the subscription television rights to both the AFL and the ARL.

6.3 Landscape in relation to programming changing

However, as a result of the recent entry by FOXTEL and Optus into the CSA, the Austar arrangements and the section 87B undertakings given by the subscription television industry, the landscape of the industry in relation to the acquisition and supply of programming is now very different.

(a) Content Supply Agreement

In March 2002, FOXTEL and Optus entered into the CSA in order to address some of the issues in relation to the high content costs. Subscription television providers in Australia pay among the world's highest programming costs. For example:

- US subscription television costs are 31-38 c per \$1 of revenue
- [Confidential]
- [Confidential]

Under the CSA, FOXTEL granted Optus the right to carry all of FOXTEL's channels until 31 December 2010, subject to certain contractual restrictions which exist in relation to FOXTEL's sub-licensing of content.

This has strengthened Optus' program offering and allows Optus to further differentiate its service offering by including additional channels in tiers. In addition, Optus can bundle its subscription television offering with other telecommunications services to differentiate its service from FOXTEL's.

The Commission notes that under the CSA certain constraints were placed on Optus, including limiting its ability to determine channel positioning and acquire new premium subscription television content without ensuring it is also available to FOXTEL. The Commission notes that given these limitations, Optus now provides very similar services to FOXTEL, both in relation to price and non-price terms and conditions.⁸⁸ Optus does differentiate its service by having some additional channels in basic and some FOXTEL channels in different tiers to FOXTEL. Optus can also include additional channels as tiers as well as through bundling its subscription television services with other telecommunications services. Optus is also free to price the FOXTEL basic and

⁸⁸ ACCC Report at 113-114.

tiered services at its discretion and the pricing of its service in fact differs to FOXTEL's.

The limited tiering conditions are necessary given that FOXTEL is assuming most of Optus' financial programming liabilities and therefore needs to be assured of a revenue stream from Optus for the channels it is sub-licensing to it. Any legislation which would have the effect of undoing this arrangement would therefore not only have serious consequences for FOXTEL, but also Optus as it may relieve FOXTEL of the obligation to assume its programming liabilities. Issues of compensation inevitably arise in any such context.

(b) Austar channel sub-licensing arrangement

FOXTEL has also entered into a new channel sub-licensing arrangement with Austar under which it supplies a number of channels (including Showtime and Encore at subsidised prices) to Austar.

(c) Section 87B undertakings

Access to content has also changed (and will continue to change) by virtue of the section 87B undertakings which were provided to the Commission in 2002 by FOXTEL, Optus and Austar. The undertakings which relate to content relevantly include:

- **Shared Channels:** FOXTEL and Optus have agreed not to acquire the 'shared channels' exclusively (including Antenna, BBC World, Cartoon Network, CNBC, CNN, Disney, ESPN, National Geographic, RAI, Sky News, Sky Racing, TCM, TVSN and World Movies). This will enable independent operators to acquire those channels directly from the channel suppliers rather than through FOXTEL or Optus⁸⁹.
- **Movie Networks:** FOXTEL and Optus have agreed not to acquire the Movie Network channels exclusively (including Movie One, Movie Extra and Movie Greats) unless they are required to do so by the Movie Network or another party has bid for those rights exclusively⁹⁰.

⁸⁹ FOXTEL's section 87B undertaking, clause 7.1; Optus' section 87B undertaking, clause 3.1.

⁹⁰ FOXTEL's section 87B undertaking, clause 7.2 – 7.3; Optus' section 87B undertaking, clause 3.1, 4.1, 4.2.

- **PMP:** FOXTEL (at the expiry of its current arrangement with PMP in December 2007) and Optus have agreed not to acquire the PMP channels exclusively (Showtime and Encore) unless they are required to do so by PMP or another party has bid for those rights exclusively⁹¹.
- **FOX Footy:** FOXTEL will sub-license the AFL channel to all subscription television operators (including network providers and resellers) on terms and conditions which do not discriminate unfairly for so long as FOXTEL holds exclusive rights to the AFL and/or produces the Fox Footy Channel⁹².
- **Infrastructure operators:** FOXTEL and Austar have offered to license their subscription television service (including sport and movie channels) to cable, satellite and MDS infrastructure operators who request the service on certain terms and conditions. FOXTEL has also undertaken to extend this to ADSL operators in the event that FOXTEL commences supplying an ADSL service. FOXTEL currently provides its service to 2 cable infrastructure operators: TransACT and Neighborhood Cable⁹³.
- **Local Content:** FOXTEL and Optus have undertaken to spend a minimum amount per financial year on Australian programs which are produced by independent third parties⁹⁴.
- **Non-affiliated Channels:** FOXTEL has undertaken that at least 30% of channels in its Essentials (basic) package are non-affiliated channels to it or any of its shareholders. This was provided to address the Commission's concerns in relation to vertical integration between content providers and subscription television operators⁹⁵.
- **Price cap:** FOXTEL has undertaken to place a cap on the price of its basic package for a period of three years⁹⁶.

⁹¹ FOXTEL's section 87B undertaking, clause 7.4; Optus' section 87B undertaking, clause 3.1, 4.1, 4.2.

⁹² FOXTEL's section 87B undertaking, clause 10.

⁹³ FOXTEL's section 87B undertaking, clause 8 and Schedule 3; Austar section 87B undertaking, clause 3.1.

⁹⁴ FOXTEL's section 87B undertaking, clause 11, Optus' section 87B undertaking, clause 6.

⁹⁵ FOXTEL's section 87B undertaking, clause 12.

⁹⁶ FOXTEL's section 87B undertaking, clause 13.

(d) Different investment incentives

As a result of these arrangements, contrary to the Commission's assertions,⁹⁷ subscription television providers now have different investment incentives and it could no longer be argued that FOXTEL (or Optus or Austar) still have the incentive to withhold access to content. Indeed it is unfair and inaccurate to make any such assertion.

It is clear from the arrangements pursuant to the CSA and the various undertakings accepted by the Commission in relation to FOXTEL's, Optus's and Austar's content that subscription television operators are open to the concept of content sharing and the non-exclusive acquisition of content.

FOXTEL regards the Commission's comments as curious and an enormous oversight of the various arrangements which FOXTEL, Optus and Austar have put in place in the past year which clearly indicate that none of these operators have the incentive to withhold content. Indeed the operators have substantially transformed their businesses to accommodate such concerns.

However, there are limits to which operators should be required or obliged to supply or share content or the circumstances in which they should be allowed to acquire content exclusively and these are essentially commercial decisions. It cannot be the case that no programming can be acquired exclusively when other alternatives are available.

6.4 Current legislation and undertakings sufficient

Programming supply arrangements and facilities-based competition can be adequately dealt with by:

- the current legislative regime contained in Part IV of the Act which prohibits the misuse of market power (section 46) and contracts, arrangements or understandings which substantially lessen competition in any markets (sections 45 and 47);
- Part XI of the Act which regulates the misuse of market power in telecommunications markets;

⁹⁷ ACCC Report at 101.

- the current legislative regime contained in Part XIC of the Act which regulates facilities based competition in telecommunications markets; and
- FOXTEL's, Optus's and Austar's section 87B undertakings which are enforceable by law.

The Commission has stated that 'it may be difficult to show that exclusive content agreements have the effect of substantially lessening competition' and that in relation to section 46 'it may be difficult to prove that any program supplier has market power in pay TV and that they used that market power for a proscribed anti-competitive purpose'⁹⁸.

FOXTEL does not agree with these comments of the Commission in relation to the inadequacy of the existing provisions contained in the Act to regulate competition issues in the subscription television and related industries. In addition, FOXTEL notes that the Dawson Committee recently recognised that section 46 of the Act was adequate and did not warrant any amendment⁹⁹.

Similar provisions have been used in the US and the UK to deal with anti-competitive programming supply arrangements and conduct on the part of a monopolist. Any difficulty in establishing a case for intervention under Part IV of the Act simply demonstrates that the arrangements are not anti-competitive and should not be interfered with. It should not be used as an argument for further unnecessary intervention. These arrangements should not be in any different position in their treatment under the Act to arrangements in other industries. Moreover there is no such international precedent available from very much more mature markets that warrants any such action.

Further regulatory or legislative intervention in the subscription television industry would be inappropriate and detrimental as:

- the industry is still immature and developing and is yet to provide a return for investors;
- the industry is undergoing significant structural and market change as a result of the CSA and FOXTEL, Optus and Austar's undertakings;

⁹⁸ ACCC Report at 115-116.

⁹⁹ Dawson Committee, *Review of the competition provisions of the Trade Practices Act*, January 2003 (**Dawson Report**) at 88.

- FOXTEL is about to invest \$600 million in commencing its full digital services (subject to receiving its exemption), a significant investment which will have an enormous impact on the industry;
- exclusivity continues to break down in Australia as shown by the CSA and section 87B undertakings;
- all movies and sport are available to network providers to license either directly on a stand-alone basis from the channel suppliers (eg ESPN, Fox Footy, Movie One) or as a package from FOXTEL or Austar (eg Fox Sports, Showtime);
- there is an abundance of non-exclusive programming including movies, sport and general entertainment available to subscription television operators;
- there is a significant amount of programming content freely available overseas which is not yet currently supplied in Australia;
- penetration is still low by international standards;
- the industry is already highly regulated including by way of the most stringent anti-siphoning laws anywhere in the world; and
- it has not been demonstrated that access to content has foreclosed competition or otherwise acted as a barrier to entry or that this has caused a lack of investment in the subscription television industry.

The Commission has not taken sufficient account of these factors, or the extent to which the industry is likely to change (particularly in relation to access to content) as a result of the CSA and section 87B undertakings.

6.5 Not necessary to enshrine the 87B undertakings in legislation

The Commission has commented that the section 87B undertakings partially address the Commission's concerns in relation to access to content in the supply of broadband and telecommunications services, however the framework could be legislated to provide existing and prospective network providers with greater certainty¹⁰⁰.

FOXTEL does not believe that there is any need for the section 87B undertakings to be legislated for a number of reasons.

¹⁰⁰ ACCC Report at 111-112.

The undertakings in relation to content will apply for 7 ½ years. This is a considerable period of time during which the industry will significantly change. The Government should provide a sufficient period of time for the industry to settle before determining whether legislation is necessary, especially in light of the commencement of digital services. It is therefore not appropriate at this stage, nor is it foreseeable, that further legislative or regulatory changes will be required. In addition, any variation of the section 87B undertakings could only be with the Commission's consent under section 87B(2) of the Act. Whether or not legislation is necessary is more properly considered closer to the expiry of the section 87B undertakings and the market conditions prevailing at that time.

The Commission has also suggested there would be benefit in reviewing the pricing principles for the provision of the content¹⁰¹. FOXTEL does not believe that such an investigation is necessary at this stage. The undertakings were accepted by the Commission after a long period of analysis and have also been already accepted and implemented by new entrant TransACT. **[Confidential]** Any assessment of the underlying pricing should not be undertaken until sufficient time has elapsed to assess the impact of the undertakings. FOXTEL submits that this would be more properly done, if necessary, closer to the time the undertakings expire.

The section 87B undertakings clearly provide certainty and are enforceable. If the Commission believed the section 87B undertakings were being breached it could, and FOXTEL expects it would, apply to the Federal Court to enforce the undertakings as it has with other section 87B undertakings. The section 87B undertakings explicitly acknowledge the Commission's right to do so. If the Commission sought to enforce the undertakings, the Federal Court has wide scope and discretion in the orders it can make, including orders to pay the Commonwealth an amount or pay compensation to those who have suffered loss as a result of the undertakings being breached. Third parties could request that the Commission enforce undertakings and seek compensation on their behalf.

The undertakings themselves are also only the first step and once agreements are reached in relation to the supply of content, third party operators will have direct contracts with FOXTEL and Austar which can be privately enforced. Network

¹⁰¹ ACCC Report at 112.

providers or resellers who sub-license the Fox Footy channel from FOXTEL will also have the right to privately and directly enforce the license contract with FOXTEL.

Overseas experience shows that regulators have even accepted that *informal* undertakings are sufficient in the subscription television industry, particularly due to the dynamic and developing nature of the industry (as opposed to the formal undertakings FOXTEL, Optus and Austar have given pursuant to the Act).

For example, in the UK, Oftel accepted informal undertakings from BSkyB which are not directly enforceable. BSkyB's undertakings covered a range of issues including pricing, bundling, transparency of pricing in the bundled package, supply of programming, making available encryption technology on non-discriminatory terms and a published rate card. BSkyB deals with numerous independent access seekers on all these issues on a daily basis in accordance with these informal undertakings. Oftel did not feel it necessary to legislate these undertakings. The Commission itself notes this in its Report and comments¹⁰²:

An important lesson from the BSkyB undertakings is that regulatory intervention (even if not regulation *per se*) has helped establish structurally competitive pay TV and telecommunications industries in the United Kingdom.

This 'regulatory intervention' was based on informal undertakings and the general UK Competition Act, not any specific subscription television directed legislation. Similarly, the Commission notes in Europe that non-statutory undertakings have been accepted in relation to a number of mergers in this area.

There is no reason why Australia should be subject to a greater level of regulatory intervention. There is already even greater certainty in Australia as the undertakings given by FOXTEL, Optus and Austar are court-enforceable undertakings provided under legislation with serious consequences for breach. The Commission makes no case beyond its assertion as to such action. Indeed the assertion contradicts abundant evidence as to the satisfactory functioning environment and curiously, the Commission does not make any similar arguments in relation to the open broadcast sector either.

¹⁰² ACCC Report at 109.

6.6 Access to content – international access regimes

The Commission selectively refers to overseas jurisdictions as support for its model of extreme legislative intervention¹⁰³. In particular, the Commission refers to the specific content legislation introduced in the United States (*US*), the informal BSkyB undertakings in the United Kingdom (*UK*) and the non-statutory undertakings which the European Commission allowed in Italy and the Spanish Government allowed in Spain¹⁰⁴.

The Commission has, however, ignored the specific contexts in which those regimes exist / undertakings were given and has failed to acknowledge the key differences between the various operators in each of those industries.

FOXTEL does not believe that it is appropriate for the Commission to make reference to the access regimes in the US, UK, Spain and Italy as Australia's subscription television industry is unique and immature. FOXTEL submits that further regulation in the industry would de-stabilise the participants and is not warranted as there are major differences between the market conditions in the US, UK, Spain and Italy at the time the legislative regime or undertakings were imposed (the relevant time for comparison) and Australia (and there continue to be such differences). In addition, there were and continue to be major differences between the operators in each of those jurisdictions as compared to FOXTEL. The imposition of a 'must supply' obligation in Australia is inappropriate, unwarranted and likely to have unforeseen consequences.

For the reasons discussed in this section, FOXTEL does not believe that the subscription television industry in Australia warrants any further regulatory intervention. The section 87B undertakings provided to the Commission and accepted in November 2002 have only just been implemented and it would be premature for the Commission or the Government to recommend further structural change.

(a) United States

The Commission states that US legislation was specifically introduced to address issues in the US about access to content¹⁰⁵.

¹⁰³ ACCC Report at 108 – 110.

¹⁰⁴ ACCC Report at 108 - 110.

¹⁰⁵ ACCC Report at 108.

It is relevant to note that the US legislation (contained in section 628 of the US Communications Act 1934) only applies to cable subscription television operators and their vertically integrated program suppliers (with an attributable interest of more than 5%), where that programming is supplied by satellite to cable head-ends. The legislation was introduced in 1992, at a time when, due to the local franchising requirements and cable monopolies, cable operators had substantial market power in their geographic area and there was little, if any, competition between operators as a result. The legislation only applies to programming suppliers that deliver programming via satellite, not suppliers that deliver programming terrestrially¹⁰⁶. It is therefore a significantly more limited regime than the one which the Commission proposes.

FOXTEL submits that the US subscription television industry was at that time and is very different to the Australian subscription television industry and comparisons with Australia are not valid. The US subscription television industry was and is established, mature, competitive and lucrative. Subscription television in the US currently has a penetration rate of approximately 84%. In addition, Australia's level of vertical integration at approximately 20%¹⁰⁷ is much lower than the level of vertical integration in the US at the time the legislation was introduced (50-53%)¹⁰⁸.

The US situation is therefore clearly distinguishable from the Australian situation as there are no cable monopolies in Australia and subscription television operators in Australia face competition from other subscription television operators (particularly in metropolitan areas where there is substantial cable overbuild as well as satellite), the real threat of entry from new infrastructure operators (availing themselves of FOXTEL and Austar's content

¹⁰⁶ Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Eighth Annual Report, 2001 at para 162.

¹⁰⁷ Figure determined by dividing number of channels in Australia in which a subscription television operator holds a voting or non-voting interest of 5% or more (using the US definition of "attributable interest") of which FOXTEL is aware by the number of channels broadcast by subscription television operators in Australia.

¹⁰⁸ The FCC noted that the level of vertical integration was 50% in 1990 and 53% in 1994: FCC, First Annual Report: *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, at 161.

supply undertakings) and, most importantly, open broadcasters who are a significantly stronger competitive force in Australia than in the US.

(b) United Kingdom

The Commission recognises that in the UK, non-statutory undertakings have operated, as opposed to any form of legislative access to content regulation such as that proposed by the Commission¹⁰⁹. The Commission states that an important lesson from the BSkyB undertakings is that regulatory intervention (even if not regulation *per se*) has helped establish structurally competitive subscription television and telecommunications industries in the UK¹¹⁰.

In 1995 and 1996, the Office of Fair Trading (**OFT**) conducted a review of BSkyB's position in the wholesale programming market which resulted in BSkyB undertaking informally to publish a wholesale rate card detailing the rates at which it would supply its wholly-owned channels (3 movie, 3 sport and 4 other channels) to third parties on a channel-by-channel basis. The undertakings also restricted BSkyB's ability to force tiering and offer discounts. In 1999 and again in early 2001, the undertakings were amended to remove from them the 4 non-sport and non-movie channels as BSkyB was found not to have market power in relation to those other channels. However, in 2000, OFT commenced an inquiry into whether BSkyB was infringing the Competition Act 1998 in its wholesale prices. In December 2002, the OFT concluded that whilst BSkyB had a dominant market position, it was not in breach of the Competition Act¹¹¹.

FOXTEL submits that it would be inappropriate for subscription operators in Australia to be subject to a compulsory supply regime such as that agreed to by BSkyB in the UK in 1995 and 1996, as FOXTEL does not have market power in relation to the supply of premium movie and sport content.

There are a number of key differences between the market position of FOXTEL and the market position of BSkyB at the time the undertakings were provided by BSkyB in 1995 and 1996:

¹⁰⁹ ACCC Report at 109.

¹¹⁰ ACCC Report at 109.

¹¹¹ OFT, OFT concludes BSkyB investigation, Press Release, 17 December 2002.

- At the time the undertakings were provided in 1995 and 1996, BSkyB wholly-owned 10 channels, including 3 movie channels and 3 sport channels. Roughly 50% of viewing of non-territorial channels was of BSkyB owned channels¹¹². FOXTEL on the other hand only wholly-owns 7 channels (Fox 8, The History Channel, fx, thecomedychannel, Fox Kids/Fox Classics, Fox Footy Channel, Fox Footy Extra) none of which are wholly dedicated movie channels and only 2 of which are sport channels. Only approximately 17.5% of subscription television viewing is of these channels¹¹³.
- At the time the undertakings were provided in 1995 and 1996, BSkyB had exclusive long term contracts with all the major Hollywood studios except one, giving them rights to over 90% of first run major films on an exclusive basis with no available substitutes for premium movie channels. FOXTEL does not own any movie channels and only licenses approximately 50% of available Hollywood movies on an exclusive basis (the PMP channels). The remaining 50% of first run Hollywood movies are available to license directly from the channel supplier (The Movie Network). In addition, FOXTEL has undertaken not to acquire the PMP channels exclusively after 2007 and has undertaken to license its entire service (including the PMP channels) to infrastructure operators.
- At the time the undertakings were provided in 1995 and 1996, BSkyB had long term broadcasting rights for many major sporting events and the only alternative premium sports channel aside from the BSkyB owned channels was the Racing Channel. In Australia, FOXTEL only owns the Fox Footy Channel and Fox Footy Extra Channel which it has undertaken to supply on a stand-alone basis to subscription television providers. In addition, there are other alternatives available for license

¹¹² OFT Report, *The Director General's Review of BSkyB's Position in the wholesale Pay TV market*, December 1996 at para 4.49 at 36-37.

¹¹³ FOXTEL's average share of total subscription television viewing, 31 March 2002 – 29 March 2003. Note that this amounts to only approximately 8.75% of total television viewing as opposed to subscription television viewing time.

directly from the channel supplier, including ESPN (as a result of FOXTEL and Optus' undertakings), the most popular sport channel worldwide and Sky Racing. Further, FOXTEL has also undertaken to license its entire service (including the Fox Sports Channels) to infrastructure operators.

- Australia's anti-siphoning regime means that the open broadcasters in Australia are a much stronger competitive force (indeed they dominate sports content) for the acquisition of sporting rights in Australia than in the UK. For example, there are 40 events on Australia's anti-siphoning list and there are only 10 in the UK. In addition, the UK has a dual rights regime which means that subscription television operators in the UK have better access to premium sports content than subscription television operators do in Australia.
- FOXTEL's section 87B undertakings are court enforceable as opposed to the BSkyB undertakings which do not have such status.

FOXTEL also submits that there are many key differences between the UK and Australian subscription television industries which highlight the inappropriateness of comparison between the two industries. For example, the UK industry was, at the time the undertakings were imposed, and still is, developed and profitable compared to Australia. Since the undertakings were given, BSkyB has introduced digital, interactive services. As previously mentioned, the current UK penetration rate is approximately 40%¹¹⁴ compared to Australia's 22%¹¹⁵.

(c) Spain

The Commission also refers to fact that the Spanish Government recently allowed the merger of the two subscription television networks in Spain¹¹⁶.

In November 2002, the Spanish Council of Ministers approved the merger between Sogecable and Via Digital, the two companies which manage Spain's

¹¹⁴ Independent Television Commission, *ITC Multichannel Quarterly* – Q1 2003 (as at 31 March 2003).

¹¹⁵ ABA Website, FAQ.

¹¹⁶ ACCC Report at 110.

two leading digital subscription television platforms. The company resulting from the merger will be controlled by the following entities¹¹⁷:

- Sogecable, Canal Plus (a subsidiary of Vivendi Universal) and PRISA (the main Spanish multimedia group); and
- Telefonica, Spain's telecommunications incumbent, which is the main stakeholder of Via Digital.

The new company, Sogecable, is estimated to serve 2.5 million digital homes and more than 80% of subscription television subscribers¹¹⁸.

It has been stated that the merger was justified 'given the tough conditions facing all European television operators and the heavy losses incurred by both Sogecable and Via Digital'¹¹⁹.

The Government allowed the merger on the basis of 34 conditions following the non-binding opinion of the competition authority, the Tribunal de Defensa de la Competencia (Office for the Protection of Competition, *TDC*).

In summary, the undertakings, which will apply for a period of 5 years¹²⁰:

- prevent the cost of the merger from being passed on to current subscribers;
- impose price controls on the new platform for the next four years;
- restrict the length of the contracts that Sogecable may sign with Hollywood Majors or with Spanish soccer clubs;
- prohibit Sogecable from acquiring exclusive rights for the transmission of premium content via UMTS or ADSL;
- prohibit Sogecable from reaching strategic agreements with Telefonica's subsidiaries or to benefit them when selling content in order not to

¹¹⁷ Alberto Perez Gomez, Government's Conditional Approval of Merger of Leading Digital-TV Platforms (2003) at 1.

¹¹⁸ Ibid.

¹¹⁹ Ibid.

¹²⁰ Ibid.

strengthen the dominant position of Telefonica in neighbouring electronic communications markets;

- force Sogecable to allow third parties to distribute its theme-specific channels;
- prohibit Sogecable from acquiring the exclusive rights to channels produced by the largest US studios or international producers;
- oblige Sogecable to grant independent programmers access to its platform under reasonable, transparent and non-discriminatory conditions.

As the Commission stated, the main undertakings are that Sogecable must waive its pre-emptive broadcasting rights for films and sporting events and its exclusive broadcasting rights with the major film studios¹²¹.

These undertakings are similar in many respects to the types of undertakings provided by FOXTEL, Optus, Austar and Telstra in relation to the CSA last year. However, while the undertakings imposed in Spain related to a merger giving the merged entity 80% of the market, the FOXTEL/Optus arrangement was not a merger but a supply arrangement between two competitors, designed to strengthen their ability to compete with each other. The breadth of the undertakings given by FOXTEL and Optus were appropriate in that context, and extending them further, to be comparable with a jurisdiction where there is a provider with 80% of the market, is inappropriate and will serve only to stifle the development of subscription television in Australia.

There are also other differences between the subscription television sector in Australia and the more mature Spanish sector. In particular, similar to the US, the sector in Spain was subject to early regulation and the country was divided into geographic areas with up to two 'concessionaires' entitled to provide services (eg cable TV, internet access and voice). One concessionaire was reserved for Telefonica and the other was for tender. In addition, the Spanish market is more developed (having been introduced in the early 1990's) and offers some digital and interactive television which Australia does not have in metropolitan areas.

¹²¹ ACCC Report at 110.

(d) Italy

The Commission also refers to the merger of two Italian subscription television operators which gave the merged entity more than 2/3 of the market¹²².

The European Commission recently cleared the acquisition by Newscorp of the Italian subscription television company, Telepiu from Vivendi Universal. Telepiu will be merged with Stream, the other subscription television company in Europe which is a 50/50 joint venture of Newscorp and Telecom Italia.

It has been stated that Telepiu and Stream have never been profitable and that programming costs have always exceeded revenue¹²³. In addition, the strong presence of 12 national free-to-air broadcasters in Italy has had an impact on the rate of penetration of subscription television in Italy and consequently its profitability. Newscorp argued that Stream would inevitably exit the market in the event of the merger being blocked and invoked the 'failing company defence'¹²⁴.

The European Commission stated in its media release that it had taken account of the chronic financial difficulties faced by both companies, the specific features of the Italian market and the disruption that the possible closure of Stream would cause to Italian subscription television subscribers¹²⁵.

The European Commission was concerned to ensure that sufficient and adequate conditions were imposed on the merged entity to ensure that the market remained open¹²⁶. The European Commission stated that it was necessary in order for competitive constraints to materialise, that premium content which drives subscription television such as blockbuster movies and football matches be accessible in the future¹²⁷. There was also a concern that Newscorp would become the 'gatekeeper' of satellite services.

¹²² ACCC Report at 110.

¹²³ European Commission, *Commission clears merger between Steam and Telepiu subject to conditions*, 2 April 2003 at 2.

¹²⁴ Ibid.

¹²⁵ Ibid.

¹²⁶ Ibid.

¹²⁷ Ibid.

In summary, the key undertakings (both structural and behavioural) provide that¹²⁸:

- Newscorp will waive exclusive rights in relation to content for blockbuster movies, football matches and other rights for non-satellite transmission;
- Newscorp will provide premium content to non-satellite competitors by means of a wholesale offer based on a retail minus principle;
- rights owners will be able to unilaterally terminate ongoing contracts (with no applicable penalty) with the merged entity and future contracts will be limited in the future (2 years for football clubs and 3 years for film producers);
- Newscorp will not 'black out' second window movie rights (the rights relating to the delayed and cheaper release of blockbuster movies on subscription television);
- Newscorp will grant satellite competitors access to its own platform and will offer all related services on fair and reasonable conditions;
- Newscorp will grant licences for its proprietary conditional access technology to all applicants on a fair and non-discriminatory basis;
- Newscorp will be obliged to enter into simulcrypt agreements within nine months from the request by competitors willing to adopt a CAS technology other than one owned by Newscorp; and
- Newscorp will divest Telepiu's digital and analogue terrestrial broadcasting activities.

Again, a number of the undertakings provided by Newscorp to the European Commission in Italy are similar in nature to the undertakings provided by FOXTEL, Optus, Austar and Telstra to address the Commission's concerns arising out of the CSA in November 2002. However, it would be inappropriate to further extend FOXTEL's undertakings as the context in which Newscorp's undertakings were given is substantially different, namely to effect a merger in

¹²⁸ Ibid.

which the merged entity would control in excess of 2/3 of the market¹²⁹. As discussed above, the context in which FOXTEL's section 87B undertakings were offered was not a merger but an agreement between competitors in an attempt to improve the nature of their competitive offerings and to address concerns about the long term viability of the subscription television industry in Australia.

It is also necessary to distinguish the Italian industry from the Australian industry as the merger between Telepiu and Stream created a monopoly subscription television supplier in Italy¹³⁰. It is also important to note that Italy's anti-siphoning regime is far less restrictive than that which exists in Australia¹³¹. Italy has 7-8 events on its anti-siphoning list compared with the 40 events on Australia's list. In addition, Australia's list includes a number of 'competitions' as events whereas the Italian list applies to 'occurrences' such as football finals and matches involving national teams¹³². Accordingly, it would not be appropriate to require FOXTEL to provide undertakings to the Commission similar to those which NewsCorp provided to the European Commission in relation to sports content as the open broadcasters and sports rights holders hold the market power for sports content in Australia.

The Italian subscription television market can be further distinguished from the Australian subscription television market in a number of ways. The most obvious difference is the fact that Italian subscription television has to date been essentially limited to satellite transmission¹³³ whereas Australia has substantial cable overbuild. In addition, digital and interactive television is already operating in Italy, which is a relatively developed market (operating since 1991) however the Australian industry is immature and Australian operators have not yet been provided with sufficient investment incentives to commence digital or interactive services.

¹²⁹ ACCC Report at 110.

¹³⁰ European Commission Decision, NewsCorp/Telepiu, April 2003 at 43.

¹³¹ *Id* at 39.

¹³² *Id* at 39.

¹³³ *Id* at 25.

(e) Conclusion

It is clearly inappropriate to make comparisons between the access to content regimes in the US, UK, Spain, and Italy as there were (at the time of the various undertakings) and still are key differences between those industries and the Australian subscription television industry. Subscription television in Australia is immature and none of the operators have reached profitability (unlike the US and the UK).

In addition, the various undertakings and legislative regimes which operate in other jurisdictions must be regarded in light of the particular context in which they were given and it is dangerous for the Commission to recommend that similar legislative regimes or undertakings be given by FOXTEL. The legislative regime in the US and the undertakings provided by BSkyB in the UK, Sogecable in Spain and Newscorp in Italy were given in particular contexts and are not the sort of highly intrusive, wide reaching statutory form of regulation that the Commission is proposing. FOXTEL submits that the section 87B undertakings which it provided in November 2002 are adequate to address the Commission's concerns and no further regulatory intervention is required.

6.7 ACCC recommendations regarding legislation for premium programming

The Commission has made four main recommendations in relation to content regulation for premium programming¹³⁴ :

- a non-exclusive measure prohibiting rights holders and channel suppliers from entering into exclusive content agreements to supply premium subscription television content rights and requiring non-discriminatory on-supply (or limiting the length of time channel suppliers can acquire subscription television content rights exclusively);
- a non-exclusive measure prohibiting channel suppliers and subscription television operators from entering into exclusive content agreements to supply premium subscription television content and requiring non-discriminatory on supply by channel suppliers;

¹³⁴ ACCC Report at 116-117.

- an access to content measure on subscription television operators to provide access to exclusively contracted premium subscription television content (as separate channels) to competing network providers and to do so on non-discriminatory terms and conditions; and
- a re-transmission measure on subscription television operators who have exclusive content agreements for them to supply their subscription television content, as it is packaged for sale to their own consumers, to competing network providers and to do so on non-discriminatory terms and conditions.

FOXTEL deals with each of these recommendations in turn. First, however, it is important to note that any legislation requiring subscription television operators to acquire content on a non-exclusive basis or a requirement to on-supply content will mean that FOXTEL's commitment under the section 87B undertakings to commence a digital service will fall away.

The Commission is well aware of this as it accepted the section 87B undertakings which specifically state that FOXTEL's commitment to provide a digital service is conditional upon there being no 'Regulatory Change' which includes, amongst other things:

- preventing providers of subscription television services (or any one of them) from acquiring subscription television rights or subscription television rights to television programs or channels (other than rights, programs or channels consisting predominantly of movies) on an exclusive basis; and/or
- requiring providers of subscription television services (or any one of them) to supply subscription television programs or channels to other providers of subscription television services.

As such, if the Government imposed a legislative regime restricting the ability of operators to acquire programming exclusively (other than in relation to movies) or imposed a legislative regime requiring operators to supply content to other providers, then FOXTEL's commitment to provide digital subscription television services will fall away.

The Commission suggests that it is likely that FOXTEL has sufficient incentives to digitise its network even if content access regulations are introduced and that the Commission therefore does not believe these provisions should stop the Government

from introducing legislation for a legislated access to content regime.¹³⁵ Two things need to be said about the Commission's comments.

First, the fact that the Commission accepted the introduction of such legislation as a carve-out of the commitment to go digital, a crucial underpinning of the section 87B undertakings, including the digital access regime, demonstrates that it accepts that such legislation would have a significant impact on FOXTEL and would undermine the current regulatory environment in which the FOXTEL partners are prepared to make the huge digital investment.

Second, despite the Commission's assertions, the Government can have no confidence or certainty that FOXTEL will digitise if such legislation is passed and it no longer has any regulatory certainty. As the Government knows, the FOXTEL partners are not prepared to commit to fully digitising its platform without certainty. FOXTEL's partners initially wished to obtain certainty through the Government before committing to commence a digital service. In the course of the discussions last year over the CSA, the FOXTEL partners agreed to rely on the proposed Part XIC amendments and seek an exemption from the Commission, rather than pursuing discussions with the Government. There was initially some resistance to this course from the shareholders as regulatory certainty was such an important pre-condition to going digital.

If such content legislation is introduced, there can be no guarantee that shareholder support will still be there.

Implicit in what the Commission says at page 116 of the Report about exclusive programming arrangements is that the Commission would not be able to prove the 'purpose' element that is required under section 46 of the Act. This means that the Commission believes that a court would accept the legitimate business reasons put forward by FOXTEL and the subscription television industry in relation to their exclusive and other programming decisions. Notwithstanding this implicit acknowledgement of the commercial and legitimate rationale, the Commission is seeking to intervene in individual contracts in order to achieve some unsubstantiated wider industry re-structuring. This approach is unusually adventurous.

Having said that, FOXTEL now turns to whether there is any need for the type of legislation the Commission has advocated.

¹³⁵ ACCC Report at 132.

(a) Non-exclusivity measure for rights holders

The Commission's first recommendation is that legislation be enacted prohibiting rights holders and channel suppliers from entering into exclusive content agreements to supply premium subscription television content to channel suppliers or subscription television providers and requiring non-discriminatory terms of supply.

FOXTEL notes that the Commission has concluded that such a measure would not be appropriate at this stage nor would it result in an efficient or effective outcome. The Commission states that if rights holders had to supply their rights to multiple channel suppliers this could lead to the creation of multiple channels with the same content, making it difficult to control quality. In addition, achieving on-supply on the basis of non-discriminatory terms and conditions would be extremely difficult and limiting the length of time for exclusive agreements with channels suppliers may not be effective¹³⁶.

FOXTEL agrees with the Commission's comments. Such a measure would be an extreme imposition on the commercial discretion of rights' holders.

(b) Non-exclusivity measure for channel suppliers/subscription television operators

It would similarly be inappropriate to place a restriction on the ability of channel suppliers to provide programming on an exclusive basis. As discussed above, channel suppliers may choose to license their product exclusively for a number of reasons, including to maximise revenue (not just penetration) by seeking a premium for exclusivity or because they prefer to associate their brand with a particular subscription television operator. Legislation such as that suggested by the Commission would severely restrict the rights of channel suppliers to extract the maximum value and revenue from their channels and hence what they could pay rights holders for their rights.

The decision whether programming or channels should be licensed exclusively should be left in the domain of the program/channel producers. Channel suppliers should be entitled to retain the commercial discretion to provide content (including premium content) to whomever they choose and should be

¹³⁶ ACCC Report at 117.

entitled to charge a premium for the supply of content on an exclusive basis. Legislation by way of mandated on-supply will limit channel suppliers' freedom to contract, amounting to a 'must supply' of their programming to any subscription television provider.

It is an unreasonable interference with commercial arrangements to impose on channel suppliers a condition that they cannot discriminate between competing subscription television providers on the price and terms of supply. This is a normal feature of commercial relationships. It would also be very difficult to enforce such legislation against suppliers based outside of Australia. The general prohibition on price discrimination has long been taken out of the Act and is dealt with under sections 46 and 51AC of the Act. No case has been made out as to why subscription television should be placed in any different position to other essential (ie non-discretionary) services supplied under the Act.

FOXTEL therefore submits that legislation restricting channel suppliers from supplying programming exclusively will not increase competition for programming but in fact decrease it, as one element in the bidding that would be eliminated, would be exclusivity. It is always up to the channel supplier or programming rights holder whether or not to license exclusive rights. Forcing channel suppliers to supply on a non-exclusive basis will reduce the options to channel suppliers when licensing those rights. The decision whether rights should be licensed exclusively should be left in the domain of the rights holders.

Legislative intervention of this nature would also materially diminish the ability of subscription television channel providers to compete with their main rivals for programming – open broadcasters – as their services would be less attractive to operators due to the exclusivity prohibition and therefore less likely to extract the same licence fees. It would further entrench the market position of the open broadcasters who would, interestingly, not be subject to any such restriction. This would be particularly the case for sport as the open broadcasters already have an advantage in acquiring programming under the anti-siphoning legislation and there are numerous examples of the open broadcasters acquiring subscription television rights to sporting events and then "hoarding" those rights (see section 4 above). Such an outcome would

highlight the differential treatment of open broadcasters and subscription television operators.

The Commission's recommendations on access to content legislation therefore have the potential to reduce the number and quality of subscription television programs offered to consumers by reducing incentives to invest in such programming. Maintaining property rights in programming and allowing a program or channel provider to license those rights exclusively may allow a program provider to obtain greater revenue for its service, which in turn, can be invested in new content. Similarly, subscription television providers may benefit from having some exclusivity in their channels, allowing them to differentiate their offerings and provide greater choice to consumers. Rather than being a 'vicious' cycle as described by the Commission¹³⁷, FOXTEL submits that some level of exclusivity (where there are other alternatives, as there are here) is in fact a 'virtuous' cycle reinforcing investment incentives and consumer benefits.

It should be emphasised that the Productivity Commission considered the issue of access to content before the CSA and section 87B undertakings (which largely address these issues) were accepted. The Productivity Commission rejected the Commission's model then on the basis that no case was made out for legislative intervention. FOXTEL submits that nothing has changed in the quality or rationale of the Commission's arguments since that time except that the CSA and the section 87B undertakings substantially transformed the operating landscape and this is given scant regard by the Commission.

Non-exclusive programming legislation is not required in light of recent industry developments, including the section 87B undertakings, dealing specifically with exclusivity in relation to certain channel supply arrangements, and the already heavily regulated nature of the subscription broadcasting sector. This demonstrates the structural shift away from the exclusive supply of programming, particularly in movies and sport, which is the Commission's principal concern.

(c) Access to content measure on subscription television operators

¹³⁷ ACCC Report at 11.

The Commission recognises that there would be costs involved in breaking exclusive content supply agreements and that this may have commercial implications for channel suppliers and subscription television operators¹³⁸. It therefore suggests that an interim measure would be to force subscription television operators to provide access to exclusively contracted premium subscription television content to competing network providers on non-discriminatory terms and conditions¹³⁹.

The existence of some exclusivity between both subscription television providers and channel providers is pro-competitive in certain circumstances as it enables a subscription television provider to differentiate its service and consumers are offered more choice and diversity of programming. Such legislation would also undermine subscription television operators' incentives to invest in new programming to create diverse offerings, if they were to be denied the opportunity of maximising return from that programming by retaining it exclusively. A number of channels would not have been launched without investment by FOXTEL due to the reluctance of channel providers to invest in new, untried programming, e.g. UKTV, thecomedychannel and fx.

Curiously, it has never been suggested by the Commission that the open broadcasters should be subject to such a regime, despite the fact that they almost always license programming exclusively and even enforce significant holdbacks against the subscription television providers. It would be absurd if Nine was forced to give access to the "Friends" program to Seven or the ABC. Similarly, a degree of exclusivity for subscription television providers to build their brand and differentiate their content should not be prohibited.

If subscription television channel providers were not able to acquire some programming exclusively, or were forced to on-supply any such programming, this would dilute the value of their services and decrease their bargaining power to bid for programming as against the open broadcasters.

¹³⁸ ACCC Report at 112.

¹³⁹ ACCC Report at 120 and 122.

In particular, the channels/programming the Commission singles out as needing to be subject to either the non-exclusivity measure discussed above or the access to content measure are¹⁴⁰:

- Fox Sports
- Fox Footy
- PMP 'Showtime'
- Movie Network 'Movie One'

As detailed in section 6.3(c) above, FOXTEL has in fact undertaken to supply the Fox Footy channel to all subscription television operators on a stand-alone basis on terms which do not discriminate unfairly between persons so supplied. Any dispute relating to the terms and conditions is subject to expert determination. FOXTEL therefore sees no need to legislate to deal with the Fox Footy channel and is genuinely puzzled by the suggestion which flies in the face of logic. For the reasons discussed in section 6.5 above, a court-enforceable undertaking should be sufficient and further legislative intervention should not be considered until such time as the undertaking expires in which case the state of the industry will need to be thoroughly examined. FOXTEL already supplies the Fox Footy channel to Austar, Optus and Neighborhood Cable and is in discussions to license it on a stand-alone basis to TransACT.

Similarly, while FOXTEL has not undertaken to sub-license the Showtime and Movie One channels, FOXTEL has undertaken not to acquire those channels exclusively (in the case of Showtime once FOXTEL's current agreement with PMP expires at the end of 2007) unless required to do so by the Movie Network/PMP or another party has bid for those rights exclusively. Optus has also given a similar undertaking. Movie One is therefore currently available for subscription television operators to license directly on a non-exclusive basis, as Neighborhood Cable does in relation to its service. Whilst Showtime will not be available to license on a stand-alone basis until the end of 2007, it is available to infrastructure operators to license as part of the FOXTEL service.

Similarly, FOX Sports is now available to infrastructure operators to license as part of the FOXTEL service. ESPN (the most popular sporting channel

¹⁴⁰ ACCC Report at 120.

worldwide) is also available to license directly from the channel supplier pursuant to FOXTEL and Optus' undertakings, as Neighborhood Cable does. The flexibility that infrastructure operators are given in order to offer competitive services and differentiate themselves from FOXTEL is discussed further in 6.8(a) below. It cannot be the case, however, that no exclusive programming is allowed when there are a number of options for competing subscription television operators in terms of access to content.

If FOXTEL was forced to license both Showtime and PMP to rival operators on a stand-alone basis this would seriously undermine FOXTEL's business, which is built on a different basis to infrastructure operators as FOXTEL's sole source of revenue is from subscription television (whereas infrastructure operators have recourse to revenues from telecommunications services). Programming is FOXTEL's core business whereas other operators provide subscription television services as a part of their overall business eg by way of bundled product and can cross-subsidise those services. FOXTEL makes an extremely small margin on these channels and any wholesale model in which it is required to supply Showtime and Fox Sports as stand alone offerings to infrastructure providers will compromise the margins it receives from the basic service. This would push a currently below break-even business into an assured continuing loss position.

Such a requirement would go beyond that necessary to address the Commission's concerns regarding access to content and would be without comparable regulatory precedent anywhere at all. An infrastructure operator would be able to supply the subscription television package at cost or even marginally above cost as the subscription television service will be bundled with other telephony and broadband services and the infrastructure provider will be able to allocate its fixed costs to those other services. If the infrastructure operator has no variable costs, they could recover the revenue through other sources and forgo the margin on basic to provide cheaper movies and sport. FOXTEL believes in these circumstances, there is a risk of significant subscriber churn and it would be very concerned that it would lose revenue and margin from its basic service.

The Commission has dismissed FOXTEL's concerns in its report on the basis that the network providers who may provide a smaller, cheaper package are

likely to only serve a relatively small number of customers on a limited geographical basis as a network provider would be unlikely to choose to deploy another broadband network in the same areas as the HFC cable networks of Telstra and Optus. In addition, the channel suppliers would be required to on-supply the channels to FOXTEL and others at the same price, taking into account factors such as the number of subscribers¹⁴¹.

FOXTEL rejects the Commission's response to this issue. FOXTEL does not see on what basis the Commission can say that it will only have a limited impact on FOXTEL. FOXTEL has not yet made a profit based on the current number of subscribers, and is striving to drive penetration and reduce churn further. Any impact on this level of penetration and churn would be significant. In addition, the Commission seems to assume that FOXTEL will only receive competition from cable operators, whereas there is also potential for new entry on satellite, which has a much broader reach. It is also very unclear how channel suppliers will be forced to price their service. Given the extremely high content costs currently, such a requirement would not seem to modify the existing concerns.

Such a drastic measure is not, in any case, necessary. FOXTEL does not believe that lack of access to Fox Sports and the PMP channels on a stand-alone basis limits the ability of network providers to offer a product best suited to their customers¹⁴². As discussed above and in section 6.8 below, pursuant to the section 87B undertakings, network providers now have a number of alternatives in accessing premium content. Put simply, what the Commission proposes is not justified in its analysis which is, in any case, commercially flawed and is without regulatory precedent anywhere including in markets that are much less rigid than Australia and very much more commercially mature.

¹⁴¹ ACCC Report at 124.

¹⁴² ACCC Report at 113.

(d) Re-transmission measure on subscription television operators

Finally, the Commission has recommended that a re-transmission measure would be appropriate to force subscription television operators who have exclusive agreements to supply their subscription television content, as it is packaged for sale to their own consumers, to competing network providers and to do so on non-discriminatory terms and conditions.

This would be similar to the current section 87B undertaking; however, the Commission has suggested that there is a need to provide network providers with greater certainty and as such recommends that the section 87B framework needs to be legislated. The Commission also suggests that there would be a benefit in reviewing the pricing principles associated with the undertaking.¹⁴³

As discussed above, there is no need for the section 87B undertakings to be legislated as they are enforceable and already contain the certainty that the Commission alleges is required. The Commission has made no case for its assertion for legislative action. FOXTEL also believes that its approach to pricing is consistent with the Commission's general principles¹⁴⁴ and that there is no need to or benefit in reviewing the pricing principles associated with the undertaking. The Commission's cavalier suggestion that there would be a benefit in doing so is made without any evidence of this benefit and is curious in light of the fact that the Commission clearly accepted the pricing of the undertaking as acceptable only last year.

The price in FOXTEL's undertaking to supply its service to infrastructure operators is a percentage range based on a retail minus formula. FOXTEL took into account a range of factors when calculating this percentage discount, including the existing wholesale rates in the market, the extent to which infrastructure operators are prepared to take on risk, the fact that FOXTEL may be able to negotiate some reduction in content costs over the life of the CSA

¹⁴³ ACCC Report at 119.

¹⁴⁴ See ACCC's

1997 Telecommunications Access Pricing Principles at p11. While FOXTEL does not agree that the Commission's Pricing Principles apply to its service, these principles support the proposition that pricing can vary between access seekers without being discriminatory.

and the fact that FOXTEL is a loss-making business with high programming and high fixed costs. FOXTEL believes that there is merit in having a range of discounts as it recognises a fundamental economic principle, namely that there are differing economies associated with serving different access seekers and different factors, such as volume commitments and the extent of the services taken by the infrastructure operator. As the Commission recognises, this promotes the most efficient investment in infrastructure in that it rewards those who are prepared to make the larger investment.

[**Confidential**] In addition, any reduction in FOXTEL's costs will be passed on to infrastructure operators if reflected in the retail price that FOXTEL charges its own subscribers. Any further legislative intervention or review is unnecessary. In particular, taking a strict avoidable cost approach would not be appropriate. No case has been made for the price regulation of wholesale content and FOXTEL believes that such regulation is totally unnecessary to ensure competition in subscription television. FOXTEL has already entered into commercial agreements with Telstra, Optus, TransACT and Neighborhood Cable. These companies, with expertise in competing across a range of markets, have clearly concluded that they will be able to effectively compete against other subscription television operators on the retail minus approach adopted by FOXTEL. Further, and crucially, FOXTEL does not have bottleneck control over the supply of content. Subscription television operators are able to approach content providers directly to compile their own packages, as Neighborhood Cable and TransACT have done.

In addition, deciding on the most appropriate principles for pricing access usually follows an extensive analysis of whether pricing regulation is appropriate. This is a highly complex process that requires detailed and exhaustive consideration and can take years to finalise. Further, FOXTEL submits that much of the evidence suggests that it is inappropriate to price regulate content at all. The FOXTEL service is quite different from other services where an avoidable cost methodology has been used eg the PSTN network which is a declared bottleneck service connecting 96% of homes in

Australia (unlike the FOXTEL service which is not declared, only connects approximately 22% of homes¹⁴⁵ and is not profitable).

The costs that would be involved in undertaking a review of the pricing principles therefore do not outweigh any perceived benefit, particularly as the Commission has not established that the FOXTEL price is unreasonable or inappropriate and that price regulation of wholesale content will further promote competition and investment.

The Commission has also suggested that the section 87B undertakings may not go far enough as the threshold for supply is that the network provider have access to 8,000 homes and some property developers may only pass 2,000 homes. The Commission rightly recognises that this 8,000 home threshold was a reasonable number to ensure that FOXTEL and Austar only had to negotiate with network providers on a sufficient scale.

Any property developers are unlikely to seek to compete with FOXTEL or Austar, as a condition of the development is likely to be that only services received through the developer's cable can be used and satellite dishes etc cannot be installed. These particular developments should therefore not be a concern to the Commission or the Government as they are not new infrastructure operators providing competition to FOXTEL, Austar, Optus and Telstra (like TransACT and Neighborhood Cable) but are rather monopolies secured by developers as an avenue to extract further captured custom.

FOXTEL notes that the Commission does not at this stage envisage that satellite networks or xDSL technology be included in the scope of broadband technologies covered by the regulation of access to content. The Commission states that competition in the supply of broadband and telecommunications services is unlikely to be improved as a result of the inclusion of satellite networks¹⁴⁶. FOXTEL notes that its section 87B undertakings in fact go further than the Commission's suggestion in this respect as they provide for the licensing of the FOXTEL service to all satellite, MDS and cable operators as

¹⁴⁵ ABA Website, FAQ.

¹⁴⁶ ACCC Report at 126.

well as ADSL in the future if FOXTEL commences a subscription television service using ADSL technology.

6.8 Access to content by other subscription television operators

In summary, there are really 3 types of subscription television providers who may wish to have access to programming and FOXTEL will deal with the options available to each of these in turn.

(a) Infrastructure operators or network providers

Infrastructure operators (or network providers as they are called by the Commission) are entities that have invested or propose to invest in infrastructure in order to provide their own subscription television services eg cable constructors such as Neighborhood Cable and TransACT and licensees of satellite capacity (rolling out their own downlink equipment and STUs) such as TARBS. These infrastructure operators provide facilities-based competition and are therefore the most important in terms of promoting competition in other telecommunications services.

These infrastructure operators are able to obtain access to content in a number of ways. New network providers are protected by FOXTEL and Austar's section 87B undertakings and specifically:

- the downstream supply undertakings by FOXTEL and Austar (licensing their packages);
- the FOXTEL undertaking to provide the AFL channel;
- the FOXTEL and Optus undertakings not to acquire the shared channels/Movie Network channels exclusively (and PMP after 2007); and
- the cap on the FOXTEL basic price for 3 years at the current satellite price (ensuring the wholesale price of the service will not increase for 3 years).

FOXTEL's and Optus' section 87B undertakings ensure that movie programming continues to be available non-exclusively for the subscription television providers to license directly, such as the three Movie Network channels, TCM, Disney, World Movies and the PMP movie channels after 31 December 2007. There are also a number of other movie channels broadcast

overseas which could be licensed by an Australian subscription television operator. In addition, as in the UK, NVOD services will soon become a reality. TransACT has also commenced a VOD service which FOXTEL understands is proving to be attractive to its subscribers.

In relation to sport, ESPN (one of the most popular sporting channels worldwide) and Sky Racing will continue to be available non-exclusively pursuant to FOXTEL's and Optus' undertakings and FOXTEL has also undertaken to license the Fox Footy Channel to other subscription television providers. There are also a number of other sporting channels broadcast overseas which could be licensed by an Australian subscription television operator.

There is also a multitude of general entertainment channels for license directly from the channel suppliers on a non-exclusive basis, both within Australia and overseas.

Infrastructure operators can therefore build their own attractive subscription television service with general entertainment, movies (eg Movie One, Disney, TCM) and sport (Fox Footy, ESPN). Neighborhood Cable licenses a number of channels directly from the channel suppliers including the Movie Network channels, the Disney Channel, ESPN and TCM. TransACT also licenses some channels directly including the Disney Channel and TCM.

In addition, FOXTEL has also undertaken to supply its entire channel line-up (including the movie and sport channels) to network providers which will enable them to access Fox Sports and the PMP movies as well as a number of other popular channels. Network providers have real flexibility in the way in which they can offer the FOXTEL services bundled with other subscription television and non-subscription television services, including:

- offering other subscription television services *instead of* the FOXTEL service. These packages might include movies (eg Movie Network Channels and PMP post-2007) and sport (eg Fox Footy, ESPN, Sky Racing) all of which can be licensed directly as a result of the non-exclusive undertakings given by FOXTEL and Optus;
- offering these other subscription television services *in addition* to the FOXTEL Essentials package (which includes Fox Sports);

- offering other tiered services as well as the FOXTEL tiers (including movies and sport tiers) as an add-on to the FOXTEL Essentials package; and
- in all cases, offering other services (such as broadband and telecommunications services) as well as or in a bundle with the subscription television services.

This provides more than sufficient flexibility to enable network providers to access content (including premium content), differentiate their service from other subscription television providers (such as FOXTEL, Telstra, Optus and Austar) and compete effectively in the provision of subscription television and, where the operator plans to bundle, in other telecommunications markets.

Infrastructure operators are able to construct viable subscription television services based on the various options. TransACT and Neighborhood Cable are 2 such examples:

- **TransACT:** TransACT is committed to connecting 100,000 homes and 14,000 businesses throughout the ACT ¹⁴⁷. It offers a 'basic package' of about 13 channels which it has licensed directly from the channel suppliers called TransTV which it bundles with various telephony and broadband services, as well as the FOXTEL service which is available as a buy-through from TransTV.
- **Neighborhood Cable:** Neighborhood Cable reaches around 20,000 subscribers in Mildura and 70,000 in Ballarat with the Geelong network reaching a further 200,000 by the end of 2003 ¹⁴⁸. Neighborhood Cable describes itself as offering 'state of the art broadband internet services' and states that its 'broadband services have been specifically designed to break price and distance barriers which have for so long disadvantaged regional Australians' ¹⁴⁹. It offers various packages of subscription television services including sports (including Fox Footy

¹⁴⁷ TransACT website: <http://www.transact.com.au/about/index/asp>.

¹⁴⁸ Neighborhood Cable website: <http://www.neighborhoodcable.com.au/corporate/aboutus/php>.

¹⁴⁹ Ibid.

and ESPN) and movies (including the Movie Network channels) which it has licensed directly from the channel suppliers.

These examples demonstrate that small, regional operators can deal directly with channel suppliers and can create viable and attractive offerings.

(b) Telecommunications carriers

Telecommunications carriers or resellers are existing or potential telephony or related telecommunications companies that do not have their own network (other than Telstra and Optus) but resell their service using the network of others.

FOXTEL agrees with the Commission that any extension of the section 87B undertakings to these carriers or resellers is not warranted¹⁵⁰. As discussed above, FOXTEL has already undertaken to sub-license the Fox Footy channel to all subscription television operators and any further intervention is inappropriate.

Carriers are in a different position to infrastructure operators as they do not contribute any infrastructure and the commercial reasons for licensing such content to these operators is very different. Extension to these resellers would not assist the Commission's main concern which is to foster facilities-based competition.

As noted by the Commission, FOXTEL has in any case already entered into an arrangement with AAPT under which AAPT receives a commission for selling the FOXTEL service and bills the service directly to its customers. This arrangement is different from the arrangements with Telstra, Optus, TransACT and Neighborhood Cable as AAPT does not have its own infrastructure unlike those operators and it receives a commission only.

FOXTEL also agrees with the Commission's rejection of a 'must supply' to these carriers for the purposes of bundling. AAPT can now bundle the FOXTEL service with its other services. Whether or not FOXTEL or other subscription television operators enter into any further such arrangements is a commercial matter for them to consider – and there will be very different commercial implications depending on the particular reseller.

¹⁵⁰ ACCC Report at 126-127.

Accordingly, a forced 'must supply' would be extremely intrusive and FOXTEL agrees with the Commission that a case for such intervention has not been made out.

(c) Access Seekers

FOXTEL also agrees with the Commission that there would be no benefit in widening the scope of access to content regulation to subscription television operators using access to carriage regulation or undertakings¹⁵¹.

Such access seekers already have access to sufficient content to establish and provide their own subscription television services. Allowing access seekers to offer exactly the same content as that provided by the infrastructure operator over the same cable is not an efficient use of the infrastructure, nor does it promote facilities-based competition.

6.9 Separation of common ownership

The Commission commented that the common ownership of Fox Sports and FOXTEL and the inhouse production of the FOX Footy channel may be an issue¹⁵².

The Commission suggested that separation of ownership between premium content production and subscription television carriage may improve the incentives for distributing such content however it would still be necessary to prohibit suppliers from entering into exclusive contracts. The Commission did recognise however that there are costs associated with regulation of this kind and concluded that separation of ownership was not necessary at this stage however if regulating access to content does not result in effective outcomes, such an approach may need to be considered.

Curiously it made no such comments on the open broadcast system.

FOXTEL submits that it is normal in subscription television markets to have a degree of vertical integration between rights holders and subscription television operators. Australia's level of vertical integration is only approximately 20%. In any event, it is the premium rights holders which have market power. Further, rights holders are able to protect themselves by creating their own premium channels and marketing it to consumers pursuant to the access regime. FOXTEL's purpose in creating the Fox

¹⁵¹ ACCC Report at 127.

¹⁵² ACCC Report at 128-129.

Footy channels is to improve the AFL subscription television product so as to compete effectively with open broadcast television. When Seven had the AFL rights, subscription television AFL coverage on C7 was of low quality.

Some level of ownership by subscription television operators of channels is therefore beneficial for consumers. Subscription television operators are often prepared to take the risks in investing in new channels that others are not prepared to eg FOXTEL's investment in UKTV. The Commission itself has noted that "[o]ne of the costs associated with imposing a prohibition on common ownership interests is the lost economies of scope that exist in integration of content production and channel supply into pay TV aggregation"¹⁵³. The Commission also quotes the US Congress as stating¹⁵⁴:

[T]hat some level of concentration and integration produces efficiencies in the administration, distributing and procurement of programming, and fosters investment in innovative and risky programs for, which may benefit consumers in terms of lower rates, better services and mere diversified programming services.

7. Access to carriage and consumer reception equipment

7.1 Introduction

The Commission concluded that it would be 'premature' for the Government to consider legislation to require subscription television operators to retransmit open broadcast services and to require dual tuners while it is unclear if subscription television operators will 'control the gateway to digital services' and while there is an opportunity for current commercial negotiations between subscription television operators and the open broadcasters to be finalised¹⁵⁵.

FOXTEL submits however that such legislative intervention, at any time in the future, is neither warranted nor appropriate. There would be significant costs in the

¹⁵³ ACCC Report at 129.

¹⁵⁴ ACCC Report at 129, quoting from FCC, *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992; Implementation of Cable Act Reform, Provisions of the Telecommunications Act of 1996; The Commission's Cable Horizontal and Vertical Ownership Limits*, FCC-01-263, September 2001, p5.

¹⁵⁵ ACCC Report at 148.

imposition of such a regime and it is not demonstrated that the benefits of the regime outweigh the costs, particularly in light of the section 87B undertakings provided by FOXTEL and Telstra.

7.2 Access to carriage and customer reception equipment

The Commission refers to concerns that were raised during market enquiries conducted as part of the Commission's assessment of the section 87B undertakings about the effect of the CSA and associated agreements for third party access to subscription television networks and STUs¹⁵⁶.

The Commission acknowledges that Telstra and FOXTEL both gave undertakings to the Commission to address these concerns including:

- Telstra's undertaking to provide access to its HFC network; and
- FOXTEL's undertaking to provide access to its STUs in both analogue and digital environments (assuming that FOXTEL commences a digital subscription television service).

Despite these comprehensive and far-reaching undertakings, the Commission has received submissions (presumably from one or more of the open broadcasters) calling for further regulatory intervention in relation to the 'control of the digital gateway for digital open broadcast and interactive services. Some submissions have called for re-transmission of digital open broadcast services over the FOXTEL / Telstra HFC network and / or requiring that subscription television operators include a digital terrestrial tuner / demodulator in its digital satellite STUs¹⁵⁷. FOXTEL deals with re-transmission in section 7.4 and dual tuners in section 7.5.

FOXTEL agrees with the Commission that further regulatory intervention is not justified as the digital subscription television networks are not a bottleneck¹⁵⁸. In any event, the section 87B undertaking provided by FOXTEL in November 2002 is the most appropriate way to regulate access to FOXTEL's STUs. A wholesale model, which has been proposed by some industry participants, is not appropriate as FOXTEL is in the business of supplying subscription television services and should not be

¹⁵⁶ ACCC Report at 133.

¹⁵⁷ ACCC Report at 134.

¹⁵⁸ ACCC Report at 134.

required to provide ancillary services such as billing or subscriber management systems as that will not promote competition for subscription television services but rather is a forced wholesale acquisition model.

The Commission has stated that interactivity can facilitate a number of new services for consumers at different levels of sophistication. It is important to note that interactive services fall outside the scope of FOXTEL's application for exemption from the standard access obligations under Part XIC. So, if the Commission considers interactive services to be a 'bottleneck' at some point in the future, the Commission has the ability to declare the service and regulate it pursuant to Part XIC of the Act, as the Commission itself recognises¹⁵⁹.

The Commission has also commented that EPG services enable consumers to make choices about which programs or services are available. FOXTEL has undertaken to negotiate in good faith with access seekers to provide EPG services on commercial terms.

7.3 Subscription television will not control the digital gateway

The Commission refers to concerns by 'industry participants' that the CSA and associated agreements will allow FOXTEL to 'control the gateway' for digital open broadcast and other digital services to subscription television subscribers¹⁶⁰.

FOXTEL regards this concern as incomprehensible given that subscription television has a penetration rate of merely 22%¹⁶¹ whereas open broadcasters have nationwide penetration of a massive 98% and that open broadcasters hold 87 - 89% of the Australian television audience compared to the 11-13% held by subscription television operators¹⁶².

In addition, FOXTEL notes that open broadcasters have been able to provide digital television since 1998 when the legislation was introduced however they only started digital transmission in January 2001. Since that time, open broadcasters have

¹⁵⁹ ACCC Report at 147.

¹⁶⁰ ACCC Report at 141.

¹⁶¹ ABA Website, FAQ.

¹⁶² Lachlan Murdoch, Deputy CEO of News Corporation, Keynote Address, 'Television from a global perspective – issues for Australia', Australian Subscription Television and Radio Association Conference, 28 February 2003; ABN-AMRO, Media Australia – FTA Developments, July 2002 at 54.

singularly failed to deliver digital services that appeal to consumers and thereby failed to drive the penetration of digital television in Australia, having just over 50,000 digital television receivers installed¹⁶³.

7.4 FOXTEL should not be required to retransmit open broadcast channels

The Commission refers to the fact that it received submissions arguing that legislation be introduced requiring re-transmission of open broadcaster's signals by subscription television providers. The Commission has indicated that there have also been suggestions that this re-transmission occur at no charge and that the digital open broadcast services should receive prominent placement on subscription television operator's electronic program guide (*EPG*).

Whilst the Commission has stated that it believes it is premature for the Government to consider legislation in relation to re-transmission before digital subscription television services have commenced (assuming that they will) and is not advocating legislative intervention at this stage, FOXTEL believes it is important to address some of the concerns raised by the Commission in relation to re-transmission.

(a) FOXTEL provides subscription television services not open broadcast services

FOXTEL's access undertakings were offered in relation to subscription television services and not open broadcast services. As stated in section 3.1 above, FOXTEL has to date invested over \$900 million in infrastructure and acquiring subscribers and does not see why, in addition to the digital spectrum the open broadcasters have been gifted, they should have carriage on FOXTEL's subscription television platform.

Open broadcasters were granted publicly owned spectrum at no charge and without having to bid for such rights on the open market. Open broadcasters were granted the spectrum on the condition that they use it for high definition television, however open broadcasters have not actively used the digital spectrum. In contrast, FOXTEL has to pay for its digital spectrum by way of cable reticulation or sourced satellite supply.

¹⁶³ Speech by Senator Richard Alston, Minister for Communications, Information Technology and the Arts at ABN-AMRO, Communications Conference 2003, 'Regulating a 'Converging Environment'', 30 April 2003.

FOXTEL is however, willing to retransmit the commercial open broadcaster's primary service (ie not multi-channels) and the ABC and SBS digital services in the future. In addition, if open broadcasters invest in digital subscription television services in the future (by creating a subscription television channel), then they can utilise the section 87B undertakings to obtain access to Telstra's network and FOXTEL's STUs and compete with FOXTEL in that way.

(b) FOXTEL currently re-transmits analogue open broadcast signals

Currently, FOXTEL retransmits the open broadcasters' television services on cable pursuant to a statutory licence existing under the Copyright Act and section 212 of the BSA.

FOXTEL originally chose to retransmit the open broadcast services on cable at no cost to them as a service to cable subscribers. FOXTEL was sued by the open broadcasters for doing so. FOXTEL was successful in those proceedings but after lobbying by the open broadcasters and the underlying rights holders in the retransmitted open broadcast services, the Copyright Act was amended to require FOXTEL to pay the underlying rights' holders 'equitable remuneration' for the re-transmission of the open broadcast services. FOXTEL is now currently in a dispute before the Copyright Tribunal over the amount that must be paid to Screenrights, the declared collecting society for the underlying rights holders.

(c) FOXTEL is willing to negotiate with open broadcasters for digital re-transmission

In a digital environment, FOXTEL is seeking to enter into separate agreements with the national broadcasters and each of the open broadcasters to retransmit their services on both cable and satellite. To date, FOXTEL has entered into a retransmission agreement with the Nine Network for cable and satellite to commence on the date that FOXTEL commences a digital cable service. This agreement was entered in order to secure PBL's support for the \$600 million investment in FOXTEL's full digitisation. FOXTEL also entered into a cable-specific re-transmission agreement with the ABC in 1999.

FOXTEL is presently in discussions with Channel Seven, Channel Ten, ABC and SBS with a view to entering into similar re-transmission agreements to the Nine Agreement encouraging satellite and cable. The Nine Agreement must be

considered in the context of Nine being FOXTEL's foundation re-transmission customer, as well as its commitment as one of FOXTEL's shareholders to the digitisation investment. That being said, the re-transmission proposals offered by FOXTEL to channels Seven and Ten are similar and very reasonable. They deliver the benefit of the significant negotiation that occurred between Nine and FOXTEL late last year. FOXTEL is well advanced in our negotiations with SBS.

Until recently, Channels Seven and Ten have been reluctant to negotiate meaningfully with FOXTEL and have been attempting to involve the Commission without any legal basis in those negotiations. Amongst other things, some open broadcasters are demanding that FOXTEL pay for and acquire satellite capacity in order to retransmit their services in circumstances when FOXTEL currently does not retransmit them on satellite and, in one instance, have made third line forcing allegations which in FOXTEL's view are without foundation.

FOXTEL is bringing significant other elements to the deal which are being offered to the open broadcasters and national broadcasters at no cost including EPG access and prominent EPG positioning (second position on first page of EPG), access to the satellite STUs, cable capacity and access to the cable STUs. In addition, the arrangement will provide the open broadcasters and national broadcasters with access to the full FOXTEL digital subscriber base which has the potential to significantly increase viewership to the open broadcast and national broadcast digital channels. It is one of the fairest proposals ever made on digital retransmission and from which FOXTEL will derive no broadcaster revenue at all.

This request should be viewed in the context of the UK experience where third parties are required to co-ordinate their own satellite capacity and pay for access to conditional access and the EPG. ITV currently pays 17 million pounds per annum to BSkyB for conditional access¹⁶⁴. In addition, it pays for satellite capacity and EPG access. EPG access is approximately 30,000 pounds per annum with conditional access¹⁶⁵. FOXTEL believes that it is reasonable to

¹⁶⁴ JB Were Media Report- News Corporation Research, 14 March 2003.

¹⁶⁵ JB Were Media Report- News Corporation Research, 14 March 2003.

require the open broadcasters and national broadcasters to secure the satellite capacity directly and to bear the risks associated with that capacity. FOXTEL will continue to carry the cable cost in its contract for cable carriage through Telstra.

7.5 Dual tuner

The Commission states that 'industry participants' have expressed concern about the ability for satellite subscription television subscribers to receive all digital open broadcast services and that digital open broadcast services will not be re-transmitted on the satellite platform as such re-transmission is not commercially feasible¹⁶⁶. The Commission states that it has received submissions advocating legislation which requires subscription television operators to include a digital terrestrial tuner in its digital satellite STU, creating a 'dual tuner' STU¹⁶⁷.

FOXTEL submits that the concept of a dual tuner is neither a cost effective nor efficient method of transmitting subscription television and open broadcast services. FOXTEL is firmly of the view that a common dual tuner STU is the least efficient and economical means to achieve this result and would render Australia a 'technology orphan' in a rapidly changing digital delivery environment.

It is not correct that re-transmission on satellite is not commercially feasible and FOXTEL submits that re-transmission of the open broadcast and national broadcast services (under commercially negotiated arrangements) is clearly the preferred way of ensuring that the open broadcaster's services are transmitted.

(a) Introduction of dual tuners not cost effective

Using Australian Bureau of Statistics data, FOXTEL calculated that in 1997 there were approximately 10.15 million television sets in Australia. FOXTEL then assumed a 3% rate of growth per annum, which resulted in an approximate figure of 12 million television sets in 2002. From FOXTEL's own and other industry data, FOXTEL estimates that there is approximately 1.8 million subscription television STUs (including homes with more than one STU) in homes, which indicates that approximately 15% of televisions in Australian

¹⁶⁶ ACCC Report at 146.

¹⁶⁷ ACCC Report at 146.

homes have a subscription television STU connected to them. In FOXTEL's estimation it would take at least 5 years to replace these boxes with new dual front-end STUs for the reason that the digital satellite STUs currently being deployed by the industry are not expected to be replaced until the end of their economic life. There is no economic sense in mandating a solution which can only deal with 15% of Australia's televisions. Digital receivers would still need to be installed for the remaining 85% of televisions.

Australian subscription television broadcasters have to date invested nearly a billion dollars to deploy the 1.8m STUs that are currently active in Australian homes (including homes with more than one STU). Approximately half of this existing infrastructure consists of digital satellite STUs that have a significant remaining lifespan and it is not feasible nor cost effective to convert them to a common STU or 'dual tuner'.

(b) Dual tuners are inefficient and would waste scarce resources

The common STU or 'dual tuner' is a theoretical digital device that would be unique to Australia. The common dual tuner STU would waste scarce industry capital in its development and would not provide a public policy solution for the provision of subscription and open digital television services as, importantly, it would make Australia a technology orphan in an area of constant change and development internationally.

In addition, a dual tuner would cost significantly more than the currently available digital open broadcasting STUs and subscription television digital STUs and would reduce the subscription television sector's autonomy. Dual tuners, if mandated by the Government, would force subscription television towards a retail STU distribution model that would slow the take-up of STUs generally and further retard growth of the subscription television industry.

A dual tuner would neither serve the commercial interests of FOXTEL, nor provide an efficient solution for the provision of both subscription television and open broadcast services to Australian homes – perhaps an intended outcome by its proponents. Re-transmission is a viable alternative and makes the need for a common dual tuner STU redundant.

This view was supported by the Minister who, earlier this year, stated that he would not make laws requiring a common set top box. Senator Alston stated that¹⁶⁸:

there is no industry agreement on the commercial aspects or on benefits to the public of such a proposal. The Government is disinclined to intervene in legitimate technical and commercial decisions of broadcasters unless clear public interest objectives exist which outweigh the costs.

8. Conclusion

Each of the above issues are of fundamental importance to FOXTEL and other participants in the subscription television sector and either currently impact or have the potential to impact upon the finely balanced subscription television business model in one way or another. As mentioned earlier, the subscription television industry is not yet profitable and has achieved only 22% penetration¹⁶⁹ compared to the significant penetration of subscription television in mature overseas jurisdictions such as the USA and United Kingdom. It is critical that Government ensures that the Australian subscription television industry is given the opportunity to develop to similar levels in a stable regulatory environment and in the case of anti-siphoning, with fundamental reform of the current regime to ensure a more competitive, internationally aligned, landscape.

Similarly, a legislated access to content regime would be an unnecessary and inappropriate interference with the rights of program suppliers and subscription television providers, in circumstances where comprehensive court enforceable undertakings have already been provided allowing for access. Any further legislative intervention would similarly undermine the stable regulatory environment in which subscription television operators are building their businesses and making significant investment decisions and would further upset the balance between open broadcasters and subscription television operators.

FOXTEL urges the Department not to pursue the Commission's access to content proposals for 4 reasons:

1. the Commission's concerns were comprehensively addressed by the ground-breaking industry solutions proposed by FOXTEL, Optus, Austar and Telstra last year;

¹⁶⁸ Senator Alston, Address to the Melbourne Press Club, 20 February 2002.

¹⁶⁹ ABA Website, FAQ.

2. the Productivity Commission considered these issues dispassionately and comprehensively and well before the CSA and the section 87B undertakings which addressed these issues were accepted by the Commission. Even at that time, the Productivity Commission found that no case for legislative intervention had been made out;
3. denying subscription television operators the ability to have any unique exclusive core programming, particularly sports programming, would further entrench the open broadcast sector and consign the subscription television industry to a permanently unviable, loss making sector; and
4. it would so alter the regulatory framework for subscription television that FOXTEL's shareholders would not have the same incentives to invest in a digital service. In fact, FOXTEL included such an event in its section 87B undertakings as an event of Regulatory Change which the Commission accepted would be sufficient justification to permit the commitment to digitise to fall away.

FOXTEL would be happy to meet with the Department or provide the Government with any additional information or assistance it may require in respect of any of the above issues.