SEVEN NETWORK SUBMISSION TO THE PRODUCTIVITY COMMISSION RESPONDING TO THE DRAFT REPORT ON BROADCASTING ISSUED FOR PUBLIC COMMENT ON 22 OCTOBER 1999

INTRODUCTION

[1] The Seven Network welcomes the draft report of the Productivity Commission on Broadcasting. While it does not agree with all of the assumptions and recommendations contained in the Report, it regards it as a courageous and visionary first step towards achieving more effective and appropriate regulation of the broadcasting industry as it moves in to the digital age.

[2] The Seven Network's position on key issues, particularly in relation to ownership, control, market entry, siphoning and the introduction of Digital Terrestrial Television (DTV) has not changed from those expressed in its original submission to the Commission. Our position does diverge from that of some of our colleagues in the industry. That is primarily because, as stated in our earlier submission, our views differ as to the likely future shape of the broadcasting industry in a digital environment. We see ourselves increasingly as part of a larger, integrated media and communications industry that is shaped by the phenomenon called convergence and where the traditional attitudes of a commercial television broadcaster are inadequate. We consider that different competitive responses are necessary if we are to structurally adjust to, prosper, and indeed survive, in the digital age.

[3] The Seven Network reiterates that a package approach is essential to the acceptability and success of reforms in key areas. We note that the Productivity Commission has adopted a similar package approach, particularly on the important issue of ownership and control, although with different elements to its package. It would be prejudicial to the public interest and risk further concentration of ownership to consider removal of cross-media laws without concurrent and effective amendments to competition law. Those changes must establish clear rules on plurality of ownership and acceptable levels of ownership concentration while also vesting significant power in the competition regulator to oversight and enforce those rules and limits.

[4] Similarly in relation to the introduction of DTV while we would support the early return of the analogue spectrum to put it to more productive economic use, this could only be contemplated if there is accelerated uptake of digital terrestrial television technology. This in turn can only be achieved if a sensible standard for digital television reception equipment that allows a low cost level of market entry is adopted and if broadcasters are permitted to offer sufficiently different

and attractive new services such that consumers have an incentive to buy digital set top boxes or integrated receivers.

[5] Since the Seven Network made its supplementary submission to the Commission in August 1999 we have conducted a more exhaustive study of developments in digital terrestrial television in comparable markets, given further consideration to the concept of datacasting, the implications of siphoning and undertaken further research into and analysis of ownership and control in the multimedia / communications market. This submission provides the Productivity Commission with a summary of our key findings.

DIGITAL TERRESTRIAL TELEVISION

[6] The Seven Network remains concerned that in the USA, the only world market that has chosen so far to introduce High Definition Television (HDTV) as part of its digital terrestrial television regime, consumer take up has been well below expectations. While the Consumer Electronic Manufacturers Association of America (CEMA) forecast purchase by consumers of 160,000 DTV receivers in 1999 and 600,000 in 2000, Mark Schubin, Technologist & Technical Editor of US publication *Videography* said in an address on 1 November 1999 entitled "*DTV- One Year Later - The Year That Wasn't"* :

> *"How many DTV receivers are now in the hands of consumers? No one knows for sure. The Consumer Electronics Manufacturers Association (CEMA) reported recently that more than 50,000 "digital television sets" had been sold to U.S. dealers by the end of August. Alas, sales to dealers are not the same as sales to home viewers. More important, CEMA's definition of a "DTV set" doesn't necessarily include anything digital, especially the ability to receive DTV transmissions. By Panasonic's estimate, fewer than 5,000 DTV decoders have been sold, even to dealers. …….*
>
> *If HDTV is the killer application it has been said to be, then this year we should see sales increase. Fifty thousand cumulative "DTV sets" by the end of August is actually a significant reduction in sales rate from the over 13,000 reported by the end of 1998* (since October 1998)*. If sales don't start to take off, we will have to do some major rethinking of what DTV is supposed to be about…"*

[7] One manufacturer that sells receivers into the US market told us that it is worrying when you know all of your customers by their first name. Another advised that it is scaling back its commitment to the US market because of the low level of consumer take up. All stressed the importance of a viable business case if DTV is to be promoted by broadcasters, manufacturers and retailers and attractive to and affordable for consumers.

[8] Seven also remains concerned at the conflicting and often misleading claims made by the various industry participants about key elements of digital terrestrial television, particularly the availability of various technological options, equipment capability and cost. If we are to learn from overseas market experience it is vital that we examine similar markets if we are to compare like with like. Given that Australia has adopted the European DVB-T standard we recently (November 1999) undertook an extensive on-the-ground (UK, Europe, Japan, S-E Asia) examination of the introduction of digital DVB-T based technology and services. Some key findings follow.

Overseas Attitude to HDTV

[9] No European country is currently considering introduction of DVB-T based HDTV (as opposed to SDTV) for consumers. No sustainable business case could be found given the high cost of the technology and the lack of identifiable new revenue sources other than subscription. There is no perceived consumer demand for a better picture quality than that provided by SDTV. Europe remains conscious of the failure of earlier forays into HDTV in the early 1990's using D2-MAC and HD-MAC technology.

[10] The United Kingdom is the only European nation to have introduced Digital Terrestrial Television to date. The UK model involves subscription based multichannel services in SDTV format. Sweden had a "false start" that focussed on better picture quality, cancelled it and is working to develop an SDTV model that focusses on multichannelling. Spain is also working to introduce DTV utilising a model similar to that of the UK.

[11] Japan attempted to introduce HDTV in the early 1990's using its MUSE system. However the technology and the "better picture quality" model were never embraced by consumers. As a result receiver prices never fell below $A25,000, the Muse system has been discontinued and labelled "an experiment". Nonetheless Japanese manufacturers continue to develop digital television technology for any emerging market. They are hopeful that High Definition component will take off in the USA as some Japanese manufacturers have made a significant R&D investment in the technology. Some have even provided broadcasters with "free" digital broadcasting equipment to help to establish the market and hopefully a de facto industry standard for broadcast equipment.

[12] Some manufacturers expressed the concern that if early problems with HDTV in the USA are not fixed quickly HDTV is unlikely to emerge as a consumer item for at least another decade.

[13] We heard regular market "whispers" that India or China may adopt DVB-T HDTV technology, no doubt motivated by the promise that such potentially large markets would eventually drive down the cost of HDTV equipment in Australia. It is equally true that if they adopt a different technology the cost of alternatives is

likely to remain high. Previous experience has taught us to be sceptical of such claims. Several manufacturers and system operators emphasised to us the importance of avoiding "bleeding edge" technology in small markets and pursuing options have at least some demonstrable commercial rollout in other and larger markets.

[14] In summary, early market experience in the UK and the US indicates that the picture quality of standard definition digital TV combined with additional and different services are the drivers of consumer demand for take up of digital television.

A "Universal" Receiver / Decoder

[15] While we actively sought a Set Top Box (STB) or Integrated Digital Television (IDTV) capable of receiving DVB-T HDTV transmissions for downconverting to SDTV for digital or analogue output, no one was able to satisfactorily demonstrate such equipment, even in prototype form.

[16] While some manufacturers are working to perfect a “multifunction” chipset that is intended to decode and display various formats of digital TV including HDTV it is our view that the chips are still in a development phase. While the chipset of itself will not add significantly to the overall cost of components in a receiver, components are not the key determinants of the final price of consumer electronics. Major manufacturers agreed that recoupment of R&D costs, the cost of licensing for proprietary technology within a receiver and, most importantly, the economies of scale afforded by large production runs, are far more important.

[17] No one is currently manufacturing HDTV capable set top boxes or Integrated Digital Televisions in DVB-T format as Australia is the only country currently proposing to introduce such services.

SDTV and HDTV Pricing

[18] This remains one of the key areas of contention where it is difficult to establish what a particular set is capable of displaying and hence what its real digital capabilities are. For example in the UK the less expensive widescreen sets are retailing on the High Street for £699 ($A1750) to £999 ($A2500). They are described in newspaper advertisements as "digital ready" and " showing the full benefits of digital technology". However it appears that all are using currently available existing wide screen picture tubes (CRT's) similar to those already on sale in Australia but capable of receiving a digital signal via a set top box and converting it to analogue display.

[19] Some large screen (80cm) 16x9 digital TV (576i) receivers operating in SDTV mode costs £3,000 ($A7,500) but these were not HDTV capable receivers. Some Australian retailers have claimed availability of cheaper SDTV IDTV

receivers. It is important to examine detailed technical specifications in order to make a valid comparative analysis of capabilities and to ensure that we are comparing "like with like.".

[20] The cheapest DVB-T set top box operating in SDTV mode in UK is retailing at £399 ($1000). The purported 'free' STB's are in fact only rental equipment that is made available to a consumer if they contract for a minimum of 12 months subscription at a cost of £ 6.99 per month for the "basic" package and a further £11 per month for premium sports (Sky Sports 2). The marketing technique is similar to that used for mobile phones whereby the equipment cost is amortised over the period of the contract.

[21] There is no cathode ray tube or "glass" available today or in the near future that is capable of displaying a full 1080i picture (1920 x 1080 pixels). Several manufacturers estimated the cost of such equipment at £10,000 ($A25,000) for the glass alone if the technical problem of reduced pixel size to enable display of 2 million pixels on a screen of sensible size and weight could be solved.

[22] Manufacturers are researching various technical and software options to enhance the digital picture quality to simulate full HDTV. However a common view was that the outcome for full HDTV display if and when it becomes a consumer item is likely to be Plasma screen or rear projection technology.

DATACASTING

[23] The concept and definition of datacasting have emerged as the most contentious in the public debate to develop a policy regime for the implementation of digital terrestrial television. This is surprising given that we could find little evidence of such services or demand for them overseas other than those already catered for by the Internet.

[24] The Commission, in seeking to encourage a regime that did not require *"…prescriptive and inevitably artificial definitions …"* recommended at 6.2 that *"datacasting should be defined liberally".* If applied with adequate safeguards there is some merit in this approach as it avoids determinism in an industry that has yet to emerge.

[25] However the Commission went on to say that *"datacasting should not be constrained by a regulatory distinction between datacasting and broadcasting"*. Given that datacasting is a concept that only relates to the broadcasting services bands, if there was to be no distinction between datacasting and broadcasting there would be no need to contemplate a definition at all. Such an approach would also ensure the emergence of a fourth commercial television network

before other regulatory mechanisms to foster competition, plurality and diversity canvassed elsewhere in the Report had been put in place.

[26] If the public policy objective is to facilitate the emergence of new and innovative multimedia services while not permitting the emergence of a de facto 4th television network before a date determined by the Parliament, some form of regulatory distinction between the services is essential. The Seven Network considers that this can be achieved without excessive prescription.

[27] The *Broadcasting Services Act 1992* and the *Telecommunications Act 1997* contain statements of regulatory policy that are valuable tools to interpretation of the statutes. A similar approach is recommended in relation to datacasting. A statement of regulatory policy should be incorporated in the legislation that makes it clear to the regulator and the Courts that datacasting must not be broadcasting as "experienced by any particular user". A suggested text could be that :

> *The Parliament intends in relation to the transition to digital technology that uses the broadcasting services bands to deliver services, that the regulatory regime should facilitate the emergence of new and different services in a competitively neutral manner and in a manner that does not allow the services to compromise the broadcasting regulatory regime by becoming de facto broadcasting services. In particular datacasting services that are delivered using the broadcasting services bands must not, in the opinion of the ABA, when experienced by any particular user, provide a service that is, or has the appearance of, or seeks to emulate aspects of, a broadcasting service*

[28] This regulatory policy could be supported by a non-determinist definition of datacasting along the following lines :

> *Datacasting means a service provided using the broadcasting services bands that provides no more than data, text, sounds, still images or moving images or a combination of any of these and which may allow the user to interactively modify the content of the particular service in real time, but does not include a service or class of services that :*
>
> *(a.) when experienced by any particular user is, or has the appearance of, or seeks to emulate aspects of, a broadcasting service; or*
>
> *(b.) can be received and stored in compressed or other format for subsequent replay in uncompressed or other format to produce images that when experienced by any particular user is, or has the appearance of, or seeks to emulate aspects of, a broadcasting service; or*
>
> *(c.) the Minister determines by notice in the Gazette does not to fall within this definition.*

[29] Broadcasting and telecommunications legislation also use individual licensing and punitive fines as disincentives to avoidance. A similar regime is recommended for datacasting services that use the broadcasting services bands as a means to deliver the service. Such a regime would require that each datacasting service is individually licensed by the Australian Broadcasting Authority under the provisions of a Part 4 of the *Broadcasting Services Act 1992* including that :

- each service be required to make application to and be approved by the ABA
- licence application to include full details of the nature and content of the service
- applicant to give an undertaking that the service provided will not be or seek to emulate a television or radio broadcasting service, and
- substantial penalties ($2m per day) to provision of unlicensed services and to breaches of the undertaking at (iii.) above.

SIPHONING

[30] In its draft Report the Commission noted Parliament's objective to ensure that major sporting events are available to free to air television. It indicated an inclination *" … to recommend that neither free to air television nor subscription television broadcasters be permitted to negotiate contracts that exclude the other form of broadcasting …".* The Commission sought further comment on this issue.

[31] When examining the economics of the television industry and the market dynamics that drive it, it is important to recognise that, as in many other sectors of the economy, when price is not the determinant product differentiation is vital to competition and commercial success. Where the core product is essentially the same - advertiser supported free-to-air television - different and attractive programming is fundamental to competition in the industry.

[32] If we all showed the same programming it would not matter what station a viewer tuned to. Advertisers would not care where they placed their advertising spend. Competition for viewer attention through different and attractive program material is fundamental to competition in the industry. Without it program quality would suffer and consumers would receive a lesser service.

[33] The holders of program rights, particularly sporting bodies, would similarly want to be in a position to offer purchasers of rights a degree of exclusivity in order to increase their value and generate sufficient revenue from the sale of rights to fund the high cost of national and international sporting competitions. For example SOCOG will fund some 60% of the cost of the Sydney 2000 Olympic Games from the sale of exclusive rights. Similarly, without revenues from exclusive rights the IOC could not maintain the modern Olympic Games.

[34] We would expect that the subscription television broadcasters also want to be in a position to secure exclusive rights to some program material, particularly sporting events and movies, as a means to differentiate their product. It is price competition from Pay TV operators around the world, News Ltd in particular, that has driven up program prices to the point where many sporting codes are being lost to free to air television. The costs are such that subscriber revenues (over a period of time on contract) are necessary to fund their acquisition.

[35] It was this "siphoning" of important national sporting events that led to bi-partisan Parliamentary support for the current anti-siphoning provisions embodied in the *Broadcasting Services Act 1992*. The Parliament is conscious of the need to avoid creation of an “information rich” who can afford to pay to view their favourite sport and an “information poor” who cannot. The competitiveness or otherwise of these rules needs to be balanced against the public interest of consumers. Most Australians expect to see premium sport free of charge on their television. They regard free access as a right. The drive to “siphon” off an ever increasing number of sports to pay or pay-per-view services disadvantages those many sports fans who cannot afford to pay or who do not expect to have to do so.

[36] Some concerns in relation to the list will be alleviated with the passage of legislation recently introduced into the Parliament. This legislation requires that free-to-air broadcasters with exclusive rights to a live event either show it live or offer the unused rights to the ABC and SBS for a nominal charge. These changes are being implemented to prevent broadcasters from not televising parts of the listed programs to which they have acquired the rights, such as Nine's failure to broadcast live the first sessions of the Ashes cricket tests in 1997preferring to screen its regular evening programs.

[37] Having regard to its other programming commitments the Seven Network seeks to ensure that its program schedules maximise public access to as much sport as possible. It is hoped that the opportunity offered by enhanced services when we move to digital terrestrial television broadcasting will help to ensure that consumers have access to all available sports viewing options.

[38] Of greater concern is the potential for major conflict to arise when the Pay TV broadcaster is in partnership with a free to air broadcaster. In that circumstance they can collude to ensure exclusive acquisition of both forms of rights. This outcome is more likely and more anti-competitive when those parties also have a "gatekeeper" role, controlling access to carriage services such as the cable and satellite networks. In this circumstance those parties exert enormous market power and are likely to dominate the market as they are the only ones that can guarantee to a sporting rights holder that their sport will receive maximum exposure in both free and pay mediums as well as enjoy the benefits of cross promotion on each. If a third party was to acquire rights to an event in

competition, the "gatekeepers" could deny market access and thereby destroy the commercial value of those rights.

[39] Commercial television broadcasting services are available Australia-wide and, most importantly are free. It is, therefore, imperative that the anti-siphoning rules are maintained to protect the public interest in ensuring that all Australians are able to receive programs of national importance and cultural significance, and to receive those programs at no cost.

[40] Consideration should also be given to preventing those that control access to carriage services for subscription services from also acquiring exclusive rights to program material.

OWNERSHIP AND CONTROL

[41] The Seven Network remains concerned at the concentration of media ownership in Australia with a consequent diminution of diversity of opinion and choice. However we also acknowledge the need for regulatory adjustment to keep pace with changing market circumstances. We agree with the Commission in relation to cross-media ownership and control rules that a package of measures must be implemented concurrently if appropriate reform that encourages competition without threatening plurality and diversity is to be achieved. However we do not agree with the Commission's recommendations at 8.4 that these objectives can be achieved at this point in time simply by significant deregulation.

[42] We acknowledge, as does the Commission at p.185 of the Report that a *"… substantial lessening of plurality …"* test as part of a public interest test could be used to assist in regulatory oversight of mergers and acquisitions in the media market. However this test will only provide adequate safeguards if are applied in the context of a wider multimedia / communications market that was discussed in our earlier submission.

[43] Further research on this aspect has reinforced our view that the phenomenon of convergence has lead to the birth of a new market. The power of players to leverage and exert undue influence across what were previously regarded as separate markets must be contemplated as must the effect of an accretion of those activities across markets on competitors.

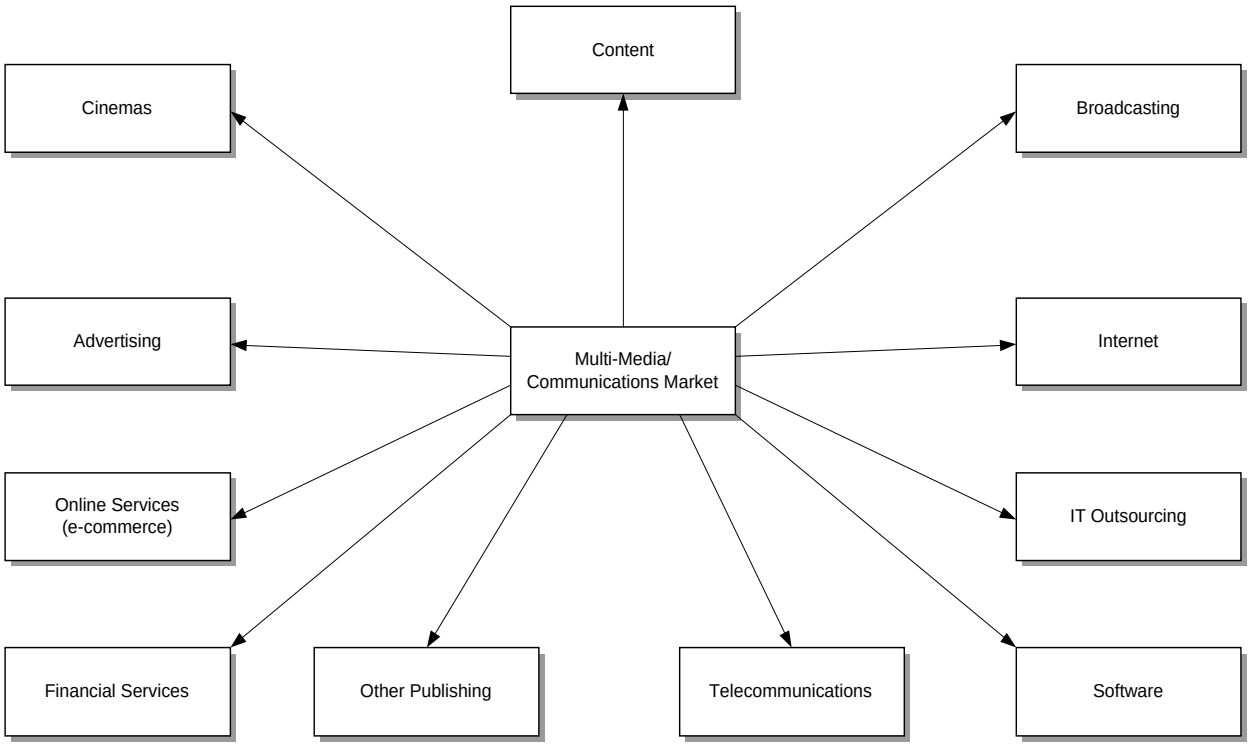
[44] There are a number of circumstances that demonstrate the importance of adopting this approach at this time including that :

- the industry is being transformed by technological convergence
- we are seeing the emergence of global networks of media and communications conglomerates that are characterised by economies of scale, scope and density

- these conglomerates are concentrated in the hands of a small number of controllers
- these conglomerates operate across traditional boundaries of market definition
- there is a growing trend for media and communications companies to vertically integrate backwards into the provision of content and an increasing concentration of ownership of content rights
- the small number of conglomerates are interacting with each other in an increasing number of areas of operation, aligning their interests by the creation of networks of interest
- although many acquisitions of rights and interests in the marketplace are not in themselves large, we are witnessing a creep towards the creation of dominant networks of companies whose interests reach across all segments of the multimedia/communications market.

[45] The Seven Network regards the multimedia/communications market as having the following components :

FIGURE 1: The multi-media/communications market



[46] The creation of this new market derives from the introduction of digital technology. The common "digital" language has facilitated the flow and cross-

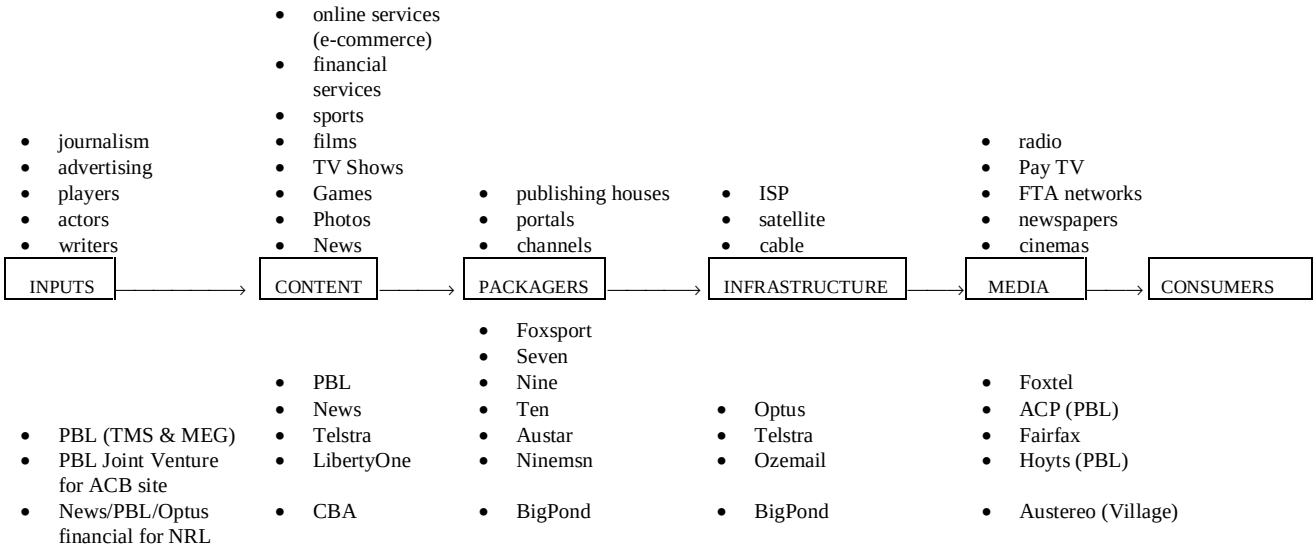
pollination of previously discrete service types across platforms and across market boundaries. This gave rise to the phenomenon tagged as "convergence".

[47] The European Commission *Green Paper on Convergence*[1] defines convergence as:

- the ability of different network platforms to carry essentially similar kinds of services, or
- the coming together of consumer devices such as the telephone, television and personal computer.

[48] This popular definition reflects *"a wider struggle between computer, telecommunications and broadcasting industries for the control of future markets."*[2] Convergence is found more in networks than at the consumer level. A value chain extending from content creation through content packaging, service provision and final delivery is being created as follows :

VALUE CHAIN



[49] In its submission to the Productivity Commission News Ltd. noted the importance of convergence and the value chain. As News itself states, convergence is not a "theoretical issue" but a reality which is blurring the lines between the delivery platforms of the media industry.[3]

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1 *Green Paper on the Convergence of the Telecommunications, Media and Information Technology Sectors, and the Implications for Regulation: Towards an Information Society Approach* (3 December 1997)

2 *Green Paper*, page 1.

3 News Limited, *A Submission to the Productivity Commission into Australia's Broadcasting Legislation* (May 1999), page 1.

[50] The recent OECD Round Table *Regulation and Competition Issues in Broadcasting in the Light of Convergence*[4] concluded that :

> *"The multimedia/broadcasting industry is undergoing fundamental change. The resulting market opportunities are substantial and may rival even the opportunities associated with the development of the personal computer itself. These developments and the resulting changes of market structure are placing existing regulatory regimes under strain and are raising new and important competition questions."*

[51] Due to these technological developments, there are vast economies of scale, scope and density in the joint provision of telecommunications services and broadcasting services.[5] Network[6] and tipping[7] effects are especially prevalent.[8]

[52] One of the challenges facing regulators of an industry which is converging in the manner indicated is the high potential for gaps in the regulatory regime.[9] Although there may be many regulators with respect to individual segments of the market, there is a risk that no single regulator has sufficient oversight of the total market. This makes the position of any regulator of the multimedia / communications market even more important. The regulatory tools available to the regulator must similarly be appropriate if any regulation deemed to be necessary is to also be effective.

[53] In the Australian context we have witnessed a remarkable and radical expansion
of the interests of three players in the value chain and all elements of the multimedia / communications market - Telstra, News Ltd and PBL. Each of these companies has moved well beyond its traditional boundaries of business and

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4 OECD, 26 April 1999, page 82.

5 Productivity Commission, *International Benchmarking of Australian Telecommunications Services* (March 1999), pages 227-231.

6 **Network effects** occur when the value of a product depends on how many other users there are. Communications technologies are the classic case of network effects.

7 **Tipping effects** occur in the presence of positive feedback effects - when the strong get stronger and the weak get weaker. Rapid growth feeds on itself until it is worthwhile for consumers to use only one supplier. The market then "tips" to that supplier. This can be a permanent tip due to so-called path-dependence in which consumers lock into technology through sunk investments (history matters). The winner of the race to the tipping point is rewarded with market power and durable monopoly rents - in the extreme form in a "winner-takes-all" outcome. Although this is not always permanent, industries demonstrating these effects can demonstrate durable and substantial monopoly characteristics.

8 Not every market will tip. However, as Shapiro and Varian emphasise, "Strong scale economies, on either the demand or the supply side of the market, will make a market tippy": *Information Rules: A Strategic Guide to the Information Economy* (HBS Press, 1999), 188.

9 The inappropriateness of current regulatory structures for a market in which convergence is occurring is a central concern of recent OECD studies.

none can any longer be regarded as purely telephone or media companies. They engage in the wider multimedia / communications market identified by the OECD and have significant interests in every segment of that market.

[54] PBL, News and Telstra have a natural incentive to tie together all segments of the industry, raising overall barriers to entry by raising the cost of entry and increasing the risks of anti-competitive behaviour due to

- the need for multi-level entry to combat the dominant network, and
- the risk of cross-subsidisation by the dominant network between the different segments of their business.

[55] When the acquisitions and collaborations by PBL, News and Telstra since 1997 are scrutinised they demonstrate a pattern whereby each is moving radically beyond their traditional core businesses. This is consistent with (indeed a significant part of) the global trend in this industry and is the subject of intense investigation by regulatory authorities around the world. PBL, News and Telstra are growing out and toward each other. The interests of PBL, News and Telstra are slowly but surely aligning. We are witnessing a (not so slow) creep towards the creation of a dominant network of companies whose interests reach across all segments of the multimedia/communications market.

[56] In these circumstances the Seven Network considers that recognition and definition of this new market is fundamental to ensuring plurality of ownership and diversity of views in the digital age. It must be understood before any meaningful reform of cross-media and other ownership rules can be achieved.

[57] The Seven Network therefore urges the Productivity Commission to give this matter further and careful consideration before finalisation of its recommendations on ownership and control.

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7 December 1999