

Submission to the
Productivity Commission
in connection with its
Review of National Competition
Policy Reforms

21 December 2004

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FOXTEL submission

Introduction

This submission is made by FOXTEL Management Pty Limited on behalf of the FOXTEL Partnership (**FOXTEL**). It addresses the Productivity Commission's review of the television broadcasting industry in Chapter 8 of the discussion paper released by the Commission on 27 October 2004.

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About FOXTEL

FOXTEL is Australia's leading subscription television provider.

It commenced distributing its services on cable in 1995, expanding to include satellite distribution in 1999. FOXTEL is now available to more than 70% of Australian homes, with approximately 1.1m homes currently connected to the FOXTEL service directly or by receipt of services provided on a wholesale basis to other providers such as Optus TV.

FOXTEL is sold to customers directly in Sydney, Brisbane, Canberra, Melbourne, Adelaide and Western Australia. FOXTEL's service is also sold in some of those places by its resellers – Telstra, AAPT and Primus.

In March 2004 FOXTEL launched its FOXTEL Digital service, giving Australian viewers the choice of more than 100 digital channels. These channels are provided by 51 different Australian and international media and communication companies, 21 of which are Australian-owned or Australian-based.

FOXTEL Digital intends to extend its innovations over the next 6 to 12 months by adding new channels and enhanced and interactive features including additional news and sports applications, as well as the Personal Digital Recorder.

FOXTEL directly employs over 1,800 people and a further 1,200 people are indirectly engaged by FOXTEL in sales and installation services nationally.

The FOXTEL Television Centre at Pyrmont in Sydney, houses television studios, broadcast operations and cable and satellite transmission facilities. FOXTEL operates a national Customer Solutions Centre based at Moonee Ponds in Melbourne, where it is building a new state of the art call centre, as well as studio facilities in Melbourne used primarily by the FOX Footy Channel.

FOXTEL is also building a new digital television campus in North Ryde, Sydney, which will headquarter FOXTEL's national subscription television operations in the future.

FOXTEL is owned through interposed companies by Telstra Corporation Limited (50% equity), News Holdings Limited (25% equity) and Publishing and Broadcasting Limited (25% equity).

1. Importance of taking a holistic approach to reform

FOXTEL fully supports the competition principles promoted by the Productivity Commission that also underpin the policy objective of the *Broadcasting Services Act 1992 (BSA)*:

*"to provide a regulatory environment that will facilitate the development of a broadcasting industry in Australia that is efficient, competitive and responsive to audience needs"*¹

FOXTEL also agrees with the Commission about the importance of the communications sector to the lives of most Australians. For this reason, FOXTEL is concerned that regulatory reform affecting the sector is only undertaken after comprehensive analysis and with a complete understanding of the likely impact of those reforms on levels of competition between existing and future participants in the relevant market.

The television broadcasting regime comprises a number of arrangements that, together, create the regulatory environment in which television entertainment is provided to Australian viewers. These regulatory arrangements include:

- the moratorium on new commercial television broadcasting licences (with limited exceptions) until 1 January 2007;
- the loan to commercial open broadcasters of spectrum in which to simulcast their existing analogue services in standard and high definition digital format, before returning their analogue spectrum to the Government;
- prohibitions on the commercial open broadcasters' use of loaned spectrum for terrestrial multi-channelling; and
- a sports programming anti-siphoning regime that gives commercial open broadcasters exclusive first access to the most valuable sports programming.

Both the Australian Competition and Consumer Commission (**ACCC**)² and the Productivity Commission³ have stated previously that the interconnection between these various arrangements mean that the reform of one should not be considered in isolation of its impact on others. Reform should instead only be considered in the context of a comprehensive review of all elements of the existing broadcasting regime.

FOXTEL agrees with this position and with Frontier Economics' recent comment that:

¹ BSA section 3(b).

² ACCC report on "*Emerging Market Structure in the Communications Sector*" (**ACCC 2003 Report**), June 2003 at pg 25.

³ Productivity Commission "*Broadcasting Enquiry Report*", released 3 March 2000, at pg 254.

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"Focusing on a particular policy question in isolation (for example, the details of the simulcast requirement) without taking into account the implications for broader questions of competition in the industry or previous regulatory commitments, risks a failure to meet the [competition policy] objectives of the [BSA]"⁴

Any such review of the television broadcasting regime should start with an analysis of the level of competition among participants in the market and existing market forces.

⁴ Frontier Economics, "A Framework for assessing the provision of services other than simulcasting by free-to-air broadcasters on digital spectrum: a report prepared for FOXTEL", August 2004 (Schedule 1 to FOXTEL's submission to the Federal Government on multi-channelling dated August 2004).

2. Competition in the television entertainment market

The television broadcasting regime concerns the supply of television entertainment to Australian audiences. FOXTEL has long maintained that the relevant market for competition purposes is the television entertainment market. This is a national market and, at a retail level, includes the commercial and national open television broadcasters, subscription television providers and video and DVD retailers, who all compete for viewers and the amount of time they spend watching television.

There are many examples of behaviour on both the supply side and demand side that support this market definition, including:

- Evidence that consumers view open television, subscription television and video and DVDs as **substitutable** with one another. This evidence includes ratings data⁵, levels of churn from subscription television providers back to open television and market research conducted by FOXTEL.
- Evidence to suggest that the price of open television (which appears to a consumer to be \$0) **constrains** the prices subscription television providers are able to charge for their services and has kept subscription television prices relatively stable.
- The **actions and views** of open television broadcasters,⁶ subscription television providers and video and DVD retailers that suggest that they perceive one another as competitors.
- Direct and vigorous competition between open broadcasters and subscription television providers (and channels) to acquire and retain the most attractive **content**.
- The methods used by open broadcasters, subscription television providers and video and DVD retailers (and their industry bodies) to **sell and promote** their respective products.
- The significant resources expended by open broadcasters and subscription television providers to **advocate** change of, or the maintenance of, Commonwealth regulation of the television industry.
- Responsive **content** and **product developments** by open broadcasters, subscription television providers and video and DVD retailers. For example:
 - in response to the broadcast of *Law & Order* on the FOX8 subscription service at 8.30pm on Sunday evenings, Network Ten stopped showing movies at 8.30pm on Sundays and scheduled in their place *Law & Order: SVU*;

⁵ For example, ratings data shows that on average half of television viewing in subscription television homes is spent watching subscription television.

⁶ For example, submissions made by the Seven and Ten networks in response to the Federal Government's issues paper on "*The provision of services other than simulcasting by free-to-air broadcasters on digital spectrum*" released on 10 May 2004 (**Multi-channelling Review**), at pg 23 of Seven's submission and pg 7 of Ten's submission.

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- recent reports disclose that Seven is "*planning to slash advertising volumes during Sunday night movies by 75% to keep viewers tuned in, rather than opting for a DVD or switching over to FOXTEL*"⁷
- there is evidence that Australian open broadcasters are following the behaviour of the US open broadcasting networks through investment in subscription television services that complement their open broadcast services. For example, Seven has invested in the SKY News Australia subscription television service, and Kerry Stokes, Seven's Executive Chairman, holds an interest in the World Movies subscription television service.
- FOXTEL launched FOXTEL Digital partly as a response to the introduction of digital television by the open broadcasters and, around the time of the launch of FOXTEL Digital, the Nine Network launched a number of enhanced applications on its digital service.

There has been discussion in the context of the Multi-channelling Review about the significance of changes to the subscription television industry since 1998 and the success of the FOXTEL and AUSTAR Digital services launched in March 2004⁸. FOXTEL agrees that subscription television has made some substantial achievements in the last few years and that the launch of the FOXTEL Digital and AUSTAR Digital services has confirmed that subscription television providers are the primary innovators in Australian television. However, these achievements do not equate to profitability and FOXTEL, the largest subscription television provider, remains loss-making. The FOXTEL Digital service that was launched in March 2004 is still in its development phase following an investment of approximately \$600 million, the biggest single investment in digital conversion by any Australian television broadcaster.

Notwithstanding the appeal of the FOXTEL and AUSTAR Digital services and subscription television generally to growing numbers of Australians, the commercial open broadcasters continue to dominate the television entertainment market and subscription television is yet to reach a viable and long-term sustainable scale.

Indicative of the commercial networks' market power is their extraordinary long-term profitability. In FOXTEL's view. The chart below illustrates this point.

⁷ *Ad News*, 3 December 2004

⁸ ACCC submission in response to the Multi-channelling Review at pg 12

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Broadcast profit margin before tax of Australian commercial television stations, fiscal 1958-2003⁹



The commercial open broadcasters' profitability is particularly notable when compared with the substantial accumulated losses that all five subscription television platforms in Australia continue to carry and the day to day losses incurred by a majority of them.

According to the most recent AFC statistics¹⁰, subscription television broadcaster operating losses for the 1996/97 financial year were \$1,058.4 million, for 1999/00 were \$675.8 million and for 2002/03 were \$451.5 million..

Other indicia of market power - audience penetration, share of total advertising expenditure, share of viewing and television and programme acquisition practices - all, similarly, point to the market dominance of the incumbent commercial television broadcasters¹¹.

The market power of the Seven, Nine and Ten networks and their regional affiliates is assisted by legislation. As the ACCC has noted, the commercial broadcasters "*are provided a level of protection from competition that is not given to firms in other industries*"¹².

⁹ Australian Film Commission "What Australians are Watching: Free-to-Air Television" as of 2 November 2004 (**AFC Free-To-Air Report 2004**), at pg 15

¹⁰ Australian Film Commission "What Australians are Watching: Pay TV" as at 2 November 2004 (**AFC Pay TV Report**) at pg 9

¹¹ For comparative market information about audience penetration, advertising expenditure, share of viewing and television usage and programme acquisition practices in the Australian television entertainment market, see FOXTEL's submission to the Multi-channelling Review, a copy of which is attached to this submission as Annexure A

¹² ACCC 2003 Report at pg xvi

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In particular, the commercial broadcasters benefit from:

- restrictions on the access of subscription television to sports programming, through a sports programming anti-siphoning regime that is the most restrictive in the world and guarantees commercial and national broadcasters exclusive first access to the most valuable sports programming;
- the moratorium on new commercial television broadcasters until at least 2007; and
- the loan to the commercial broadcasters of publicly-owned spectrum, at no charge, to subsidise their transition from analogue to digital.

The nexus between the long-term profitability of the commercial open broadcasters and the legislative advantages they enjoy has also been noted by commentators, including the ACCC:

"An ABN AMRO report on the media sector released in July 2002 noted that the operating margins of Australia's major FTA television companies (at an average of 28 per cent) were among the highest in the world (global average of 18 per cent). The report commented that this was the result of the benefits provided by the current regulatory structure of the Australian FTA industry.

*"A more recent report released in June 2004 forecasted an industry EBIT margin of 27 per cent for the 2004/05 financial year, with continuing margin expansion projected for the next two years reaching in excess of 30 per cent by the 2007/08 financial year. It also noted that industry pre-tax profit margins are near the upper limit of their 10-20 per cent long term range and that FTA sector EBIT margins are above the other main media sub-sectors."*¹³

Among the amendments made to the BSA in 1998 to accommodate the introduction of digital terrestrial television, the Government prohibited commercial broadcaster multi-channelling on the digital spectrum loaned to them *"to ensure that the developing pay TV sector is not unfairly disadvantaged by the digital conversion of existing commercial and national broadcasters"*¹⁴.

In FOXTEL's view, the Federal Government's recognition of an imbalance between the relative economic strengths of the commercial open broadcasters and subscription television providers was inherent in its policy rationale for prohibiting commercial open broadcaster multi-channelling in 1998. As the figures indicate, this imbalance has not changed and, on this basis, the policy rationale for the prohibition still applies.

¹³ ACCC submission to the Multi-channelling Review at pg 11, quoting ABN AMRO, *Time to fact the FACTS*, July 2002, pg 31, and *FTA Television – the TV margin cycle*, 22 June 2004, pg 21

¹⁴ Explanatory Memorandum, *Television Broadcasting Services (Digital Conversion) Bill 1998 and Datacasting Charge (Imposition) Bill 1998*, at pg 16

3. Commercial broadcaster terrestrial multi-channelling - issues to consider

Commercial open broadcaster multi-channelling, either "free-to-air" or subscription, will advantage Seven, Nine and Ten as against subscription television providers particularly in the area of programme acquisition. The disparity between existing commercial open broadcaster and subscription television channel budgets puts subscription television at a significant disadvantage when negotiating with rightsholders for attractive programming¹⁵.

Both commercial broadcasters and subscription television providers acquire programming of appeal to Australian viewers from the same foreign and domestic sources and, because they broadcast programming of similar genres, there is significant competition between them for attractive programming.

However, because of the disparity between commercial broadcaster and subscription television channel revenues and profitability, the commercial broadcasters are able to outbid subscription television providers for the most popular general entertainment programming, and the commercial broadcasters are, in addition, uniquely advantaged when bidding for sports programming by the existing sports anti-siphoning regime..

In the 2004 financial year, Australia's commercial television networks had combined revenues of approximately \$2.66 billion¹⁶, compared with \$1.2 billion¹⁷ for subscription television operators . The disparity is even more notable considering the much wider cost base subscription television operators must support, including customer receiving equipment and customer service, and the cost of acquiring programming (including, in the case of FOXTEL and AUSTAR, more than 100 channels carried on their digital platforms).

If commercial network multi-channelling on the terrestrial broadcasting service bands is introduced, the commercial broadcasters will need to acquire more programming to fill their new channels and they will do this in competition with subscription television broadcasters.

However, the commercial broadcasters have the benefit of larger revenues and long-term, positive operating profits that can be reinvested into content, compared with the mainly loss-making subscription television providers such as FOXTEL. The commercial broadcasters are therefore in a

¹⁵ A detailed explanation of programme acquisition practices in the television entertainment industry is contained in section 3.2 of FOXTEL's submission to the Multi-channelling Review, a copy of which is attached to this submission as Annexure A

¹⁶Source: CEASA (Commercial Economic Advisory Service of Australia), 01/07/03-30/06/04

¹⁷ Source: CEASA and FOXTEL Analysis

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stronger position when it comes to competing for attractive programming. Accordingly, the likely result of commercial network multi-channelling at this stage in the development of subscription television, and in isolation of the abolition of the sports anti-siphoning regime and other restrictions impeding subscription television's ability to compete, will be an increase in the market dominance of the Seven, Nine and Ten networks, to the material detriment of subscription television, other existing and future participants in the television entertainment market and, ultimately, viewer choice and product diversity.

FOXTEL believes that there is a public benefit in avoiding this result that outweighs the costs of postponing the removal of the restriction on commercial open broadcaster multi-channelling until it can be introduced at a time that does not have a detrimental effect on innovation and competition in the television entertainment market. On this basis, FOXTEL strongly disagrees with the high priority the Productivity Commission is giving to removing restrictions on multi-channelling and datacasting.

4. Regulatory reform to support competition and innovation in the television industry

FOXTEL shares the Federal Government's belief that digital television is the surest way of achieving the Productivity Commission's stated goal of facilitating the emergence of new and innovative ways to deliver more content and choice to Australian viewers.

The large scale investment needed to support the roll-out of digital television infrastructure and the importance of regulatory stability to securing this investment, was recognised by the Federal Government in 1998 when it legislated to protect the commercial open broadcasters' digital investments - by placing a moratorium on the issuance of new commercial television broadcasting licences until at least 2007.

The moratorium guaranteed commercial broadcasters at least six years from the commencement of their digital services in January 2001 in which to stabilise their digital investments.

The FOXTEL Digital and AUSTAR Digital services were launched in March 2004 at a cost of deployment of approximately \$1 billion - substantially more than the estimated \$600 million spent on converting the terrestrial television sector to digital¹⁸.

The FOXTEL Digital service delivers Australian viewers significant new viewing opportunities, including:

- expanded programming choice, with more than 100 channels and services that provide programming covering all genres, including movies, sport, news, general entertainment, lifestyle, documentaries, music and children's programming;
- FOXTEL Box Office, a 24-hour near-video-on-demand service screening blockbuster movie titles starting each 15-30 minutes;
- Sky News Active, an interactive service allowing viewers to control and choose the news they want to view from eight live video and five live text screens; and
- widescreen and digital sound, including more than 47 channels broadcasting 16:9 widescreen content and 13 channels with enhanced surround sound; and
- programme closed captioning to assist the deaf and hearing impaired.

¹⁸ Ian McGarrity, Chairman, Digital Broadcasting Australia, presentation at the Network Insight Seminar *Digital TV: the reviews*, 8 June 2004.

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FOXTEL will add to these digital innovations over the next 12 months, including through the introduction of:

- new channels;
- further interactive "on-screen" voting and messaging;
- additional FOXTEL Sports Active applications, extending those currently available on AFL and NRL programming to cricket, Super 12 Rugby, basketball and tennis; and
- Personal Digital Recorders.

The high profile of FOXTEL Digital among consumers and commentators as innovative has not, however, moved the FOXTEL business from loss-making to profitable and the substantial expense to subscription television of funding its digital roll-out has made it even more vulnerable to shifts in the competitive landscape.

For this reason, FOXTEL believes that its digital investment should be given a period of regulatory certainty without major change (which multi-channelling would be), commensurate with that given to the commercial television networks to establish their digital investments when, in 1998, they were given the benefit of the moratorium on new commercial open broadcasting service licences until at least 2007.

An approach along these lines will assist to secure the valuable, but expensive investment contributions that digital subscription television has made, and hopes to continue to make, to Australian television services.

5. FOXTEL recommendations

A reform agenda for facilitating the emergence of new and innovative content and more choice for consumers without harming the market forces that currently provide innovation and competition in television in Australia would be as follows:

- Before making any decision about spectrum use and allocation, the Government should decide whether or not a 4th commercial television broadcasting service should be introduced after expiration of the current moratorium. If Australia is to have a sustainable 4th commercial broadcasting service its survival will depend on a postponement of the introduction of terrestrial multi-channelling by the incumbent commercial broadcasters until the new entrant has had sufficient time to establish;
- There should be a four year period from March 2004 (the time of launch of major digital subscription television services in Australia) until March 2008, during which there is no permitted "free" or "subscription" terrestrial multi-channelling by the commercial broadcasters on the digital spectrum loaned to them in 1998;
- When and if they are permitted to multi-channel, the only service the commercial broadcasters should be allowed to provide on their digital spectrum in addition to their primary simulcast service should be "free" so that all members of the public can access and benefit from it;
- The anti-competitive regulation of sports broadcasting through the "sports anti-siphoning" regime should be abolished – prior to allowing "free" terrestrial multi-channelling by the commercial broadcasters; and
- Simulcast and HDTV requirements should be retained, as complementary drivers of digital television take-up.

6. A revised Productivity Commission proposal

For all of the reasons set out above, FOXTEL recommends the Productivity Commission revise the first paragraph of the draft proposal set out at page 165 of its discussion paper to read as follows :

"The Australian Government should amend its broadcasting policy to remove, in balanced stages that promote competition and innovation in the television entertainment market, the restrictions on the number of commercial free-to-air TV stations, sports programme acquisition, multi-channelling and datacasting".

Schedule 1